FROM STATE-LED GROWTH TO GLOBALIZATION: THE EVOLUTION OF ISRAELI CAPITALISM

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This article examines the development of the Israeli capitalist class and the role played by the state apparatus in that development. In contrast to analyses claiming that Israel was a "socialist-type" economy prior to the mid-1980s, it argues that the Labor Zionist movement fostered the emergence of an indigenous capitalist class by encouraging the growth of private capital through key conglomerates initially tied to the state. Following the 1985 Economic Stabilization Plan, these conglomerates were placed in private hands linked with large foreign capital. Israel's recent incorporation into the global economy has undermined the traditional sustaining elements of the Zionist project, producing a crisis of legitimacy in the state. It also has important ramifications for the future of Israeli-Palestinian relations.

IT IS WIDELY recognized that Israel's economic structure over the last two decades has changed significantly to embrace an outwardly expanding vision of global capitalism. This shift has been marked by the privatization of state-owned and quasi-state enterprises, the relaxation of government control of the capital markets, and increased foreign investment. Popular and academic commentary has analyzed the ramifications of this shift on the political, legal, economic, and cultural spheres of Israeli society as well as on relations with Arab neighbors.[1]

Despite the large number of books and articles devoted to this dramatic transformation, attempts to explain it are not persuasive. Most analyses posit the changes as the result of an ideological shift in Israel's ruling elite. According to this view, the Israeli leadership initially subscribed to a version of socialist ideology. In the mid-1980s, however, as a result of the end of Labor's power monopoly and the rise of the right wing Likud, the leadership was said to have abruptly embraced a neo-liberal capitalist prescription for the country's economic woes. This ideological-push explanation of the transformation of Israel's political economy[2] fosters the view of Israel as a "special case" whose uniqueness defies standard methods of historical inquiry.

This article argues that the emphasis on ideology has played down and in some cases obscured Israeli class relations. The fact that Israel's economy

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was state-controlled and directed for decades by the Labor Zionist movement was not a reflection of socialist ideology but an outgrowth of the context in which it developed: during the colonization period, the absence of a strong indigenous Jewish capitalist class led the state (or proto-state) to control investment, but this control was not antagonistic to private capital. To the contrary, from 1948 on the state pursued policies aimed at nurturing a capitalist class by encouraging a few key families to undertake joint projects and investment with state and quasi-state enterprises. The turning point in this state-led class formation was the 1985 Economic Stabilization Plan (ESP), which led to the emergence of private capital as a class independent from the state.

THE EARLY YEARS

In the pre-state period, the private Jewish capitalist class resident in Palestine was a weak and disorganized force incapable of taking the lead in the Zionist project of settling the land. From the beginning of the 1930s, this leadership role was assumed by the Labor faction of the Zionist movement represented by Mapai (The Workers Party of Eretz Israel) and its principal arm, the Histadrut (General Federation of Workers in Eretz Israel). Until 1948 the Histadrut (whose leadership substantially overlapped with Mapai's) controlled the key elements of the Zionist project: colonization, economic production and marketing, the labor force, and defense. And since local private capital was too weak to provide enough employment for the new immigrants, it fell to the Labor Zionist movement, particularly the Histadrut, to create jobs by "establishing its own industrial, financial, construction, transport, and service enterprises."[3] These enterprises ultimately formed the core of the great conglomerates that for decades dominated the Israeli economy.

When Israel was established in 1948 under the leadership of Labor Zionism, the Jewish population was overwhelmingly composed of European (Ashkenazi) Jews, who comprised 87.5 percent of all Jewish immigrants to Palestine between 1919 and 1948.[4] With the expulsion of most of the indigenous Palestinian population in 1948, resulting in the absence of the readily exploitable working class traditionally found in colonial situations, the state embarked on a massive immigration program aimed at bringing Jews from the Middle East and North Africa (Mizrahi Jews) to settle in the new state. The imported Mizrahi Jews were able to constitute a working class on which the economic foundations of the country could be built. The Mizrahim thus laid the basis for the first wave of industrialization that began in the late 1950s and was centered on the so-called Development Towns.[5]

This early history is instructive with regard to the role played by the state (or prior to 1948, the "pre-State state," as the Histadrut is often termed) in class development. At the level of the working class, the state led the process of immigration and settlement of Mizrahi Jews in specific industries and localities.

At the level of the capitalist class, the Labor Zionist movement, through its unchallenged control of the state apparatus, adopted a strategy of state-led industrialization funded through external capital flows. This period—which lasted until 1973—was characterized by high levels of growth financed by capital transfers from German reparations and international Jewry. In this initial period of state and class formation, the state directed virtually all capital transfers to favored business groups involved in the "national project." In return, these groups (mostly owned by Labor Zionism as represented by Histadrut and other wings of the movement) undertook industrialization projects and investment in areas designated as crucial for the development of the state.

By the late 1960s, these favored business groups had coalesced into five large conglomerates or holding companies that spanned both the financial and the industrial sectors of the economy. These five—Bank Leumi, Bank Hapoalim, Israel Discount Bank Holdings (IDB), Koor, and Clal—formed with their various subsidiary companies an interlocking web of complicated cross-holdings and joint ownerships involving a combination of private family-owned capital and state-owned and quasi-state (i.e., Labor Zionism) capital. All the holding companies apart from Clal (which was owned by the first three) had their origins in the pre-1948 settlement period. Except for IDB, which was controlled by the Recanati family, a Greek-Jewish family of merchants and shipbuilders who settled in Palestine in 1935 and became active in the Zionist movement, all were linked to wings of the Zionist movement; Bank Hapoalim and Koor, for example, were owned by Histadrut, and Bank Leumi was founded by the World Zionist Organization (WZO) in the early twentieth century. The economy continued to be dominated by the five conglomerates throughout the period, but at the same time the state promoted selected private investors allied to the state and the Zionist movement by lending to them at low interest rates and granting them licenses and monopoly concessions. In 1968, the state even encouraged a group of private investors to establish a company (the Israel Corporation) specifically as a vehicle for channeling private capital into joint projects with the Histadrut companies and state-owned ventures. And through the various joint ventures and ownerships of state and quasi-state capital with the favored families, the large conglomerates formed a shell under which private capital was nurtured and could grow.[6] A major recession in 1966–67 caused a wave of bankruptcies and mergers, which wiped out many of the smaller firms and hastened the consolidation process of private capital.

The 1967 Israeli occupation of the West Bank and Gaza Strip (WBGS) increased the size of Israel's domestic market and provided a cheap and highly exploitable source of labor: by the mid-1980s Palestinians from the occupied territories made up 7 percent of the Israeli labor force.[7] By 1985, approximately one-third of the WBGS labor force worked in Israel (47 percent in the construction industry). As this process of proletarianization of the Palestinians of the territories accelerated during the late 1970s and 1980s, incipient protest from Mizrahi Jews was partly allayed, with the Palestinians now occupying the lowest rungs of the labor market.

THE ECONOMIC CRISIS OF THE 1970S AND 1980S

Beginning with the Israeli occupation of the West Bank and Gaza Strip in 1967, military production moved to the center stage of the Israeli political economy, a process that accelerated following the 1973 war. This military production, in large part supported by aid from the United States, was directed by the state to favored sections of Israeli industry.

At the same time, however, the Israeli economy entered a long period of low growth combined with high inflation (stagflation). What caused this crisis in the Israeli economy, and how should it be understood in relation to the development of an Israeli capitalist class? Most traditional analyses of Israel's economic situation during those crisis years adopt a neoclassical approach that emphasizes various "mistaken" policies followed by the Israeli state—for example, promoting a steep rise in defense expenditure at the expense of investment, failing to restructure the economy from import-substitution to growth based on the export of new technologies, running large deficits, and failing to encourage increased productivity in light of rapidly rising wages and excess demands.[8]

Such perspectives all view specific categories of analysis such as inflation, growth, prices, and wages as neutral aggregates rather than expressions of social relations. Yet the economy is an arena of social struggle in which contradictory interests are counterpoised. It is thus that describing "growth" overall is inadequate insofar as a rise or fall in one category can obscure huge gains or losses for specific groups in society; treating analytical categories as neutral aggregates serves only to obscure the actual processes occurring within the political economy.

An alternative approach is found in the work of Jonathan Nitzan and Shimshon Bichler, who argue that the Israeli political economy needs to be understood from the viewpoint of the struggle for differential accumulation—defined as the struggle by competing capital blocs to augment their capital compared to other owners of capital.[9] In other words, the important factor is not the absolute rate of return on capital, but rather the ability to achieve a better return than other competitors. Furthermore, there are two forms of differential accumulation: accumulation through depth is characterized by an attempt to achieve better than average profit margins, and accumulation through breadth aims at increasing market share.[10]

The approach of Nitzan and Bichler is important because it highlights the core monopoly companies, which benefit from stagflation by being able to make enormous profits at the expense of other firms. Specifically, they show that the post-1973 stagflation affecting Israel's economy was extremely profitable for the five key conglomerates, primarily because of state military spending, allowing them to accumulate large amounts of capital. Thus,

TABLE 1: INTERRELATIONSHIPS AMONG THE FIVE CONGLOMERATES

Holding Company	Related Bank	Controlling Parent
Koor	Bank Hapoalim	Histadrut
Clal	IDB, Bank Hapoalim, Bank Leumi	Histadrut and IDB
IDB Holdings	IDB	Recanati Family

while Israeli economic growth as a whole dropped between 1973 and 1985—the key years of stagflation—to 3 percent per annum (from average annual rates of 10 percent until 1972), the share of profits of the top five conglomerates as a percentage of GDP increased from 0.5 percent in 1973 to nearly 2.3 percent in 1985.[11] In terms of strengthening the core conglomerates in the economy, then, Israeli policies were not "mistaken," as traditional analysis tends to imply, but part of a process critical to the development of an indigenous capitalist class. Following their separation from the state after 1985, these conglomerates became the key business groups of Israeli capitalism.

THE BIG FIVE

The industrial nongovernmental economy during the period 1974–85 was dominated by Koor, Clal, and IDB Holdings. Three banks—Hapoalim, Leumi, and IDB—controlled the financial sector. As IDB Holdings and IDB were branches of one company owned by the Recanati family, the economy was effectively dominated by just five conglomerates. The interrelationships are shown in Table 1.

Defense was a core business concern for all the conglomerates. In 1982, for example, over 50 percent of Koor's employees (around 34,500) worked in defense-related areas, and these industries provided 20 percent of Koor's exports.[12] Michael Shalev has shown how the profits of Koor, Clal, and IDB Holdings paralleled almost exactly the levels of the state's defense procurement during this period.[13] The dual process of high military spending coupled with inflation led to massive rates of capital accumulation for the core business groups, while the economy as a whole suffered from stagflation.

Of the four largest banks in Israel, only one (IDB) could properly be considered a private company before the mid-1980s. This was not because of Labor Zionism's ostensibly socialist ideology, but for pragmatic reasons having to do with the pre-state period, when jobs had to be provided for the Jewish immigrants in order to ensure the Zionist settlement project. Hence Labor Zionism's doctrine of "Hebrew Labor," which mandated—often by force—the exclusion of Arab labor and the employment of Jews only. The three banks associated with the Zionist movement (Bank Leumi, Bank Hapoalim, and United Mizrahi Bank) all harnessed their mobilization of capital to this end. In this sense, the banks could be described as financial arms of political movements, not as institutions motivated primarily by profit. For this reason, prior to 1983, share ownership does not give a clear picture of bank control. Voting rights of the "founders' shares" are far more significant: Shareholders

TABLE 2: STATE POLICIES AND THEIR BENEFICIARIES, 1974–85

State Policy	Description	Beneficiary
Control of the capital market.	Banks were forced to finance the government deficit by purchasing government bonds.	Koor, Clal, and IDB Holdings benefited the most from the large government deficit that was used to finance military spending.
Government subsidies and grants.	Most investment was channeled by the state to the big five conglomerates according to "national priorities."	Koor, Clal, and IDB Holdings benefited from the huge subsidies given to industry.
Ending indexation of government loans in an environment of high inflation.[15]	Government lending was unindexed and therefore borrowers were in effect given a negative rate of interest in an environment of high inflation.	All five of the big conglomerates benefited as the major borrowers of government money.
Allowing the manipulation of bank shares.	Banks were permitted to set their own share price by purchasing their own shares.	Primary beneficiaries were the three top banks, Hapoalim, Leumi, and IDB.

with less than 2 percent of Bank Leumi shares held 75 percent of the voting rights, while shareholders with only a 0.03 percent stake in the United Mizrahi Bank controlled 50.02 percent of the voting power.[14] The three largest banks—Bank Leumi Le Israel, Bank Hapoalim (the Worker's Bank), and the IDB—have controlled more than half the banking industry's assets and liabilities since 1948. Bank Hapoalim and Bank Leumi are both among the world's top 200 banks.

The five conglomerates that came to dominate the economy—the Hapoalim Group, Leumi Group, Koor, Clal, and IDB Holdings—were successful because they were favored by the state and Labor Zionism. The state pursued four main policies, summarized in Table 2 above, to promote their growth: directing investment through government control of the capital market; providing subsidies to favored companies, particularly in the military sector; allowing the banks to reap large profits as a result of inflation; and permitting the banks to manipulate the prices of their own stocks.

Despite the banking system's high level of monopolization, the government tightly controlled the Israeli capital market until 1985. This control was exercised through limits on the amounts banks were allowed to lend, high reserve requirements, and regulations controlling bank fee structures and interest rates.[16] Provident funds controlled by the banks had to invest in government bonds and securities. The government also controlled both supply and demand within the capital market, as the investment policies of all major savings institutions—provident funds, insurance companies, and pension funds—required approval from the Ministry of Finance.[17] Banks and pension funds were obligated to use the savings accumulated from the public either to purchase non-negotiable government bonds or to finance private-sector loans as directed by the government.[18]

The control of the capital market stemmed from the exigencies of state building in the context of a capitalist class too weak to finance development to a level adequate to meet state demands. A large proportion of the capital entering the capital market stemmed from intergovernmental aid or unilateral gifts. Thus, between 1961 and 1965, imported capital channeled through the government equaled 31 percent of total private savings.[19] The preeminent role of the state in leading the national project by directing the capital market is well expressed in a Bank of Israel annual report: "because of the incompatibility which sometimes exists between business objectives and long-term national needs, the government has to direct the limited resources to conform to the economy's priorities. Credit constitutes in many cases a key instrument in the activation of resources, and therefore qualitative direction of credit exercises considerable influence on resource allocation."[20]

The government's control of credit benefited the banks because they were integrally linked to industry through the conglomerate system. Thus, the organizations that received loans and grants through the mechanism of the capital market were essentially the same organizations that provided the loans themselves. In this way, the capital market benefited the conglomerates twice over.

Meanwhile, private capital during the period 1973–85 witnessed an increasing consolidation centered on the families closely linked to the state. These families developed under the protection of the five large conglomerates through joint projects and investment and dividing the market share. By the early 1980s there were monopolies run by private capital in the areas of coffee and sweets (the Elit company, owned by the Frumchenko and Moshovitz families) and pasta and soups (the Ossem company), as well as monopolies in cigarettes, carpets, and drugs.[21] Other monopolies developed in the nonprivate sphere, including for cooking oils, margarine, and mayonnaise (the Shemen monopoly run through the Histadrut), and dairy and other agricultural products (the Tnuva company through the kibbutzim and moshavim).[22] Steel was controlled by two major companies, one private and the other owned by the Histadrut.[23]

THE ECONOMIC STABILIZATION PLAN AND PRIVATIZATION

The economic slowdown that characterized the Israeli economy as of the early 1970s had developed into an unprecedented crisis by the end of the decade, with inflation reaching three-digit levels by 1980: 131 percent in 1980, 116.8 percent in 1981, 120.4 percent in 1982, and 145.6 percent in 1983. During this period, the economic growth rate declined to an average of 1.6 percent annually.[24] Initially, these levels of inflation were not felt by the population as a whole because of the cost-of-living-allowance (COLA) that provided incremental increases in real wages to compensate for rises in the consumer price index. Once monthly inflation rates began to reach 10–20 percent, however, the COLA increment was unable to shield the population. In a climate where the value of a monthly salary could change by 20 percent from the beginning to the end of the month, household—to say nothing of national—financial planning was impossible.

In 1983, after years of price-manipulation by the key banks, the price of Israeli bank shares dramatically collapsed. This was followed by the onset of hyperinflation, which reached 373.8 percent in 1984.[25] In an attempt to meet the crisis, a team drawn from the government and academia devised an economic stabilization plan (ESP), which the National Unity Government, comprising both the Labor and Likud parties, adopted on 1 July 1985. The ESP–the principal elements of which were greatly reduced government subsidies, devaluation of the currency, restrictions on wage growth, opening the economy to foreign capital, and privatization—was a turning point for the Israeli economy. It marked the beginning of a new period in which the emergent capitalist class would be given control over the key sectors of the economy. The adoption of the ESP thus represented a break with the old system in which the state had sheltered and promoted capital accumulation within the big conglomerates, and opened the door to the process of privatization. Significantly, it was not the supposedly neoliberal Likud that initiated these changes but Labor: Prime Minister Shimon Peres was the main architect of the ESP and the Histadrut pushed it, while the Likud actually dragged its feet because it understood that it would hurt its constituency.[26] Later, of course, the economic policies of the two parties became indistinguishable from one another, both being based on neoliberalism.

Significantly, it was not the supposedly neoliberal Likud that launched privatization but Labor; the Likud had dragged its feet.

Crucial to the development of the "new" capitalist class was the policy of privatizing of the State Owned Enterprises (SOEs) and the network of companies controlled by the core conglomerates. The SOEs had been established with the founding of the state and, similar to the Histadrut empire, were concentrated in manufacturing and industry. They constituted another arm of state control over the economy, particularly in areas deemed sensitive to security such as basic infrastructure, airlines, and communication. Up until the mid-1980s, SOEs accounted for 20 percent of the GNP, with the Histadrut-owned companies accounting for another 20 percent.[27] In 1984, the government owned 0.4 percent of all manufacturing plants but 12 percent of the largest 100; the figures for the Histadrut were 4.4 percent and 35 percent respectively.[28]

The privatization policy began tentatively a year or so after the ESP; from 1985 to 1989, eight SOEs were sold for a total of $338.5 million.[29] The pace of privatization picked up in the first half of the 1990s, during which period the state sold part interest in some leading SOEs, including Israel Chemicals Ltd. (to the privately-held Israel Corporation) and Bezeq, the telephone monopoly, for a total of $3.2 billion.[30]

But it was the second half of the 1990s that saw the largest escalation in privatization, this time involving the big banks as well as the break-up of the

Histadrut conglomerates. By the end of the decade, the state had transferred to private hands SOEs that in 1994 had employed over one-third of state employees and contributed more than 50 percent of total SOE sales. As for the conglomerates, Koor was privatized in 1995 through a sale to the U.S.-based Disney family and its company Shamrock Holdings. In 1997, the Canadian billionaire Charles Bronfman (the Bronfman family are influential figures in the WZO and Jewish Agency) bought Shamrock's share and took control through his company Claridge Israel. That same year, the government sold its 43 percent share in Bank Hapoalim[31] (which in turn owned 20 percent of Koor) to a group headed by U.S. investor Ted Arison[32] for over $1 billion. Arison was born in Palestine in 1924, but moved to the United States in the 1950s where he set up the world's largest shipping line, Carnival Cruises. He had close relationships with the Labor Party's Haim Ramon as well as Likud's Benyamin Netanyahu.[33] Bank Leumi and Clal were also broken up and sold to a mix of local and foreign investors.

The state's privatization strategy reinforced its role in the formation of the capitalist class. Rather than listing companies for privatization on the stock exchange, the government generally launched restricted tenders to secure buyers who would constitute "controlling nuclei" of these enterprises. In general, buyers of the government shares were drawn from two categories: the family-owned private capital nurtured during the first four decades of the state, and international (mainly North American) capital, particularly that with historical ties to the Zionist movement. An example of the first category is the government's sale of the controlling interest in Israel Chemicals Ltd. to Israel Corporation, at the time owned by the Eisenberg family, in a privately placed bid; the privatization was carried out in stages between 1993 and 1997. By the time the deal was made, Israel Corporation had already gained control of several other former SOEs privatized in stages from the early 1990s. As a result of the Israel Chemicals deal, the entire mineral resources of the Israeli state are now controlled by private interests.[34] (In 1999, the family-owned Ofer Brothers group bought the Eisenberger's share in Israel Corporation, which means that the Ofer group now owns 60 percent of Israel Corporation, with Bank Leumi owning another 19 percent.[35]) As for the international capital category, in addition to buyers with longstanding links with the Zionist movement (e.g., Arison and Bronfman), multinational corporations are also investing in state and quasi-state enterprises. By 2000, for example, the U.S.-based investment company Merrill Lynch and the UK-based Cable and Wireless owned large chunks of Israel's telephone monopoly, Bezeq, which began to be privatized in 1990. While the government still has the controlling interest in Bezek, it plans to sell its remaining stake in the coming year.

Despite the massive program of privatization led by the state from 1985, important sectors of the economy remained in state hands. Israel Electricity Co., which employs over one fifth of state employees, El Al, the national air carrier; Israel Aircraft Industries, the largest Israeli exporter, and the controlling share of Bezeq remained in the government's hands by early 2003. These SOEs are a critical test for the neoliberal project of the Israeli state, for they represent the bastion of the Histadrut's support—well-protected Ashkenazi workers who for decades represented the social base of the Labor Zionist consensus. The economic recovery plan put forward by the new finance minister Netanyahu in March 2003 represents this last wave of privatization, bringing with it a possible undermining of the Zionist consensus which underpinned the state (see below).

OPENING UP TO THE GLOBAL ECONOMY

Concomitant with privatization, as we have seen, is the increasingly global orientation of Israeli capital. Instead of monopoly profits based on state-led defense spending or an orientation toward the domestic market, Israeli capital began to seek partnerships with the dominant centers of global capital in an attempt to expand its international market share. This opening of the Israeli economy to the world economy was made possible by the relaxation of foreign ownership and investment laws initiated by the ESP and the joint-listing of local companies on world stock exchanges in the mid-1980s.

The first step in the process of trade liberalization took place in 1975, when Israel signed a Preferential Trade Agreement with the European Economic Community (EEC, precursor to the European Union [EU]). With the signing in 1985 of a free trade agreement (fully functioning by 1995) with the United States, Israel became the only country in the world with preferential trade agreements both with both the United States and the EU. Other measures introduced as part of the ESP included tariff reductions on imports from countries not having trade agreements with Israel. Such steps had a significant effect on the structure of Israeli industry, moving it from one with a traditional low-technology base toward one emphasizing high-technology. This change was also made possible by an influx between 1990 and 2000 of some 1 million Russian Jews, over two-thirds of whom were trained in the scientific, technical, or professional sectors. By 2001, 80 percent of industrial exports came from the high-tech sector.[36]

All these developments resulted in a loss of domestic monopoly positions and forced the opening up of Israeli industry to the global economy. The level of foreign direct investment in the Israeli economy increased rapidly during the 1990s. Large multinational corporations set up local franchises in Israel, established joint ventures with Israeli companies, and became part owners of some of the large conglomerates, as noted above. Israeli companies actively sought foreign investment from global capital: Israel currently ranks second only to Canada among foreign countries in the number of its companies listed on U.S. stock exchanges. During the same period, a second form of internationalization became apparent, with foreign multinationals establishing local branches of international companies, particularly in the high tech sector. Thus Microsoft, IBM, CISCO, Intel, Motorola, and other large multinationals opened local branches for both production and research.

Opening new markets overseas, weakening the state-owned sector, and allowing the influx of foreign capital into the Israeli market constituted crucial steps in the formation of the new capitalist class. The globalized nature of ownership has altered the traditional pyramidal conglomerate controlling both financial and industrial concerns. In contrast to the old model of intertwined banks and industrial groups, the major banks, privatized in varying degrees following their de-nationalization in 1983, are now controlled by a range of local and international interests and have divested many of their nonfinancial holdings.

On the industrial level, a small number of new holding companies have risen to a par with the old holding companies. This does not indicate a broadening of ownership so much as the expansion of the market as a whole through the widening scope of accumulation. Although the old holding companies have been split from their financial concerns, the same families and capitalist centers from pre-1985 dominate the new Israeli economy, albeit with the added influence of international capital.

At present, Israel's industrial and financial sectors are dominated by twenty-three holding companies, many of which have interlocking relationships; actual control, then, is far more concentrated. The twenty-three holding companies had revenues of over $22 billion in 2000 and produced over 20 percent of Israel's GDP that year.[37] This figure is an underestimate because it doesn't include the revenues from companies owned by the holding companies themselves. One analyst has estimated that the top eleven holding companies control two-thirds of Israel's GNP.[38]

The new capitalist class emerged from the fusion of indigenous private capital linked to the state, foreign (mainly U.S.) capital buying into state-owned enterprises, and former state bureaucrats and military officers who had led the privatization process.

As Israel's economy has undergone transformation, with increasing privatization and globalization, the new Israeli capitalist class is in place. Its development was initiated and led by the state, and as of the late 1980s emerged from three sources: indigenous private capital closely linked to the Israeli state apparatus and the core conglomerates, mainly the Ofer, Recanati, Nimrodi, Strauss, Eisenberg, Meridor, Moshovitz, and Salkind families; foreign (mainly U.S.) capital buying into the Israeli companies divested of state and quasi-state (i.e., Histadrut) ownership; and former state bureaucrats and military officers who had led the privatization process and who form the lowest rung of the new capitalist class as managers and board members. In this latter regard, more than 75 percent of the key executive personnel of Israel's top one hundred private companies come from high-ranking positions in the Israeli state bureaucracy,[39] while Israel's corporate boardrooms boast significant numbers with high-ranking military experience. One of the symbols of Israel's new economy is telecommunications and the ubiquitous mobile phone; Israel has the second largest mobile phone density in the world, and the union of capitalism and Zionist state bureaucracy is eloquently expressed by the fact that Israel's leading cellular company, Cellcom, jointly owned by U.S. and Israeli capital, is headed by the ex-director of Israel's General Security Services (Shabak).

CONSEQUENCES OF OCCUPATION AND GLOBALIZATION

The transformation of the Israeli economy may have benefited the capitalist class, but not the broader society. In fact, after a boom period during the 1990s ushered in by the so-called "peace dividend" and a roaring U.S. bull market, the Israeli economy by 2003 had entered the longest recession in the history of the state. The per capita GDP had contracted 6 percent in two years, a larger and more prolonged drop than anything witnessed in the 1950s and 1960s. Official unemployment has reached 10.3 percent, though the actual figure is without doubt significantly higher due to the number of people who have given up looking for work. In February 2003 the government recorded a $579-million budget deficit, the highest thirty-day overdraft on record.

A major cause of the economic crisis is the ongoing Palestinian intifada. The Bank of Israel estimated its direct negative effects on the economy in 2001 at 3.8 percent of GDP, arising from losses in the construction industry, tourism, agriculture, and exports to the Palestinian Authority (PA).[40] In 2002, a further 3.8 percent of GDP was attributed to the intifada's impact on private consumption and investment. That same year, per capita private consumption fell by 2.5 percent, a decline not seen in almost two decades, while nonresident investment has dropped by nearly 80 percent since 2000.[41] Increased defense spending related to the intifada has caused a ballooning budget deficit, which in turn led Standard and Poor's in April 2002 to lower Israel's credit rating from stable to negative.

These losses have been compounded by the global economic downturn, particularly the bursting of the high-tech bubble. The Bank of Israel estimates that this factor cost the Israeli economy an additional 3 percent of GDP in both 2001 and 2002. The decline of the U.S. stock market has directly affected those key Israeli companies listed on U.S. exchanges, such as Koor, Teva, and myriad high-tech companies.

These figures point to one of the key contradictions facing the Israeli state at the current juncture. On the one hand, the post-1985 economic changes were intended to "normalize" the Israeli economy vis-à-vis the global capitalist economy. To a large extent this has been successful, and, as discussed above, a capitalist class separate from the state has developed with strong links to U.S. and other foreign capital. However, an inevitable consequence of the state-led formation of the capitalist class has been the opening up of the Israeli economy to the uncertainties of the global economy, and hence to crisis. The economic base that underpinned Israeli "exceptionalism"—positive economic growth for forty-eight consecutive years—could not be sustained within a globalized capitalist economy.

As a result, the Israeli state is less and less able to shield its working class from economic distress. The hegemonic position of Zionist ideology within the Israeli polity was largely based upon the economic privilege guaranteed to the majority of its citizens—particularly Ashkenazis employed by the five dominant conglomerates. In this regard, Israel's entry into a globalized economy has the potential of undermining the stability of Zionist hegemony. Hence the neoliberal reforms have led to a massive income gap—the second largest gap between the lowest and highest deciles in the industrialized world.[42] The child poverty rate is second only to Mexico among developed countries.[43] Moreover, these aggregate figures hide the extreme differences between strata within Israeli society. In 1999, the salary of an Ashkenazi employee averaged 1.5 times that of a Mizrahi employee and twice that of an Arab employee.[44] Half the Palestinian-Israeli children live in poverty, compared to 17.2 percent of Jewish-Israeli children.

The economic transformation means that Israel is facing a crisis of legitimacy stemming from the contradiction between neoliberal capitalism and the state's traditional role.[45] This has been clearly illustrated in the debate surrounding Netanyahu's 2003 economic recovery plan put forward shortly after the formation of the new Sharon government. Netanyahu's plan fully adopts the recommendations of the International Monetary Fund (IMF) and is intended to push forward the neoliberal drive of the 1990s. Key features of the plan include a NIS 11.4 billion (approximately $2.4 billion) cut in government spending; an 8 percent cut in public sector wages; layoffs of approximately 4,000 state employees in 2003; a freeze on national insurance benefits; a 5 percent rise in water tariffs, public transportation, and municipal taxes; raising the pension age to 67; and canceling immigrant benefits, mortgage grants, and aid to needy university students. Layoffs and other such measures will be exacerbated by the massive privatization schemes mentioned above targeting companies such as El Al, Oil Refineries Ltd., Israel Aircraft Industries, and Israel Electric.

This plan will severely affect the social base of many of the parties within the Knesset, including the religious parties whose electorate has traditionally relied on state subsidies. Mizrahim in the development towns and Israeli settlers beyond the Green Line will see their areas losing many tax benefits previously given by the state. Workers in the remaining SOEs will face severe wage cuts. The hardest hit will be the Palestinian citizens of Israel, whose poverty levels already far exceed those of Jewish Israeli citizens.

Netanyahu's economic plan came at the urging of the U.S. government. Israeli officials confirmed that they had been informed orally that the $1 billion military grant and $9 billion in loan guarantees over three years promised as part of the war against Iraq were conditioned on implementation of the economic plan. Indeed, the Fiscal Year 2003 Supplementary Appropriations Bill submitted to the U.S. Congress, which details U.S. aid to Israel, states that this aid will "take into account the budgetary and economic reforms undertaken by Israel."[46]

Certainly, the opening of markets, liberalization of currency and capital markets, and other neoliberal economic policies contributing to the formation of the new capitalist class were not unique to Israel, but were rather characteristic of the period dubbed "the new era globalization." Israel is highly dependent upon the global economy, and the institutional guardians of this order, such as the IMF, determine to a large extent Israel's economic policy. Netanyahu's plan closely follows the recommendations made by the IMF representatives who visited Israel in December 2002 and clearly called for cuts in social benefits, reduced tax levels for business, cuts in the government budget, and the privatization of state companies.[47] The flip-side of this process is the increased impoverishment of the bulk of Israeli society as the Israeli government implements the neoliberal reforms demanded by the capitalist class and its global supporters.

The political implications of such measures are significant. While the cutbacks in the safety-net traditionally provided by the state, at least for its Jewish citizens, could weaken the hitherto iron-clad consensus behind Zionist ideology and widen the potential space for a radical challenge to the status quo, they are more likely to fan the growth of extreme right wing populist forces such as the Shinui Party. Shinui's demagogic rhetoric scapegoating the Mizrahim and the religious finds growing support among marginalized Ashkenazi, even as it promotes a neoliberal economic policy. Shinui was the first of the government parties to embrace Netanyahu's economic plan.

In addition to calling for an acceleration of the neoliberal project, the December 2002 IMF delegation echoed the feeling of much of Israeli capital when it stated that economic recovery would be difficult to envision without resuming political negotiations with the Palestinians. One of the key consequences of Israel's post-1985 economic transformation and the development of an Israeli capitalist class increasingly in step with the global economy concerns the attitude of this class toward the occupation. Beginning in the mid-1980s and accelerating with the Oslo process, Israel's new capitalist class has sought a solution to the costs connected to the occupation (e.g. high levels of military expenditure, the Arab boycott, and impediments to foreign investment). The solution envisaged is based on ending direct military rule and cantonizing the Palestinian territories under Palestinian "self-rule." The Oslo process was intended to achieve this outcome via negotiations, and Israel's current war against the Palestinian people aims at imposing this solution by force. This is clear in the strategy pursued by both Labor and Likud governments: implementing a system of movement control based on closures and permits, the imposition of a compliant PA, and the strategy of creating isolated Palestinian enclaves surrounded by settlements and separation walls.[48]

There seems to be a growing consensus among Israel's new capitalist class, the U.S. government, and the EU that a political solution must be found to the current intifada. There is evidence of this in recent IMF and Bank of Israel reports, as well as in commentary from various Israeli business leaders. While on the surface the extreme solutions proposed by the Israeli "Right"—a term generally applied to the settler parties and Likud—appear to have gained strength in recent years, the reality is that the solution sought by Israeli and global capital is cantonization rather than "transfer." The complementary roles played by Labor and Likud during the intifada is a reflection of this, and it does not seem farfetched to suggest that it is the likely outcome of the U.S. road map.

At the same time, there seems to be a strong tendency within the Palestinian leadership to see Israeli policy solely through the lens of military conflict. Rather than understanding Israeli military policy as an extension of economic and political strategy, it views Israeli politics as a simple Right/Left dichotomy, with the so-called Labor "doves" on one side and the Likud "hawks" on the other. The Oslo process is equated with peace, and the U.S. government is viewed as its handmaiden. Part of the reason for this misconception derives from the same tendency examined in this article: falsely locating Labor Zionism as part of the Left because of its ideological claims, rather than understanding its actual role in the state and class-building projects.

History should teach us otherwise. The record of the past decade around the world indicates that those who suffer most in a neoliberal order are the poorest and most vulnerable. Movement toward a negotiated settlement that is driven by the interests of that order will almost certainly not result in either liberation or justice.

NOTES

1. See, for example, G. Shafir and Yoav Peled, eds., *The New Israel: Peacemaking and Liberalization* (Boulder: Westview, 2000) for a collection of articles on this theme and Maoz Azaryahu, "McIsrael? On the 'Americanization' of Israel," *Israel Studies* 5 (Spring 2000), p. 41, on cultural shifts in Israeli society.

2. See, for example, Yair Aharoni, "The Changing Political Economy of Israel," *The Annals of the American Academy of Political and Social Science* 555 (January 1998), pp. 127–46, and Jonathan Paris, "Regional Cooperation and the MENA Economic Summits" in Shafir and Peled, eds., *The New Israel.*

3. Zachary Lockman, *Comrades and Enemies: Arab and Jewish Workers in Palestine, 1906–1948* (Berkeley: University of California Press, 1996), p. 53.

4. Central Bureau of Statistics, *Statistical Abstract of Israel, no. 51*, table 2–24 (Jerusalem: Central Bureau of Statistics, 2000), pp. 2–64.

5. Development Towns were designated by the state as key sites of industrialization. Built around one or two labor-intensive industries, the towns were inhabited mainly by Mizrahi Jews, while the industries were overwhelmingly owned by Ashkenazis.

6. One example of the interpenetration between state and private capital is the Meridor family which, though traditionally linked to Revisionist Zionism, saw its family companies strongly supported by the state. The fleet of its shipping company Maritime Fruit Carriers was financed by an $18 million grant from the Israeli government in 1962, under orders from the Labor Party's Minister of Finance Pinhas Sapir. Joel Beinin, "Private Capital in Israel," *MERIP* (September–October 1986), p. 36. See also Uri Davis, *Israel: Utopia Incorporated* (London: Zed Publishers, 1977), p. 51.

7. Noah Lewin-Epstein and Moshe Semyonov, "Occupational Change in Israel: Bringing the Labor Market Back In," *Israel Social Science Research*, 2, no. 2 (1984), pp. 3–18.

8. See, for example, Yair Aharoni, *The Israeli Economy: Dreams and Realities* (London and New York: Routledge, 1991)

p. 85; Bank of Israel Annual Report (Jerusalem; Israeli Ministry of Finance, 1979): p. 5.; Yakir Plessner, *The Political Economy of Israel: From Ideology to Stagnation* (Albany: State University of New York Press, 1994), p. 239.

9. For a detailed explanation of their approach as it applies to the Israeli and U.S. economies, see Jonathan Nitzan and Shimshon Bichler, *The Global Political Economy of Israel* (London: Pluto Press, 2002).

10. Jonathan Nitzan and Shimshon Bichler, "From War Profits to Peace Dividends: The New Political Economy of Israel," *Capital and Class* 60 (Autumn 1996), p. 61. According to the authors, Israel experienced the first form during the stagflation years, moved to the second during Oslo, and is reverting to the first with the second intifada. See Nitzan and Bichler, *The Global Political Economy of Israel*.

11. Ibid., 74.

12. Daniel Maman, "The Social Organization of the Israeli Economy: A Comparative Analysis," in *Israel the Dynamics of Change and Continuity*, eds. David Levi-Faur, Gabriel Sheffer, and David Vogel (London: Frank Cass, 1999), p. 95.

13. Michael Shalev, *Labor and the Political Economy in Israel* (Oxford: Oxford University Press, 1992), p. 301.

14. Jonas Prager, *Banking Privatization in Israel, 1983–1994: A Case Study in Political Economy* (Jerusalem: Institute for Advanced Strategic Studies, 1995), p. 12.

15. Indexation refers to linking the interest rate on loans and the loan principal to the inflation rate or exchange rate. From 1967 onwards, most indexation of government loans was abolished. As a consequence, in periods of high inflation the amounts that borrowers of government loans needed to repay was considerably less than the original amount of the loan.

16. Prager, *Banking Privatization in Israel*, p. 3.

17. Israel Discount Bank, "Opening Up the Financial Markets in the Last Decade," http://www.israel-discount-bank.co.il/trends/fine01.html (December 2001).

18. Plessner, *The Political Economy of Israel*, p. 38.

19. Ibid., 41.

20. Bank of Israel Annual Report, 1955 (Jerusalem: Israeli Ministry of Finance, 1955), pp. 194–95, quoted in Plessner, p. 40.

21. Beinin, *Private Capital*, p. 35.

22. Shlomo Frenkel, "Israel's Economic Crisis," *MERIP* (October–December 1985), p. 21.

23. Ibid.

24. Henri J. Barkey, "When Politics Matter: Economic Stabilization in Argentina and Israel," *Studies in Comparative International Development*, 29, no. 4 (Winter 1994), p. 49.

25. Aharoni, *Changing Political Economy*, p. 137.

26. See Lev Grinberg and G. Shafir, "Economic Liberalization and the Breakup of the Histadrut's Domain," in G. Shafir and Y. Peled, eds., *The New Israel: Peacemaking and Liberalization* (Boulder: Westview Press, 2000), pp. 103–27.

27. Haim Barkai, "Fifty Years of Labor Economy: Growth, Performance and the Present Challenge," *The Jerusalem Quarterly* 50 (Spring 1989), pp. 81–109.

28. Aharoni, *Changing Political Economy*, p. 133.

29. State Enterprise Authority, *Annual Report for 1989* (Jerusalem: State Enterprise Authority, 1990).

30. There was resistance to certain privatizations on security grounds. For example, when the state in the early 1990s wanted to privatize Shekem Army Canteens, which provided all the food for the army as well as their families, the military protested on the grounds that the buyer would be able to determine the number of Israeli soldiers, considered a state secret. Privatization did go through, however, and the SOE was bought by Elco Holdings, controlled by the Salkind family and having major interests in electrical appliances and real estate.

31. Hapoalim, originally a Histadrut bank, was, along with other banks, effectively taken over by the government following the 1983 Bank Shares Collapse as a prelude to being privatized.

32. Arison, who died in 1999, was worth between US$6 to $10 billion and was ranked as one of Forbes's 400 wealthiest individuals. Amotz Asa-El and Dan Gerstenfeld, "Ted Arison, World's Wealthiest Jew, Dies in Tel Aviv," *Jewish Bulletin of North California* (8 October 1999).

33. Ibid.

34. Subsidiaries of Israel Chemicals produce 35 percent of the world's bromine, 9 percent of its potash, 3 percent of its phosphate rock, and 9 percent of its magnesium metal. Dun and Bradstreet, *The Top 100 Companies in Israel, 2001* (Tel Aviv: Dun and Bradstreet, 2001), p. 27.

35. Ibid., 206. The Ofer brothers also run a commercial shipping line called Ofer Shipping and have shares in one of the world's largest cruise-ship enterprises, Royal Caribbean Cruises, as well as high-tech interests. Stella Korin-Lieber, "Navigating Through Uncertainty," *Globes Arena Plus*, 31 May 2000, http://www.globes.co.il.

36. Israeli Ministry of Foreign Affairs Web site, http://www.mfa.gov.il.

37. World Bank, Country Information Israel, http://devdata.worldbank.org/external/CPProfile.asp?SelectedCountry=ISR&CCODE=ISR&CNAME=Israel&PTYPE=CP.

38. Daniel Maman, quoted in Rochelle Furstenberg, "Israeli Life: Who gets to be a millionaire?" *Haddassah Magazine* 82, no. 6 (February 2001).

39. Based on the author's analysis of information from Dun and Bradstreet, *The Top 100 Companies in Israel, 2001.*

40. International Monetary Fund, Staff Report for the 2002 Article IV Consultation—Israel, 2003, p. 3.

41. Bank of Israel, *Annual Report, 2002*, p. 30.

42. Timothy Smeeding, "Poverty and Income Distribution," David Jesuit Luxembourg Income Study (Washington: Center for Policy Research, 2002), p. 6.

43. Yael Gvirtz, *Yedi'ot Aharonot*, 12 November 2001.

44. Shlomo Swirski, Yaron Yecheskel, and Etti Konur, *Israel, A Social Report* (Jerusalem: Adva Center, 1998).

45. For the impact of the neoliberal "revolution" on constitutional and legal matters, see Ephraim Kleiman, "The Waning of Israeli Etatisme," *Israel Studies* 2, no. 2 (Fall 1997), pp. 146–71.

46. Ran Dagoni, "U.S. Military Grant also Conditional on Economic Plan," *Globes,* 26 March 2003.

47. International Monetary Fund, Staff Report for the 2002 Article IV Consultation—Israel, 2003.

48. For the impact of Israel's economic transformation on Palestinian society in the West Bank and Gaza Strip, see Adam Hanieh, "Class, Economy and the Second Intifada," *Monthly Review* 54, no. 5 (October 2002).