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The territorial logic of an export-led growth strategy: Israel's regime change after the Second Intifada

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In recent decades, neo-mercantilism has become ubiquitous among small and large states. The conventional explanation for the appeal of an export-led growth regime has focused on the material interests of domestic growth coalitions. This article offers an alternative explanation for transition to export-led growth strategies, based on the geopolitical and territorial interests of states. It posits that states embrace a mercantilist export-led growth model because it aligns with their geopolitical objectives. The article demonstrates the geopolitical hypothesis based on the transition of Israel from a consumption-led to an export-led growth strategy after the end of the peace process and the outbreak of the Second Intifada in 2000.

Keywords: *Export-led growth strategy, neo-mercantilism, growth coalition, territorial logic of capitalism*

JEL codes: *053, O43, N15, E12*

1 INTRODUCTION

In recent decades, neo-mercantilism has become prevalent among both small and large states. This shift towards export-oriented models is not only limited to major players like Germany and China but also includes smaller economies, as evidenced by studies by Güvercin (2020), Rapidis (2010), Kuus (2002), and Gray (2011). The widespread adoption of neo-mercantilism poses a puzzle, considering the evidence that it does not always lead to higher growth rates (Höpner 2019), and it is likely to exacerbate income inequality while potentially contributing to international imbalances (Palley 2003). Therefore, it becomes crucial to explore the political factors driving this trend.

A common approach focuses on the distributive implications of the export-led growth model. This explanation is rooted in theories that emphasize societal actors as the driving force behind the emergence and stability of export-led growth regimes, as highlighted in reviews by Clift (2014) and Oatley (2023). This article presents an alternative explanation that views the export-led growth model as a neo-mercantilist strategy propelled by the geopolitical preferences of the state rather than the material interests of firms and workers. According to this viewpoint, a country's growth model is shaped by the interplay between economic logic and the territorial logic of states, resulting in both complementarities and contradictions between domestic politics and international geopolitics.

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The article examines the case of Israel, a medium-sized economy located in an unstable region characterized by significant complementarities and contradictions between the economic and territorial considerations, which differ from those observed in Western European economies. The focus is on the early 2000s when Israel experienced a profound economic transformation amid a geopolitical crisis. This period marked a shift from consumption-led growth in the 1990s to export-led growth, coinciding with the termination of the peace process with the Palestinian Authority and the outbreak of the Second Intifada. This article argues that these two events were interconnected causally: the change in Israel's geopolitical circumstances led to the transition from consumption-led to export-led growth.

The historical analysis presented in the article utilizes a combination of quantitative and qualitative evidence. The quantitative evidence encompasses six sets of indicators that provide insights into different facets of Israel's growth model in two distinct periods: the Peace Economy period (1991–1999) and the post-Intifada period (2003–2008). On the other hand, the qualitative evidence draws on extensive research conducted on primary documents. These documents were analyzed using a text analysis program called MAXQDA and subsequently examined manually. The article includes a selection of quotes from the documents to support its arguments and findings.

The article is structured into two main parts. The first part, which is theoretical in nature, begins with a historical examination of the concept of mercantilism, emphasizing the evolving meanings of the term and its fluctuations throughout history. It specifically underscores the differentiation between the economic rationale of mercantilism and its territorial considerations. Subsequently, it delves into an elaboration of the territorial logic of mercantilism, and introduces the geopolitical hypothesis that posits the primacy of the state's territorial interests over the interests of societal actors within the mercantilist regime. It concludes by outlining the distinction between *ex ante transformative actors* and *ex post stabilizing actors*. Accordingly, the geopolitical hypothesis contends that in certain cases, social groups assume the role of *ex post* stabilizers rather than *ex ante* transformers.

The second part of the article is composed of three sections. The first section provides evidence to support the descriptive claim that Israel's growth regime transitioned from consumption-led to export-led following the Second Intifada. In the second section, the hypothesis suggesting that social groups played an *ex ante* transformative role in this change is refuted. It demonstrates that there was no *ex ante* support for the transition to an export-led growth strategy. The third section within the second part delves into the examination of the geopolitical hypothesis, which posits that the regime change was primarily influenced by the perceptions of the hawkish political elite regarding the state's interests. The discussion critically evaluates the strength of the geopolitical hypothesis, as well as its potential for generalization.

2 THEORY

Within the post-Keynesian economic (PKE) framework, an export-led growth strategy, often referred to as mercantilism, serves as an alternative to a consumption-led strategy. Its primary goal is to stimulate economic growth through exports, with its distributional impacts typically favoring the private sector, especially exporters and the financial sector. However, in reality, the forms, objectives, and political foundations of mercantilist strategies can greatly differ. Notably, these strategies are often employed as tools of economic statecraft rather than purely for economic advancement. This section will delve into the history of mercantilism and present the geopolitical rationale behind adopting an export-led growth strategy, often linked with mercantilism.

2.1 Mercantilism: a history of a concept

In its early phase during the sixteenth century, mercantilism was closely associated with bullionism, a policy approach that advocated the accumulation of large volume of precious metals by states. This early form of mercantilism shared certain similarities with current strategies aimed at attracting foreign capital. As the trade empires of the Netherlands and England emerged, mercantilist thinkers began advocating policies that promoted exports and minimized imports. Maintaining a trade surplus became a manifestation of both economic and political power. After the nineteenth century, when the British Empire moved away from mercantilism, the ideology, now also referred to as economic nationalism, was adopted by Germany and the United States, the two largest late-industrializing nations (Helleiner 2021). Economic nationalism was considered a necessary transitional phase in the development of late-developing economies. Following the decline of colonialism after the Second World War, developmental economists started endorsing mercantilist policies as a strategy for economic development. Late-developing economies employed protectionist measures such as tariffs and subsidies to manage their balance of payments and safeguard domestic production (Thirlwall/Hussain 1982).

The term ‘export-led growth models’ emerged in the 1980s as a counterpoint to import-substitution policies followed by developing economies. These models advocated *de jure* economic liberalization, denoting the absence of policies favoring domestic market sales (Krueger 1985: 20; Sachs et al. 1995: 22–23). The model gained traction based on the assumption that *de jure* openness, involving the removal of tariffs and subsidies, enhances efficiency and thereby optimizes economic growth (Palley 2003; Onaran/Stockhammer 2005: 66). Consequently, the export-led growth model represents a departure from the mercantilism and protectionism.

In recent times, post-Keynesian economists have embraced the concept of the export-led growth model and charged it with a new meaning. Within the post-Keynesian literature, the export-led growth model was perceived as an alternative to the consumption-led growth model. Post-Keynesian economists argue that that even when states engage in trade and capital liberalization, different growth models can emerge based on the relative contributions of domestic consumption and (net-)exports to overall economic growth (Baccaro/Benassi 2017; Hein 2023). From a post-Keynesian perspective, an export-led growth model is characterized by a significant reliance on exports for driving economic growth. The literature makes a distinction between the growth model, strategy, and regime, although the boundaries between them are not always well-defined. However, this differentiation is useful for understanding the interaction between structural characteristics (model), government policies (strategy), and the broader institutional impact of the growth model and strategy (regime) (Hassel/Palier 2021).

In the post-Fordist era, financial liberalization introduced new dimensions to the discussion on mercantilist strategies, highlighting concerns about financial dependence, vulnerability, and the need for protection against global financial markets. During this period, states began targeting not only their current account but also their financial and capital accounts, leading to the interaction between economic nationalism and financial nationalism. To finance their trade deficits, governments sought to attract foreign investment, leading to a shift from a domestically-based to an FDI-based investment strategy (Mertens et al. 2022). This investment strategy is often referred to as financial mercantilism or a dependent market economy, as it enables economies to tap into foreign savings (Aizenman/Lee 2006; Aromí 2021; Nölke/Vliegenthart 2009). According to Stockhammer, an export-led growth strategy can contribute to financial stability by externalizing financial instability (Stockhammer 2020: 31). In some cases, such as the China–US interaction, where the exporting country

becomes the lending country, an export-led growth strategy requires 'external financialization' (Stockhammer 2022: 175). While the complementarities between export-led and FDI-led growth models are complex, there is sufficient evidence to suggest that they are interdependent rather than operating in isolation.

The complex historical evolution of mercantilism reveals that the concept of neo-mercantilism is multifaceted. There are, in fact, three distinct yet interconnected aspects to the term neo-mercantilism: the post-Keynesian aspect, which emphasizes the pursuit of foreign demand; the developmental aspect, which underscores the drive for industrialization; and the financial aspect, which focuses on seeking protection against external dependence and vulnerabilities. While the post-Keynesian aspect pertains primarily to economic considerations – the quest for higher growth rates – the developmental and financial aspects give rise to geopolitical objectives associated with mercantilist strategies. Hence, when one seeks to explain the adoption of mercantilist strategies, one has to account for the complementarities between the economic and territorial drivers of this change.

2.2 The geopolitical hypothesis

Society-centered CPE theories posit that domestic societal actors, including social groups and economic interest groups, play a central role in shaping the domestic economic regime (for a comprehensive overview, see Clift 2014; Oatley 2023). These actors are driven primarily by their material interests and tend to coalesce into social blocs (Amable 2017: 5) or growth coalitions, which actively pursue changes in the economic regime or work to maintain stability once a regime is established (Baccaro et al. 2022).

However, when an export-led growth model is part of a neo-mercantilist strategy, it is likely to be driven by state actors whose perceptions of the state's territorial interests are influenced by external geopolitical factors. This perspective draws upon the insights of scholars in International Relations (IR) and International Political Economy (IPE), who emphasize the impact of external systemic factors on national economic regimes (Oatley 2019; Schwartz/Blyth 2022; Schwartz 2009). According to this approach, growth models emerge from the interplay of complementarities and contradictions between the economic and territorial logics of capitalism (Harvey 2005; Arrighi 1994; Jessop 2003). Territorial logic focuses on 'the political, diplomatic, and military strategies invoked and used by a territorially defined entity such as a state as it struggles to assert its interests and accumulate power in its own right', whereas economic logic focuses on the ways in which economic power 'flows across and through continuous space, towards or away from territorial entities' (Harvey 2005: 82). Although the literature on the territorial logic of capitalism predominantly focuses on the economic statecraft of hegemony who employ their economic influence as geopolitical leverage, small and medium-sized states also utilize trade and finance policies as defensive strategies. This article proposes that the adoption of export-led growth strategies by small states should be understood within the framework of their economic statecraft strategies. In this context, states may embrace an export-led neo-mercantilist regime, even if it does not yield immediate growth benefits, when the political elite perceives it to be in the state's interests. This line of reasoning is referred to in this article as the *geopolitical hypothesis*.

The geopolitical hypothesis posits that the state possesses relative autonomy in relation to social groups and has the capacity to shape them to a certain extent. Nicos Poulantzas argues that 'states take responsibility for the interests of the dominant capital' (Poulantzas 1978: 73) due to the internationalization of capital and the imperialistic tendency of states. Along similar lines, Bob Jessop argues that 'there is no guarantee that political outcomes will serve the needs of capital - even assuming that these could be objectively identified in advance in sufficient detail to provide the basis for a capitalistically rational plan of

state action and inaction' (Jessop 2003: 41). Jessop further claims that the state has the capacity 'to damage the interests of capital in general' (Ibid.). According to Polanyi, the state gives rise to the 'birth' and 'death' of classes (Polanyi 2001: 159). As social groups are generally less concerned about the state's territorial interests than the political elite, contradictions between the territorial and economic logic can lead to tensions between the political elite and social groups. In such cases, the political elite may seek to enhance the legitimacy of its perception of the state's interests through a discourse of legitimacy (Baccaro/Pontusson 2019: 18; Baccaro et al. 2022: 35).

The geopolitical hypothesis concerning the adoption of an export-led growth strategy encompasses two interrelated mechanisms: one linking geopolitical factors to the perceptions of the domestic political elite regarding the state's preferences, and another emphasizing the interaction between the state and domestic societal actors. In the historical section, the analysis demonstrates how both mechanisms can account for Israel's transition from a consumption-led growth strategy in the 1990s to an export-led growth strategy following the Intifada.

3 HISTORICAL ANALYSIS

This section of the article examines the shift in Israel's growth strategy from consumption-led to export-led during the 1990s and 2000s. Drawing on the geopolitical hypothesis, the analysis establishes a causal connection between the outbreak of the Second Intifada and the change in growth strategy. The historical portion begins with an overview of the historical argument and subsequently delves into a comprehensive analysis of the historical context.

3.1 Israel's transition from a consumption-led growth to a neo-mercantilist regime: the argument

Israel's political culture has been characterized by a top-down approach since its inception, shaped by its economic history and geopolitical circumstances. From the 1950s to the 1970s, Israel was governed by a dominant party, Mapai, which maintained strong connections with the powerful labor union, known as the Histadrut. Through its ownership of 20 per cent of Israel's productive capacity, the Histadrut exerted significant influence (Krampf 2018; Shalev 1984; Maron/Shalev 2017). During this period, the nation's drive for industrialization took precedence over conflicts among societal actors. Consequently, social classes in Israel were largely formed and influenced by state-led initiatives rather than emerging organically.

The national purpose in Israel has been further reinforced by the ongoing territorial conflicts with neighboring countries, which have overshadowed socioeconomic concerns (Abulof 2014). Despite trade and capital liberalization and the privatization of state-owned enterprises during the 1990s and 2000s, the top-down political culture has persisted (Shalev 1998). Israel's democracy ranking, as per V-Dem, falls within the third decile (20–30 per cent), in contrast to Western European nations that rank in the top decile (V-Dem 2023). This selection of Israel as a deviant case, in comparison to Western European liberal democracies, suggests that the regime change in Israel was likely driven by territorial considerations, with the growth coalition playing a role in stabilizing the regime *ex post*.

In 1985, the Israeli government introduced the Stabilization Plan, which proved to be a transformative moment in the country's economic history. Over the following five years (1986–1990), the government's primary objective was to bring the inflation rate down and to stabilize the economy. Throughout the 1990s (1991–2000), Israel underwent a

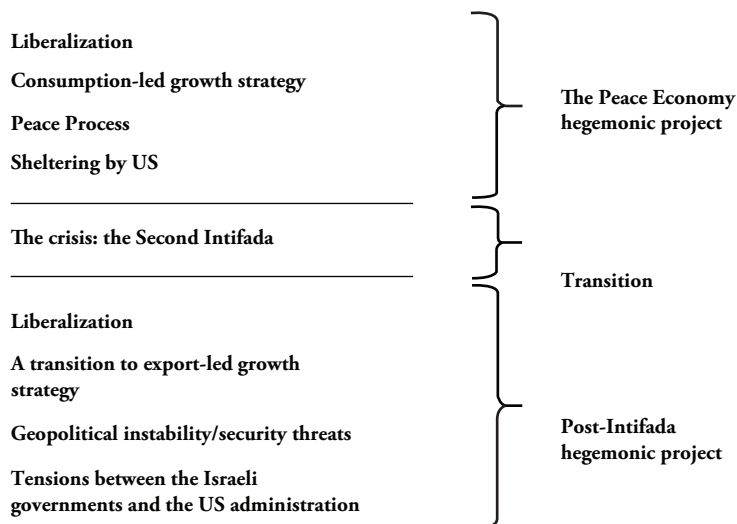
rapid process of liberalization, privatization, and globalization, coinciding with peace negotiations with the Palestinians. The outbreak of the Second Intifada marked the conclusion of the Peace Economy period, followed by a brief transition phase (2001–2002) before the emergence of the post-Intifada economic model (2003–2008), during which, this article argues, the government adopted a mercantilist export-led growth model. This article primarily focuses on the Peace Economy period and the subsequent post-Intifada period.

During the Peace Economy period, Israel's growth model was consumption-led. This strategy was enabled, the article will argue, by two territorial factors: the peace process and financial assistance from the US. After the Second Intifada broke out in 2000, the Israeli government shifted to an export-led growth strategy. Between 2002 and 2008, the growth model of Israel was export-led, and it was accompanied by an increase in FDI. The article suggests that this change was driven by the termination of the peace process and the concern of the hawkish government about Israel's dependency on the US. The historical narrative is summarized in Figure 1.

The historical argument is broken down into three claims:

1. A growth regime change took place between 2000 and 2002: the government shifted from a consumption-led growth model (1991–2000) to an export-led growth model (2003–2008).
2. The consumption-led growth model was feasible due to two non-economic – territorial – enabling preconditions: the peace process and financial support from the US. After the Second Intifada, consumption-led growth was no longer feasible because of the escalation of the conflict and the growing gap between the Israeli and the US interests.
3. During the transition period, none of the dominant societal actors in Israel advocated a growth model change. Rather, the advocates of a regime change were right-wing (hawkish) politicians who were concerned by the dependence of Israel on US support.

Those claims will be examined in part 2 of the article.



Source: Author.

Figure 1 The empirical narrative

3.2 The Peace Economy hegemonic project

As of 1985, after the execution of the *Emergency Stabilization Plan*, Israel entered an era characterized by liberalization and economic integration. However, until 1992, trade liberalization was incremental. Only after the election of Yitzhak Rabin's government (1992–1996) the liberalization and integration process was accelerated (Krampf 2018; Krampf et al. 2022).

The rapid liberalization process is demonstrated by the indicators presented in Table 1. Revenue from import taxes fell from an average of 6.6 per cent of GDP during the Stabilization Period to 4.8 per cent during the Peace Economy period (1991–2000). Export subsidies dropped from 1.14 per cent to 0.21 per cent, and corporate tax rates from 52 per cent to 38 per cent. Rabin's government accelerated the privatization process. The annual average income of the state from the selling of state-owned enterprises during the Peace Economy period was ten times higher than in the previous period and reached more than \$800 million (Table 1).

Passive liberalization was not associated with an export-led growth strategy. Despite trade liberalization, the relative size of imports and exports shrank during the 1990s from 66 per cent during the Stabilization Era to 64 per cent during the 1990s. The ratio of exports to GDP was 27 per cent during the Peace Economy compared to 29 per cent during the Stabilization era. This claim is supported by the fact that the contribution of net exports to growth during the 1990s was negative – –0.7 per cent compared to –0.21 per cent during the stabilization era (Table 2). Moreover, the annual average of the current account deficit during the 1990s was 2.7 per cent compared to 0.1 per cent during the previous period (Table 3). The high growth rate during the decade accounted for the growth in private consumption and public spending (an annual average of 7.4 per cent) (Table 2). The contribution of consumption to growth during the Peace Economy period reached 3.5 per cent, and that of investment was 1.7 per cent compared to 3 and 0.3 percent, respectively, during the stabilization era (Table 2).

The government took supply-side measures to assist exporters in the nascent high-tech industry. The government used the Capital Investment Encouragement Law (CIEL) to channel subsidies to exporting firms. It also channeled support to high-tech firms through the Chief Scientist's Office, which was responsible for state-funded private R&D (FC 1994). Throughout the 1990s, the government shifted resources to exporting industries.

Table 1 Indicators of liberalization and integration (annual averages for each period)

	Net taxes on Export imports ^a (GDP %)	Export subsidies ^a (GDP %)	Corporate tax rates ^a (GDP %)	Total income tax on non-wage income ^a (GDP %)	Privatization: state income from privatization (annual average; \$ million) ^b
Stabilization Period	6.6	1.14	52.4	8.1	85.0
Peace Economy	4.8	0.21	38.0	6.6	832.7
Intifada	3.6	0.10	36.0	6.3	72.0
Post-Intifada	3.8	0.00	33.0	6.6	1104.8

Notes: Stabilization period: 1986–1990; Peace Economy: 1991–2000; Intifada: 2001–2002; post-Intifada: 2003–2008.

Sources: ^aBank of Israel; ^bShapira (2010).

Table 2 Indices of growth model and economic openness

	Net export ^a	Growth Contribution of			Economic openness (%)	Export share of GDP (%)
		Private consumption	Gross Domestic Investment	Government Spending		
Stabilization period	-0.21%	2.99%	0.59%	0.31%	66	29
Peace Economy	-0.69%	3.47%	1.71%	0.70%	64	27
Intifada	-1.29%	1.13%	-1.49%	1.21%	60	30
Post-Intifada	1.13%	2.03%	0.80%	0.20%	62	33

Notes: Stabilization period: 1986–1990; Peace Economy: 1991–2000; Intifada: 2001–2002; post-Intifada: 2003–2008. ^aGrowth contribution of component X is defined as $\Delta X/Y$ when Y is GDP.

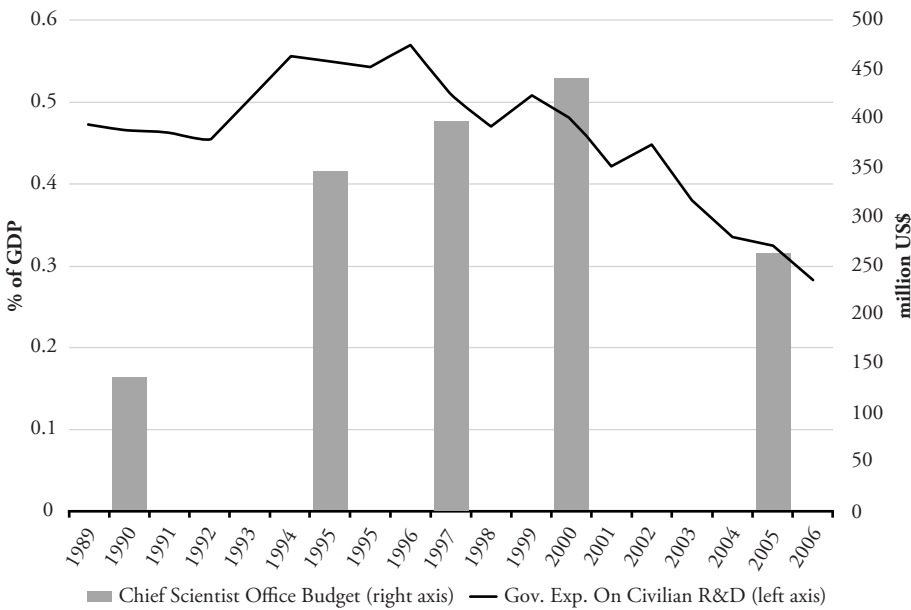
Source: Israel Central Bureau of Statistics.

Table 3 External vulnerability indices

	Current Account						External debt (% GDP)
	GDP growth ^a (%)	Export, annual growth (%) ^a	Export (% of GDP) ^b	Balance of trade (% of GDP) ^b	Import (% of GDP) ^b	Current account (% of GDP) ^b	
Stabilization period	4.6	5.7	31.1	−5.3	36.4	−0.1	41.1
Peace Economy	7.4	9.7	28.6	−5.4	34.0	−2.7	25.5
Intifada	−1.2	−3.9	32.1	−2.7	34.7	−1.3	22.6
Post-Intifada	5.4	7.6	39.2	−0.3	39.5	2.6	20.8

Notes: Stabilization period: 1986–1990; Peace Economy: 1991–2000; Intifada: 2001–2002; post-Intifada: 2003–2008.

Sources: ^a Bank of Israel (tables 2.A.40(2) and 2.A.47); ^b World Bank Data.



Source: Author, using data from Avnimelech (2009).

Figure 2 Chief Scientist's Office's budget and government expenditures on civilian R&D (GDP %)

The Chief Scientist Office's budget more than tripled throughout the decade, from less than \$150 million to \$450 million. Total government expenditure on civilian R&D reached a peak of 0.57 per cent of GDP in 1996 (Figure 2).

Despite the support for exporting industries, the current account and trade deficits during the Peace Economy continued to increase (Table 3). The growing external

deficits thus had to be financed by foreign capital. During the 1990s, capital flows were liberalized, and Israel was able to attract foreign investment (Table 4). At the beginning of the decade, capital inflows – portfolio and FDI combined – reached less than 1 per cent of GDP; by the end of the decade, capital inflows reached 5 per cent of GDP, and capital outflows almost 10 per cent. The share of foreign investment to total investment grew throughout the decade, from less than 15 per cent to more than 50 per cent (Figure 3).

The capacity of Israel to finance the growing trade deficit through foreign investment was conditioned by the continuation of the peace process and the sheltering by the US. As long as the peace process continued and Israel received loan guarantees from the US, foreign private investors channeled their investment to the growing Israeli economy. Implementing a consumption-led growth strategy based on high public spending and high real wages while liberalizing the economy increased the current account deficit, which was financed by an inflow of capital that was highly susceptible to geopolitical circumstances.

The financial shelter Israel received from the US was not without strings attached: there was a clear link between the loan guarantees and Israel's dovish ideology. Prior to the inauguration of the peace process – during Shamir's government – President Bush rejected Israel's request for \$10 billion in loan guarantees from the US and \$5 billion in guarantees from Germany. Bush stated that the US would veto any Congressional decision to grant the guarantees unless Israel froze the expansion of settlements in the occupied territories (Diehl 1991). Shamir refused to agree to Bush's terms, and Israel did not receive the guarantees (Reuters 1991). However, when Rabin's government was elected, it accepted Bush's conditions, and the guarantees were approved.

In sum, the stability of the consumption-led growth model during the Peace Economy period rested on two non-economic – geopolitical – factors: the continuation of the peace process and the US financial assistance. The growth regime benefitted the workers as well as the business community. Even after the assassination of Rabin and the election of Benjamin Netanyahu in 1996, the center-right wing government was not able to change the regime, despite ideological differences.

In the post-Intifada period, the liberalization process did not stop but rather deepened. During that period, revenue from import taxes decreased to an average of 3.8 per cent of GDP compared to 4.8 per cent during the Peace Economy. Corporate tax rates dropped from 38 to 33 per cent, and export subsidies were eliminated. State income from privatization increased from a yearly average of 830 million to 1.1 billion dollars (Table 1).

However, in the post-Intifada period, the government shifted to an austerity-based neo-mercantilist strategy. Net-export contribution to growth rose from –1.3 per cent during the Intifada to 1.1 per cent in the post-Intifada period. Consumption contribution fell from 3.5 per cent during the Peace Economy period to 2 per cent, and the contribution of investment from 1.7 to 0.8 per cent (Table 2). The export share of GDP rose from 27 per cent to 33 per cent (Table 2). The budget deficit was less than half of what it was in the Peace Economy period. Private consumption per capita was 4 per cent lower, government spending on wages was almost halved, and domestic civilian expenditure was three-quarters of its volume during the Peace Economy period (Table 5).

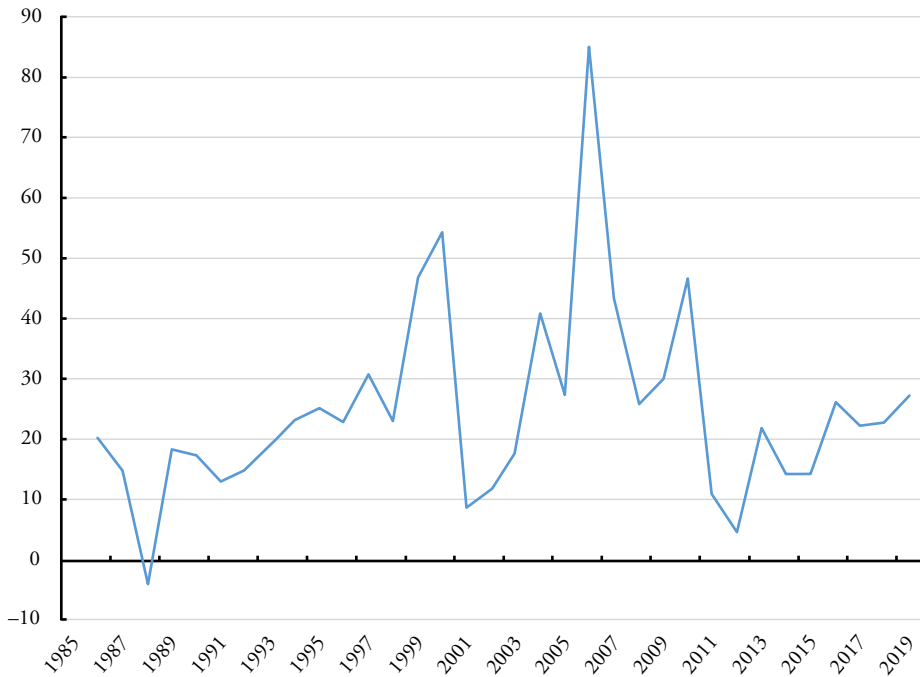
In terms of Israel's external position, the austerity policy was successful. Gross capital inflow almost doubled compared to the Peace Economy period (Table 4). Israel's invasion of Lebanon in 2006 had no significant impact on foreign investment. During the operation, foreign investment peaked at 80 per cent of total investments and 16 percent of GDP (BoI 2019). The governor of the Bank of Israel pointed out that between 2003 and 2006, Israel's risk premium, as measured by Israel's Credit Default Swaps, improved

Table 4 Financial liberalization indicators

	Portfolio			Foreign Direct Investment		
	Inflow		Outflow	Inflow		Outflow
	Volume (\$million)	Change (%)	Per GDP (%)	Volume (\$million)	Change (%)	Per GDP (%)
Stabilization period	887	-5.9	1.8	189	11.5	0.4
Peace Economy	2,384	50.2	2.2	2,030	64.0	1.8
Intifada	251	-40.6	0.2	1,677	-44.3	1.3
Post-Intifada	3,624	53.6	2.5	6,857	64.4	4.5

Notes: Stabilization period: 1986–1990; Peace Economy: 1991–2000; Intifada: 2001–2002; post-Intifada: 2003–2008.

Source: Bank of Israel Annual Report 2019.



Source: Author, from data calculated from the Bank of Israel's Central Bureau of Statistics.

Figure 3 Foreign investment as a share of total investment (%)

Table 5 Government spending (annual averages for each period)

	Domestic expenditure (% of GDP) ^a	Government spending on wages (% of GDP)	Public civilian consumption per capita (1995 = 100)	Government deficit (% GDP)
Stabilization Period	22.06	1.0	88.2	-2.6
Peace Economy	20.23	2.9	97.3	-6.3
Intifada	18.20	2.2	96.5	-6.4
Post-Intifada	14.90	1.5	93.4	-2.8

Notes: Stabilization period: 1986–1990; Peace Economy: 1991–2000; Intifada: 2001–2002; post-Intifada: 2003–2008. ^aIncludes transfer payments, direct allowances, credit benefits, and nominal interest rate payments.

Source: Bank of Israel Annual Report 2019.

rather than declined (FC 2006b). In 2006, Israel was ranked 85 in its exports to GDP ratio, three places below Germany. In that year, Israel's current account balance reached a surplus of 4.5 per cent.¹

1. Calculated based on World Bank data.

The implementation of the austerity policy started in December 2002, when Arik Sharon's government declared the *Economic Defense Shield Program*, and was completed in April 2003, a month after the appointment of Benjamin Netanyahu as a Minister of Finance, when the government announced the *Economic Recovery Plan* (Knesset 2003).

3.3 The social-bloc hypothesis examined

According to society-centered CPE theories, the primary driver of a growth strategy change is social groups that expect to benefit from it. As the article pointed out above, social groups may play an *ex ante* transformative or *ex post* stabilizing role. This section examines whether domestic social groups played an *ex ante* transformative role.

According to Aviguer-Eshel and Filc, the lower tier of the middle class improved its material position relative to other groups within the working middle class after the reform (Aviguer-Eshel/Filc 2018: 511). Therefore, they argue, this group was part of the social bloc that promoted the transition from the consumption-led growth model to the neo-mercantilism growth model. However, the social welfare of the middle class as a whole deteriorated (Dagan-Buzaglo/Konor-Atias 2013). Moreover, most welfare indicators show that the wage earner was better off during the Peace Economy period: during the 1990s, real wages increased at an annual pace of 2.4 per cent compared to 0.4 per cent during the post-Intifada period. Private consumption increased annually by 7.1 per cent during the Peace Economy period compared to 3.4 per cent during the post-Intifada period. Transfer payments to households dropped from 9.8 per cent of GDP to 9.4 per cent, and government spending on social security and welfare from 26.6 per cent to 24.8 per cent (Table 6).

Return to labor between 1993 and 2000 was above 58 per cent and close to the OECD average. From 2000 onwards, the return to labor fell rapidly (Figure 4). The inequality of disposable income after taxes and transfers was below 0.32 per cent in 1995 and above 0.37 per cent after 2005 (Bleikh 2015, fig. 2-B: 316). The poverty rate of households (by disposable income) was below 7 per cent until 2000, surged above 10 per cent in 2005, and reached 12 per cent in 2010 (Bleikh 2015, fig. 8-B: 330).

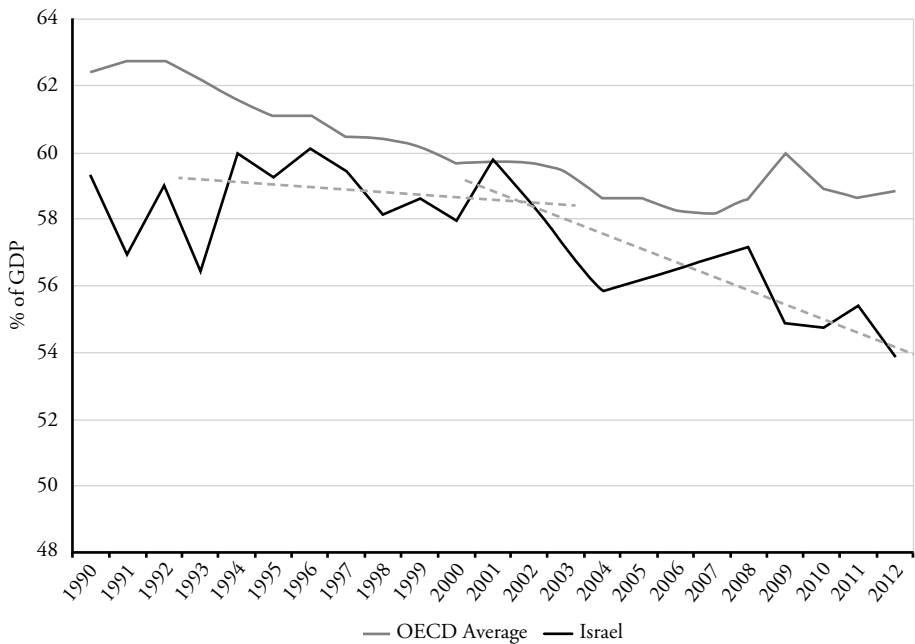
According to this data, even if certain social groups within the working class improved their relative position vis-à-vis other groups, the material conditions of the working class as a whole deteriorated due to the growth model change. Certainly, there was nothing in the

Table 6 Redistribution indicators (annual averages for each period)

	Transfer payments to firms (% GDP)	Transfer payments to households (% GDP)	Social security, welfare and semi-public goods (% of GDP)	Current private consumption (annual change, %)	Real wage (annual change, %)
Stabilization Period	1.2	9.2	23.3	6.6	1.2
Peace Economy	1.9	9.8	26.6	7.1	2.4
Intifada	1.1	10.8	27.6	7.5	−3.9
Post-Intifada	1.5	9.4	24.8	3.4	0.4

Notes: Stabilization period: 1986–1990; Peace Economy: 1991–2000; Intifada: 2001–2002; post-Intifada: 2003–2008.

Source: Bank of Israel Annual Report 2019.



Source: Bank of Israel Annual Report (2017: 125, fig. E1).

Figure 4 Return to labor in Israel and the OECD average (% of GDP)

hawkish government's economic reform which offered any compensation for the working class. Hence, it is concluded that the support of the working class cannot explain the transition to an export-led growth model.

Another group that could have played an *ex ante* transformative role is the business community. There is extensive evidence that the business community was highly supportive of the Peace Economy regime (Ben-Porat 2006) – not only did it benefit from the opening of new markets for Israeli products and from the pouring in of capital, but it also enjoyed generous government support to firms.

When Netanyahu's reforms were discussed, many still adhered to the view that the Israeli economy would not be able to take off without a peace process. Avraham Shochat, the former Minister of Finance, formulated this logic succinctly: 'There is one thing that everyone understands ... the platform that produces economic growth is geopolitical [*medinit*]' (FC 2002b: 5). The business community warned that without a peace process, the 'industries will collapse, and foreign and domestic investments will cease' (Hermony 2002).

During the recession caused by the Second Intifada and the dot-com global crisis, the President of the Manufacturers Association called for more support for the private sector: 'We should be thinking about increasing budgets, not how to reduce them'. 'I beg you,' he addressed Netanyahu, the Ministry of Finance, 'you have to encourage growth engines, not weaken them' (FC 2003b). These demands were voiced amid the intention of the Ministry of Finance to curb support to businesses. The Ministry of Trade and Manufacturing supported the manufacturers' position, warning that manufacturers needed more assistance from the government (FC 2003b). Netanyahu sought to improve Israel's external competitiveness and attract foreign investment (FC 2003c). Contrary to the Peace

Economy approach, he rejected the idea of direct support to exporting industries (FC 2003d; FC 2004).

To summarize, whereas the transition to an export-led growth model benefitted the exporting industries, there is no evidence that they supported the change *ex ante*. The reforms, therefore, must be explained based on a top-down process in which state actors and the political elite – mainly the government – impose the change on the societal actors.

3.4 The geopolitical hypothesis examined

A state-centered top-down policymaking mechanism assumes that certain domestic actors – the political elite – have to capacity to impose their preferences on domestic societal actors. However, the question persists of how to explain the preferences of the political elite. Maron/Shalev (2017) argue that the Israeli government implemented neoliberal reforms to restore its autonomy. Along similar lines of argument, Guy Ben-Porat argues that Netanyahu's reforms were supported by the state bureaucracy and were opposed by the majority of the population (Ben-Porat 2005: 240–241). Those studies highlight the top-down political culture in Israel, but they do address the question of the political elite preferences formation. This section argues that the political elite was driven by a national geopolitical purpose. It sought to restore growth but also to improve Israel's capacity to endorse a hawkish foreign policy.

Since its inception, the political elite perceived Israel's dependence on foreign capital as a strategic threat to its sovereignty. The reliance on external financial assistance made the state vulnerable to external economic shock and to eternal political pressure. The dependence of Israel on foreign assistance was a structural feature of the Israeli economy. However, the Israeli government employed strategies to lower the political costs associated with financial dependence.

During the 1970s, Israel enjoyed generous and practically unlimited financial support from the US, which financed Israel's militarization and its welfare policies. In the 1980s, the US started to be more selective in its financial support, and it exerted soft pressure on Israel to reach peace agreements with its neighboring countries and with the Palestinians. The dovish left-wing camp saw the US assistance to Israel as one of Israel's key assets, which secured Israel's sovereignty if not existence.

The hawkish right-wing camp interpreted the reliance of Israel on US assistance as a menace to Israel's sovereignty. During Yitzhak Shamir's government (Likud center-right government) in the early 1990s, the US conditioned financial assistance to Israel by restricting the expansion of the settlements. When Netanyahu won the election in 1996, one of his first initiatives was to declare that Israel was 'going to achieve economic independence ... self-reliance and great economic strength' (Netanyahu 1996). Hence, Israel's trade deficit was perceived as a territorial issue rather than a purely economic one.

In 2001, after the election in Israel and before embarking on *Operation Defensive Shield* in Gaza, Ariel Sharon, now the Prime Minister, declared that 'we', Israel, 'have only ourselves to rely on' (quoted in Barnea/Kastner 2006: 20). Sharon's declaration referred to Israel's intention to reject the Road Map multilateral peace negotiation track endorsed by Bush and shift to a unilateral track. When Sharon rejected the plan, the left-wing parties warned that it would have devastating implications for the US–Israel relationship (FC 2002a). The right-wing camp hailed Sharon's approach.

In the post-Intifada period, the hawkish government faced the problem of how to stimulate the economy without renewing the peace process and without deepening Israel's dependence on US assistance. Benjamin Netanyahu, the Minister of Finance in Sharon's

government since March 2003, laid down an economic strategy designed to enable Israel to overcome the economic recession without restoring the peace process (FC 2003d). Netanyahu's new model was designed to spur growth by improving Israel's external competitiveness and attracting foreign investment (FC 2003c). Contrary to the Peace Economy approach, he rejected the idea of direct support to exporting industries (FC 2003d, 2004).

Netanyahu wanted to eliminate not only the welfare state for workers but also the welfare state for businesses. Accordingly, between 2000 and 2005, the Chief Scientist's Office budget decreased from \$440 million to \$270 million (Figure 2). The Ministry of Finance explained that government support for high-tech companies is ineffective in terms of foreign investment because the inflow of investment is determined by global trends (FC 2006a). All in all, the government reduced transfer payments to firms from an average of 1.9 per cent of GDP during the Peace Economy period to 1.5 per cent (Table 6).

Netanyahu's strategy was supported by David Klein, the governor of the Bank of Israel. When the economy entered a recession in the early 2000s, the bank was very slow to lower interest rates. The bank justified the high interest rates based on the need to maintain 'stability in the financial and foreign currency markets' and to maintain Israel's credit rating (Klein 2001). The governor also justified his tight policy based on precarious security conditions (Klein 2001: iii). Klein's formulation discloses the logic that linked the economic and the territorial logics: the high geopolitical risks required the government to follow stricter macroeconomic rules than during the Peace Economy period in order to compensate global investors.

The hawkish government's key problem was how to pursue the liberalization process during a period of intensified security conditions and without making territorial concessions. During the Intifada, Israel suffered from terror attacks within its legal borders. Experts agreed that these attacks posed a strategic threat to the economy (Meridor et al. 2002; Eckstein et al. 2003). The Institute for National Security Studies stated that the government must 'externalize the conflict' by pushing the fighting outside its borders (Tov 2003). Netanyahu advocated the building of a separation barrier (FC 2003a). The externalization of the conflict turned out to be a critical non-economic pre-condition for Israel's growth regime.

For the hawkish political elite, the separation barrier was an essential element in Israel's new 'self-help' security strategy. Bush, however, saw the building of the barrier as a unilateral move that undermined the multilateral peace negotiation that he tried to revive. Influenced by the moderate camp in his administration led by the Secretary of State Colin Powell, Bush declared that the US would deduct the separation barriers costs – \$300 million – from Israel's loan guarantees (Zoughbie 2014: 67–68). The divergence between the US and Israel deepened following the 9/11 terror attacks when Bush struggled to put together an international coalition to invade Iraq that included Saudi Arabia. Bush had to distance himself from Israel to maintain the cohesiveness of the coalition (Barnea/Kastner 2006: 40). At the same time, voices within the Israeli right-wing parties called for substituting US financial assistance with Israeli bonds issued in the US (FC 2004).

During the 2000s, Israel was still dependent on the US. In absolute terms, the annual financial assistance of the US to Israel has not changed since 1985. However, the volume of financial assistance in terms of Israel's GDP declined significantly (Figures 5a and 5b). Whereas in 1985, US economic and military assistance accounted for 10 per cent of Israel's GDP, in the early 2000s, it was less than 3 per cent. In 2007, it dropped to 1.4 per cent, and in 2016, it to less than 1 per cent. Therefore, the capacity of the US to use Israel's financial subordination for its geopolitical purposes declined. In 2016,

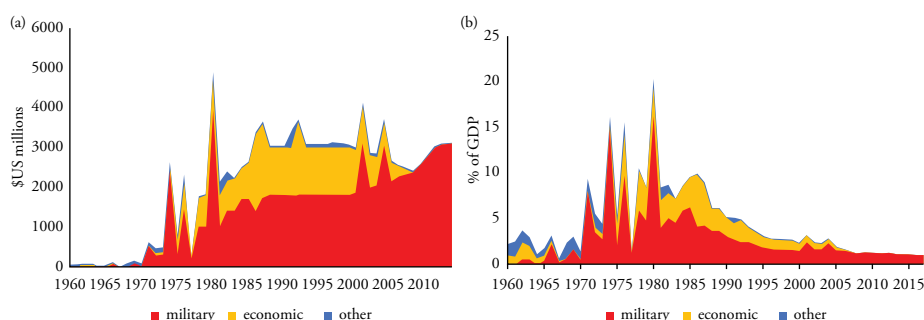


Figure 5 US financial aid to Israel

Barak Obama pointed out, ‘In some ways, because Israeli society has been so successful economically, it has, I think, from a position of strength been less willing to make concessions’ (Obama 2016).

4 DISCUSSION

The theoretical part of the article presented the geopolitical hypothesis regarding a growth model change. The geopolitical hypothesis argues that a state may adopt a growth strategy due to geopolitical factors, and that in such cases, growth coalitions serves as *ex post* stabilizers rather than as *ex ante* transformative actors.

The historical part of the article argued that the geopolitical hypothesis can explain Israel’s transition from consumption-led growth during the 1990s to export-led growth during the 2000s. This claim was broken down into three key claims. The first is that during the early 2000s, Israel shifted from a consumption-led growth regime to an export-led regime. This claim is strongly supported by the growth contribution indicators as well as the other quantitative data regarding Israel’s economic policy and performance. It is also supported by previous research (Krampf et al. 2022; Avigur-Eshel/Filc 2018).

The second claim concerns the interaction between the economic logic and the territorial logic. The article argued that the consumption-led growth regime was preconditioned by two non-economic factors: the peace process and US financial aid. The rapid liberalization and privatization process, which was coupled with expansionary monetary and fiscal policies, increased Israel’s external vulnerabilities, but the peace process and the US financial aid compensated for it. However, this strategy deepened Israel’s dependence on US financial support. Therefore, there were strong complementarities between the liberalization process, the peace process, and the backup provided by the US. Those complementarities worried the right-wing hawkish parties, which sought to limit Israel’s dependence on the US. For the left-wing dovish parties, the dependence on the US was considered a liability, because their perception of Israel’s interests overlapped with the expectations of the US from Israel.

The third claim pertains to the role of social groups. The article contends that there is no evidence to suggest that any particular social group or industry – including those from industries that ultimately benefited from the growth strategy change – played a significant role in driving the transition. The business sector, in particular, expressed concerns regarding the potential impact of austerity measures and anticipated reductions

in state support for research and development. Additionally, as the shift towards an export-led growth strategy unfolded, it generated its own set of winners, which stabilized it in retrospect.

The general implication of the Israeli case is that the emergence and stability of the growth regime need to be examined not only from the perspective of their contribution to the material benefit of societal groups – workers and firms – but also from the perspective of their impact on the state's territorial interests. The state has preferences that cannot be reduced to short-term pecuniary interests or social groups, and it has the capacity to act upon those preferences. Those preferences are formed in the international geopolitical context rather than the domestic socio-economic context.

To what extent the geopolitical hypothesis of the export-led growth strategy can be generalized to other countries? The geopolitical hypothesis is likely to serve as a robust explanatory factor given two scope conditions. First, the geopolitical mechanism of change is likely to be dominant in countries characterized by a top-down political culture, that is, in countries in which the civil society is relatively weak vis-à-vis state actors. Second, the geopolitical mechanism of change is likely to be dominant in countries that face real or perceived external security threats. In such cases, the external perceived threats are likely to overshadow the legitimacy of social groups to make demands based on socioeconomic considerations.

Those conditions are satisfied by Turkey and South Korea. Ziya Önis argues that Turkey is characterized by a 'top-down culture' and, therefore, policy changes 'have not been initiated on the basis of a broad social consensus' (Önis 2003: 3). During the second period of the Justice and Development Party (AKP) (2011 onwards), the government implemented elements of an export-led growth strategy (Altınörs/Akçay 2022). During the same period, it was struggling to position itself as a regional power (Güvercin 2020; Rapidis 2010). Güngen/Akçay (2024) show that in Turkey and Egypt, the state and the military establishment shaped the growth model by creating an alliance with the capital elite.

South Korea is another case in which external state preferences played a key role in shaping the economic regime. Throughout the second half of the twentieth century, South Korea enjoyed generous financial support from the US, and it faced a continuous existential threat from North Korea. Recently, with the rise of China and the declining power of the US, South Korea internationalized the economy in order to lower its dependence on the US (Gray 2011). In that sense, the growth strategy of South Korea cannot be understood without reference to the 'vicissitudes of the post-war US hegemonic project in East Asia' (Ibid.: 304).

5 CONCLUSION

This article examined the geopolitical hypothesis regarding the formation, stability, and change of growth models. The hypothesis suggests that economic regimes are shaped by external systemic factors which influence the political elite's perceptions of state preferences. Based on those perceptions, the political elite makes policy decisions that affect the growth regime, even if those decisions are not consistent with the material interests of domestic social groups. The geopolitical hypothesis further argues that after the growth regime changes, social groups may realign their behavior and interests with the change, and therefore they stabilize the regime *ex post*, despite the fact that they were not drivers of change. The geopolitical hypothesis offers an alternative to comparative political economic theories, according to which social groups play an *ex ante* transformative role.

The article demonstrates the argument by studying the transition of Israel from a consumption-led growth strategy to an export-led growth strategy. It argues that Israel adopted an export-led growth strategy after the Second Intifada, not because it was the best way to achieve growth but because it was more consistent with its geopolitical circumstances. Given the escalation of the security situation and the growing tension between Israel and the US, the continuation of the consumption-led growth model was not viable.

The analysis of Israel's case suggests that, in specific scenarios, export-led growth strategies should be examined as variants of neo-mercantilism. Unlike approaches aimed at maximizing growth or societal well-being, neo-mercantilism prioritizes the geopolitical interests of the state. Consequently, to comprehend the adoption of an export-led strategy, it is essential to consider the interconnectedness of the economic and territorial aspects of the regime. The interplay between these two elements creates internal synergies and tensions within the export-led growth regime.

However, the neo-mercantilist export-led growth strategy has its limitations. While it may achieve short- and medium-term success, it accumulates domestic resources and directs them towards high-productivity industries, neglecting low-productivity sectors. Consequently, this approach exacerbates internal inequality and poverty while bolstering overall productivity. Additionally, although an export-led growth strategy, if successful, can reduce the reliance on foreign financial aid, it also heightens the economy's vulnerability to global economic downturns. Consequently, in the long run, a neo-mercantilist export-led growth strategy is unlikely to be sustainable and is expected to be highly susceptible to global growth cycles.

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