

Jerusalem Letter

the Jerusalem center

JERUSALEM INSTITUTE FOR
FEDERAL STUDIES

CENTER FOR
JEWISH COMMUNITY STUDIES

Daniel J. Elazar, Editor and Publisher • David Clayman, Executive Editor

ISSN: 0334-4096

No. 36: 1 Tevet 5741/December 8, 1980

THE POLITICAL ECONOMY OF ISRAEL, 1948-1980

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The development of political-economic thought in Israel during the 32 years since the establishment of the state, as expressed in the decisions of its leaders, has been characterized by constant conflict between such social objectives as social justice and immigrant absorption, and serious physical and financial restrictions (the lack of raw materials and capital, respectively). This conflict took place against the background of a highly volatile security situation which necessitated tremendous defense expenditures, both in money and in manpower, even during the supposedly "quiet" periods when Israel was not involved in one of the five wars it was forced to wage against its enemies, from the establishment of the state until the signing of the peace treaty with Egypt.

Rapid Development and Immigrant Absorption (1948-1960)

"Rapid economic growth" was the primary objective of Israel's economy and society during the first twelve years after the establishment of the state. The socio-political approach which guided its leaders during this period was to provide employment in productive industry as rapidly as possible for the hundreds of thousands of immigrants who arrived in Israel during the course of the War of Independence and immediately afterwards, many of whom were sitting idly in transit camps, exposed to the danger of spiritual and social decay. The approach of the leaders to the solution of this problem was to strive for rapid economic development in order to create new places of employment, limited only by the amount of foreign currency that could be obtained without causing political dependency.

This policy prompted the founding of new kibbutzim, moshavim, and development towns and the construction of new neighborhoods in established cities. New plants were established in traditional branches of industry as well as pioneering plants in branches in which Israel had had no previous experience. Many of these were not ideally situated from an economic point of view and they were not always efficiently run, but most fulfilled the primary objective of providing

The Jerusalem Letter is a periodic report intended to objectively clarify and analyze issues of Jewish and Israel public policy.
Subscriptions: \$25 per year

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places of productive employment for immigrants and for all those who wanted to share in the national task of immigrant absorption, economic development, and the settlement of the development areas. Construction projects included housing, schools, and hospitals, and, despite the Sinai campaign of 1956 and continuing security problems, the standard of living slowly began to rise.

Financial resources were another key to success, since a strong desire to act and a sincere readiness for personal sacrifices alone cannot ensure success within a reasonable timespan. It was clear that the longer the period of building and absorption, the greater the danger that a large gap would be created between veteran settlers and immigrants, between immigrants from developed countries and from developing countries, especially the Arab world. Thus, there was a race against time: to build as quickly as possible in order to lay a sound foundation for the development of a modern society and economy which could absorb the large number of immigrants before their inherent resistance to this process became too great. While in the first stage the problem was primarily that of absorption in productive employment, the new problem of a growing social gap between different segments of the labor force soon emerged. The creation of places of employment at virtually any price brought in its wake the real danger that Israeli society would be divided into "two Israels."

The leaders of the state were guided by high aspirations and goals on the one hand, and by the need to overcome the conditions limiting rapid development on the other. The decision regarding German reparations, taken before the wounds of the Holocaust had healed, was a part of this dilemma. National responsibility for the future of the nation -- which required physical and emotional sacrifices in order to build a just society in an independent state -- came into conflict with the personal problem of conscience and the individual desire for revenge and dissociation from Germany.

The Strengthening of the Economy and its Increased Competitiveness (1961-1972)

In the twelve years which followed the period of mass absorption and rapid development, from 1961 to 1972, the emphasis was shifted to the strengthening of the state's economy base and the lessening of its dependence on financing from abroad. The central goal of the economic policy was to attain economic independence. In order to achieve this goal, two more concrete objectives were set forth:

- a change in the structure of the economy: the transfer of the means of production -- capital and labor -- from the local market to exports;
- the increased competitiveness of the economy -- increased productivity and the improvement of quality, management, and marketing.

On the basis of these principles, and in order to alter the structure of the economy and to increase its competitiveness, the economic policy was radically altered, as expressed first and foremost in the 1962 decision to greatly devalue the Israeli currency.

The primary objective of this devaluation was to abolish the complicated system of incentives which had been developed over the course of time to encourage exports and to protect local products. The export premiums for individual industries were abolished, and were in time replaced by collective incentives for the different branches of industry. The administrative protection of local industry was replaced by fiscal protection, with the declared aim of gradually exposing Israeli products to competitive imports.

At the same time, the different rates of exchange which had existed before 1962 were abolished; the foundations were laid for a modern money market and modern banking, and the stock exchange began gradually to play a positive role in the capital market. Other profitable sources of foreign financing were gradually developed, reducing the almost absolute reliance on Jewish aid (the United Jewish Appeal and Israel bonds) and on international-political sources, such as the American government, German reparations, etc.

An agreement was signed with the European Common Market, according to which tariffs on Israeli exports to the Common Market countries were to be abolished over a period of several years, while tariffs on imports to Israel were to be lowered over a longer period of time (two years as opposed to twelve). Without future competitiveness, Israel will not be able to live up to this agreement. Nevertheless, it must be recognized that without this agreement, and without the advantages it provides, Israel's chances for continued progress or even for maintaining the status quo would be small.

With the rising pressures of inflation, a policy of recession was introduced at the beginning of this period, primarily in order to limit both the growing scope of construction (except for housing projects) and local demand, directing production efforts to exports. The sharp drop in immigration in the mid-1960's, which surpassed all predictions, precisely during a period of significant cut-backs in government development projects and in the construction industry as a whole, led to unemployment of unpredicted proportions.

The Six Day War and the security demands it placed on the economy again stimulated inflation and gave rise to difficulties in the balance of payments. In early 1970, a "package deal" was signed by the government, the Histadrut, and the employers' associations to limit private consumption and to restore the orderly development of the economy, despite increased defense spending caused by the war of attrition on the Egyptian border.

The reactions to this policy were expressed principally in increased social tensions and unstable labor relations. There were numerous strikes, some more justified and others less; higher wages were demanded because salaries were not sufficient to ensure a suitable livelihood, but also in order to maintain the differentials between the wage scales of various professions.

The common cause of these wage demands, strikes, and growing social tensions was primarily the continuing defense burden imposed on the public throughout the entire generation. It is relatively easy to demand sacrifices from the people for a limited time, especially when the danger is very tangible, as in time

of war, but maintaining a regimen of abstinence and self-restraint over an extended period of time is an almost impossible task.

This situation was further complicated by the increased wealth caused by the accelerated economic development and illegal tax evasion. The hundreds of millions of German marks which poured into the hands of many families in Israel, as part of the German reparations, added to a sense of deprivation on the part of those who, in the natural course of events, were not entitled to compensation from Germany for loss of life, health, property, etc. In other words, the personal reparations from Germany, which contributed considerably to the development of the economy, over and above the payments made directly to the state, contained the seeds of social conflict and served as a stimulus for raising the standard of living above the level warranted by the growth of the national product.

The Energy Crisis and the Balance of Payments (1973-1977)

The entire world entered into a serious crisis as a result of the rising costs of crude oil and oil products, and of all types of energy, at the time of the Yom Kippur War. The tripling of the cost of crude oil over a short period of time resulted in an economic regression in most of the developed countries, and an economic crisis in other oil-importing countries. The affected countries reacted by raising the price of products under their control, such as basic food products, raw materials, industrial equipment, weapons, etc. The oil-producing countries could, of course, pay these costs, but the countries poor in raw materials suffered from the rising cost both of oil and of the other products.

Israel found itself in an even more serious situation. It was forced to go to war, with all this entails of foreign currency expenditures, manpower mobilized in the army instead of in factories and agriculture, and the loss of national product. In addition, after the war, Israel had to invest huge sums in re-equipping its army, with arms of a scope and quality previously unknown in the Middle East, primarily because the oil crisis had brought prosperity to Israel's enemies, and they could acquire -- for themselves and for countries friendly to them -- unlimited arms of any quality they desired. The Western countries, which had previously spoken of an arms embargo in the Middle East, now removed all obstacles from the Arabs in order to increase exports and reduce unemployment.

In light of the existing situation throughout the world, and especially in Israel, the Israeli government decided to try and solve the problem, unprecedented in scope, of a four billion dollar deficit in its balance of payments (import surplus) through coordinated and firm action significantly limiting domestic demand and providing far-reaching incentives for exports. Positive results were not long in coming and over a period of two years, from 1975 to 1977, the import surplus was reduced by a third, whether we include direct defense imports or limit our analysis to non-military imports.

This success was achieved without causing a rise in unemployment, at a time when most of the countries throughout the world were experiencing a sub-

stantial level of unemployment. The "price" paid in exchange for this was the freezing of the standard of living and of economic growth. Thus, a real improvement was achieved in the area of the principal economic goal, that is in reducing the deficit in the balance of payments, but serious social problems remained. A supreme effort was invested for the future, while calling for sacrifices in the present.

The New Economic and Social Policy (1978-1980)

In May 1977, in a government changeover, the Likud took over the Israeli leadership. In all the previous governments, the social-democratic party (Mapai) had been the ruling party, and its socio-economic approach had guided Israel's economic policy for close to 30 years. Under the new regime, the management of the economy was placed in the hands of the representatives of the Liberal Party, whose socio-economic approach differs widely from that of its predecessor and is based on the non-interference of government in the economy. Control over foreign currency was abolished, and the subsidies on basic commodities and public transportation were substantially reduced as well as the subsidy on capital by which the previous government had directed new investments to export industries and to the development areas. The three existing rates of exchange of the Israeli pound (for transfer of capital, imports, and added value exports) were unified, and the export incentives, which had increased the relative profitability of exports over the local market, were abolished.

As a result of this policy, the yearly rate of inflation reached three figures, a rate unprecedented in the Israeli economy, even in the years of privation following the establishment of the state. Parallel to this, there was a marked deterioration in the balance of payments, following a considerable rise in imports as opposed to a modest rise in exports.

This situation was not merely the result of a radical change in the dominant economic philosophy and policy, and but also and primarily the result of the special composition of the government coalition. The prime minister and his party (Herut) represent a welfare, though not socialist, approach to the weaker social classes from which Herut draws most of its votes. The contradiction between the liberal approach of the minister of the treasury and his party, and the welfare approach of the prime minister and his party was reconciled by a general improvement in the standard of living at all levels of society. Both private and public consumption increased, accompanied by a growth in the government's budgetary deficits, creating great pressures of demand. Since the end of 1979, when the liberal minister of the treasury was replaced, the economic policy has again placed a burden on all levels of society and, as a result, there has been a certain improvement in the balance of payments and the rate of inflation was somewhat declined.

From the first, Israel's economy has been substantially affected by the policies of its government which has had to be highly interventionist, certainly by American standards. This, in turn, had led to very strong political influences

on economic policy, to the point where there is almost no separation between economics and politics. At the same time, the long term trend has been toward freeing the economy from socialist-style controls and increasing free choice and market factors coupled with government fiscal controls more commonly found in the West. This trend actually was initiated by the socialist government in power in the 1950's. Today the dispute between the Labour Party and the Likud is over method and detail more than over direction.

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