

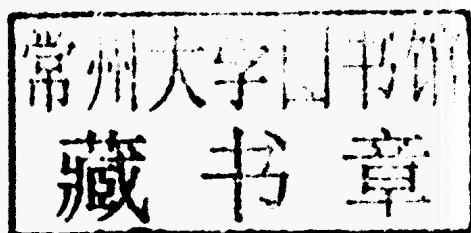
The Israeli
Economy from
the Foundation
of the State
through the
21st Century

Paul Rivlin

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THE ISRAELI ECONOMY FROM THE FOUNDATION OF THE STATE THROUGH THE 21ST CENTURY

This book analyzes the development of the Israeli economy in its historical context. It shows how the ideology of the dominant group in the Zionist movement led to the development of agriculture, thus meeting the preconditions for successful industrialization. Remarkable, if uneven, growth has taken place, with increasing allocations for defense. Regional isolation led to the emphasis on high-quality exports for developed markets that has stimulated the technological base. Israel has benefited from mass immigration and increased access to foreign capital – factors that have transformed the economy. The book includes chapters on the development of the Jewish community in Palestine during the British Mandate; macroeconomic developments and economic policy; globalization and high technology; defense; the economics of the Arab minority; Israeli settlements and relations with the Palestinians; and the role of religion. It concludes with an examination of the socioeconomic divisions that have widened as the economy has grown.

Paul Rivlin is the Sandra Glass Senior Fellow at the Moshe Dayan Center for Middle East and African Studies at Tel Aviv University. He is the author of four other books: *The Dynamics of Economic Policy Making in Egypt* (1985), *The Israeli Economy* (1992), *Economic Policy and Performance in the Arab World* (2001), and *Arab Economies in the Twenty-First Century* (2009), as well as numerous monographs, papers, contributed chapters, articles, and reports on economic development in the Middle East and on international energy markets, defense, and trade economics. Educated at Cambridge, Harvard, and London universities, he has taught undergraduate and graduate courses on Middle East economics at Tel Aviv University, Ben-Gurion University of the Negev, and London University, and he has been a visiting professor of economics at Emory University. He has lectured in the United States, China, Canada, Egypt, India, Japan, Turkey, and Europe.

This book is dedicated with love and thanks to my mother, Zena, and to the memory of my father, Michael. As a child, I learned to discuss and debate the issues of the day around their kitchen table, usually with clarity and sometimes with passion. They taught me to think critically, to express myself clearly, to be concerned about events outside the home, and much else. My debt to them is great.

אם אין אני לי, מי לי; וכשאני לעצמי, מה אני
מסכת אבות פרק א, יג

If I am not for myself, who is for me?
And if I am only for myself, what am I?

The Ethics of the Fathers

“The political problem of mankind is to combine three things: economic efficiency, social justice, and individual liberty.”

John Maynard Keynes “*Liberalism and Labour*,” *The Collected Writings of John Maynard Keynes* Vol. IX, *Essays in Persuasion*. 1926; London: Macmillan St. Martins for the Royal Economic Society, 1972.

Preface

In my book, *The Israeli Economy*, published in 1992, I called for extensive reforms – largely designed to reduce government intervention – many of which have since been implemented. I also suggested that Israel's political culture made it difficult to create consensus around economic and other objectives. Since then, Israel's political structure has become more fragmented. A debate about economic and socioeconomic strategy has not, however, occurred. Instead governments of all kinds have implemented neoliberal policies. Political choices have been made about economic issues, usually under the guise of stabilization policies or because of the requirements of globalization, often with severe social consequences. The public was offered no alternatives by any significant political party. Despite this, there have been many economic achievements, including the absorption of more than a million immigrants in the 1990s and early 2000s, mainly from the former Soviet Union and Ethiopia during a period of regional conflict. It is against this complex background that I decided to write this book, which expands on what I wrote nearly twenty years ago, develops new themes, and reaches different conclusions, as would be expected with the passage of time.

The central theme in this book is the clash between efficiency and growth on the one hand and equity on the other. Market economies produce many, but not all, of the goods and services that people want: State bureaucracies do not. Market economies do not coincide with the model of perfect competition so laboriously taught to economics students. The truth is rather the opposite: In market economies, there are, as Adam Smith suggested, constant attempts to undermine competition. Even more worrying is the collusion of governments in the negation of competition. Furthermore, in a globalized system, governments are under pressure to limit public spending in order to reduce taxation. This limits their ability to compensate for the

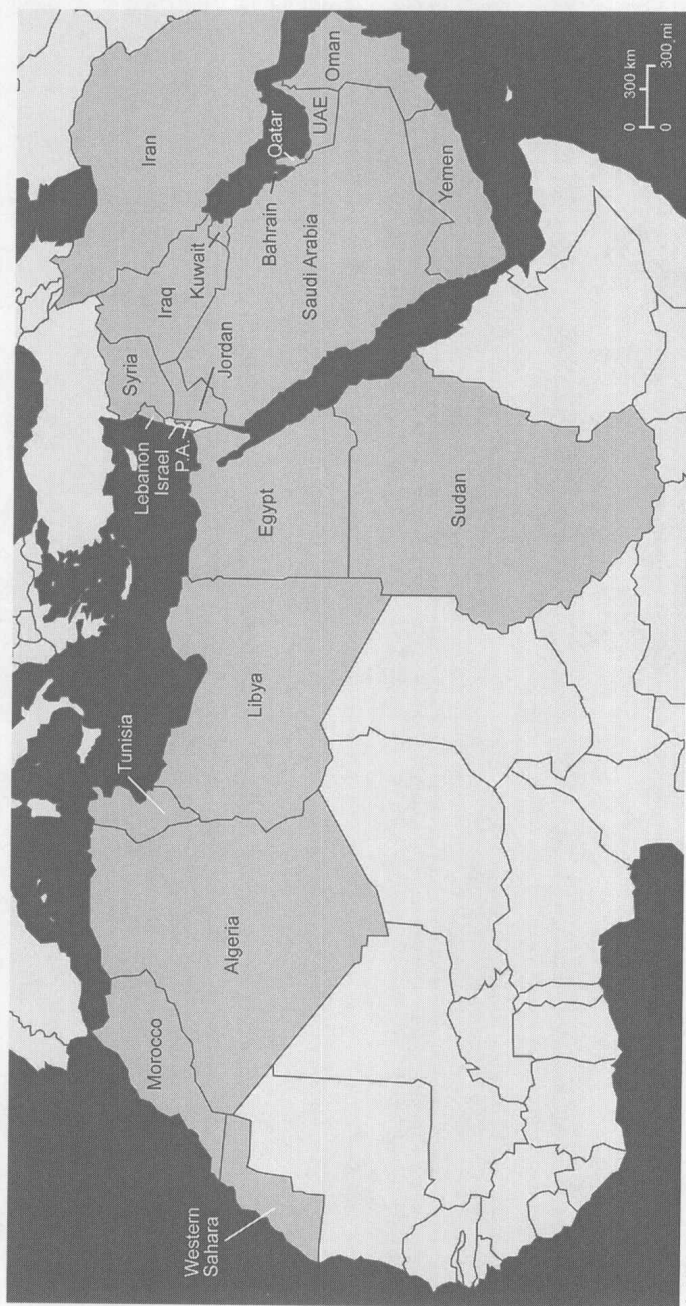
inequalities that market forces produce. The other issue that plays an increasing role is market failure. We are rediscovering, at great cost, something that some – usually the so-called unorthodox – economists knew all the time: Markets do not always work. Global warming is perhaps the greatest of these failures, but the international financial collapse of the second half of 2008 also raised fundamental questions about unregulated or deregulated financial markets. These issues are present in Israel, sometimes in an acute form, although they are hidden behind the more immediate problems of defense and so are neglected even more than in other countries.

This book is also a modest plea for a more realistic economics than that which prevails today. We need to look at the relationships between economics, politics, and sociology, and possibly other disciplines. For that reason, this book examines the ideas, values, and traditions of the different groups that have made up the Israeli population and analyzes their political strength and role. This is how ideas are formed, institutions built, and culture is made. A historical setting or context is essential to understand peoples' actions and reactions. The lesson of the current international financial crisis is that unregulated markets do not produce economically optimal solutions, let alone socially optimal ones; the effects of globalization should have taught us that lesson years ago.

I would like to thank Shlomo Avineri and David Webb for very useful suggestions; Elias Kraushaar for his enthusiastic work on the text; William Guterman and Daniel Maddy Weitzman for their help with references, and Evie Goldfarb for her assistance. Arie Arnon, Ruth Klinov, and Jacob Metzger kindly gave me permission to quote their publications, as did the Maurice Falk Institute for Economic Research in Israel. I am very grateful to Scott Parris, my editor at Cambridge University Press, and his colleagues for skillfully steering this project to completion. Three anonymous reviewers made numerous suggestions, many of which have been adopted.

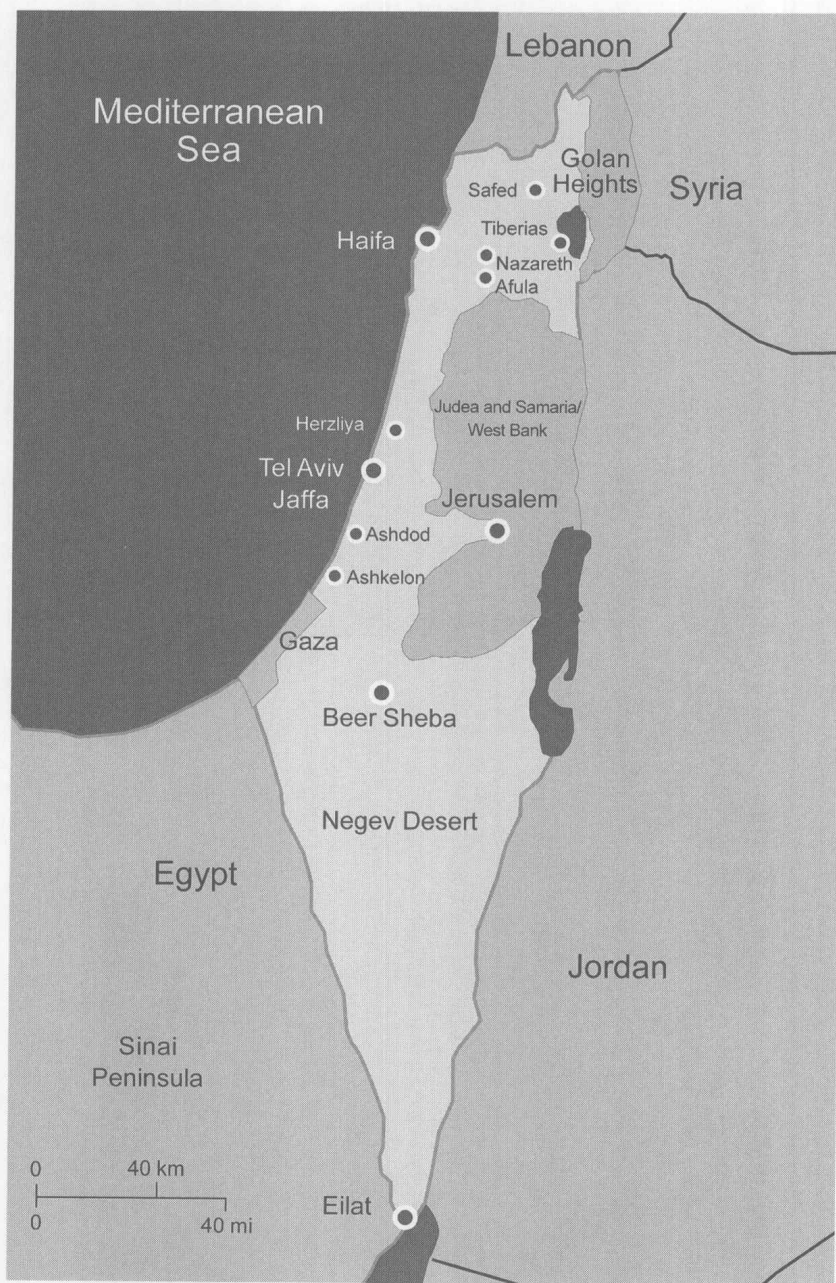
My family – Rosemary, Ben, and Alex – is the *sine qua non* of all my work. They have accommodated a sometimes absent and often absentminded husband and father and have encouraged me to continue researching and writing. Rosemary, once again, improved drafts and produced the graphics. Finally and belatedly, thanks to my aunt, Miryam Zafran.

I am, of course, responsible for all errors and omissions.



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The Middle East



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Israel

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