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THE IMPERMANENT WAR ECONOMY?

Peace dividends and capital accumulation in Israel

Jonathan Nitzan and Shimshon Bichler

Introduction

Since the end of the 1980s Israel appears to have begun a fundamental transformation. From a militarized economy characterized by large government deficits, heavy dependency on the United States and intense stagflation there is also now a decisive move toward peace and regional integration, coupled with continued economic growth and declining military spending. These developments come amidst a deep ideological and cultural change which sanctions the centrist/liberal world-view of the Labour and Meretz parties. Increasingly, there are calls not only for a more open foreign policy but for an entirely different regime based on political democratization and economic liberalization. The emphasis is on small government, sound finance, and market reform; the acceptance of laissez-faire brings lower income taxes, smaller fiscal deficits, scaled-down social services, and a heightened process of privatization. The Zionist-collectivist ethos seems finally to have given way to the universal culture of business enterprise.

The purpose of this article is to offer an alternative analytical framework for understanding this long-term transformation. First, we argue against the conventional separation between the "political system" and the "economic system." This separationist approach has been popular among Israeli scholars but its analytical value is open to doubt. Second, instead of the common aggregate/statist approach, we take the disaggregate route of political economy, accentuating the historical role played by key power groups. And, finally, rather than focus merely on domestic considerations, we claim that both the earlier military economy and the current trajectory into "peace

markets" are part of broader global developments, particularly the internationalization of business institutions and the changing nature of the capitalist nation-state. In our opinion, the sharp "U-turn" in Israeli history is intimately linked to the changing nature of "capital accumulation" and "corporate concentration," both in Israel and in the United States. For the large core firms at the center of the economy, which we view as principal actors in this process, accumulation and concentration are two sides of the same process. With the evolution of modern capitalism, the leading firms are increasingly driven not to maximize their profits but rather to "beat the average." Specifically, they seek to achieve a "differential rate of accumulation" – that is, to *exceed* the average rate of return in the economy. However, since a differential growth in profits implies control over a growing share of the aggregate capitalized assets, for these firms the goal of accumulation means a quest for rising corporate concentration.[1]

Differential accumulation can be achieved in two ways. One is to raise the "depth of accumulation" by maintaining profit margins above the economy's average. The other is to focus on the "breadth of accumulation" by expanding market share. Although the two methods are not mutually exclusive, economic conditions which are conducive to one often undermine the other. During the 1970s and much of the 1980s Israel and the United States were both characterized by a political-economic structure in which a combination of corporate concentration and stunted growth gave rise to "military Keynesianism." Under these circumstances, corporate concentration is typically maintained and enhanced by expanding the "depth of accumulation"; the large corporations try to raise their profit margins above those of smaller periphery firms and the ensuing "profit competition" often culminates in a stagflationary spiral.[2]

However, since the mid-1980s, and particularly with the disintegration of the Soviet Union and the opening to business of China, India, and Southeast Asia, the large firms both in Israel and in the United States have changed gear, moving toward an alternative model of peaceful expansion.[3] Under this latter regime the core corporations advance their differential position by expanding the "breadth of accumulation"; instead of competing over profit margins, the differential increase in profits now depends on a rapid intrusion into new markets, where the large firms succeed in expanding their market shares faster than their smaller counterparts. This mode of differential accumulation is accompanied by falling military spending, disinflation, and revived growth.

The focus on the process of accumulation sheds new light on the history of Israel. The first section examines some of the fundamental assumptions underlying the Israeli political and economic literature since the late 1960s. According to this literature, Israel represents a "special case" – but that is so only because most writers chose to ignore the process of accumulation. If the latter is put at the center of analysis the forces underlying the Israeli war economy, as well as its current transition to peace markets, no longer seem

unique. The second section examines briefly the "military bias" of mature capitalist economies, with specific emphasis on the United States. In the third section we argue that until the late 1980s the Israeli military bias was similarly affected by pressures emanating from growing corporate concentration, as well as by the country's role in the superpower confrontation. These considerations could then help explain the current peace process. In the fourth section we claim that fundamental changes in the global pattern of accumulation have left the Israeli elite (and many of the Arab ones) with little choice but to accept the imperative of open borders and global ownership. In a certain sense, the current enthusiasm for peace is similar to the earlier obsession with national security – they both serve the quest for differential accumulation.

Theoretical background

The Israeli literature dealing with the economics and politics of war and peace suffers from several related shortcomings:

- an emphasis on the "statist" frame of reference;
- a view that the historical development of Israel was predetermined by "unique" circumstances;
- a belief that as a consequence of these circumstances Israel has developed into a "special case" of classless society – a society in which the process of capital accumulation and the role of elites could be safely ignored.

We deal with these issues in turn.

The "statist" or "state-centered" approach grew increasingly fashionable in the 1970s.[4] The basic unit of analysis here is the nation-state, whose actions are dominated by an amorphous group of "central decision-makers," "state officials," or "rule-makers." This group is supposedly driven by the national interest and seeks to achieve broad macroeconomic goals such as growth and a favorable balance of payments, or macropolitical aims like military prowess and social stability.[5] These broad ends are perceived as independent of the particular interests of various societal groups and, indeed, are often emphasized for their universal nature.

The aims of the state are formulated in "aggregate" terms – a habit of thinking which emerged and consolidated with the Keynesian paradigm.[6] In this aggregate framework it is customary to subdivide society into two systems of "economics" and "politics." In the Israeli context, it is assumed that the economic system would guarantee universal welfare – that is, if it were allowed to function "efficiently." The political system may undermine that efficiency when it seeks to achieve additional goals such as "national security" but fails to find the optimal rate of substitution between security and economic growth along the nation's production-possibilities frontier.

With its foundations deeply embedded in this neoclassical paradigm, the focus on "aggregate welfare" enables the writer to remain within the boundaries of the national consensus,[7] and has driven many Israeli academics to accept the supremacy of the political echelon.[8]

The total subjugation of the economy to the state is manifest throughout the writings of the economists and other scholars who have "studied" and opined on the issue.[9] Indeed, the Hobbesian view has been so thoroughly accepted in the Israeli political literature that some researchers have decided to skip the analysis altogether and turn directly to policy implications. Klieman, for example, still has little doubt about the militaristic course of Israeli society. For him, the main issue is the benefit to the "state," and the principal questions are how Israel could best respond to mounting challenges in the global weapon market and how it should preserve its position and competitive advantage. The answer is succinctly summarized in Klieman's own words: "In order for the Israeli arms industry not to perish, it should continue with its tradition of domestic dexterity and external cunning." In his opinion, the key is a proper reading of the world arms market, leading to a most revealing conclusion that "those who foresee the future and respond adequately will get the juiciest market share."[10]

The substitution of advice for serious research is typical of an academic community captured by rigid consensus. Perhaps the clearest expression of this consensus is the repeated use – often unconscious – of terms such as "we," "us," and "ours," usually coupled with a need for "sacrifice."[11] And once defense cuts are put out of the question (due to the supremacy of "national security" concerns) an economist can self-assuredly step in to announce that "if we want to enjoy this kind of growth in the future, we must begin immediately by rapidly reducing the standard of living."[12]

The adoption of this state-centered approach by Israeli academics was greatly facilitated by the view of Israel as *sui generis*. The first basis for this characterization is the challenge to Israel's right to exist, which has always presented a constant threat to Israel. Among others articulating this very notion are Peri, on the one hand, and Horowitz and Lissak, on the other, who respectively write: "Since its establishment, and in fact even prior to 1948 Israel has been in a state of war" and "the all-encompassing nature of war in Israel and the centrality of security to national existence have created a situation whereby numerous spheres, which in parliamentary democracies are considered 'civil,' fall within the security gambit and are enveloped in secrecy."[13] And so, "[b]eyond the ideological and political disagreements prevailing in the Israeli public, there was always a broad consensus regarding the threat for survival embedded in the Israeli–Arab dispute."[14] The consequence was that Israel became a unique case.[15]

The second and perhaps more important reason for the uniqueness of Israel stems from its own "primordial sin": the East European founding

fathers instituted an authoritarian "socialist" culture which, according to the overwhelming majority of Israeli social scientists, lies at the heart of the "Israeli malaise."

Beginning in the 1920s, the political system seized control of the economy, first through the Labour party and the Histadrut (federation of labor unions), which then transferred their power to the government of the newly formed state. The result was the institutionalization of an authoritarian/statist culture, which resulted in Israel failing to maintain the requisite separation between economics and politics, and allowing the public political domain to impinge upon the private economic sphere.[16] The model is fairly simple. Most broadly, it argues that a socialist tradition inevitably gives rise to a statist bureaucracy, which in turn depresses the spirit of private enterprise and ends in a lack of vitality and chronic stagnation. From the new-right perspective of Sharkansky:

> the predominance of the government in Israel's economy makes it the most socialist country outside the Eastern Bloc. Along with a government budget that exceeds gross national product (GNP), there are numerous detailed controls on the activities of government officials, private-sector companies, and individual citizens.... It is Israel's fate to suffer the worst from the centrally controlled east and the democratic west.[17]

In short, Israel is like no other capitalist society. Its history is the result of "the trilateral relationship between the settlement movement, the pioneering elite which exercised its control through the political parties and the bureaucratic stratum which recognized its hegemony."[18] It is "a party state in which almost everything is determined by political parties."[19] According to Arian, power, and hence the historical course of Israeli society, lies within the formal political sphere, in the hands of the political elite.[20]

This conventional "wisdom" of the primacy of politics and "decision-makers" serves not only to separate the study of politics and economics, but also to divert attention from the class structure of Israeli society. Indeed, since control is in the hands of politicians and former army officers, and since these people do not generally come from a capitalist background, it goes without saying that class conflict is irrelevant to the Israeli case. Israel, so it seems, is a classless society in which the process of capital accumulation, the growth and consolidation of a ruling class, the ownership of resources, the distribution of income, the control of economic power, the methods of persuasion, legitimization, and the means of violence could all be safely ignored. Paradoxically, if there is any recognition of "class struggle" in Israel, it has been largely limited to the pre-independence era – a period in which the society was hardly industrialized, in which there was barely any accumulation of capital or a meaningful working class, in which the most

organized groups were the agricultural cooperatives, and in which the army and the police were those of a colonial power.[21] Since the 1970s, however, when these characteristics where long gone – replaced by a highly concentrated business structure, international economic integration, a developed industrial system of mass production, and an urban amalgamation of wage-earners – there has been no single study about the Israeli ruling class or the process of accumulation, let alone the connection between them.

The "military bias"[22]

An alternative assessment of Israeli history could begin from a theoretical framework linking the process of capitalist development and the budgetary crisis arising from military spending, expansionary foreign policy, and armed conflict. Early Marxist writers such as Hilferding and Luxembourg, and institutionalists like Veblen offer some insight into the analysis arising from such an approach. They saw the tendency toward economic and military expansionism as an outgrowth of the concentration of capital in the leading industrialized countries of their time.[23] Later authors, such as Kalecki, Tsuru, Sweezy, and Steindl, further claimed that a rising "degree of monopoly" created a tendency for the societal surplus to rise while at the same time limiting the extent to which this surplus could be offset by profitable investment outlets.[24] The historical solution appeared in the form of "military Keynesianism," where a "Keynesian coalition" between big business and organized labor administered rising military spending and a more aggressive foreign policy as a means of maintaining aggregate prosperity and high employment.[25] Other writers even went a step further, suggesting that the militarization of the economy was driven not by the aggregate needs of employment and output, but rather by the profit requirements of the largest "core" firms of the "monopoly sector"[26] or "monopoly capital."[27]

Conceptually, much of this research was concerned with the effect of economic structure on military spending. However, after the 1950s and 1960s, with the American involvement in Korea and Vietnam, it became increasingly clear that causality ran both ways, and that military expenditures were in turn a factor of restructuring. One of the first to recognize this double-sided link was Michal Kalecki. In his articles on "The fascism of our time" and "Vietnam and U.S. big business" he predicted that the growing American involvement in South-east Asia would shift the balance of power from the "old" civilian industries on the east coast to the "new" military-oriented groups in the west. Rising military budgets, he argued, would redistribute income in favor of the latter and fortify the "angry elements" within the U.S. ruling class, leading to what Melman later called a "permanent war economy."[28]

It now appears that Kalecki was right, and that the war economy, which in the United States lasted until the late 1980s, has indeed shifted the center

of gravity of U.S. business in favor of arms contractors. With the post-war decline of the American economy *vis-à-vis* Europe and Japan, the large U.S.-based companies were faced with a growing predicament of excess capacity – which was then counteracted, first, by rising aggregate concentration via mergers and acquisitions, and, second, by a growing reliance on government budgets, particularly in the area of military, space, and medical technology. An analysis of differential accumulation by the "Arms Core," comprising the sixteen largest military contractors based in the U.S., reveals that these developments have resulted in a heightened process of classic differential accumulation; when measured as a share of the Fortune 500 total, the net profits of these firms soared to over 10 percent in the mid 1980s, up from around 5 percent during the Vietnam war.[29]

These considerations prove significant for the Israeli case in two ways. One is a striking structural similarity. The military bias of the U.S. economy suggests that there is a direct link between military spending and market structure. The Marxist thesis of "military Keynesianism" – that is, the counter-cyclical use of military spending to achieve macroeconomic goals – may have been adequate for the 1950s and 1960s when rising defense spending came together with overall economic expansion;[30] this thesis seems less robust, however, from the 1970s onward. Military procurement has become concentrated in a relatively small number of large firms (with the 100 leading contractors typically accounting for about 70 percent of the total prime contract awards), and as the dependency of these firms on military budgets tended to increase, the flexibility of the U.S. administration in manipulating these budgets tended to decline.[31]

If we can generalize, it seems that under certain historical conditions, particularly in an early state of development or after a severe structural crisis, military spending can play a macroeconomic role. But as the economy "matures," and the concentration of capital and centralization of ownership passes a certain threshold, military spending becomes less able to serve "overall" economic goals, and is catering more to the interest of "dominant" political and business groups. In this latter stage the macroeconomic impact of such expenditures often becomes stagflationary,[32] but that is tolerated given their positive effect on the most powerful firms at the core.[33] The Israeli economy, we shall argue, followed a similar historical pattern, with military spending initially associated with overall growth, and subsequently accompanied by rising corporate concentration and heightened stagflation.

Second, beyond the structural similarities there is also a direct connection between the military bias in the two economies. Since the late 1960s Israel has become increasingly integrated into the U.S. orbit – a process which was partly a result of global expansion by U.S. arms producers. During the period between the late 1960s and late 1970s, when U.S. domestic military spending experienced a cyclical downturn, arms exports became increasingly crucial to the well-being of the defense contractors – first, as a stop-gap

measure for falling orders at home and, second, because they usually provide far higher profit margins.[34] Moreover, the most significant factor affecting the rise of arms exports has been the global redistribution of income following the 1973 oil crisis. The explosive growth of oil revenues made the countries belonging to the Organization of the Oil Producing Countries ideal clients for weaponry and in 1974, after the U.S. exit from Vietnam, the Middle East became the world's largest importer of armaments.

The result of these situations was that the military bias of the Israeli economy coincided with this U.S. foray into the armament market of the Middle East. Israel accepted its role as a U.S. satellite in this hostile region in return for massive military aid and U.S. consent for economic protectionism. For the large U.S. arms contractors military sales to Israel quickly became part of a heightened arms race, which drew even larger clients such as Iran and Saudi Arabia into the cycle. For the large Israeli firms the combination of a war economy and trade barriers proved equally beneficial, generating rising profit margins and a rapid surge in differential accumulation.

The structure of the Israeli economy

In assessing the parallels and interactions between the U.S. and Israeli economies it is instructive to begin with a bird's-eye view of Israel's economic structure during the height of its militaristic phase. Our analysis follows the dual-economy approach which emphasizes the firm rather than the industry; furthermore, given our focus on differential accumulation, we look specifically at the distribution of profits rather than standard proxies such as sales or value added.[35] During the mid-1980s the Israeli dual economy was characterized by a "big economy" of about fifty firms, surrounded by a "small economy" comprising the rest of the business sector and nonprofit organizations. The perimeter of the "big economy" is composed of large firms which enjoy a leading position or even a monopoly in a given industry, while the center consists of a core of five conglomerates: Leumi, Hapoalim, Israel Discount Bankholding (IDBH), Koor, and Clal (the latter being controlled by the first three).

The history of the core conglomerates mirrors that of Israel. Bank Leumi was established in 1902 to finance colonial settlements by the Zionist movement. Bank Hapoalim was formed in 1921 in order to finance cooperative activity in agriculture, construction, and industry. IDBH began as a private bank in 1936, when capital flight from recession-hit Europe and British preparations for the Second World War fueled an economic boom in Palestine. Koor was established in 1944 as the industrial subsidiary of Solel Bonhe, after war spending had turned the latter into the largest contractor in the Middle East. Clal was set up in 1962 as a joint venture designed to lure foreign investment through tax incentives and subsidies, and eventually became a "gravity center" for the domestic core groups, the government, and

foreign investors. During the 1950s there were also other relatively large groups, but these declined or merged with the five core conglomerates; since the 1970s the latter have come to define the center of the Israeli economy.[36]

By the 1980s the core groups were dominant in almost every significant business activity – from raw materials, through finance, consumer- and investment-goods industries, services, and merchandising, communication, and advertising – usually with the backing and cooperation of the government.[37] According to Dun & Bradstreet, in 1984 the core groups and the government controlled about half of the 100 leading industrial firms – 23 were controlled by Koor, 8 by IDBH, 8 by Clal, and 9 by the government. Based on this listing, the core and the government controlled 28 of the top 50 and 14 of the top 20 firms.[38] A similar picture emerges in the banking sector, where Leumi, Hapoalim, and IDBH controlled 80 percent of all assets, employment, and branches, and 70 percent of all net profits (excluding foreign subsidiaries). The core groups also control many of the non-industrial sectors, such as fuel and gas, merchandising, construction, insurance, shipping, and real estate. The perimeter of the "big economy", with its smaller investment groups and medium-sized firms (some of which are foreign subsidiaries, mostly of U.S. conglomerates), is associated with the core through numerous ownership, trade, investment, and credit ties. These associations were strengthened during the "gilded age" of the Israeli stock market, and are now boosted further with the wholesale privatization of government-owned enterprises.

Since the 1970s the cohesion of the core groups has been reflected in the high correlation that exists between their separate performance indices, such as sales, value added, subsidies, taxes, executive compensations, and, most importantly, net profits.[39] Moreover, this cohesion extends beyond the dry statistical picture. Underlying the numbers lies the power/class structure of Israeli society. Since the 1950s this structure has been consolidated through a growing web of reciprocal business ties, as well as through personal, kinship, and cultural bonds among the Israeli business, political, and military elites – ties which eventually led to the emergence of an Israeli ruling class.[40] The amalgamation of this class is embedded in cross-ownership, procurement rights, credit arrangements, and endless unwritten conventions and rules which define the "natural state of things" in Israeli society.

A thick cloak of silence normally covers the nature of this institutional structure; its existence comes to light, however, on the rare occasion of intra-elite conflict. Thus, after a heightened redistributional struggle among the leading business groups precipitated by the 1983 stock market crisis, the Bejsky Commission – nominated to carry out an inquiry into the collapse – "suddenly" discovered that the large banks had for years cooperated, and rather tightly, in many of their diversified activities. Among other things, the banks' managers collaborated in manipulating share prices, in

predetermining real rates of return on such stocks, in offsetting excess supply, and in maintaining a common front against an unpredictable finance minister. The banks had also concealed information, window-dressed their financial reports, and engaged in illegal foreign-exchange activity – none of which could have been done without collusion.[41]

In contrast to the "big economy," which in many respects acts like a single "bloc," the "small economy" is much more amenable to standard industrial analysis. Firms are small, usually operating in a single industry, and often consist of a single plant; performance is subject to wide fluctuations with little or no inter-company correlation. While in the big economy, the separation between "economics" and "politics" has little meaning, in the small economy the distinction is much more evident, with the link established only indirectly through loose professional associations and pressure groups. For example, until the early 1970s net profits (after taxes) for the five core conglomerates and the rest of the business sector moved in the same general direction. During the subsequent period, the mid-1970s to the mid-1980s, however, the patterns were no longer similar; profits for the core firms were rising rapidly, while those for the rest of the business sector were actually falling.[42] The consequence was a rapid process of differential accumulation by the core firms.

The period after the 1967 war saw a parallel duality developing in the labor market. The first analysis of this process was provided by Farjoun, who emphasized the unequal exchange between the developed Israeli economy and the underdeveloped Palestinian one.[43] Attempts to create a dual labor market began even before independence in 1948, with the Israeli elite striving for a separate agricultural economy based solely on Jewish labor. However, with the 1967 occupation of the West Bank and Gaza Strip, and the concurrent militarization of the big economy, the emphasis shifted. From then on, writes Farjoun, there was a growing need "for a cheap, mobile labour force, with no social rights; a free labour force in the classical meaning of the term." This was achieved by the proletarianization of the Palestinian population, which was rapidly becoming the main labor pool for a growing number of small-economy sectors, such as agriculture, construction, services, and low-technology civilian manufacturing.[44] During the time of the study, wages in the small economy were only half those paid in the big economy and, according to Farjoun, the survival of this sector was more or less contingent on the availability of Palestinian workers.[45] The other side of this process was that the big economy, particularly its financial and military branches, came to rely solely on Jewish, unionized workers, with much higher earnings and relatively extensive social security.[46]

Yet, through the use of "aggregates," standard analysis of Israeli society has managed more or less to ignore this marked duality. The ruling ideology has masked the true economic regime. Viewed through macroeconomic and

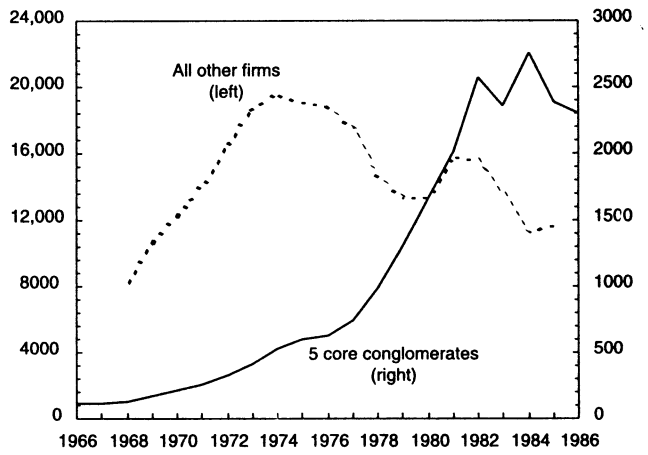

Figure 3.1 Real net profits (1980 NIS; three-year moving average)

Source: *Statistical Abstract of Israel* and company financial reports.

macropolitical spectacles, the nation-state is seen as inhabited by an amorphous body of "private" and "government" agents, who are subject to the equilibrating influence of economics ("civilian" in the Israeli case) and to distortions emanating from politics (mainly in the "security" and "welfare" domains). The central questions are concerned with "societal" welfare – how to maximize overall growth and minimize inflation while assuring national security. Since the 1970s, however, this framework has become gradually less useful. Both the economy and security seem to have deteriorated. Growth plummeted, inflation soared, the external accounts plunged into crisis, and Israel's military superiority was put in question. But the apparent curtailment of aggregate welfare was misleading, for while the small economy was feeling the brunt, the large conglomerates at the core of the economy were actually thriving.

The aggregate approach offers a useful abstraction only when the underlying phenomena are commonly shared *across society*. However, when there are systematic divergences in the experience of different groups the assumption of structural stationarity no longer applies. Under these latter circumstances – for instance when military expenditures cause stagnation in most sectors but prosperity for the arms contractors, or when government credit policy stifles the small economy while subsidizing the core conglomerates – the aggregate view serves to conceal the underlying process of differential capital accumulation and its consequent ramifications for social restructuring.

The interaction between macroeconomic development and differential accumulation in Israel could be perceived as belonging to three distinct "regimes":

- the period between 1955 and 1972, characterized by emphasis on the differential breadth of accumulation, with rapid macroeconomic growth and a "latent" structural consolidation;
- the 1973–84 era, in which the emphasis shifted to the differential breadth of accumulation, accompanied by severe stagnation and rapid inflation;
- the post-1985 era, distinguished by retrenchment for the big economy, followed by a shift toward an open "peace economy" and a return to the differential breadth of accumulation.

During the 1955–72 period the economy expanded at an average annual rate of 10 percent. Differential accumulation by the core conglomerates, on the other hand, was relatively contained, and between 1966 and 1972 their profit share of gross domestic product (GDP) remained below 0.5 percent. The post-1973 period was fundamentally different; there was a marked drop in overall growth rates, to an average of 3 percent between 1973 and 1985, and as stagnation lingered the profit share of the core firms started to rise rapidly, climbing to nearly 2.3 percent of GDP in the early 1980s. From the mid-1980s onward, differential accumulation for the core firms turned negative, and over the 1986–1990 period their profit share of GDP collapsed to less than 0.75 percent. The political-economic shift since the late 1980s has contributed to revived overall growth, now accompanied by a parallel recovery for the core companies. In this section we deal with the first two regimes. The third phase is discussed in the last section of this chapter.

Until 1972 economic growth in Israel was disproportionately affected by two "external" stimuli: the unilateral capital inflow of German compensation between 1955 and 1965 and the "Palestinian boom" in the immediate years after the 1967 war. During the 1955–65 period unilateral transfers from Germany accounted for most of the capital import, and until the early 1960s their levels were almost identical to the annual change in gross national product (GNP). Indeed, the end of these transfers in 1965 was followed by the severe recession of 1966–7. The situation changed again in 1968, when the Israeli market suddenly expanded to include 1 million new consumers from the occupied territories of the West Bank and Gaza Strip. Furthermore, the post-war years, roughly until 1973, saw very rapid increases in the number of Palestinian employees working in Israel – from zero to over 60,000 in just five years – and a consequent increase in purchasing power. This combination of an overnight expansion of markets and a rapid process of proletarianization had a decisive multiplier effect on the Israeli economy. Indeed, by 1974, when the growth in the number of

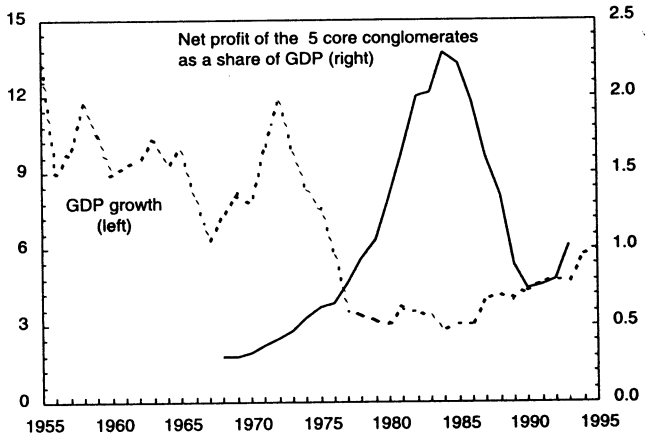

Figure 3.2 Macroeconomic growth and differential accumulation (%; five-year moving average)

Source: *Statistical Abstract of Israel* and company financial reports.

Palestinians working in Israel stabilized at a lower rate (eventually peaking at 140,000), the economy reverted back to stagnation.[47] These external impetuses acted to mitigate the latent process of aggregate concentration, primarily through their positive impact on the expansion of the small economy. However, after 1974, with the growing differential accumulation by the big economy, the picture began to change. The concentration process came into the open, accompanied by a fundamental political shift and the gradual decline of the government as a central economic force. The right-wing Likud bloc, which assumed power in 1977, adopted an aggressive foreign policy and high military spending, while its "liberal" economic agenda of laissez-faire hastened the ascent of the core conglomerates.

The core conglomerates of today were consolidated during the mixed-economy period after independence. During the 1950s and early 1960s investment was almost entirely financed by unilateral capital transfers and managed more or less exclusively by the government. The allocation of capital was determined partly by the government's import-substitution policies, but also (and often more so) by political and family ties. The government developed "special relationships" with several rising business clusters, which were originally considered to be "national agents" and eventually grew into the core groups of today.[48] The pattern of these relationships started to take shape immediately after independence, with the distribution of land and other properties belonging to the Palestinians who left during the war; it developed further during the austerity period of the

early 1950s, which saw the allocation of exclusive certificates, monopolies, procurement, and other forms of "goodwill" to well-connected domestic groups and foreign investors; [49] and it was consolidated with the inflow of German compensation payments, which financed a decade of growth between 1956 and 1965.

The 1950s was a period of sharp contrasts. On the one hand, massive Jewish immigration from Europe, Asia, and Africa more than doubled the population in just a few years. These were mainly impoverished refugees, with few marketable skills, often without knowledge of the language. Their harsh conditions in 1951 were vividly captured in the memoirs of David Horowitz, then general director of the Finance Ministry:

> As the immigration waves rose, the economic problems imposed themselves on us with enormous might, forceful enough to break the backs of those in charge with immigration absorption. Tens of thousands of people were crowded in the *ma'abarot* [transit camps] and the camps for the ailing. They were grieved by war, tormented with the horrors of the Holocaust and often burdened with large families. Within a short while, 60,000 people, or 10 percent of the [Jewish] population, were congested into the camps. A similar number stayed in decaying buildings of abandoned Arab towns and villages. The tent and hut camps were damp and cold during the winter and burning hot through the summer. The congestion, filth, and stench exhausted their strength and shook their souls.[50]

However, the population grew at over 9 percent a year, which meant that even with no per-capita growth overall economic activity was nonetheless rising very rapidly. And so, while most of the population suffered acute shortages and hardship, the business potential for well-placed companies was huge. It is hence hardly surprising that where David Horowitz saw misery and despair Harry Recanati, then owner and director of the Discount Bank (later IDBH), perceived business success:

> By 1951, I had good reasons for being satisfied with the completed task. The bank left to us by our father had prospered and constituted the base for a first-rate Israeli financial group.... I had striven thinking about new initiatives in Israel, but in vain. We already had in our group all the subsidiaries appropriate to our basic operations.[51]

The Discount Bank, established only fifteen years earlier by tobacco merchants and realtors, grew rapidly to become the second largest bank and fifth largest industrial concern, with a wide variety of investments in areas like rubber, paper, fuel, shipping, aluminum, insurance, construction, mortgage banking, citrus orchards, and electrical equipment. Such an expansion, experienced also by a select number of other groups, would have been inconceivable without solid and consistent government backing.

The first years of statehood were crucial, for it was during this period that the central institutions of accumulation, particularly the relationship between the government and corporate sector, were set. Harry Recanati, who was later unseated from his position as the IBDH group's chairman following a family feud, was not entirely comfortable with these cozy relationships:

> I said to myself that our bank had completely changed. It was no longer the family bank founded by my father. My brothers turned it into an industry, against my will. There were other things that caused me anguish: the flattering advertisement, much of which was created under our own aspiration, the charity organizations and institutions established under our auspices with tax deductible donations, the indiscriminate support of all political parties, left and right, to acquire the friendship of each and every one, and the stock market maneuvers where share prices were jointly determined in collusion among several banks. Even less cherished was our managers' friendship with government officials in Jerusalem. I resented their constant striving for government benefits of every kind, all under the pretext of the national interest. Our group was a private business, not a public institution. It was unjust and undignified to bank on government grants for the benefit of shareholders who were mostly affluent capitalists. I was well aware that my views were uncommon in Israel. This was a country where too many financiers and businessmen enjoyed the allocation of public wealth and were continuously nourished by German payments, U.S. grants and donations from the Jewish Diaspora.[52]

The rapid expansion of public services and the acceleration of the Israeli–Arab conflict after the 1956 Suez war accentuated the centrality of the government and boosted the significance of the military elites. However, under the surface these developments ushered in a more fundamental process of corporate concentration. Foreign unilateral transfers and loans, which induced aggregate growth, were not equally allocated across the economy, but, rather, were channeled disproportionately to a selected number of firms. Indeed, during the 1950s and 1960s growth was propelled not by the "animal spirits" of local or foreign capitalists, but through "administrated" capital formation. Capacity was rising not because of an eager entrepreneurial quest to tap a growing market, but rather through directed government grants or subsidized loans. For the leading capitalists at the receiving end, accumulation often took place before production even started.

This allocation system, known as the "Sapir method," after the finance minister of the time, encouraged the formation of binding institutional arrangements and enhanced centralization – though for a while its negative effect on economic growth was more than offset by the continuous flow of immigrants and foreign assistance. Only after 1970 or so, when these external stimuli were no longer available, did the economy enter its monopolistic stage of "militarized stagflation."

Since the early 1970s economic activity has rapidly converged around two related poles – defense and finance. Earlier forays into military-related manufacturing were often explained by Israel's political isolation, though economic considerations were at least equally important. Initially, domestic production of weapons fitted nicely with the Labour government's import-substitution effort, while, later, military exports were seen as a possible solution to the country's chronic current-account deficit. Financial activity became increasingly significant, much as in other capitalist countries, as a consequence of a merger wave during the 1960s and early 1970s. At the center of this process stood the would-be core conglomerates, which started to form during the 1950s with the amalgamation of small family banks and saving and loans cooperatives.[53] Their expansion began in earnest, however, only during the 1965–6 recession, when the government's austerity policy triggered a massive wave of business consolidation[54] and stripped labor cooperatives of their remaining autonomy.[55] In the early 1970s the government also started liquidating its direct industrial holdings, moving toward indirect intervention through subsidies and military contracts.

After the early 1970s the growth of the large conglomerates came to depend increasingly on the differential "depth" rather than "breadth" of accumulation. This was achieved in three principal ways. First, mergers and acquisitions brought a larger share of the profit under the control of these firms, enabling them to better control competition and prevent an unruly rise in capacity. Second, with civilian production entering a period of protracted stagnation, resources started shifting into financial activity and inflation began to rise. This inflated the conglomerate's financial assets relative to the economy's total and eroded the share of labor. Finally, and perhaps most importantly, the intensification of the Israeli–Arab conflict contributed to rising military spending and growing arms exports (mainly to dictatorships and peripheral countries such as South Africa, Panama, Taiwan, Ecuador, Zaire, Thailand, Nigeria, and Iran). This burdened the aggregate economy but, much as in the United States, the ensuing "military bias" was highly beneficial, both relatively and absolutely, to the leading arms contractors of the big economy. Moreover, high tariff barriers, capital subsidies, grants, and tax exemptions to support the militarized economy contributed further to the ascent of its large conglomerates.

This pattern of "military/financial accumulation" was typical to all of the core firms. The Discount group (IDBH), for example, entered the military

sector during the late 1960s, when rising superpower tensions in the region created lucrative business opportunities in the arms industry. After the 1967 Israel–Arab war it recruited Dan Tolkowsky, a former commander of the Israeli air force, to head its newly reorganized industrial subsidiary, Discount Investment Corporation. A descendant of the pre-independence bourgeoisie with close ties to the Labour party leadership, Tolkowsky was well situated for the task, and as his company expanded he moved to recruit other high-ranking officers from the army, Shin Beit (security service), and Mossad (spy agency) as heads of many of its subsidiaries.[56] In a short time Discount Investment Corporation acquired numerous holdings in the military sector – usually in association with tax-exempt foreign partners[57] – and within a few years it began to account for a rising share of IDBH's overall profits. The main outlet for these profits was the flourishing stock market, where IDBH-run mutual and pension funds were increasingly active in stock manipulation – another major source of profit for the group.

Much like IDBH, Koor too was enjoying the post-war prosperity. Riding the military multiplier and boosted by cheap credit from Bank Hapoalim, the group's labor force more than doubled to 22,000 in 1974, up from only 10,000 in 1967, while its net earnings rose to $16 million from a loss of $4 million. Koor's numerous operations, which until then did not have any coherent structure, were grouped into thirteen "brigades" according to military-bureaucratic principles. Top managerial positions were staffed by retired army officers and financial decisions were centralized. Although still nominally owned by its own workers (as well as by all other members of the Histadrut), the company was now behaving much like any other capitalist enterprise, with the ratio of executive compensation to factory-floor wages rising. Strategically, Koor concentrated on acquiring companies rendered vulnerable by the 1965–6 recession. Dozens of firms in areas such as chemicals, steel, edible oil, pharmaceuticals, and the automotive industry were taken over. The biggest incursion, however, was into defense – particularly through Koor Trading, which dealt with arms exports, and Tadiran, which acted as a principal weapon producer.[58] The Clal group also began to grow during the 1960s, and its expansion was not much different from that of IDBH or Koor. After a few difficult years (in which losses were covered by the government) the group was taken over by Bank Hapoalim (42 percent), IDBH (33 percent), and others. From 1969 onward Clal expanded via mergers and acquisitions, financed largely by subsidized government loans.[59] As in the cases of IDBH and Koor, the expansion brought Clal into every corner of the economy, with holdings in diverse areas such as textile, cement, frozen food, paper, and rubber. Most significantly, Clal developed into the "gravity center" of the big economy – both by virtue of its ownership structure and through a dense network of joint ventures with the other core conglomerates. For instance, Clal is a joint owner, together with Discount Investment, of the paper monopoly Hadera Paper; together with

Koor, it controls the cement monopoly Nesher; and with Elron, from the Discount group, it controls the electronic-imaging giant Sitex. Finally, much as the other groups, Clal, too, became dependent on both the military and finance sectors. For instance, its Urdan subsidiary manufactures land platforms for the army, including Israel's main battle tank (Merkava), its automotive subsidiary supplies armored vehicles and trucks, while its ICI subsidiary provides military communication gear. In the financial branch, Clal entered the insurance sector, where, after taking over many of its mid-size competitors, it became the leading company.

The interaction between the military and financial sectors in Israel was not coincidental. The country's large military-related deficits were financed partly by grants and loans from the U.S., but mostly by a bulging domestic debt. The arrangement was doubly beneficial for the core conglomerates, which enjoyed not only the benefit of massive military spending, but also the consequent investment outlet opened through the issuance of inflation-indexed government bonds. Capitalists often object to large government deficits on the grounds that these serve to "crowd out" private investment, though in the closed war economy of the 1970s and early 1980s the large Israeli capitalists had little to lose from this type of arrangement. True, massive government borrowing contributed to three-digit real rates of interest, but these hardly hurt the core conglomerates. First, their virtual monopoly over credit helped them maintain the real spread between lending and borrowing rates at 20–50 percent and, second, the effect on their profit of a high-interest-rate regime was more than offset by political ties which assured cost-plus government contracts, subsidized credit, and low taxes.

Moreover, to the extent that monetized deficits contributed to inflation, for the core conglomerates inflation's positive effect on profits and the value of financial assets far outweighed its impact on rising wages. Despite these benefits, after the 1970s there was growing pressure for greater "liberalization" of the capital market. The goal, though, had little to do with improving "allocative efficiency." Indeed, when the government began to withdraw from the market, reducing the role of its directed loans, gross investment started to drop – falling to about 15 percent of GDP in 1985, down from 30 percent ten years earlier. The real reason behind the liberalization push was that the core conglomerates discovered a new gold mine – the stock market. Tight collusion, particularly among the large banks, enabled them to manipulate the price of their own shares – as well as those of many others – to the point of guaranteeing investors *a predetermined real rate of return*! In the words of the Bejsky Commission, the banks were able to create a "new type of security" combining the properties of shares and indexed bonds in the same paper. But in order to maximize the benefit of this invention the government had to be pushed out, and that required "liberalization."[60]

The gradual withdrawal of the government gave rise to a "parallel monetary policy" managed by the big banks; on the one hand, their systematic stock manipulation was tantamount to printing money, while, on the other, the consequent market buoyancy enabled them to "absorb" much of this newly created money by issuing new stocks. The consequence was a rapid inflationary redistribution of income. In broad terms, the principal winners were shareholders, whose financial assets appreciated much faster than the rate of inflation (stock-market capitalization increased from 8 percent of GDP in 1973 to 99 percent by 1982).[61] But even that fails to convey the full extent of the ensuing redistribution. Although Israel has no official data on the distribution of wealth, it is clear that the main beneficiaries of the inflationary process were the three largest banks. These banks became the biggest owners of their own stocks, which by 1982 rose to account for a full 44 percent of the economy's aggregate liquid assets, up from only 7 percent in 1973.[62]

The concentration process, which remained latent during the 1950s and 1960s, had now emerged with all of its consequences. After the 1970s the external stimuli of immigration, capital inflows, and market expansion were all gone, and as a result the focus of accumulation shifted from breadth to depth. By now the economy had already accumulated a dense network of "distributional coalitions" whose interests lay in *stagflation* rather than growth and price stability. The process of corporate concentration and income redistribution undermined the political power of organized labor and restricted purchasing power. The economy began to suffer from "excess capacity" – that is, an excess over what could be sold at *profitable* prices. For firms in the big economy, business success was thus increasingly dependent on limiting the growth of capacity while using inflation to raise their distributive share in the stagnating pie. Indeed, after the early 1970s there was a drastic drop in net investment – to a mere 5 billion NIS (New Israeli Shekels) in 1986, down from 21 billion NIS in 1973 (figures in constant 1980 prices) – coupled with a rise in inflation to over 400 percent in the mid-1980s, up from less than 20 percent in the early 1970s.[63] Yet despite the stagflation – or rather because of it – the large Israeli conglomerates were now experiencing their fastest expansion ever.

In summary, after the 1970s the Israeli economy was increasingly characterized by a dual economy dominated by several large core conglomerates whose differential accumulation was sustained mainly by raising the depth of accumulation. The principal vehicles were armaments and finance – the first supported by the accelerated Israeli–Arab conflict and the growing superpower involvement in the region, the latter by intensifying stagflation. The Israeli government was getting deeper into debt – with domestic debt servicing accruing principally to the big economy, and with foreign payments helping to support the export drive of U.S.-based military contractors. In the process the structure of power in Israel underwent a fundamental transformation, whereby the core conglomerates grew

increasingly intertwined through a web of cross-ownership, business, political, and kinship ties, while the government was gradually reduced to the role of a mere intermediary.

Significant as it was, this transformation has made little impact on the conventional wisdom of power, which still sees the subjugation of the "private" to the "public" as the key ill of Israeli society. The main problem, we are still told, is the superiority of politicians over businessmen, of parties over companies, and of the state over the economy. According to Shapiro, Arian, Aharoni, and numerous others, it is the socialist tradition perpetuated by a dominant party system which undermined the economy and threatened democracy.[64] Unfortunately, by mistakenly equating the *effective* structure of power with its *formal* appearance, this approach became increasingly anachronistic; while the effective locus of power has shifted, interpretations based on its formal appearance remained mired in a bygone past.

During the 1950s and 1960s, with the government controlling most capital inflows and investment, and being involved in diverse fields such as agriculture, industry, construction, and mass public services, the notion of Israel as a "dominant-party system" offered a useful analytical framework. However, with the growing "military bias" after the 1970s, the government gradually lost its central role in the economy, moving from direct economic involvement to indirect support and subsidization of the big economy, and eventually to passive mediation between the large domestic conglomerates, the leading American-based armament companies, and the U.S. Administration. During the late 1980s, as a consequence of its mounting institutional obligations toward the big economy in both of these countries, the Israeli government lost control over its own fiscal and monetary policy, and eventually gave up the initiative even in matters of foreign policy. Much as in the United States of the 1960s, the "military bias" of Israel's big economy served to enhance militaristic tendencies among the country's elites. Unlike the old "political" militarism of pre-independence, the new brand was driven by "economic" considerations rooted in the very process of accumulation. Moreover, Israel was becoming important, both directly and indirectly, to the profitability of U.S. military contractors, and they too were having an impact, albeit an indirect one, on the course of foreign policy. As a consequence of these changes, it seems fair to say that from the mid-1970s onward the dominant-party system had given way to a new system of "dominant capital."

In many ways, the Israeli regime of "militarized stagflation" was self-propagating. Rising military expenditures and debt servicing, on the one hand, and weaker labor unions and wage erosion, on the other, contributed to a differential accumulation by the big economy, and hence to its growing political leverage. For almost two decades, from the late 1960s to the mid-1980s, the rising power of the core conglomerates more or less guaranteed the continuation of this regime.

But then the militarized order collapsed. The early signs of this collapse appeared in 1986. First came the cancellation of the "Lavi project" – a domestically produced fighter aircraft which fell prey to vehement objections from the U.S. arms lobby. Then Israeli arms producers started losing money. After years of hailing the aggregate benefits of military production and exports, the tone suddenly changed. Journalists, politicians, and academics, who had previously labored to demonstrate the technological, economic, and cultural contributions of arms sales, were now turning to attack the armament industry. After having been subsidized for decades, these industries suddenly became a "burden." The most vulnerable were government-owned companies, whose chronic losses of up to $1 billion annually made them an easy target for massive layoffs and outright closure.

The questions revolve around what and why. What made the military business elite reverse its course? Why was the old order of war profits falling apart and what brought the new regime of "peace dividends"?

From war profits to peace dividends: the new order

Israel's transition into a new era of peace has been affected by several domestic and regional developments, but these must be understood within the broader transformation of global capitalism. Until recently, globalization occurred mainly in the realm of *production*, with companies spreading their factories around the world and shifting their sources of output in line with changing expectations about cost and profit. The current phase extends globalization into the realm of *ownership*. Increasingly, the spread of multinational companies into emerging markets involves not only the creation of new productive capacity, but also the establishment of ownership ties. The pace of this process has been greatly enhanced, first by the rapid growth of equity and money markets in the emerging economies, and, second, by their ongoing process of privatization. As a consequence, the expansion of multinational companies is increasingly becoming a matter of "business as usual," with far less nationalistic overtones on the receiving end.

The globalization of ownership is intimately linked with a worldwide shift from the differential depth of accumulation to the differential breadth of accumulation. For the local elites in the emerging markets, the first stage of this transition often appears in the form of severe economic crisis and a threat to the institutions underlying the differential depth of accumulation. Thus in Brazil the debt crisis of the 1980s undermined the arrangement of an *entreguista* (collaborator) state, in which public spending and government-owned corporations in the resource sector were underwriting the expansion of multinational companies and private capital; in India the foreign-exchange crisis of the early 1990s brought an end to the protectionism of the "license raj"; in South Africa the nose-dive of gold prices after 1980 put a seal on the "labor shortage" rationale of apartheid; and in Israel the

collapse of the war economy and the bursting of the stock-market bubble eliminated the main mechanisms of internal redistribution.[65] Following the crisis, the second stage is almost invariably associated with a fundamental rethinking of the link between capital and the state. With the ideological collapse of socialism and Keynesianism, there is a growing recognition that the "natural right of investment" – that is, the customary right to control a portion of the societal surplus – can no longer be secured solely by "domestic legitimization" and must increasingly rely on "global market power." Thus the depth of accumulation declines in significance and the breadth of accumulation comes to the fore. The external manifestation of this process is the falling of trade barriers and the opening of previously closed economies to foreign investment. The heightened significance of balance-of-payments and currency considerations means that foreign investment can no longer be considered unwelcome. Most developing countries run a current-account deficit, and, given that intergovernmental loans and transfers are on the decline, financing this deficit must increasingly rely on *private* investment flows.

For the local business groups, the initial effect often comes in the form of disintegrating institutional arrangements and a resulting collapse of the "normal rate of return." This stage is usually short-lived, however, and is quickly compensated for by the ability to "go global"; for large companies with relatively limited foreign investment, the advantage of outward expansion is that differential accumulation is no longer constrained by the inherent barriers of domestic redistribution. Examples abound. In South Africa, for instance, the large conglomerates such as Anglo-American are under pressure to disinvest in some of their diverse local holdings and consequently lose their stranglehold over the local market. Such disinvestment, however, is likely to help rather than hinder profitability. In contrast to their U.S. counterparts, whose foreign subsidiaries account for over 25 percent of their overall net profits, South African corporations receive only 5 percent of their earnings from abroad, and are eager to raise this percentage significantly. Indeed, the process of disinvestment is intimately linked with the removal of capital controls, allowing local firms to take their first unconstrained steps into the world economy.[66] The situation of the Israeli core firms is not much different, for they too are under growing pressure to disinvest in order to accommodate pent-up demand from foreign investors. The solution is outward investment, particularly in the emerging markets of Asia, Latin America, and the former Eastern Europe.

Renewed emphasis on the differential breadth of accumulation – a foregone conclusion among the leading multinational corporations for quite some time – is rapidly becoming an article of faith in the periphery countries as well. The main consequence of this new consensus is the globalization of ownership – initially through cross-border corporate

alliances and subsequently also through the diffusion of transnational ownership. In this sense, the current phase of globalization implies a higher level of absentee ownership. Although the process is still dominated by Western-based firms, the nationality of owners becomes not only increasingly difficult to ascertain but also increasingly irrelevant to the process of capitalization. First, there is the growth of pension- and mutual-fund investments, the owners of which are not one but several stages removed from the production process. Second, with the rapid capital accumulation occurring in emerging markets and with the growth of their own middle classes, outward financial investment by Taiwanese, South African or Brazilian conglomerates, mutual funds, and eventually also by pension funds will augment the absentee nature of global investment.

On the face of it, globalization seems to imply greater competition. Although global alliances are on the rise and the large corporations continue to grow in size, these factors seem to be more than counteracted by the rapid decline in trade and investment barriers. Moreover, the opening of the world economy is accompanied by significant technological changes and macroeconomic growth. Large populations undergo a rapid process of proletarianization, which in turn facilitates the mushrooming of a vibrant small economy. The growth of the small economy is also assisted by the labor-intensiveness of the information revolution, so that software companies in Bangalore, India, for instance, need only minimal capital outlays in order to achieve annual growth rates in excess of 50 percent. The process is not limited to the computer industry, and is common wherever production is affected by the falling cost of communication and control.

One has to be careful, however, not to equate growth in the number of small firms or in their share of sales with rising competition. The real test of the latter is the direction of differential accumulation – that is, the extent to which the rate of return of the world's largest firms exceeds or falls short of the average. So far, there is little evidence that this has been undermined by globalization. In fact, freer trade and investment may very well contribute toward faster differential accumulation. First, the growth of the small economy is at least partly a consequence of a more effective system of outsourcing by large corporations. In contrast to the "putting-out" system in eighteenth-century England, today's multinational companies are able to enforce universal standards and low profit margins on their suppliers, and can shift from one supplier to another (indeed from one country to another) in a matter of days. Seen from this perspective, the relative growth of the small economy is to some extent a barometer of the progressive absenteeism of ownership; instead of extracting the surplus from its own subsidiaries, today's giant corporation operates more as a profit center, appropriating the surplus via a long chain of small suppliers. The fact that the latter system is preferred to the former suggests that it may well be more profitable.

Second, free trade makes it difficult to object to horizontal mergers and acquisitions. Since the end of the nineteenth century there have been roughly four merger waves in the U.S. The 1990s may mark the beginning of a fifth, global wave. The consequence could be the emergence of "global dominant capital" – this time with little countervailing powers and no regulatory body. If that happens, by the end of the twentieth century differential accumulation may accelerate and the degree of global aggregate concentration may well exceed current levels.

The shift of emphasis from depth to breadth in the process of differential accumulation, together with the consequent globalization of ownership, carries significant political implications. Although these cannot be analyzed here, it seems clear that the main consequence is a heightening of the conflict between "McWorld" and jihad[67] – that is, between the advent of democratic institutions and conciliatory foreign policy, on the one hand, and a backlash of religious fundamentalism and xenophobic nationalism, on the other. The move from a war economy to peaceful accumulation in Israel is part of this conflict.

Conclusion: the needed transitions

The 1980s marked a severe economic crisis in Israel, with the differential depth of accumulation running into external and internal barriers. The principal cause was the demise of the Soviet Union and the changing political-economic arithmetic of the Middle East. Relative to the heyday of the 1970s and 1980s, the oil slump of the 1990s has pushed GDP per capita in the region's oil-exporting countries down by as much as 30–80 percent. At the same time, the populations of these countries have more than doubled.[68] The result has been an ongoing socioeconomic crisis and growing political vulnerability and a shift in perspective on who is the enemy. Western governments now see their main threat as Islamic fundamentalism, and, with the old communist menace gone, their principal solution is a geopolitical realignment. The basis of this realignment is a pro-Western axis extending from Turkey, through Syria, Lebanon, Jordan, Israel, and Egypt (and possibly even Morocco, Tunisia and eventually a post-Hussein Iraq). This axis is expected to serve a number of purposes. Militarily, it will constitute an effective wedge in this hostile area and help ensure stability in the Persian Gulf. Economically, this axis fits well into the emerging-markets agenda of multinational corporations and, assuming the peace drive prevails, U.S.-based companies are eager to secure their regional position *vis-à-vis* competitors from other countries. Politically, the hope is that lower trade and investment barriers will boost macroeconomic growth, and that rising standards of living will then provide an alternative to the anti-Western rhetoric of fundamentalist Islam.

This changing international framework has fatally undermined the Israeli

war economy. Up until the mid-1980s U.S. military contractors (and oil companies) gained from Middle East militarization.[69] A proportion of their weapon exports went to Israel, which was also instrumental in maintaining regional tension, in assisting U.S. arms exports, and in subversive activity around the world.[70] In return, the "deal" was for the U.S. to let Israel maintain its own military industries (provided these did not undermine U.S. arms shipments) and to allow it to keep a tightly oligopolistic market with high tariff, import, and investment barriers. However, since the mid-1980s world recession and a massive drop in global demand for arms forced U.S.-based producers to fight vigorously for contracts, so Israeli contractors had to give. The consequences were a decline in domestic military procurement, as opposed to arms imports (which have remained relatively stable), as well as a very rapid collapse of Israeli arms exports.[71] In order to win export orders Israeli weapon-makers now find it necessary to team up as subcontractors with American groups. In parallel, since the 1990–1 Gulf war Israel is no longer seen as a U.S. watchdog in the region, so U.S.-based companies can now demand the opening of the Israeli economy to more imports and foreign investment. From this perspective, one could argue that the same U.S. interests which earlier supported an oligopolistic war economy for Israel are now promoting its transition toward an open peace economy.

For the Israeli core conglomerates, these external developments came on top of growing internal constraints. Until the mid-1980s differential accumulation by these companies was supported by militarized stagflation, which kept their profit margins way above the economy's average. However, like any system of redistribution, this was limited by its own barriers. First, inflation threatened to throw the fiscal management out of balance, and the stock-market collapse of 1983 was a clear sign that business management too was getting out of hand. Second, in order to continue fueling differential profits in the big economy, military spending had to rise in *relative* terms, but that could not be done without eventually suffocating the economy. Moreover, military exports, which were for a long time considered an economic panacea, were now running into increasing difficulties. Part of the problem was growing international competition from the U.S., as well as from smaller "emerging" suppliers such as Brazil and South Africa, but that only masked the larger internal limitation. In absolute terms, Israel's domestic demand for major weapon systems is far below the necessary threshold for cost-efficient development. Under these circumstances, arms exports required either massive subsidies, which Israel could decreasingly afford, or captured markets, which the new world order no longer supports.

Finally, since 1987 the Palestinian intifada (uprising) has tested the dual-market relationship between Israel and the occupied territories. Until the mid-1980s the West Bank and Gaza Strip were seen as political and business gold mines of which the benefits, in the form of cheap labor and captured markets, far exceeded the maintenance cost. However, with the collapse of

oil prices these costs began to mount. Lower income remittances from Palestinian workers in the Persian Gulf put growing pressures on a population already besieged by a rate of unemployment in excess of 50 percent, mass seizure of land, administrative barriers, and constant humiliation. The eventual backlash turned the territories into a net burden. Under these conditions, continued occupation threatened the very social fabric of Israeli society and the legitimacy of its so-called "national consensus."

The convergence of these forces coincided with an economic slump the severity of which paralleled the recessions of 1965–6 and the early 1970s. In contrast to the previous downturns, however, the prospects for the core conglomerates now looked particularly dim. The earlier periods of stagnation were accompanied by a heightened military bias and accelerating inflation, which contributed to differential depth of accumulation by the core groups and *augmented* the aggregate concentration of profit; this time neither military spending nor inflation were viable options. A change of regime seemed imminent. And, indeed, much as in the aftermath of the South African, Indian, or Brazilian crises, the Israeli business elite, too, realized that the old order had finally reached its limits and had to go. The new path was fairly clear. The Israeli conglomerates now had to focus on expanding their differential breadth of accumulation, which implied an end to the war economy, liberalization, "flexible" labor markets, lower trade barriers, and capital decontrols. None of this could be sustained without peace, and so from 1990 onward the core conglomerates grew increasingly vocal in their support of regional reconciliation.[72]

The implications are twofold. First, it is necessary to remove the Arab boycott and create a perception of a stable regional environment in order to enable Israeli companies to expand business connections *outside* the region. The Middle East itself offers future potential for Israeli firms, but the immediate gains are limited; GDP per capita in most neighboring countries is very low, there is little overlap between the Arab demand profile and Israeli production lines, and suspicion and hostility still linger.[73] The main promise lies outside the region, particularly in the emerging markets, and the effects are already evident in the data. The growth rate of Israeli exports has gradually declined, falling from 20 percent in the 1950s (from a very low base) to 8 percent in the 1980s. The geographical distribution between industrial and developing countries was fairly stationary until the late 1980s; however, since 1990 growth patterns have diverged. Growth in exports to industrial countries has remained stationary at less than 8 percent per year, but with the unfolding of the peace process and the weakening of the Arab boycott export growth to the emerging markets has surged to nearly 14 percent per year.

Second, the process of outward expansion is intimately related to the changing ownership structure of the core conglomerates. Since the early

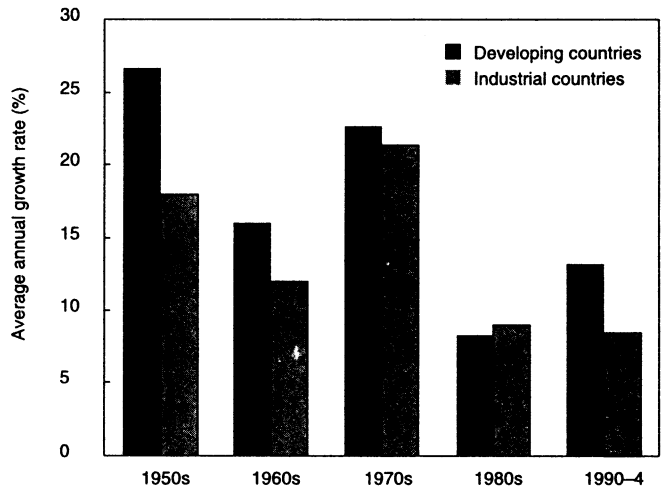

Figure 3.3 Israeli exports (US$)

Source: Statistical Abstract of Israel.

1990s direct foreign investment in Israel (as well as of Israeli companies abroad) has increased. The nature and extent of this investment marks a sharp departure from past experience. Whereas earlier most foreign investors had to be attracted by large grants and generous tax exemptions in order to compensate for Israel's high country risk, the current trend is driven by a desire to establish regional footholds in preparation for Middle East development. Companies which have never before operated in Israel – such as Volkswagen, Nestlé, Citicorp, Cable & Wireless, Shamrock, Enron, Bechtel, Toyota, and many others – are now teaming up with the Israeli conglomerates, either through direct investment or via the secondary market.

This process coincides with growing pressure on the core conglomerates to disinvest their holdings. In preparation for such disinvestment there is increasing criticism of the "excessive" power of the large firms. In 1995 a government-commissioned study *suddenly* discovered that the Israeli economy was "too concentrated" and recommended that the key holding groups be dismembered by separating financial holdings from industrial operations. The main target is Bank Hapoalim, which according to the study has ownership stakes in over 770 non-financial companies across the economy – including 34 percent of Clal and 25 percent of Koor.[74] In addition, the bank holding groups themselves are up for sale. The three largest banks – Hapoalim, Leumi, and Discount – have been under government

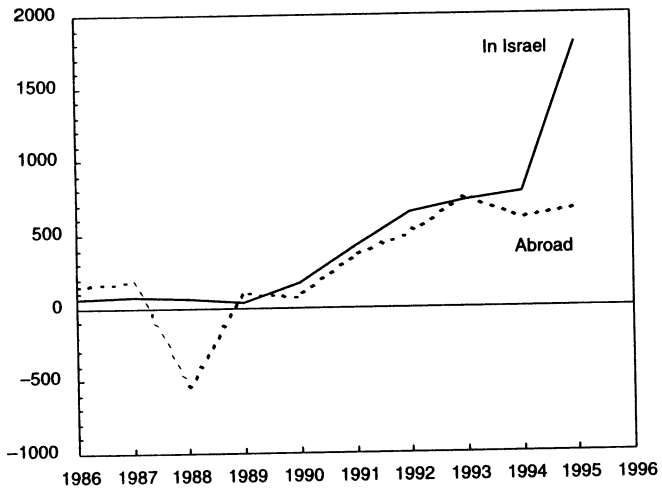

Figure 3.4 Foreign direct investment (US$ million)

Source: *Statistical Abstract of Israel.*

control since the stock market crash of 1983 and are now being set for re-privatization.

Officially, disinvestment and privatization are sanctioned in the name of "competition" and "efficiency," but this merely serves to conceal the changing nature of absentee ownership. Much as in South Africa, the attack on big business is at least partly driven by pressure from the United States and Europe to open the Israeli market to foreign investment. However, as in South Africa, the Israeli business elite, too, is set to benefit from the ensuing restructuring. The rigid cross-ownership structure of the core conglomerates was adequate for the earlier regime of a closed militarized economy. The emphasis was on the differential depth of accumulation by maintaining above-average profit margins. This necessitated an intricate system of mutual "understandings" and institutional arrangements such as coordinated stock manipulation, synchronized price increases, a common front against labor demands, and a closed system of military procurement – all of which were facilitated by cross-ownership and multiple holdings. The end of this regime, however, eliminated some of the need for close coordination and reduced the need for conglomerate structures. Direct investment is no longer seen as the only means of controlling the flow of profit; this can now often be done more effectively and with far greater flexibility through portfolio stock ownership.

These conjectures suggest that we should be careful not to misinterpret

the apparent decline of the core conglomerates. On the face of it, the pending dismembering of these groups, the entry of foreign investors, and the rise of smaller (mainly high-technology) groups seem to imply that the Israeli economy is entering a period of falling concentration and greater competition. Such conclusions may prove too hasty for two principal reasons. First, with Israeli outward investment on the rise, differential accumulation will increasingly depend on the company's global position and the strength of its international ownership ties. On these counts, the core groups are already far ahead of their smaller counterparts, and their differential pace of outward expansion suggests that the gap will only widen.[75] Second, with corporate realignment becoming more commonplace and frequent – via takeovers, mergers, and acquisitions – our existing definition of Israel's dominant capital may prove too rigid. As the pattern of ownership grows more fluid and unstable it may be necessary to go beyond corporate entities and identify the holdings of key individuals. Such data may be hard to collate, but the evidence it would provide would be well worth the effort.

Notes

1 The concept of differential accumulation was first introduced in J. Nitzan, "Inflation as restructuring: a theoretical and empirical account of the US experience" (unpublished doctoral dissertation, Department of Economics, McGill University, Montreal, 1992), where it was used as a basis for understanding inflation as a process of corporate restructuring. The significance of differential accumulation for international political economy, with special emphasis on energy conflicts in the Middle East, is analyzed in J. Nitzan and S. Bichler, "Bringing capital accumulation back in: the weapondollar-petrodollar coalition – military contractors, oil companies and Middle East 'energy conflicts'," *Review of International Political Economy* 2(3), 1995, pp. 446–515, and S. Bichler and J. Nitzan, "Putting the state in its place: US foreign policy and differential capital accumulation in Middle East 'energy conflicts'," *Review of International Political Economy*, forthcoming. An analytical model and econometric analysis of differential accumulation in Israel is given in 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), 1996, pp. 52–97.

2 Nitzan, "Inflation as restructuring."

3 This pattern of accumulation has been labelled "ultra imperialism" by some Israeli writers.

4 See C. Tilly (ed.), *The Formation of National States in Western Europe*, Princeton University Press, Princeton, New Jersey, 1975; S. D. Krasner, *Defending the National Interest*, Princeton University Press, Princeton, New Jersey, 1978; and T. Skocpol, "Bringing the state back in: strategies of analysis in current research," in P. B. Evans, D. Rueschemayer and T. Skocpol (eds.), *Bringing the State Back In*, Cambridge University Press, Cambridge, 1985, pp. 3–37.

5 See, for instance, A. Arian, *Politics in Israel: The Second Generation*, 2nd edition, Chatham House, Chatham, New Jersey, 1989.

6 S. Tsuru, "Keynes versus Marx: The methodology of aggregates," in D. Horowitz (ed.), *Marx and Modern Economics*, Modern Reader Paperbacks, New York and London, 1968, pp. 176–202.

7 J. Robinson, *Economic Philosophy*, Penguin, Harmondsworth, Middlesex, England, 1962, pp. 117–18.

8 Thus E. Berglas, in "Defense, standard of living and foreign debt" (in Hebrew, *Economic Quarterly* 17(67), September 1970, pp. 191–202), asserts that "the central problem of the economic policy in Israel is choosing the right point on the curve [production-possibilities frontier]," yet he immediately adds that this choice must be determined by "security considerations" which are "beyond the domain of this article." That particular article was written at a sensitive period, right at the end of the Israel–Egyptian war of attrition – though time has done little to change the author's basic presumption. Thirteen years later, after the 1982 Israeli entanglement in Lebanon, Berglas still claimed that "the purpose of military expenditures [in Israel] is both to deter potential enemies from starting a war and to achieve superiority once a war has started," and that "it is thus difficult even in retrospect to assess the success or failure of a military expenditure program" (E. Berglas, "Defense and the economy: the Israeli experience," discussion paper 83.01, the Maurice Falk Institute of Economic Research, Jerusalem, 1983). Likewise, Hasid and Lesser, while working as senior economists at the Ministry of Security, asserted that although "Israeli society is democratic, free, peace seeking and striving for a standard and quality of living much like the progressive western states, Israel is coerced into a permanent state of war." In this context, they explained, "the allocation of resources for security involves national risks which are very difficult to assess in any objective way" (N. Hasid and O. Lesser, "Economic resources for Israel's security," in Hebrew, *Economic Quarterly* 28(109), 1981, p. 243). These assertions may all be true, of course, but then there arises the simple question: If the size of the military budget, decisions about the occupied territories, the fate of the settlements, and the dependency on the United States are all determined by "autonomous" state officials, uncompromising Arab regimes, and ideological inclinations, why the scientific pretensions of rational "economism"?

9 According to E. Sadan, an economics professor and general manager of the Finance Ministry at the time, "In Israel economic goals arise naturally from the general goal of the survival of the state." Indeed, "planning for survival includes economic growth, and even when this is not an objective in and of itself, it is a means for making possible the establishment of the defense system required for future wars" (E. Sadan, "National security and national economy," in Hebrew, in Z. Lanir (ed.), *Israeli Security Planning in the 1980s: Its Politics and Economics*, Tel Aviv University, the Jaffee Centre for Strategic Studies, Tel Aviv: Ministry of Defense, 1985, p. 119). (Sadan has since converted to advocating peaceful regional integration.)

10 A. Klieman, *Double-edged Sword: Israel Defense Exports as an Instrument of Foreign Policy*, in Hebrew, Am Oved, Tel Aviv, 1992, p. 326.

11 On the concept of "we," see R. J. Barnet, *Roots of War: The Men and Institutions Behind US Foreign Policy*, Atheneum, New York, 1972, p. 7. Additionally, Aharoni, for example, describes how "we are required, and justly so, to demonstrate resilience and hold out against political and economic pressures," while "our young are called for a long reserve service and bloodletting" (Y. Aharoni, "Institutional rigidity and resource utilization," in Hebrew, *Economic Quarterly* 16(62), July 1969, p. 157). Although Aharoni hinted that the Labour government of Golda Meir should reevaluate its priorities, he was also quick to add that this was "not to doubt the need to devote whatever is necessary in order to assure our very survival" (Aharoni, p. 160).

12 Berglas, "Defense, standard of living and foreign debt," p. 195.

13 Y. Peri, *Between Battles and Ballots: Israeli Military in Politics*, Cambridge University Press, Cambridge, 1983, p. 1; D. Horowitz and M. Lissak, "Democracy and national security in a continuous conflict," in Hebrew, *Yahadoot Zemanenu* 4, 1988, p. 28.

14 Horowitz and Lissak, *Trouble in Utopia: The Overburdened Polity of Israel*, State University of New York Press, Albany, New York, 1989, ch. 6.

15 See D. Horowitz, "The Israeli defense forces: a civilianized military in a partially militarized society," in R. Kolkowitz and A. Korbonski (eds.), *Soldiers, Peasants and Bureaucrats*, George Allen & Unwin, London, 1982, p. 96. See also A. Mintz, "The military-industrial complex: the Israeli case," in M. Lissak (ed.), *Israeli Society and its Defense Establishment*, Frank Cass, London, 1984, p. 104; and G. Ben Dor, "Politics and the military in Israel in the seventies," in Hebrew, in M. Lissak and E. Gutmann (eds.), *The Israeli Political System*, Am Oved, Tel Aviv, 1977, p. 431.

16 Y. Shapiro, for example, believes that, contrary to the basic individualistic liberal principles of Western society, Israel has failed to adopt the requisite economic perspective to encourage private enterprise (Y. Shapiro, *The Organization of Power*, in Hebrew, Am Oved, Tel Aviv, 1975, pp. 207–8; see also, Y. Shapiro, *The Democracy in Israel*, in Hebrew, Massada, Ramat Gan, 1977; A. Arian and Y. Aharoni, *The Political Economy of Israel*, in Hebrew, Am Oved and the Levi Eshkol Institute, Tel Aviv, 1991). The consequences for Israeli society were detrimental. The petrifying effect of political dominance since the British Mandate era has created grave "distortions," mostly associated with the evils of a "socialistic tradition" and excessive "government intervention" (N. Halevi and R. Klinov-Malul, *The Economic Development of Israel*, Praeger, New York and Jerusalem, 1968, p. 4). "The socialist ideology," writes Ben Porath, "included a distrust of the market, a view of profits as mere rewards to parasitism, and (paradoxically) a view of services as unproductive" (Y. Ben-Porath (ed.), *The Israeli Economy: Maturing Through Crises*, Harvard University Press, Cambridge, Massachusetts, and London, 1986, p. 14).

17 I. Sharkansky, *The Political Economy of Israel*, Transaction Books, New Brunswick, New Jersey, 1987, p. 5.

18 Y. Shapiro, *An Elite Without Successors: Generations of Political Leaders in Israel*, in Hebrew, Sifriat Poalim, Tel Aviv, 1984, p. 45.

19 G. Goldberg, *Political Parties in Israel: From Mass Parties to Electoral Parties*, Ramot, Tel Aviv University, Tel Aviv, 1992, p. 16.

20 A. Arian, *Politics and Government in Israel*, in Hebrew, Zmora-Bitan, Tel Aviv, 1985.

21 D. Giladi, *The Yeshuv During the Fourth Migration 1924–1929: An Economic and Political Examination*, in Hebrew, Am Oved, Tel Aviv, 1973: and G. Yatziv, *The Class Basis for Party Association: The Example of Israel*, in Hebrew, Research in Sociology, Department of Sociology, Hebrew University, Jerusalem, 1979.

22 For a detailed analysis of the "military bias" in the U.S., see Nitzan and Bichler, "Bringing capital accumulation back in," and Bichler and Nitzan, "Putting the state in its place."

23 R. Hilferding, *Finance Capital: A Study of the Latest Phase of Capitalist Development*, edited with an introduction by T. Bottomore, from a translation by M. Watnick and S. Gordon, Routledge & Kegan Paul, London, 1910, 1981; and R. Luxemburg, *The Accumulation of Capital*, translation from German by A.

Schwarzschild, with an introduction by J. Robinson, Monthly Review Press, New York, 1913, 1951.

24 M. Kalecki, *The Last Phase in the Transformation of Capitalism*, Monthly Review Press, New York, 1972; S. Tsuru, "Has capitalism changed?," in S. Tsuru (ed.), *Has Capitalism Changed? An International Symposium on the Nature of Contemporary Capitalism*, Iwanami Shoten, Tokyo, 1961; P. M. Sweezy, *Modern Capitalism and Other Essays*, Monthly Review Press, New York, 1972; and J. Steindl, *Maturity and Stagnation in American Capitalism*, Monthly Review Press, New York and London, 1976.

25 D.A. Gold, "The rise and decline of the Keynesian coalition," *Working Papers on the Kapitalistate*, vol. 6, 1977, pp. 129–61.

26 J. O'Connor, *The Fiscal Crisis of the State*, St. Martin's Press, New York, 1973.

27 P. Baran and P. M. Sweezy, *Monopoly Capital. An Essay on the American Economic and Social Order*, Modern Reader Paperback, New York and London, 1966.

28 Michal Kalecki, "The fascism of our time," 1964, and "Vietnam and US big business,"1967, both reprinted in M. Kalecki, *The Last Phase in the Transformation of Capitalism*, Monthly Review Press, New York, 1972; and S. Melman, *The Permanent War Economy: American Capitalism in Decline*, revised and updated, Simon & Schuster, New York, 1985.

29 Nitzan and Bichler, "Bringing capital accumulation back in."

30 See Melman.

31 The Reagan years saw a sequence of publicized corruption scandals in the defense sector, but even modest attempts to regulate procurements were quickly aborted. Indeed, the drop in military spending since the late 1980s would have been far more difficult to implement had it not been for the collapse of the Soviet Union and the rise of global investment outlets through the North American Free-Trade Agreement (NAFTA), the General Agreement on Tariffs and Trade (GATT), and the "emergence" of Latin America and Asia.

32 As described in R. P. Smith, "Military expenditure and capitalism," *Cambridge Journal of Economics* 1(1), March 1977, pp. 61–7.

33 J. L. Griffin, J. A. Devine and M. Wallace, "Monopoly capital, organized labor, and military expenditures in the United States, 1949–1976," in M. Burawoy and T. Skocpol (eds.), "Marxist inquiries: studies of labor, class and states," *American Journal of Sociology* 88, 1982, supplement.

34 For the military contractors, arms exports became paramount again in the 1990s, when the long-term ascent of global military expenditures gave way to a downward trend in the wake of a new world order of "peace dividends."

35 The dual-economy literature dates back to the 1940s (see, for example, J. Steindl, *Small and Big Business*, Basil Blackwell, Oxford, 1945). Notable dual-economy analyses of the U.S. economy are offered by R. Edwards, *Contested Terrain: The Transformation of the Workplace in the Twentieth Century*, Basic Books, New York, 1979; and J. Bowring, *Competition in a Dual Economy*, Princeton University Press, Princeton, 1986. Most studies on the structure of the Israeli economy tend to deal with the plant and focus on "real" activity, using standard industrial classifications. The firm and its finances are usually seen as belonging to the sphere of business administration and rarely bear on such analysis. However, the growth of the large Israeli conglomerates since the 1970s, with thousands of diversified holdings and complicated inter-conglomerate links, have rendered this framework largely inadequate for the study of accumulation and business power. Of course, this methodological problem is hardly unique to Israel and complicates the analysis whenever an economy enters its conglomerate stage. According to Scherer and Ross, for example, the standard industrial classification for U.S. firms became decreasingly useful after the 1960s (F. M. Scherer and D. Ross, *Industrial Market Structure and Economic Performance*, 3rd edition, Houghton Mifflin, Boston, 1990, p. 418).

36 For details on the British Mandate period, see T. Gozansky, *Formation of Capitalism in Palestine*, Miphalim Universitaim, Haifa, 1986, ch. 3.

37 A detailed statistical analysis of the performance of the core groups is given in R. Rowley, S. Bichler and J. Nitzan, "Some aspects of aggregate concentration in the Israeli economy, 1964–1986," working paper 7/88, Department of Economics, McGill University, Montreal, 1988. The emergence of the Israeli business elite and its interaction with the political and military elites since the turn of the century are examined in S. Frenkel and S. Bichler, *The Rich Families*, in Hebrew, Kadim, Tel Aviv, 1984. On the relations between the Israeli big economy and the government, see Y. Aharoni, *Structure and Performance in the Israeli Economy*, in Hebrew, Cherikover, Tel Aviv, 1976, ch. 6.

38 Dun & Bradstreet, 1984.

39 For details, see Rowley, Bichler and Nitzan, "Some aspects of aggregate concentration in the Israeli economy, 1964–1986."

40 Frenkel and Bichler, *The Rich Families*.

41 M. Bejsky, V. Ziller, Z. Hirsh, Z. Sarnat and D. Friedman, *Report of the Commission of Inquiry into the Manipulation of Banking Shares*, in Hebrew, Government Printer, Jerusalem, 1986, pp. 32, 35, 38, 40, 73–4, 82, 102, 159.

42 The series for "all other firms" reflects the profits of large firms other than the five core conglomerates, in addition to profits in the small economy. However, given the close correlation between the profits of the core corporations and those of the large satellite firms (see, for example, H. Levi, "Capital structure, inflation and the price of capital in Israeli industry, 1964–1978," in Hebrew, discussion paper no. 795, the Maurice Falk Institute of Economic Research, Jerusalem, 1979, and "Capital structure, inflation and the price of capital in Israeli industry from 1964 to 1978," in Hebrew, research paper no. 122, the Maurice Falk Institute of Economic Research, Jerusalem, 1981), the exclusion of the latter from the category of "all other firms" will have had the effect of making the divergence even greater.

43 See, E. Farjoun's works: "The Palestinian workers: an economic reserve army," in Hebrew, *Red Papers*, no. 5, Jerusalem, 1978; "Palestinian workers in Israel: a reserve army of labour," *Khamsin*, London, no. 7, 1980, pp. 107–43; and "Class division in Israeli society," *Khamsin*, London, no. 10, 1983, pp. 29–39.

44 Farjoun, "The Palestinian workers," p. 4.

45 The paramount role of Palestinian workers became patently clear after 1987, with the intifada (uprising) in the occupied territories. Repeated closures of the territories after Palestinian attacks in Israel have proven detrimental to the small economy. With construction and agricultural wages too low for Jewish laborers, the government had to replace the Palestinians with over 80,000 "guest workers" from Eastern Europe and Asia.

46 Farjoun, "The Palestinian workers," p. 17.

47 Note that this view, which attributes the post-1967 economic growth to the rapid expansion of markets and proletarianization, is generally rejected by mainstream Israeli economists. Indeed, many tend to see the occupied territories as a net cost to the Israeli economy – first, because the availability of cheap Palestinian labor reduced the incentive to invest in new technologies and, second, due to the need to spend heavily on security. Tuma (p. 594), for instance, estimated in a recent symposium on "The Economies of Israel and the Occupied Territories" that the occupation reduced Israeli annual economic

growth by 1.07 percent between 1967 and 1982. In the same symposium, Berglas and Klieman argued that the forced integration between the two economies contributed a mere 2 percent to Israel's GDP. According to their computations, the real winners – in terms of standard of living – were the Palestinians (E. H. Tuma in "The economies of Israel and the occupied territories: war and peace – a panel discussion," in Hebrew, *Economic Quarterly*, no. 139, pp. 593–606). Underlying this calculus lies the same logic as that which sees slavery as an economic loss to the United States and colonies as a net burden on empires; taken *ad absurdum*, such logic implies that over the past five millennia of power civilization humanity was merely busy accumulating losses. The problem, again, is in the aggregates. It is only in the fictitious world of Pareto that an *entire* society can lose or gain. In the real world of occupation and domination the negative aggregates always conceal some definite winners – in the Israeli case, these were the small economy and the expanding middle class. But even that description fails to reveal the whole story. If we were to compute economic surplus on the basis of *unequal* exchange, the Palestinian contribution to Israeli GDP would turn out to be much higher. Indeed, without the occupation the very development of the Israeli economy, as well as its income distribution, would have been far different. As for the Palestinians, a quarter-century of Israeli occupation prevented their industrialization, forestalled the creation of monetary and fiscal systems, confiscated land and water resources, hindered technological education, and encouraged the emigration of skilled workers. Although we will never know for sure, it is not unreasonable to conclude that they would have done better without this occupation.

48 On the paramount role of government during the 1950s, see D. Patinkin, "The Israeli economy in the first decade," 1965. The pattern of sectoral capital allocation is discussed in H. Barkai, "The public sector, Histradrut sector and private sector in the Israeli economy," sixth report 1961–1963, the Maurice Falk Institute of Economic Research, Jerusalem, 1964.

49 Many of today's established companies (now often controlled by the core conglomerates) were born during the austerity era, while many members of parliament and politically connected individuals became millionaires in a matter of only a few years.

50 Horowitz, *In the Heart of Events*, in Hebrew, Massada, Ramat Gan, Israel, 1975, pp. 23–4.

51 H. Recanati, *Recanati, Father and Son*, in Hebrew, Kenne, Jerusalem, 1984, p. 71.

52 *Ibid.*, pp. 92–3.

53 During the 1920s Palestine had seventy commercial banks and 100 savings and loan cooperatives; by the 1970s only five banking groups remained.

54 Some of the largest corporate casualties included the Central Company for Trade and Investment, Gass-Rasko and Israel Holdings (all absorbed by Clal), PEC (by IDBH) and Africa–Israel (by Bank Leumi). Many banks, including the fourth largest (Britain–Israel), went bankrupt or merged with the largest banking groups.

55 During the recession, the Histadrut (confederation of labor unions) took over the workers' pension funds. The immediate purpose, backed by the finance minister, Sapir, was to boost the ailing finances of companies such as Koor, Solel Bonhe and Teus. Jacob Levinson, then chief executive officer of the Histadrut-affiliated Bank Hapoalim, took over seven such pension funds, merging them all into a single giant fund named Gmool. By making Gmool a department within his bank, Levinson was able to bypass the Histadrut's regulatory procedures, so

he could use the fund as a leverage for takeovers. The consequence was a massive redistribution whereby hundreds of millions of dollars of workers' savings were converted into incomes for a limited strata of ex-army officers, financiers, and politicians. (Levinson committed suicide in 1984 after his plan to siphon assets from Bank Hapoalim to U.S. investment companies controlled by his associates was discovered.)

56 The officers were everywhere. Koor, for example, entered the arms business in the late 1960s and in 1968 nominated Meir Amit, a former head of both military intelligence and Mossad, as its chief executive officer. Amit was later replaced by another former army general, Ysha'ayahu Gavish. The "crown jewel" of Koor – the high-technology manufacturer Tadiran – was headed by Elkana Caspy, a deputy commander of the communication corps. Tadiran's board of directors included another former head of military intelligence, Yehoshua Sagee, as well as his deputy Eli Halakhmy. Similarly, when the Clal group entered the military business it got itself a former chief of staff, Zvi Zur. Politically, many of these figures were associated initially with the Raffi party (established in the 1960s by General Moshe Dayan and Shimon Peres) and later with Dash (a political party formed in 1975 by major military contractors and financiers, and headed by Ygael Yadin, another former chief of staff).

57 These partnerships included Elron (jointly owned by TRW), Elbit (with Control Data) and Iscar and Iscar Blades. Investment in the latter two companies was shared with Stephen Wertheimer, a former member of Knesset and a leading advocate of Ian Rand's laissez-faire philosophy, who skillfully combined the benefits of massive government contracts with the glory of free enterprise.

58 Tadiran was originally owned jointly by Koor, GTE, and the government. In 1969 the government transferred its share to GTE, which finally left the partnership in 1987. The company's business success turned it into a semi-autonomous unit within Koor, and, as with the other contractors, its management was rapidly staffed with ex-army officers. A newspaper article from the mid-1980s provides insight into the pattern of political and military business linkages within Tadiran:

> After the chief executive officer, the strong man in Tadiran is the head of international trading, Itzhak Raviv. Raviv recently moved into arms exports, a change which caused some uproar in the company. The main reason is the pending retirement of Yehoshua Sagee [an ex-head of military intelligence who was given a dishonorable discharge after the 1982 Lebanon war]. Sagee was brought to Tadiran for his connections and put at the helm of a special marketing unit of 16 people. Raviv now wants to replace him with Eli Halakhmi, who served in the army under Sagee and was [also] given a dishonorable discharge under humiliating circumstances. After leaving the army, Halakhmi was nominated head of police intelligence, but was dismissed after revelations about his involvement with companies convicted of criminal offenses. Halakhmi was also entangled in the sale of forged Bank of Israel certificates; his partner in the central bank was sentenced to six years in prison, though Halakhmi was not charged. Halakhmi's girlfriend during that time was Leah Levi, deputy senior prosecutor at the Tel Aviv district attorney's office, where the charges were laid. She was forced to resign after being convicted for falsifying receipts.... After leaving the district attorney's office, Halakhmi brought her to work in Tadiran.
>
> (*Hadashot*, March 22, 1985)

59 Aharoni, *Structure and Performance in the Israeli Economy*, Am Oved and the Levi Eshkol Institute, Tel Aviv, 1976, p. 299.
60 Bejsky *et al.*, *Report of the Commission of Inquiry into the Manipulation of Banking Shares*, p. 59.
61 Bank of Israel, *Annual Report* and Central Bureau of Statistics, *Statistical Abstract of Israel*, various years.
62 Bejsky *et al.*, *Report of the Commission of Inquiry into the Manipulation of Banking Shares*, p. 61.
63 Data are from the Central Bureau of Statistics, *Statistical Abstract of Israel*, various years.
64 Shapiro, *The Democracy in Israel*; Arian, *Politics and Government in Israel*; and Aharoni, *The Political Economy of Israel*.
65 Bichler and Nitzan, "Putting the state in its place"; J. Nitzan, "Israel and South Africa: prospects for their transitions," *Emerging Markets Analyst* 4(10), 1996, pp. 12–18.
66 Nitzan, "Israel and South Africa."
67 B. R. Barber, "Jihad vs. McWorld," *The Atlantic*, March 1992, pp. 53–5, 58–63.
68 Nitzan, "Israel and South Africa," pp. 13–15.
69 Nitzan and Bichler, "Some aspects of aggregate concentration in the Israeli economy, 1964–1986".
70 A. Sampson, *The Arms Bazaar. From Lebanon to Lockheed*, Viking Press, New York, 1977; and A. Cockburn and L. Cockburn, *Dangerous Liaison: The Inside Story of the US–Israeli Covert Relationship*, Stoddart Publishing, Toronto, 1991.
71 J. Nitzan, "The Israeli defense industry: a peace dividend for stock pickers?," *Emerging Markets Analyst* 3(1), 1994, pp. 8–9.
72 An analysis of public statements by the various elites since the late 1980s suggests that the first to endorse the new order of peace and globalization was the military echelon, followed by the business elites. The politicians were last in joining the peace wagon (R. Hakeynee, "The political process and elites: statements by the elites regarding the peace process from the mid-1980s until the Declaration of Principles (September 1993)," in Hebrew, mimeograph, Hebrew University, Jerusalem, 1994). The new position of the core conglomerates was succinctly summarized by Benjamin Gaon, chief executive officer of Koor (formerly controlled by the Histadrut): "It is the responsibility of the Israeli business community to assist political leaders by cementing peace on the solid ground of business" ("Koor's Mr. Turnaround builds bridges in the Middle East," *Financial Times*, February 13, 1995, p. 12).
73 E. Sagi and Y. Sheinin, "Opportunities for trade with Arab countries," in Hebrew, *Economic Quarterly* 41(1), April, 1994, pp. 15–27.
74 *Ha'aretz* 4, December 13, 1995.
75 A recent newspaper article showed that since the beginning of the peace process fewer than twenty companies enjoyed systematic long-term profit growth. Most of these were associated with the core conglomerates (*Ha'aretz*, January 10, 1995).

4

THE ISRAELI DILEMMA OVER ECONOMIC DISCRIMINATION AND LABOR-MARKET COMPETITION

Noah Lewin-Epstein and Moshe Semoyanov, with J. W. Wright, Jr.[1]

> The very fact that there is economic discrimination constitutes an added motive for every individual majority group to maintain such discriminatory practices. Discrimination breeds discrimination. The effect creates a circular process which causes job limitations and that keeps the minority group's economic status low.
>
> Gunnar Myrdal

Introduction

This quote comes from Myrdal's famous commentary on "The mechanics of economic discrimination" in his book *An American Dilemma: The Negro Problem and Modern Democracy*.[2] This 1944 book initiated the still unresolved U.S. debate over the roles, agencies, markets, and social institutions play in maintaining ethnic economic inequality. This chapter further contributes to this debate, but with special reference to the Israeli dilemma over the Arab position in Israel.

While Nitzan and Bichler illustrate in Chapter 3 how the core conglomerates in Israel have created structures which allow them "to protect their possessions of opportunities to acquire...superior resources,"[3] we will investigate the structural dynamics that cause ethnic inequalities on the socioeconomic level. For example, workers from the superordinate group who are employed in lower-status jobs tend to support policies meant to confine minority workers and entrepreneurs. While the elite business group is most concerned with controlling international financing mechanisms, the average Jewish Israeli voter wants legal regimes that support biased market structures at occupational, social, and residential levels.