From *Altneuland* to the New Promised Land: A Study of the Evolution and Americanization of the Israeli Economy

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Israel is often seen as an economic miracle. An examination of the evolution of the Israeli economy from the prestate period until today allows a glimpse into both the initial underlying values of the Israeli economy as well as the dramatic crises, developments, and events that have shaped contemporary Israeli society. From a primarily agricultural-based, semisocialistic economy, Israel has emerged as one of the fastest-growing economies in the world and a leader both in high-tech and in income inequality. This work surveys the history of the Israeli economy and suggests possible future directions it may take.

The summer of 2011 will likely be remembered as a period of unprecedented interest, agitation, and protest with regard to the economic realities of contemporary Israeli society. Indeed, the Israeli economy has undergone profound changes since the process of "liberalization" began in the mid-1980s. These changes were the result of a fundamental paradigm shift regarding the dominant economic ideology of Israeli policymakers toward a belief in the correctness—if not the necessity—of transforming the Israel economy into one in which market forces dominate.

The changes in economic ideology and policy, and their subsequent impact both on the structure and performance of the economy and on Israeli society on the whole, are often referred to as representing the "Americanization" of the Israeli economy producing market dynamics and a society ever more similar to the American Jewish experience. The purpose of this article is to trace the forces that shaped and transformed the Israeli economy from the first days of political Zionism to today, with an emphasis on the role of American ideology and ideologues in transforming Israel from the country with the most centralized economy outside of the communist world in the 1950s to the market-based "American-style" economy in place today.

THE GENESIS OF THE ISRAELI ECONOMY: THE PRESTATE PERIOD

The doyen of Israeli sociology, Shmuel Noah Eisenstadt, suggested that Israeli society could be best understood as the story of a small immigrant society built up by revolutionary pioneers.[1] In the context of this discussion, it is interesting to note the parallels that Eisenstadt draws between the revolutionary pioneer experience in Israel and that of the founders of the American revolutionary endeavor.

In both cases, a small group of settlers evolves into a social elite in a geographic area characterized by an uncertain political status and lack of adequate economic infrastructure. This elite ultimately rises up against the colonial power (of course, Great Britain in both cases) and establishes a state in which they set the ideological tone. While both states undergo massive immigration, the elite succeeds in creating and transmitting an accepted narrative regarding the essence of the state's existence—even after being outnumbered by later settlers.

With that, Eisenstadt notes the obvious differences between the two societies with regard to—among other things—the relative role and rights of the state versus the individual. These differences are evident in the very documents that put forward the raison d'être of the foundling nation. The American Declaration of Independence, for its part, opens with expressions of belief concerning "inalienable Rights"—stressing those of "Life, Liberty and the pursuit of Happiness."[2] That of Israel places the emphasis on national rebirth and the role of the state in the "Ingathering of Exiles from all countries of their dispersion…[while promoting] the development of the country for the benefit of all its inhabitants."[3]

The integral role of the state in the economic lives of its citizens is already evident in the novel *Altneuland* (Old-New Land), which was Theodor Herzl's (1902) blueprint for the Jewish state in the making.[4] The economic order of the state presented by Herzl was termed "mutualism"; it consisted of a semisocialistic system in which almost every element of life is organized and achieved via cooperative efforts of the citizens. While these cooperatives allow for individual initiative, such initiative was to have a "higher purpose" and be directed toward economic justice and the common good. Accurately predicting later developments in the Jewish state that would come into being (and those in other progressive states), all citizens were to be provided with accident, sickness, old age, and life insurance.

Herzl's activities were, in fact, both an expression of and a catalyst for the feelings of many European Jews regarding the necessity to find alternatives to contemporary Jewish life in Europe. The Israeli author Amos Elon suggested that as the great masses of East European Jewry searched out their options in that context, three choices for Jewish "activism" emerged: emigration, social revolution, and Zionism.[5]

Kahan suggested that Jews who immigrated to America viewed their previous lives in Europe as the embodiment of poverty and were driven to seek individual material success so as to erase memories of that economic situation.[6] This individual focus—of course—fit in well with the American psyche and helped them realize their desire to make America a "new Promised Land" for them.

Those who chose the "original" Promised Land, for their part, viewed their previous lives in Europe as the embodiment of national disgrace and powerlessness. They were driven by a revolutionary fervor to contribute to a new egalitarian, labor-oriented socialist society that would allow them to escape the trauma of their previous social identity as nonproductive economic elements that were no more than pawns in the relations among the nations. This communal focus would, of course, come to characterize the underlying focus of the Zionist enterprise on nation-building within a socialistic vision of the future. Lacking both capitalists and capitalism, Palestine circa 1900 was fertile ground for an alternative economic ideology.[7]

Thus, while East European Jewish immigrants to the United States adopted and adapted the rules of a market-based economy, those who immigrated to Palestine viewed the Zionist revolution and the socialist revolution as complementary—and inseparable—goals and sought to create an economy in which market forces were controlled for the benefit of society as a whole.[8]

The centrality of this goal to the Zionist enterprise can be witnessed in a speech given in 1934 by David Ben-Gurion, the leader of the Labor Zionist movement and future prime minister of Israel. In it he emphasizes the need to "create a model society based on social, economic and political equality."[9] For Ben-Gurion and his contemporaries, the building of a socialist-style labor economy was tantamount to and a necessary predecessor of the establishment of a viable Jewish national economy. This goal could best be achieved through the central control of the economy in a manner that would elicit and direct individual sacrifice in the present for the advancement of the community toward some greater future.

To that end, Labor Zionist leaders advanced the semiautonomous nature of the Jewish community (Yishuv) under the British mandate through the establishment of the General Labor Federation (Histadrut or "self-reliance"), which would serve as the basis of the country as a workers' commonwealth. The Histadrut would quickly become the one major source of political and economic influence in the Yishuv, overseeing and coordinating the activities of agricultural settlements, trade unions, industrial concerns, urban (nonagrarian) cooperative arrangements in the area of housing, trade, and transport, a newspaper and publishing house, a sick fund, and a bank.

While there was always a minority that called for greater levels of economic freedom among members of the Revisionist movement and others, the policy and activities of the Yishuv were clearly in the hands of Labor Zionists. The centrality of this ideology is evident in a letter written by an opponent of Labor Zionist economic policy, Dan Patinkin, the best known of the Chicago-school free-market economists in Israel during the first decades of its existence. Hard pressed to oppose government policy, Patinkin wrote to a colleague in the United States in 1949 that despite his basic opposition to Labor Zionism, "One of the fundamental things is that Israel would never have been built if the people had listened to economists. They would never have dared and succeeded in doing what they have done."[10]

THE STATE OF ISRAEL IS BORN: THE ISRAELI ECONOMY BETWEEN EAST AND WEST

On the background of the ideas and achievements of Labor Zionism, the state of Israel was born. The end of the British mandate served to further strengthen the Labor Zionists as all public properties and resources were transferred to the new government of Israel, led by a coalition of three rather orthodox socialistic parties with personal and ideological ties to the leaders of the Histadrut sector—which would flourish at the expense of both private enterprise and the public sector during the first years of the state's existence.

Early Israeli economic policy was designed around the twin goals of realizing Labor Party ideology (the advancement of an egalitarian society based on social-democratic principles and the protection of workers' rights) and readying the state for the necessity to absorb large masses of immigrants. The policy during this first period of Israel's independence, from 1948 to 1957, was characterized by the creation of an avowed quasi-command economy that maintained a strict rationing policy, which gradually evolved into a "mixed" economy where government intervened and directed most aspects of economic activity.[11] The 850,000 residents of Israel at the time of its independence would be called upon to perform the nearly Herculean task of absorbing an almost equal number of mostly destitute immigrants, with 684,000 immigrants arriving from 1948 to 1951 and an additional 100,000 by the end of the first decade of Israel's existence.[12]

The ideological underpinnings of early Israeli economic policy were such that recently revealed internal correspondence of the British Foreign Office and the United States Department of State indicate that both nations viewed the fledgling state as "teetering" between Eastern ("communist") and Western ("capitalistic") influence. As such, the American government included Israel as one of the nations that were to receive propaganda materials that would point out the advantages of "the American way."[13]

Yet the Labor-led government of David Ben-Gurion had little faith in "the

American way" as a guide to nation-building. Instead, these leaders had an implicit belief that the good of the people would be best provided by government-directed economic efforts. Ben-Gurion asserted that if United States was—indeed—the land of plenty and the richest country in the world, it was because the interventionalist policy of Franklin Delano Roosevelt had saved it from economic ruin at the hands of free private enterprise. In the spirit of a quote attributed to John Maynard Keynes, the Labor Zionists essentially believed that the state is wise and the market is stupid.[14]

While Ben-Gurion would repeatedly state that private enterprise was not prohibited—and perhaps even encouraged, it was to take place on the backdrop of a distinctly controlled economy. Even after the strict controls of the austerity period were abandoned because of rampant black market activity, government retained tight control over the economy and its intervention was felt in all markets and sectors through the early 1960s.[15] All of this contributed to the fact that Israel had the lowest wage differential of any noncommunist state during the first fifteen years of its existence.[16]

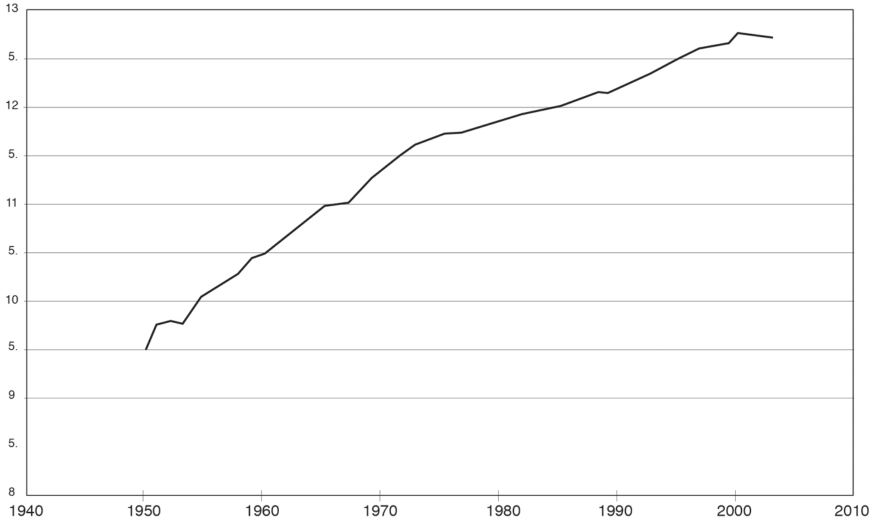
This control took the form of strict oversight and intervention in capital markets, patterns of private consumption, and economic initiative of the private sector and was supplemented through the economic operations of the government companies and that of the Histadrut with which the government was ideologically and economically associated. This control was further cemented by the Labor Zionist narrative through which immigrants learned that it was Labor socialism that brought them to Israel and Labor socialism that provided them with food to eat, a roof over their heads, and medical care.

THE FIRST CRACK IN THE SYSTEM: THE ISRAELI "ECONOMIC MIRACLE" FALTERS

As Figure 1 shows, Israel's economy grew at an astounding rate in the first two decades of its existence. With an annual growth rate of roughly 10% per year for that period,[17] many termed Israel an "economic miracle." From 1948 to 1966, Israel had:

- The highest annual growth in gross national product (GNP) in the world (653%)
- The highest annual investment of total resources in the world
- Among the lowest income differentials in the world
- A rise in GNP per capita of 270%
- A rise in private consumption of 550%
- A growth of 388% in the foreign trade surplus

Figure 1
Economic Growth (percentage) in Terms of GDP, 1950–2003



Source: *Israel Statistical Yearbook*, 2005.

For more detailed information, see Table 1.

However, with this growth came a spiraling level of private consumption and increased income differentials—even among the various parts of the Histadrut labor union and within Histadrut-operated frameworks.[18] Thus, despite the overwhelming prevalence of the Labor Zionist narrative in Israeli society during this period, by the early 1960s dissenting voices concerning economic policy options began to be heard in a more organized and vigorous fashion.

More specifically, there was an increasing demand among the growing middle class, merchants, and industrialists for economic reform that would free the economy from the constraints imposed on it by the Labor-led socialist government. Many of those arguing for the liberalization of the economy would coalesce in 1961 to form the Liberal Party—the first political movement whose raison d'être was the advancement of a market economy.[19]

The calls on the "economic right" for a fundamental change in economic policy led to some liberalization with regard to trade and foreign currency rates. There was indeed a growing sense among policymakers that the "traditional" Labor approach was no longer viable for the maturing economy.[20] And while the economy continued to grow in the early 1960s, growth seemed out of control as the government repeatedly had to struggle with a burgeoning balance-of-payments problem.

Table 1
Gross Domestic Product and Private Consumption
(at 1975 prices—New Israeli Shekels)

	Gross domestic product	Private consumption
1950	10,184	5,394
1960	16,932	9,368
1970	27,915	12,427
1980	35,993	18,041
1989	41,428	22,779
2000	74,438	41,284
2005	84,024	46,294

Source: *Israel Statistical Yearbook*, 2005.

Successive policy initiatives failed to steady the ship, and in 1965 the Israeli economic miracle ran aground as the country experienced its first major recession. Economic growth nearly ground to a halt and unemployment rose threefold in the period 1965–1967, resulting in an emigration wave of unprecedented proportions.[21]

It is unclear whether the Labor government's socialist-based policy would have been able to draw Israel out of that recession. Before the government could properly respond, the Six-Day War erupted—an event that would fundamentally change Israel's political, social, and economic map.

THE 1967–1973 PERIOD: FROM WAR AND ITS SPOILS TO WAR AND ITS COSTS

The Six-Day War set into motion forces—including economic forces—whose impact is still felt today. The economic morass and existential threats that characterized the period leading up to the war were replaced overnight by a near-euphoria fueled, partially, by the political and economic opportunities that emerged from the outcome of the fighting. Indeed, in the post-Six-Day War period Israel experienced a surge of economic growth and activity that had not been seen since the first days of the state, due primarily to increased military spending and increased—and cheap—labor supply from newly acquired territories. From 1968 to 1973 (the outbreak of the Yom Kippur War) the economy grew by 48%. Along with that came a tremendous growth in the inflation rate, reaching an annual level of 17% for 1971–1973.[22]

It was also at this time that the United States began to play an increasingly important role vis-à-vis Israel both on the formal plane—political, strategic, and economic, and on the informal plane—ideological and societal. In addition to becoming Israel's strongest (and, sometimes, seemingly only) ally in international forums, the United States also increasingly was seen as a type of "big brother" that one seeks to emulate.

During this period Israelis were more and more exposed to the American standard and style of living thanks to the increasing number of Israelis who traveled overseas, a meteoric surge in tourism to Israel, and (relatively) large-scale immigration from the United States.[23] Israelis learned that while they had experienced economic and military miracles, materially speaking they were far behind their "American cousins" with whom they came into contact.

There were also other important "new arrivals" to Israel in the aftermath of the Six-Day War that had important symbolic value regarding the ideas and mores of Israeli society. First, in the summer of 1967 Israeli national television had its first broadcast—a military parade celebrating the recent victory. Successive Labor governments had resisted pressure from the public to initiate television broadcasting, seeing it as a threat (as it was) to the inward-looking, communally focused society it advocated. As was the case elsewhere, the television would act as a "window on the world" for Israelis. More specifically, with time the view available from this window would be of America: its television shows, its lifestyle and values.[24]

Another "symbolic" step toward a more Western consuming-oriented society was the arrival to Israel of Coca Cola in 1968. It was instantly embraced for what it was—literally a taste of "abroad": a piece of the "good life" that may have come now that security concerns seemed to be a thing of the past.

But, more important, it was also at this time that a public discussion emerged regarding the relative merit of the "traditional-Israeli" versus "American-style" economic arrangements. The bearer of the new message was free-market advocate and future Nobel Prize winner Milton Friedman, one of those Americans who came to visit Israel during this period.

In a series of lectures and meetings in 1972 with academics, politicians, and public servants involved in determining economic policy, Friedman urged a reexamination of the Israeli economy in light of the new reality in which it found itself. Perhaps inspired by the biblical scenery, he urged the audiences to "Set your people free" and liberalize the economy in the image of its most important and stalwart friend, the United States.[25] The debate over the ideas Friedman espoused was—at the time—more academic in nature, and few could foresee that within a matter of years they would become the ideological backbone of official Israeli policy.

Still, some things remained unchanged. A "business as usual" attitude still held sway, with the government retaining its role as the economy's central actor. It kept exerting a great deal of control over the economic activity of individual economic actors even as economic growth and opportunity created larger levels of differential income. In fact, at this time a rise in government expenditures (mostly military in nature) had the effect of increasing the government's share of the gross domestic product (GDP) from roughly 35% in 1967 to nearly 65% by 1973.[26] Hence there was a reduction both in the growth of the business sector and in the government's ability to amass sufficient funds from the public to finance its outlays.

THE YOM KIPPUR WAR AND THE BATTLE FOR ECONOMIC SURVIVAL

As in so many areas of Israeli life, the 1973 Yom Kippur War set the stage for momentous changes in both the functioning of the Israeli economy and the way in which people thought about economic ideas. The war shattered the faith individuals had in the ruling government and its policies. People searched for new possibilities of rebuilding confidence in the state.

The costs of the war—both the immediate ones associated with the battlefield and the long-term ones associated with the economic disruption it caused—were further amplified by the exponential rise in fuel costs. Israel staggered out of the war into a bad case of "stagflation" that saw inflation rise to an annual rate of nearly 40% during 1974–1977 with real economic growth (not related to government expenditures, which continued to soar) nearly absent. All this, and associated hoarding of foreign currency, soon put the country itself in an inflationary spiral from which it would only—barely—emerge a decade later. The long-term impact of the war is also evident in the previously mentioned Figure 1, as the growth of the Israeli economy dropped to a 4% annual rate for the post-1973 period.[27]

It was at this juncture that Chicago University-trained free-market advocate Dan Patinkin came to the forefront of the public debate over the country's economic future. Patinkin and his many students—called the "Patinkin boys," many of whom had been advancing in careers in both academia and government—published numerous articles in the popular press urging both politicians and the public to consider new economic options. Unlike the frameworks in which Milton Friedman had advocated similar ideas, these debates took place far from the ivory tower. Instead, via newspapers and the electronic media, the public at large became exposed to—and increasingly enamored of—the ideas promoted by Patinkin and his associates.

It is also worth noting the U.S. government's role in the formulation of Israeli economic policy in the new "post-Yom Kippur War" reality. The massive (gratis) U.S. airlift of military supplies to Israel during the war was absolutely crucial to its war effort. Also during this period, Israel became the recipient of significant U.S.

military and civilian support. In many ways Israel became a ward of the United States both economically and in terms of its international standing and relations. Thus, it is not surprising that as the U.S. government became—literally—invested in Israel it took an increasing interest in the day-to-day functioning of the Israeli economy. Young noted that the United States actively encouraged both the debate over liberalizing the Israeli economy and policy changes and restraint on the part of the government aimed at bringing the economy under control.[28]

It was clear to all that the traditional Labor Zionist ideology had run its course in many regards. Eisenstadt noted that the unique economic model created by Labor governments ultimately faced a struggle between egalitarianism and the growth of a larger professional and upper management class in all sectors.[29] The Labor Zionist vision was successful in creating the basic infrastructure of the nascent state. But it could not ultimately solve the riddle of how to perpetuate the semisocialist ethos while allowing the economy to develop into a full, modern, diversified structure. Indeed, some argued[30] that it was precisely the rise in wage differentials that allowed the Israeli economy to emerge from its doldrums.

Regardless of the exact economic dynamics at play, the shock of the 1973 war and its subsequent economic ramifications reinforced feelings held by many since the early 1960s that the Labor Party's semisocialist economic model was incapable of dealing with the state's economic challenges. These failings—along with a series of high-level disclosures of corruption in Labor—were the final death knell for the economic ideology of the Labor Zionist era.

THE "GREAT SHIFT" AND THE ECONOMIC REVOLUTION THAT WAS NOT

The Israeli television broadcast on the results of the May 1977 elections opened with one word: "*Mahapach*" (or "great shift" in Hebrew). After nearly thirty years in opposition, the Likud Party led by Menachem Begin would be in power. Central to its ideology was a staunchly antisocialist and pro-free-market economic platform. The Likud took as one of its central coalition partners the Liberal Party, which had been advocating economic liberalization since the early 1960s. Not surprisingly, the Liberal Party asked for—and received—control of the Finance Ministry.

It was fully expected that the new Likud-led government would make fundamental changes in how the Israeli economy operated. This expectation was further reinforced when—during a previously scheduled visit to Israel shortly after the elections—the now Nobel Prize-bearing Milton Friedman met with Prime Minister Begin and accepted his invitation to extend his visit so as to consult with the new government.

With Begin's encouragement, Friedman put together a plan for economic reform aimed at moving Israel toward a free-market economy. The plan's main elements were:

1. A reduction in the size of government and in government spending
2. A reduction of government intervention in the economy via liberalization of fiscal, trade, and labor policies
3. A reduction of the tax burden
4. Privatization and encouragement of competition

Ostensibly, the stage seemed set for a fundamental shift toward a more liberal, "American-style" economy. However, the stress must be placed on "ostensibly," because it soon became apparent that despite having expressed clear and vigorous opposition to the Labor-style economy, the new government exhibited behaviors very similar to those of the government it had replaced.

Frustrated, but forgiving, Friedman would later note that government leaders—in his words—"have their hearts in the right place vis-à-vis economic ideology."[31] However, it soon became clear that local political interests made real reform a difficult goal to achieve. Friedman further noted that the government never actually adopted an overall plan, and that much time and energy was spent bickering among private interests and newly appointed party officials over the ways to utilize newly available resources. Thus, instead of policy these newly elected officials strove to do what newly elected public officials are wont to do: work—first and foremost—for their reelection.

In lieu of a unified economic policy, reform was piecemeal and not particularly coherent. What change that actually did subsequently occur seemed to pander to election interests and only served to further fuel inflation. Despite much rhetoric and American encouragement, there were only marginal and sometimes contradictory changes in policy including some minor changes regarding the exchange rate and the right to hold foreign currency and a reduction in import duties on durable goods. At the same time, government spending increased dramatically making the government an even more central economic actor.

These new regulations allowed the Likud government both to create the sense of movement toward economic freedom and to provide a sense of swift (if marginal) material gain among the lower rungs of the economic ladder (most of whom were Likud supporters) who had easier access to consumer goods.

Not surprisingly, one of the immediate results was a sharp increase in personal consumption. Combined with the rise in government spending, the effect was to further fuel inflationary trends previously addressed. Thus, inflation rose from 35% in 1977 to over 70% the following year and averaged 77% for 1978–1979. Indeed, as Israel moved toward elections in the summer of 1981 inflationary pressures loomed as never before.

As the elections drew near, the Likud government's third finance minister, Yoram Aridor, introduced a new supply-side economic policy with the rather immodest—and far from prophetic—name of the "correct economy." Critics would claim that the policy, whose basic tenets were an increase in food subsidies, the creation of an artificially strong shekel, and a reduction of import taxes on certain durable goods such as television sets, was no more than "election politics." Whatever the underlying motivation, private consumption soared, the trade deficit grew, and economic growth almost came to a full halt.

Some commentators[32] saw the policies of the first Likud-led government as the main catalyst in introducing conspicuous consumption as a norm in Israeli society. A growing number of Israelis no longer seemed willing to sacrifice individual benefits for communal or national goals, to subordinate their short-term wellbeing to long-term outcomes. In the Israeli reality of the 1980s, the "Labor ethos" already seemed no more than a legend.

Indicative of this and fueled by heightened uncertainty, widespread stock speculation developed as the stock market climbed ever higher.[33] As it would later turn out, the seemingly never-ending rise in stock prices resulted from the manipulation of the stock market by the banks—with the tacit approval of the government. Meanwhile, though, the financial market provided steady gains as the public exhibited a frenzy of short-term investing and personal consumption; much of the public felt that they—too—had finally "made it."

While inflation and national debt grew, government actors scrambled for a policy that would restore public confidence. Perhaps indicative of both his basic lack of understanding of the psychology of economics and his admiration for the United States, Finance Minster Aridor suggested substituting the American dollar for the ever-plunging Israeli shekel as the official currency. This suggestion, which was roundly criticized and quickly withdrawn, only further fueled fear and uncertainty in the public.

When the proverbial bubble burst in January 1983, thousands of private citizens, businesses, and other organizational frameworks faced bankruptcy. Not surprisingly, economic growth came to a standstill as the trade deficit grew to mammoth proportions. Indeed, in 1984 Israel had the dubious honor of having the highest per capita deficit budget as it sought to remain solvent as a country.

As Israel hobbled toward another election in 1984, yet another Likud-coalition finance minister, Yigal Cohen-Orgad, tried to bring the economic crisis under control by introducing anti-inflationary measures aimed at encouraging economic restraint by both the public and the government. Despite the fact that the country was experiencing an almost catastrophic annual inflation rate of nearly 500%, once again populist concerns related to the upcoming election made it impossible to put effective economic policy in place. One could say that the Israeli economy was critically ill—but refused to take its medicine.

THE UNITED STATES STEPS IN

By all accounts, including its bank account, Israel had a staunch and sympathetic supporter in American president Ronald Reagan. Indeed, it was widely felt that U.S.-Israeli relations had never been as close, warm, or as crucial—to Israel—as they were during the Reagan years. It was also in this period that the United States sought to influence Israeli economic policy as never before.

As the Israeli economy seemingly spun out of control, both Reagan and his secretary of state George Schultz shared a twin fear that the Israeli economy was on the verge of collapse and that the United States would ultimately have to pick up the pieces. Indeed, one of Schultz's economic advisers, Stanley Fischer, would later comment that by mid-1984 Israel was totally dependent on the United States for its economic survival.[34]

It was in this context that Secretary of State Schultz was instructed to take immediate and firm action to reduce the risk that the United States would have to save its ally Israel from insolvency. Schultz appointed Fischer and fellow economist Herbert Stein as a special task team on the Israeli economy. So that the U.S. government could better understand the details of the economic crisis and optimal ways of resolving it, the two were sent on a fact-finding mission in the summer of 1984

En route to Israel, Stein noted in his diary that there was a long-held American belief that Israel needed to undertake policy change to move its economy forward. More specifically, since the mid-1970s the Americans had spoken to Israel about the need to: (1) implement tax cuts, (2) privatize various publicly held companies, (3) deregulate commercial activities, (4) dismantle monopolies, (5) remove subsidies, (6) free capital and credit markets, and (7) reduce import restrictions and costs. The trip to Israel was aimed at enabling the development and implementation of a master plan based on both American ideas and concerns and the facts on the ground.

Once in Israel, Stein and Fischer would hold an array of high-level and intensive discussions with politicians, policymakers, and others actors who influenced Israeli economic policy. Following these meetings they passed on their conclusions—and a series of suggestions—to Prime Minister Shimon Peres, then heading the joint Labor-Likud national unity government. However, upon returning to Israel in the winter of 1984–1985 to see what progress had been made, they discovered that there had been none whatsoever. Instead, as always, domestic politics seemed to stand in the way.

Learning of Israel's inability—or lack of interest—in taking the "advice" of a good friend, Secretary of State Schultz instructed his special advisers to Israel to inform the Israeli government that, in lieu of progress on economic reform, the United States had decided to freeze all monetary transfers to the country.[35] This

American decision to flex its muscles had the desired effect. Shortly after the announcement of this decision, the Israeli government adopted most of the American "recommendations" as policy.[36]

The Israeli policy that was put in place in 1985 was informed by many of the long-held American beliefs previously noted. Specifically, the policy was built around these basic elements:

1. Reducing public expenditure
2. Reducing government control and use of capital markets
3. A real devaluation and a temporary freeze on the exchange rate
4. Reducing taxation

A PARADIGM SHIFT

Israel's 1985 Economic Stabilization Plan did just that: stabilize the economy. It erased the government's deficit and also led to a marked reduction in its expenditures. Indeed, until the major influx of immigrants from the former Soviet Union beginning in 1989, the government budget was nearly balanced. Hence inflation dropped from an average annual rate of 385% for 1983–1985 to only 20% for 1986–1990. Government reserves increased and per capita government debt and the overall trade deficit declined.

As we will see, the 1985 program would mark a basic shift in Israeli economic policy. With stability came a growing belief in the value—if not absolute necessity—of structural reform in the economy so that stability could lead to growth. In the two decades since, successive Israeli governments—whether led by Labor (such as the Rabin, Peres, and Barak governments) or Likud (such as the Shamir, Netanyahu, and Sharon governments)—have all pursued an increasingly "promarket" policy.

The changes in economic policy roughly fall into five categories: (1) reduction in the size of government and government spending; (2) financial market reforms; (3) foreign currency market reforms; (4) labor market reforms; and (5) reforms related to the market for goods and services.[37] Each of these aspects of policy will now be considered.

REDUCTION IN GOVERNMENT SIZE AND SPENDING

One major focus of the 1985 stabilization program was the reduction in the size and outlays of government. The period from 1967 to 1985 was marked by high levels of fiscal deficit related to a rising public debt as public sector expenditure rose from a rate of 35% of the annual GNP to some 75% of it. Indeed, by 1985 the relative size of the Israeli public sector was *the highest* in the world.[38] Not surprisingly, this contributed to the fact that in 1984 Israel also had the largest per capita public debt in the world with the fiscal deficit constituting 15% of the GNP during that year. The Israeli economy was truly at the abyss.

Through a combination of American pressure and the political dynamics associated with a national unity government, a newfound fiscal discipline emerged in Israeli policy. There were immediate and significant slashes in defense spending, subsidies to the business sector, and a concomitant reduction in interest payments resulting from the ever-increasing public debt.[39] The results were soon felt: the 1985 budget deficit was only half that of 1984 and by 1986 the budget was in surplus. This trend has continued until today.

Currently, public expenditures account for 55% of the GNP and public debt equals only 3% of it. The Israeli public sector is now similar in size to those of European countries such as Italy, France, and the Netherlands. Over this period economic inequality has grown in Israel, leading to an ever greater reliance on welfare-related transfers. The burgeoning costs of these transfers have been at the forefront of battles both in the Knesset and in public discourse, with the growing number of unemployed and poor being seen as "victims" of the market economy. The changes in this regard are noteworthy with the number of families relying on supplemental transfers from the government rising from 11,000 in 1982 to 157,000 in 2002.[40]

FINANCIAL MARKET REFORMS

Since the earliest days of the state, extensive government involvement in the financial market had been a hallmark of economic policy. Until the stabilization program, the guiding principle of monetary policy was to provide means to address the government's budget-deficit needs [41] The government used its involvement in the money market and the capital market to prevent competition from private financial frameworks and, thus, allow it to achieve its goals at a relatively low cost to itself. Essentially, these goals were to promote growth and development of areas and activities to which it gave high national priority (the "nation-building" aspect of Labor Zionism) until 1973 and to finance its burgeoning debt after 1973. The government-backed deposits and bonds left little room for private initiatives. In fact, the end effect of the government's manipulations of the structure and processes of the financial markets was that by 1985, those markets had essentially been nationalized.

An essential part of the stabilization program was the reduction of government involvement in the domestic financial and capital markets. Beginning in 1987 these moves took on even greater importance as the government encouraged competition among financial actors and removed restrictions on the international flow of capital. The government extracted itself from the money market's operations by limiting its own use of the market while advancing that of private initiatives. It lowered the rates of liquidity ratios on deposits and eliminated quotas on foreign currency credit and bank guarantees. In addition, a large variety of restrictions on the financial markets that had been in place since the creation of the state were abolished.

Significantly, the government also began acting in 1987 to allow institutional investors more freedom with regard to the placement of their funds. Traditionally, these actors were compelled to invest over 80% of their funds in government bonds. This figure has steadily decreased to the current level of 40%. The private bond market was further strengthened by the liberalization of the process of private bond offerings and their taxation. Finally, the government reduced the level of support and subsidies it provided to pension funds.

All of the above contributed, among other things, to a flurry of activity in the Tel Aviv Stock Exchange as both individual and institutional investors—in Israel and from abroad—sought to take advantage of the new opportunities provided by the liberalization of economic policy and the growth it subsequently offered. Similarly, the Israeli "high-tech revolution" of the 1990s led to a 600% increase in foreign investment in Israel from 1992 to 1998, transforming the country into a central player in the high-tech world.[42]

One area in which financial reform has yet to be completed relates to the nature and expansiveness of the financial activities of the banking system. The level of concentration of the Israeli banking system is second only to that of Finland in the West.[43] The two major players, Bank Hapoalim and Bank Leumi, control nearly two-thirds of the banking industry and are very heavily present and active in a wide array of financial and other economic frameworks. One of the largest "public battles" of 2004 was that between then-finance minister Benjamin Netanyahu, who had vowed to create much more competition in this arena, and the banks, which had lobbied and expended tremendous resources on stemming change. Netanyahu prevailed and some very fundamental changes in both the banking industry and the overall financial industry have been implemented.

As noted, an initial foreign currency reform was first undertaken immediately after Likud's rise to power in 1977. However, both because of the severe economic morass of the period (raging inflation, growing public and private debt, etc.) and politics, the policy failed. In fact, in the period immediately after this attempt, restrictions in this area actually increased. Given the long-term and deeply embedded insecurity that the public felt regarding the fiscal integrity of the shekel, it was not surprising that the foreign currency reform that occurred in the wake of the 1985 program was partial and gradual. Indeed, it spanned a period from 1987 to 1998. Two important stations on the road to liberalization of foreign exchange policy: were (1) Israel's decision in 1993 to accept Article VIII of the International Monetary Fund Agreement prohibiting exchange restrictions on international currency account transactions, and (2) the decision in 1998 to remove all remaining restrictions in this area.

The business sector was the first to benefit from the liberalization; it was believed such a policy would stimulate growth that would be quickly felt with regard to the country's gross domestic product (GDP). Following that, individuals and then institutional investors benefited from the reforms which helped monitor the flow of funds related to the internal debt. In addition, restrictions on the inflow of capital preceded those on the outflow of capital so as to guard against the loss of capital needed to cover the domestic debt. Finally, the exchange rate was changed so as to allow the fluctuations within a "safety band" outside of which the government would intervene so as to give investors and other economic actors a greater sense of security and stability.

LABOR MARKET REFORMS

A concern for labor and its rights had been a central element of Labor Zionist ideology and subsequent government economic policies. The Histadrut has been a main player in the Israel economy, often viewed as a tripartite system consisting of the public, private, and Histadrut sectors.[44] While the 1985 Economic Stabilization Plan fostered some basic—if not immediately felt—changes in labor market policy, these were not part of a comprehensive policy regarding labor but often a by-product of policies pertaining to other economic aspects. Similarly much of the change in the Israeli labor market stemmed from outside forces such as massive immigration, changes in the security situation, and demographic changes regarding the composition of the labor force.

One of those changes that were dictated by policy concerned adjustments of cost-of-living allowances both regarding the amounts and frequency of such adjustments. Following the above measures—and in response to economic development—came a number of changes regarding contributions to social security, unemployment policy and benefits, and changes in pension policy.

The massive influx of often highly trained immigrants from the former Soviet Union along with relaxation of regulations concerning foreign workers in the 1990s contributed to greater levels of wage flexibility. Similarly, an increase in the strength of separate trade unions on the one hand, and the existence of personal wage contracts on the other, have weakened the base and strength of the Histadrut. Nathanson and Zisser suggest that the expansiveness of organized labor in Israel may be much lower than previously thought and not essentially different from many West European countries.[45]

Another major change regarding the labor market was the tremendous expansion of employment agencies in the 1990s. Estimates indicate that by the end of the 1990s, fully 5% of the labor force was employed via such agencies, a rate much higher than that of other, similar Western countries.[46] Likewise, there has been an increasing dependence on outsourcing in the Israeli economy. All of this has the effect of increased labor-wage flexibility from which employers can benefit. Not surprisingly, the last decade has witnessed a significant increase in the disparity of wages in the labor market; yet another indicator of wage flexibility.

REFORMS RELATED TO THE MARKET FOR GOODS AND SERVICES

Another central focus of reforms associated with the 1985 Economic Stabilization Plan concerned economic policies as they affected goods and services. It was clear that there was a need to engender increased competition and this was addressed via three vehicles: (1) liberalization regarding imports, (2) changes regarding public services, and (3) privatization.[47]

Although Israel had entered into a series of trade agreements with the European Community from 1965 to 1975, numerous regulations were imposed so as to protect local goods and services. The early 1980s witnessed a retreat from the liberalization policy and an increase in nontrade barriers, particularly from countries that might have provided inexpensive alternatives to locally produced goods.

However, this began to change following the adoption of the 1985 economic program and the signing of a free-trade agreement with the United States in the same year. That agreement was just one part of a new overall policy aimed at opening the Israeli economy to international trade.[48] As in other areas, the liberalization process was gradual. In addition, because of disagreement between policymakers who were more ardent supporters (in the Bank of Israel and the Finance Ministry) and less ardent supporters of these reforms (primarily in the Ministry of Industry and Trade), during its first years the liberalization process was often incomplete and inconsistent.

Indeed, the process seemed to really accelerate only toward the end of the decade. First, from 1989 to 1993, all discriminatory import purchase taxes were eliminated. Concurrently, from 1990 to 1992, all duties related to foreign travel, the purchase of foreign currency, and imported services were similarly erased as were regulations regarding the compulsory licensing of industrial goods. In addition, the 1990s witnessed a reduction both of nontariff barriers and of the tariffs themselves from rates of 20%-75% to rates of 8%-12% according to the goods in question. Finally, export subsidies were phased out.

Thus, from 1985 to 2000 the policy changes enacted led Israel to nearly total exposure vis-à-vis foreign trade and had the effect of strengthening market forces and reducing costs to the consumer. Gabai and Rob noted that, in sum, the liberalization of the trade process achieved its main goals of increasing competition and relatively decreasing consumer prices in various areas as Israel became one of the most open economies in the world—with relatively little negative impact on local levels of unemployment.[49]

Another area of concern of the 1985 program was active government involvement in the provision of goods and services. Starting in the late 1980s—and in the spirit of the 1985 plan—there was a growing focus on the detrimental impact of the various elements of publicly owned infrastructures involved in water, electricity, oil, telecommunications, and local and international transportation services. The monopolistic nature of most of these services along with the strength of the labor unions associated with them had created a situation where they caused significant and measurable damage to the economy.[50]

Wages were high, products and services were expensive and inefficient, and the price structures tended to discriminate against the individual consumer. While, for the most part, these frameworks remain in existence, there were significant changes in the means by which prices were set and government oversight increased.[51] Recent years have seen a virulent battle between such groups as the port-authority and electric-company workers and recent governments that have vowed to inject competition into those areas.

Privatization had long been a central element of the "advice" given to Israel by the U.S. government. The objective of the privatization process was to create a situation in which the private sector led economic activity via market forces so as to augment competition in the Israeli economy. As we will see, this goal has—at best—been only partially achieved given the breadth and nature of the privatization process over the last two decades.

At the time the Economic Stabilization Plan was implemented in 1985, there were 160 state-owned companies employing nearly 9% of the labor force, with 90% of those employed by the ten largest frameworks.[52] Significantly, among those business concerns were those noted above and Israel's four largest banks, which held over 90% of all banking assets—not to speak of their control over institutional investments (such as provident funds and pension funds) and a wide variety of business enterprises. Today the government still controls a hundred of those companies, having relinquished control of only three large employers.

The privatization process gained momentum only in 1993 when a detailed policy—which included the establishment of a government authority—was put in place to address it. This process reached its peak in 1997–1998, at the apex of an economic upswing that had brought significant foreign investment to Israel. Among those frameworks privatized have been the major banking institutions (nationalized after the 1983 stock-market failure), Zim Shipping Lines, some of the country's ports, the national airline El Al, and the oil refineries. Labor unrest has been associated with the above process and seems to foretell potential difficulties regarding the privatization of such operations as the remaining ports and public utilities where there are very potent and militant labor unions.[53] Indeed, a leading economic commentator noted that the privatization of further frameworks may prove to be difficult—if not well-nigh impossible—as the state has lost most of its ability to manage the daily activities and direct the long-term strategy of the more powerful state-owned operations.[54]

All of this has led many to view the privatization process as the weak link in Israel's transformation into a market-oriented economy.[55] First, in many cases, the selling-off of shares in government-owned frameworks did not result in the government relinquishing majority control of those enterprises. As such, most of the privatization efforts cannot be seen as much other than a process that raised capital for the government. Equally significant, unlike the case of Britain, in most instances the government has not succeeded (or acted) to transfer controlling interests of those frameworks to the public at large, but rather to a small group of individuals or corporate entities. This has sparked criticism both regarding the appropriateness of the price paid for what had been public assets and the concentration of economic power among a small group of leading families in Israel.[56]

These fears and criticisms of the growing "centralization" of the Israeli economy eventually emerged as one of the major themes of the 2011 wave of social unrest. The matter became so central that Prime Minister Netanyahu established a special committee to offer solutions for a process that was seen to have gone off course, taking the totality of Israeli society with it.

SUMMARY: FROM LABOR ZIONISM TO ZIONIST NEOCONSERVATISM

As we have seen, the founders and shapers of Israel strove to create a society that would advance the underlying principles of Labor Zionism. This contributed to the establishment of an economic order in which the government played a central—if not the central—role. It was only when Israel reached the verge of an economic cataclysm—and only with the guidance and goading of the U.S. government—that an economic policy was put in place in which market forces were predominant. In a matter of a few years Israel underwent a process, reminiscent of the rise of capitalism, in which the prevalent narrative evolved from viewing moneymaking pursuits as a necessary evil to accepting them as an activity that is both valued and encouraged.[57]

Indeed, the process that began with U.S.-inspired policy changed both the face of the Israeli economy and, subsequently, of Israeli society itself. À la Albert,[58] the Israeli economy has evolved from being reminiscent of the Rhine model of capitalism, in which labor unions and management share power and government provides a relatively strong safety net, to an economy like that of the United States in which free-market capitalism is given a free(r) rein. In the latter, market changes will be pursued more readily—even at the expense of the weaker segments of the population.

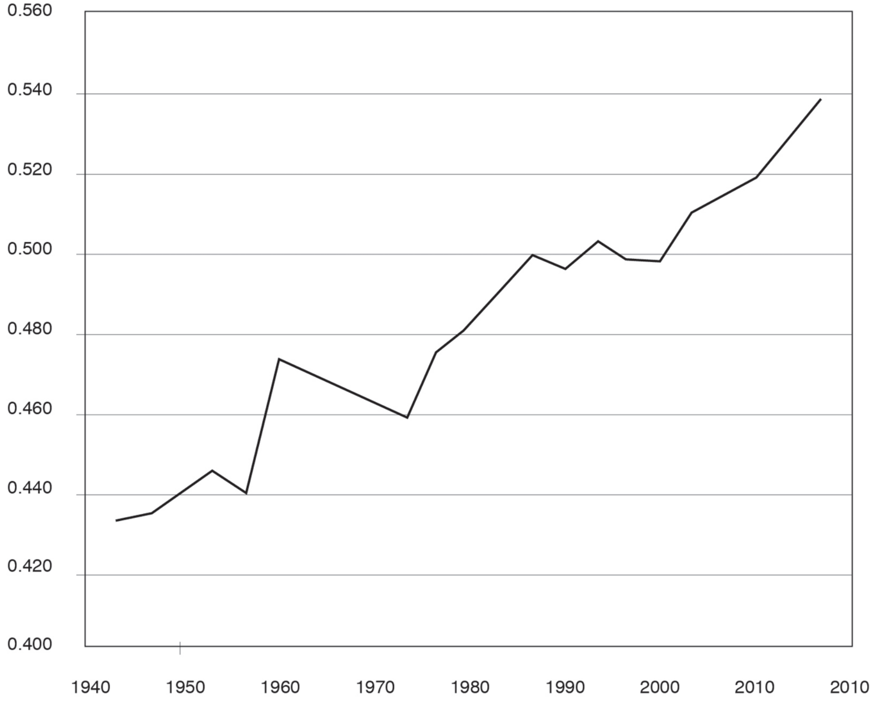
One indication of the extent of this metamorphosis is the changes in the Israeli economy's rank on the Economic Freedom of the World scale (which measures economies' relative "openness" and market orientation) over the last twenty-five years. While, in 1980, Israel was ranked 102nd out of 105 countries on that scale, by 1990 it had advanced to 97th (out of 113) and by 2007 to 44th (out of 123), its highest rating. By 2009 it had gone down to 83rd, to a great extent because of the large size of its government and credit and labor regulations.[59] Significantly, the scores Israel received on many aspects of the measure—related to monetary policy, trade policy, and ease of doing business—were virtually the same as those of the United States. Indeed, the profile of the Israeli economy that appeared in a recent U.S. government publication on the international business scene noted that "the business environment and style will seem familiar to American businesses."[60]

Not surprisingly, such a swift and extensive change in economic policy significantly affected Israeli society. Israelis are not only experiencing unprecedented economic freedom, but many unprecedented economic opportunities. The average adjusted disposable income rose (in 1995 New Israeli Shekels) from 39,195 NIS in 1995 to 57,077 in 2000, 62,849 in 2005, and 82,596 NIS in 2009.[61] One additional—and very controversial—change concerns the rise in income differentials in Israel. As previously noted, during the first two decades of its existence this differential, as measured by the Gini factor, was the smallest outside of the communist world. However, Dahan notes that the economic liberalization policy led Israel to become the Western economy with the largest wage differential, recently surpassing its economic alterego the United States.[62] This situation has subsequently prevailed and it, too, was a focal point of the 2011 protest.

Of course, the last two decades have witnessed a *general* rise in wage inequality in most Western economies. However, both the gradient of that change and the sheer income differential in Israel exceed those of leading developed economies. From 1979 to 2002, the Gini index for inequality in income distribution (before taxes and transfer payments) increased in Israel by 23% from .43 to .53 (the dynamics inclusive of those two factors were similar, with respective indexes of .31 and .38 for 1979 and 2002). Indeed, an examination by Deininger and Squire indicates that wage inequality in Israel outstripped that of such countries as the United States, Canada, the United Kingdom, France, Germany, Italy, Japan, and Taiwan.[63] The Israeli economy's dramatic transformation in this regard is clearly visible in Figure 2.

Recently published OECD statistics indicate that Israel continues to be among those countries with the largest income inequality. In fact, income inequality in

Figure 2
Inequality in Income (before taxes and without transfer payments), 1979–2002



Source: Institute for National Social Welfare, 2004.

Israel after taxes and transfers is larger than in all OECD countries except Chile, Mexico, Turkey, and the United States.[64]

Zeira noted that the rise in wage inequality in Israel can be partially attributed to changes that occurred in most developed economies. Among them are:

1. The development of information technology and its subsequent employment opportunities for particular segments of the population. Notable in this context is the spectacular growth of the Israeli high-tech industry and the massive influx of foreign money associated with that growth.
2. Globalization and the associated growth in competition with products from less developed economies (with lower wages).
3. The decline of trade unionism.

Table 2
Israeli Economic Growth

	Imports (in millions of $U.S.)	Exports (in millions of $U.S.)	% exports of imports
1970	1,462	733	51.2
1980	7,994	5,291	67.4
1990	15,325	11,450	75.8
2000	35,749	28,340	80.2
2005	45,034	36,610	82.5

Source: *Israel Statistical Yearbook*, 2005.

Nevertheless, he noted that certain specific dynamics associated with the Israeli experience accentuated this phenomenon, such as:

1. The large immigration wave from the Soviet Union, which brought a million new immigrants to Israel from 1989 to 2000 (currently accounting for nearly 13% of the population).
2. The tremendous influx of foreign workers to Israel from the mid-1990s on.[65]

Voskamp and Wittke noted that the most successful examples of industrialization were not simply copies of other systems that worked but, instead, adaptations of external models to local political, economic, and social conditions.[66] Similarly, it could be expected that the most successful examples of economic liberalization also would require adapting well-known ideas to the specific reality of the host country. It can—and has—been argued that this has not been the case in Israel. Thus, while the *economic* success of the 1985 Economic Stabilization Plan and the subsequent market-oriented policies it engendered is widely accepted—and even celebrated[67]—its impact on Israeli society and the underpinnings of Zionist ideology is less clear.

The economic hardship suffered by some together with the ideological discomfort it has fostered has led to a vocal and varied series of confrontations over the last few years, including a virulent public debate among leading political figures.[68] Perhaps the most blunt and memorable statement in that ongoing debate belongs to current president Shimon Peres, who characterized the present economic reality as an example of "piggish capitalism."

Fukuyama would have one believe that the forces behind the pursuit of economic interests entailed in capitalism are such that they make all other interests and objectives superfluous. Regarding his view of the future in that context, he suggested that: "The very struggle for recognition, the willingness to risk one's life for a purely abstract goal, the worldwide ideological struggle that called forth daring, courage, imagination, and idealism, will be replaced by economic calculation, the endless solving of technical problems, environmental concerns, and the satisfaction of sophisticated consumer demands."[69]

However, it currently seems equally likely that the pendulum of economic ideology will swing back (as pendulums are wont to do) and a unique Israeli model of the market-oriented economy will emerge. This "homemade" Israeli model would likely embrace not only the economic freedoms of individual actors but also many of the elements associated with the "traditional" Zionist narrative concerning the national and communal significance of the reemergence of Jewish sovereignty.

A FINAL WORD

It seems likely, then, that at some point there will be a fundamental reexamination of the American-style market-oriented economy that has emerged in Israel with liberalization since 1985. The genesis of such a process occurred in the summer of 2011, and the unlikely catalyst was none other than the price of cottage cheese.

What began as a fairly unorganized boycott of cottage cheese sparked by steep prices for it and other dairy products soon morphed into protests against a variety of matters including the dramatic rise in expenses associated with housing, food, public transportation, fuel, and sundry goods and services. Indeed, thanks to such high costs—and the relatively low level of salaries in Israeli—activists noted that Israel's poverty level was double that of other developed countries—and second only to the United States. The protests coalesced into a call for "social justice."

Buoyed by a series of media exposés on the structure and performance of the Israeli economy, activists suggested that progress toward the type of social justice envisioned by the founders of the state could only occur if Israel's economic reality was changed. Invariably, those elements that were seen as in need of change could be traced back to the economy's liberalization. Among matters that were seen as requiring reexamination were:

- The removal of price controls on basic food products
- A tax system that was seen to favor the wealthy and those with significant income from stock investments
- A privatization policy that was seen as leading to a concentration of economic power in the hands of a few families

- A lack of competition associated with the concentration of economic activity
- A decline in employee rights—and a growing gap between the salaries of average workers and top management

À la Voskamp and Wittke,[70] activists suggested that the Israeli economy could only truly succeed if traditional Jewish and Zionist values were reintroduced into economic policy. As such, there have been increasing calls for a return to values of communal responsibility and support for the needy, a more egalitarian economy with regard to salary discrepancies, and an economy in which individual rights and opportunities are given more priority than those of larger, more powerful economic actors.

It is currently unclear how the protest movement of the summer of 2011 will affect the Israeli economy's long-term evolution. It seems evident, though, that the value of what is seen as the economy's Americanization has been called into question. Government-appointed committees, the popular press, and the public sphere have all addressed how economic policy should be formulated to take into account both market forces and the realities of the global economy, while leveraging traditional Jewish and Zionist ideas. As such, it turns out that the American dream may not be the answer to the Israeli reality.

NOTES

1. Shmuel Noah Eisenstadt, *The Transformation of Israeli Society* (London: Weidenfeld & Nicolson, 1985).
2. The term "pursuit of happiness" from the Jeffersonian perspective referred to the rights of individuals to realize their economic and material desires. This conception of rights can be seen as contributing to the very positive attitude toward the role and value of individual enterprise—and business on the whole—in American society. As we will see, the Israeli experience regarding these matters is quite different.
3. A further examination of these documents would show that whereas the American state in formation derived its legitimacy from the consent of the governed, the Israeli state in formation derived its legitimacy from the national rights of the group as a whole. The societies that subsequently emerged reflect the differences in their genesis.
4. The decision to write the novel came at one of the low points in Herzl's efforts to advance the idea of a Jewish state. Commenting on the work in his diary, he wistfully notes that if his plans have become but dreams, than perhaps his dreams should become a plan.
5. Amos Elon, *The Israelis: Founders and Sons* (New York: Holt, Rinehart & Winston, 1971).
6. Arcadius Kahan, *Essays in Jewish Social and Economic History* (Chicago: University of Chicago Press, 1986).

7. Yoav Peled and Adi Ophir, eds., *Israel: From a Mobilized Society to Civil Society* (Tel Aviv: Hakibbutz Hameuchad, 2001) (Hebrew).
8. An example can be found in a characteristic leaflet in 1904 by one of the groups that would later form the backbone of the Labor Zionist movement:

   > Jewish workers of all countries unite behind the banner of *Poalei Zion*! Brothers and sisters of the workers' class! We see before us two great and powerful movements: on the one hand socialism which seeks to liberate us from economic and political slavery; and on the other hand Zionism which seeks to liberate us from the yoke of Diaspora. Both affect us greatly. Both promise us a glorious future. Both are vital for us as life itself.... (quoted in Elon, *The Israelis*, 75)
9. Quoted in Elon, *The Israelis*, 81.
10. Quoted in Robert Leeson, "The Early Patinkin-Friedman Correspondence," *Journal of the History of Economic Thought* 20, 4 (December 1998): 433–448, 439.
11. The extent of government control over the economy can be seen in a speech by Dov Yosef, the minister responsible for the austerity program:

    > We shall determine a modest and rational diet which alone will be available to the public.... We shall permit the production of luxury goods only for export, and stop the importation of all luxury goods.... All imports will require licenses from the Ministry of Supplies and Rationing. Importers will be allowed to sell their goods only to wholesalers licensed by the Ministry of Supplies and Rationing. Each wholesaler will be allowed to sell his goods only to a given number of consumers, who will be allowed to buy only from him, according to the coupon books which will be issued to the entire population.... The consumer will give the retailer the appropriate coupons, and the latter will turn them over to the Ministry of Supplies and Rationing.... (*Protocols of the Knesset*, 1950)
12. Israeli Central Bureau of Statistics, *Statistical Abstract of Israel, 2005* (Jerusalem: Israeli Central Bureau of Statistics, 2005). The primacy of immigration on the national agenda can be seen in the words of future prime minister Golda Meir during a debate on the austerity program. Responding to questions and criticisms concerning the details of the program with a healthy dose of stoicism, emotion, and ideology, she simply stated that "there is no avoiding this simple choice; either ration immigration or ration food and clothing." She added: "After all what is demanded of us? A little less extravagance, so as to not dissipate the inheritance for which our dear ones gave their lives. They did not die for the sake of prosperity, but for the state and a great immigration" (*Protocols of the Knesset*, 1950).
13. Tom Segev, *1949: The First Israelis* (New York: Owl Books, 1998). These materials included Hollywood movies—particularly Westerns, stories about life in America, and articles concerning the underlying ideological themes of American society.
14. Former Bank of Israel governor David Horowitz would write that "Ben-Gurion detested the belief in economic laws and the autonomy of the economic mechanism.... He never understood them and thought of them as deliberate obfuscation and an impediment to man's will. He wanted to force the laws of economics, break their power and reveal their uselessness" (David Horowitz, *Life in the Center* [Tel Aviv: Masada, 1972] [Hebrew]). Ben-Gurion's position brings to mind Bernard Manderville's criticism that many of his contemporaries and predecessors would "conceive men not as they are but as they would like them to be."

15. A. P. Lerner, "The Historian and the Israeli Economy," in Shlomo Katz, ed., *The Midstream Reader* (New York: Thomas Yosseloff, 1960), 226–237.
16. Joseph Zeira, *Economics and Society Program: Eleven Disputes in Economics* (Jerusalem: Van Leer Jerusalem Institute, 2007).
17. Ibid.
18. The Histadrut became increasingly attuned to its own "elite" as it pushed for entitlements and a rising standard of living in a differential fashion. This created different classes of laborers within the Histadrut. The less skilled workers (mostly of Sephardic background) did not generally benefit from these efforts and were not truly allowed to participate in the frameworks that they ostensibly owned. This laid the seeds for the eventual revolt—and even a sense of fury—against the "Ashkenazi" Labor Party and the Histadrut in the 1977 and 1981 elections.

    In private communication with the author, Israeli historian David Ochana, who has written extensively about the Sephardi population in Israel, noted that they never really embraced the Labor ideology. As the community came of age in the 1970s, a sense of frustration and anger mounted at the ruling Labor Party and Histadrut for what was seen as a paternalistic and biased attitude toward their interests.
19. This party would eventually become a central catalyst in the changes in economic policy precipitated by the establishment of a Likud-led, nonsocialist government in 1977.
20. Warren Young, *The Impact of American Jewry on the Israeli Economy* (Ramat Gan, Israel: AJC-Argov Center, 2001).
21. Ibid.
22. Eisenstadt, *Transformation*.
23. The nearly twenty thousand immigrants from the United States brought with them expectations and a lifestyle until then almost completely unknown in Israel.
24. Tamar Liebes, *American Dreams, Hebrew Subtitles: Globalization from the Receiving End* (New York: Hampton Press, 2003).
25. Milton Friedman, *Monetary and Economic Development* (New York: Praeger, 1972), 54–55.
26. Avi Ben-Bassat, "The Obstacle Course to a Market Economy in Israel," in Avi Ben-Bassat, ed., *The Israeli Economy, 1985–1998: From Government Intervention to Market Economics* (Cambridge: MIT Press, 2002), 1–63.
27. Zeira, *Economics and Society Program*.
28. Young, *Impact of American Jewry*, 2001.
29. Eisenstadt, *Transformation*.
30. E.g., Nicholas Kaldor, "Alternative Theories of Distribution," *Review of Economic Studies* 23 (1956): 83–100.
31. Quoted in Young, *Impact of American Jewry*.
32. E.g., Eisenstadt, *Transformation*.
33. A thorough discussion of this period can be found in the *Beisky Report*, the official summary of the government investigation into the bank-stocks price-fixing mechanism. Interestingly, among the important institutional actors involved in stock speculation were the kibbutzim. Literally "gambling away the farm," it eventually took a government decision to bail out the kibbutzim and save many of them from insolvency. Not surprisingly, the economic behavior of the kibbutzim and their subsequent success in receiving preferential

treatment further eroded the position of their benefactor the Labor Party and its economic ideology.

34. Young, *Impact of American Jewry*. In an interesting turn of events, Fischer would not only eventually help design and navigate the American-initiated stabilization plan through the Israeli bureaucracy, but also be appointed governor of the Bank of Israel in 2005.
35. Ibid.
36. Thus, while then-prime minister Shimon Peres and finance minister Yitzhak Moda'i are widely given credit for "saving the Israeli economy," it can be argued that it was the U.S. government that actually saved Israel from itself. Although this is not to diminish the efforts and acumen required of Peres and others in gaining support for the government's economic policy, one cannot discount the impact of the clear-cut American message concerning the consequences of not undertaking the desired changes.
37. Ben-Bassat, "Obstacle Course."
38. Michael Strawczynski and Joseph Zeira, "Reducing the Relative Size of Government in Israel after 1985," in Avi Ben-Bassat, ed., *The Israeli Economy, 1985–1998: From Government Intervention to Market Economics* (Cambridge: MIT Press, 2002), 61–84.
39. During 1985–1998 defense spending was reduced from 21% of the GNP to 9%, transfers to the business sector from 13% to 3%, and finance expenses from 13% to 7%. However, not all aspects of public outlays decreased over this period; in fact, there were significant increases regarding transfers to households. These transfers were a function of various factors including changes in policy away from commitment to full employment, political pressures by various interest groups (where ultra-Orthodox parties played a central role), and demographic changes related to the aging of the population, massive immigration from the former Soviet Union, and an increase in economic inequality.
40. Israeli Central Bureau of Statistics, 2003.
41. Joseph Djivre and Daniel Tsiddon, "A Monetary Labyrinth: Instruments and the Conduct of Monetary Policy in Israel, 1987–1998," in Avi Ben-Bassat, ed., *The Israeli Economy, 1985–1998: From Government Intervention to Market Economics* (Cambridge: MIT Press, 2002), 85–128.
42. Israel has consistently been ranked as the third or fourth most important center of high-tech activity along with Silicon Valley, southern California, and the Boston area. High tech currently accounts for 15% of Israeli GDP and half of all exports. The amount of *foreign* venture capital investment per capita in Israel is the highest in the world.
43. Ben-Bassat, "Obstacle Course."
44. Eisenstadt, *Transformation*. The Histadrut's complex role in the Israeli economy came to the forefront during a lengthy, extensive, and highly controversial strike by the nation's doctors, who were Histadrut members. In many cases, those who went on strike refused to provide services to fellow Histadrut members who received health services via the Histadrut-operated sick fund, being treated at Histadrut-owned medical facilities. The multiple and conflicting interests represented by various elements of the Histadrut system were yet another blow to the weakening organization, which had—rightly or wrongly—increasingly been viewed as discriminatory toward Sephardim. The 1985 Economic Stabilization Plan would further weaken the Histadrut.
45. Roby Nathanson and Guy Zisser, "The Influence of Trade Unions on Wage and the Labor Market: An Empirical Analysis," in *The New World of Work in an Era of Economic Change*,

Ministry of Economics and Planning, 1996 (Hebrew). Yet, following lengthy strikes in government offices and in the government-owned ports in 2003–2004, it was reported that Israel led the world in the per capita cost of labor disputes.

46. Yael Artstein, "The Flexibility of the Israeli Labor Markets," in Avi Ben-Bassat, ed., *The Israeli Economy, 1985–1998: From Government Intervention to Market Economics* (Cambridge: MIT Press, 2002), 379–422.
47. Ben-Bassat, "Obstacle Course."
48. Yoram Gabai and Rafael Rob, "The Import-Liberalization and Abolition of Devaluation Substitutes Policy: Implications for the Israeli Economy," in Avi Ben-Bassat, ed., *The Israeli Economy, 1985–1998: From Government Intervention to Market Economics* (Cambridge: MIT Press, 2002), 281–308.
49. Ibid. Examples of the change in the consumer landscape can be found in the changes in the respective penetration rates of various items from 1985 to 1995. Overall, the rate increased from 21% to 30% in that period with significant increases in such areas as wood and wood products, from 12% to 20%; leather products, from 25% to 40%; and textiles, from 33% to 46%. Net imports doubled from 1980 to 1990 and more than doubled from 1990 to 2000.
50. The wages in the public sector industries have traditionally been higher than the national average. This trend has intensified since the 1970s with the average wage of transportation and communication workers reaching 30% above the national average and that of electricity and water workers more than double the national average by the late 1990s (Gronau, 2002).
51. Reuven Gronau, "Structural Changes in the Israeli Public Utilities: The Reform That Never Was," in Avi Ben-Bassat, ed., *The Israeli Economy, 1985–1998: From Government Intervention to Market Economics* (Cambridge: MIT Press, 2002), 281–308.
52. Ben-Bassat, "Obstacle Course"; Moshe Justman, "Structural Change and the Emergence of Israel's High-Tech Sector," in Avi Ben-Bassat, ed., *The Israeli Economy, 1985–1998: From Government Intervention to Market Economics* (Cambridge: MIT Press, 2002), 445–484.
53. One example is the repeated attempts by successive governments to privatize the country's ports. This has been part of government policy since 1993 and spawned programs to do so in 1994, 1997, and 2003. The last attempt resulted in a lengthy strike that cost the Israeli economy damage estimated at nearly $100 million. A recent article in the *Maariv* daily noted that 50% of the workforce at the ports are blood relatives and that there were years in which *every* new employee hired had at least one family member already working in the organization.
54. Moshe Pearl, *With Open Eyes* (Tel Aviv: Maariv Books, 2002) (Hebrew). In a series of examples that would not embarrass Kafka, Pearl shows how enterprises ostensibly operated by the state implement policies whose aim is to stymie state influence. For instance, in an attempt to dampen the ardor of potential suitors, the Israel Electric Company (which the government would like to privatize) undertook a fiscal policy that enabled them to present their financial figures such that the organization was seen as having an outstanding debt of $9 billion as of the end of 2002.
55. E.g., Ben-Bassat, "Obstacle Course."
56. Whereas the United States has witnessed a decrease in what has been termed "family capitalism" (centralized wealth and ownership in the hands of a few families) since the begin-

ning of the twentieth century, in Israel this process seems actually to have intensified as the country entered the twenty-first century.

57. Albert O. Hirschman, *The Passions and the Interests: Political Arguments for Capitalism before Its Triumph* (New York: Prentice-Hall, 1997).
58. Michael Albert, *Capitalism vs. Capitalism* (New York: Wiley, 1992).
59. Fraser Institute, http://www.freetheworld.com/2007/3EFW2007ch3.pdf.
60. www.buyusa.gov.
61. Israeli Central Bureau of Statistics, 2009.
62. Momi Dahan, "The Rise of Earning Inequality," in Avi Ben-Bassat, ed., *The Israeli Economy, 1985–1998: From Government Intervention to Market Economic*s (Cambridge: MIT Press, 2002), 485–518. Note that even after government reforms, transfer payments in Israel are such that inequality after such payments is similar to that of West European nations and less than that of the United States (Zeira, *Economics and Society Program*).
63. Klaus Deininger and Lyn Squire, "Measuring Income Inequality Database," http://www.worldbank.org/research/growth/dddeisqu.htm.
64. "An Overview of Growing Income Inequalities in OECD Countries: Main Findings," in *Divided We Stand: Why Inequality Keeps Growing* (OECD Publishing, 2011), available online.
65. Zeira, *Economics and Society Program*.
66. Ulrich Voskamp and Volker Wittke, "Industrial Restructuring in the Former GDR," *Politics and Society* 19, 3 (1991): 371.
67. Ben-Bassat, "Obstacle Course"; Daniel Patinkin, "Israel's Stabilization Program of 1985, or Some Simple Truths of Monetary Theory," *Journal of Economic Perspectives*, Spring 1993, 103–128; Young, *Impact of American Jewry*.
68. The role of the United States and its "economic vision" has consistently found its way into the public debate about Israel's transition to a market-oriented economy. First, the leading advocate of this transition has been perceived to be Netanyahu. Many have viewed his political persona and economic agenda as an American import resulting from his time in the United States when he was younger. Many of those opposing the growth of market forces have decried the "Americanization" of the economy. Further, both government figures and the banks enlisted the support of American financial experts to bolster their opposing claims about the necessity and likely consequences of the bank reform advocated by the current government. Finally, as noted, one of the American architects of the 1985 Economic Stabilization Plan, Rhodesian-born Stanley Fischer, is now governor of the Bank of Israel.
69. Frances Fukuyama, *The End of History* (London: Penguin, 1989), 18.
70. Voskamp and Wittke, "Industrial Restructuring"; "An Overview of Growing Income Inequalities in OECD Countries: Main Findings," in *Divided We Stand: Why Inequality Keeps Growing* (OECD Publishing, 2011), available online.