'Greater Israel' policy brings the Israeli economy to breaking point

by Richard Katz

If present trends continue, Israel will be spoken of in years to come with the words of tragedy: "what might have been."

If one did not know Israel's past successes, and only looked at its predicament now, one might mistake it for a "basket case" country. Its inflation rate is close to 140 percent. (It was only 35 percent before Menachen Begin brought in Milton Friedman to apply his anti-inflation nostrums.) Forty percent of the 1983-84 government budget must be used to pay debt service, domestic and foreign. Twenty-seven percent of its 1982 export income had to be used to pay foreign debt. Yet exports fell 5 percent, making debt repayment even more difficult.

The military budget consumes almost 27 percent of GNP. Its stealing of resources from capital investment has pushed the latter to 16 percent below its 1975 peak, resulting in near-zero growth in productivity.

Construction alone fell 8 percent in 1982; real wages fell 2.5 percent; and, for the first time ever, Israel suffered zero growth in inflation-adjusted GNP, along with zero growth in industrial production.

Above all, Israel is losing its most important resource: Israel's brightest, best educated young people, often willing to die for Israel, are no longer willing to live there. Since 1981, emigration has overtaken immigration.

The country survives only on the basis of enormous aid from the U.S. government and, to a lesser extent, world Jewry.

The era of nation-building

This was not always so. Blessed with a talented population and constant economic support from the outside, Israel had once been a showcase of economic development. It absorbed huge numbers of immigrants and "made the deserts bloom."

Unlike other developing countries, from the beginning Israel enjoyed the advantage of immense income from other nations, a combination of American financial aid, German reparations, and support from world Jewry. For more than 30 years, Israel was allowed to run a trade (goods and services) deficit equal to 25-35 percent of its GNP; in other words, to enjoy a *net import* of economic resources adding 25-35 percent to what it produced itself. Israel's creditors simply let it import what it needed and pile up more debt.

In 1982, Israel enjoyed net imports of almost $5 billion—about $1,250 for each man, woman and child, an amount three to five times the entire per capital GNP of most developing nations. Providing a similar subsidy to Mexico, for example, would mean allowing it to enjoy a $75 billion trade deficit year after year.

However, even that level of support would have gone for nought except for the existence of Israel's prime resource: its people. Unlike most other developing countries, Israel possessed a well-educated, cultured, modern population capable of absorbing modern technology. During the 1950s and early 1960s, a majority of Israel's growing number of college graduates studied engineering and science, and throughout the 1970s, forty to fifty percent of Israeli immigrants were professionals, technicians, scientists, or engineers.

Up through approximately 1975, Israel used its foreign support and human wealth to implement an extraordinary program of nation-building. Particularly under Israel's economic czar of the 1950s and 1960s, Pinchas Sapir, Israel applied 25-30 percent of its total economic resources (domestically produced GNP plus net imports) to capital investment, a higher rate of investment than in most developed countries. In this period, Israel created transport, housing for the immigrants, modern agriculture and industry, and a prestigious university and cultural system.

Perhaps nowhere was the advantage of Israel's modern population better shown than in agriculture. From 1949 to 1960, using high-technology inputs, Israel increased its farm output almost *seven times* while not increasing its number of farmers at all. Israel became a major exporter of agricultural technology.

The legendary image of Israel as a nation of kibbutzim exporting oranges and running handicraft shops is no longer true; in one generation it has turned itself into a nation of modern industry. All of this was accomplished with a nation now numbering only 4 million, the size of a big American city, spread out over a land no bigger than New Jersey.

Greater Israel: a strategy for economic suicide

Those blessings of the past are now being squandered. Year after year, in the pursuit of a chimerical "Greater Israel," the Begin regime is sinking 20-25 percent of the entire resources of the nation into military spending. The defense budget now far surpasses the entire gross capital investment of the country (see **Figure 1**), taking resources away from education, social infrastructure, industrial development, and so forth.

This problem certainly did not begin with Begin. In the 1950s and early 1960s, Israel's defense spending had been proportionately very small, but this radically changed after the 1967 and 1973 wars. Nor did Israel originally choose to be surrounded by hostile neighbors—as underscored by a recent release of British state documents exposing London's "divide-and-conquer" role in 1949 in preventing otherwise willing Arab nations from recognizing Israel. However, recent Israeli governments, particularly Begin's, have been more willing to bear the economic and other burdens of war than to seek a peace denying them "'Greater Israel."

Begin now proposes to compound the problem, not only by expanding domestic military spending, but by turning Israel, already the world's seventh largest arms exporter, into an even bigger one. A report of the Ministry of Industry and Trade issued following the Lebanon invasion, entitled "'Industrial Strategy—Post Operation Peace for Galilee," proposes to increase Israel's arms exports to 35 percent of total exports. They warn that a higher figure could be achieved, but this would not be prudent since the market is made volatile by the vicissitudes of world politics.

This is a prescription for suicide. Israel no longer enjoys the level of foreign subsidies that in the past allowed it to sustain much higher defense spending than other nations.

Israel had never internally generated the surplus to support the enormous capital investment needed to house its immigrants, modernize agriculture, increase its productivity, and arm its military. For most of Israel's history, as can be seen in **Figure 1a,** most of its entire gross capital investment (all private and business investment in equipment, construction and housing) was "'financed" in real economic terms through the mechanism of *net imports,* i.e., importing much

Israel defense spending overtakes capital investment

Figure 1

Division of total resources [GNP plus net imports]

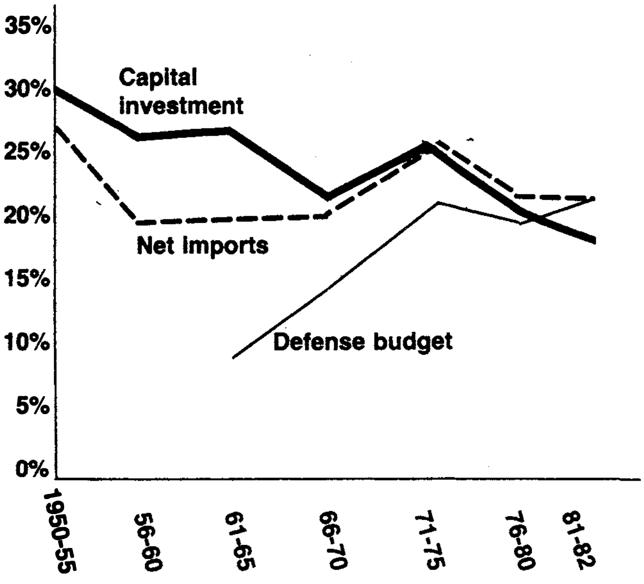
(in billions of 1975 shekels, annual average for period cited)

Year	1950-55	56-60	61-65	66-70	71-75	76-80	1975	1982
Gross capital investment**	.5	.6	1.1	1.2	2.3	2.1	2.4	2.0
Defense budget	na	na	.3*	.8*	1.8	2.0	2.5	2.3
Net imports**	.4	.5	.8	1.2	2.4	2.2	3.0	2.5*
Total resources**	1.6	2.5	3.9	5.6	9.2	10.2	10.5	11.4*

Source: *Statistical abstract,* Israel Central Bureau of Statistics.

Figure 1a

Gross capital investment, defense budget, and net imports as percentages of total resources



Note: The astounding 16 percent absolute decline in capital investment from 1975 to 1982 shows the close correspondence between Israel's economic health and the level of resources sent in by other countries. The 1975-82 drop was caused by the abrupt 16 percent fall in net imports during that period. As seen in the comparison of the 1971-75 average to the 1976-80 average, this is a long run problem, not just a product of recession.

*EIR estimates based on incomplete figures for total period.

****Definitions:** *Gross capital investment* includes all government and private investment, including all business investment, residential construction, etc.

Net imports is the net inflow of resources to Israel as measured by the balance of payments current account deficit (goods & services).

Total resources is the sum of the Gross National Product plus Net Imports.

Defense figures were classified in 1950's and early 1960's.

more than it exported, several times more during the 1950s. This subsidy not only let Israel run huge levels of capital investment, but to devote ever-larger proportions of its resources to defense spending, up to 20 percent by 1971-75.

As long as the subsidy from the outside kept growing in tandem with capital and defense needs, it seemed as if the growing defense burden could be sustained. All this changed after 1975. Due to the 1973 oil crisis, and the consequent 1973-75 world recession, Israel's real (constant 1975 shekels) net imports fell drastically, even though its balance of payments deficit in *current* value zoomed. By 1982, real net imports had fallen 16 percent below the 1975 peak. In proportion to total resources, net imports were only 17 percent in 1982 versus 25 percent in 1975.

Even though net imports fell, defense spending did not. As seen in **Figure 1a,** the war economy kept taking larger and larger slices of Israel's total economic resources.

With the military taking more resources, Israel could not afford to continue its capital investment. As seen in **Figure 1,** capital investment fell not only in proportion to total resources, but absolutely. By 1982, Israel's capital investment was 16 percent below the 1975 peak. Productivity, which had averaged 5-7 percent from 1963-75, suddenly dropped to negligible, sometimes negative, rates. GNP growth, which had averaged more than 10 percent for years, slowly ground to a halt, hitting zero in 1982, destined for negative growth in 1983. With capital investment cut to the bone, Israelis in both the ruling Likud and opposition Labour parties say the population's living standard will have to be the next sacrifice to defense's insatiable maw. Even some military planners worry that capital cuts now mean there won't be a sufficient industrial base for the military five years from now.

Israelis point say capital investment has not dropped as much as the figures say: investment persists, but it is in the occupied West Bank, and thus not included in the official figures. Roads and electrical grids are being built, but only in the West Bank. Young couples cannot find affordable housing in Tel Aviv or Haifa—and thousands of over-priced apartments go empty—but new subsidized, cheap settlements spring up to lure the young to the occupied territories.

"The cost of the 'Greater Israel' policy has been very high," says Israeli economist Gur Ofer, presently working at Harvard, "'and not only in terms of the defense budget. There is tremendous infrastructure development in the West Bank, and in southern Lebanon, at a time when Israel's own infrastructure, roads, telephone lines, and so forth are deteriorating."

Moreover, 6-8 percent of Israeli jobs, particularly in construction and services, are now filled by Arab commuters from the occupied areas at lower wages than Israelis' (though higher than on the West Bank itself.)

Through such developments, the Begin regime has "created facts" against the Israeli opponents to annexation; it has built in an Israeli dependence on continued economic ties of a colonial type toward the West Bank. This has created a fight within the Labour-affiliated Histradrut trade union federation between those who say its companies should not take construction jobs in the occupied areas, and those who say it must to avoid bankruptcy given the lack of internal Israeli construction. In the end, the Histadrut's Soleh Boneh construction firm decided to go into the West Bank.

The foreign debt crisis

The shrinking supply of economic resources, and their increasing absorption by military spending and West Bank occupation, are now manifested in a debt crisis just as bad as those of the developing countries. In 1982, 12 percent of Israel's GNP and 27 percent of its export income had to be used just to pay the interest on its foreign debt. The 1983-84 budget drawn up by Finance Minister Yoram Aridor calls for 40 percent of the budget to go just for foreign and domestic debt service, compared to 20 percent in 1982-83! Even defense may be cut in real terms to pay for the debt.

As can be seen in **Figure 2,** as long as Israel devoted the net imports to capital investment, and as long as the world absorbed Israeli exports at 20-25 percent annual rates of growth, its foreign debt had been manageable. Then came Paul Volcker and Ayatollah Khomeini, a man Begin had helped bring to power. The depression set off by these two men ended Israel's export growth and put it into an unmanageable debt crisis.

In 1983, for the first time, Israel's foreign debt service will exceed its total military and economic aid receipts from the United States, forcing it to borrow heavily on the private market to cover its trade deficit. However, its ability to repay will worsen. Exports fell 8 percent for all of 1982, but the decline accelerated to 15 percent in the fall, indicating that 1983 is likely to show the second drop in a row. Unfortunately for Israel, the majority of its exports still consists of items such as fruits, diamonds, and textiles, for which world demand is sharply dropping.

As long as the U.S. Congress continues to shell out ever-increasing amounts of new money, roll over past Israeli debts, and so forth, the debt crisis can, of course, be managed. But this process only increases Israel's reliance on the good graces of another country, hardly a prescription for political independence. Israelis report a growing resentment inside the country regarding this dependence, but they say they are not sure how to deal with it.

The "Swiss model' option

The Begin regime proposes to handle this crisis by creating a "Swiss-model" economy: an economy based on international banking, arms exports, and "technetronic"-oriented industrial exports.

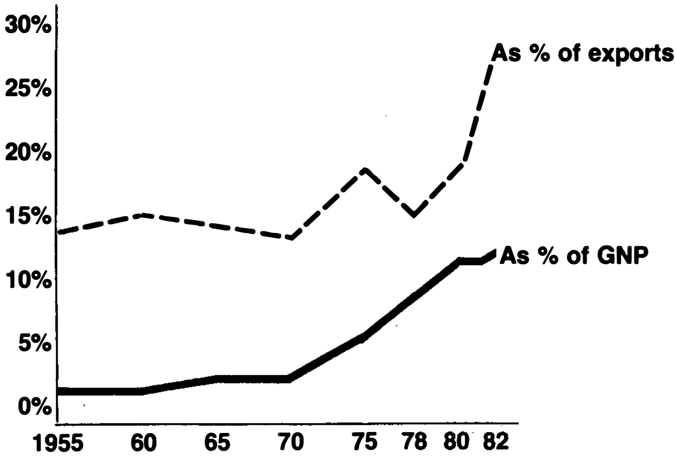
Israel's banking has mushroomed in the past years to take up, along with other business and financial services, an astounding 8 percent of Israel's labor force. Israel Discount Bank's New York subsidiary is now the 64th largest bank in the United States, and the foreign assets of the Israeli banks

Figure 2
Israel's debt and debt service
(in billions of current U.S. dollars)

Year	55	60	65	70	75	80	81	82
Total foreign debt*	$ .5	.9	1.7	3.5	10.3	21.8	24.2	26.4***
GNP**	$1.2	2.4	3.4	5.3	11.4	17.7	20.7	22.7
Exports	$ .1	.3	.7	1.4	3.8	10.1	10.8	10.2
Foreign debt service*	$.02	.05	.1	.2	.7	1.9	2.2	2.8

Source: *Statistical Abstract,* Israel Central Bureau of Statistics

Figure 2a
Foreign debt service as percent of exports, GNP



*Total foreign debt as measured by the Central Bureau of Statistics is somewhat higher than as measured by the Bank of Israel since the former includes the liabilities of Israeli banks abroad, without discounting for their assets.

Debt service is taken from the balance of payments table. It is the figure in the current account services column labeled "income from investment: payments."

Although this category includes some items besides interest on outstanding foreign debt [e.g., foreigners' repatriated profits on stocks], in the Israeli case, foreign debt payments predominate. This method may somewhat overstate the total percent of debt service to exports and/or GNP, but the trend line is not distorted. On the other hand, Israel's total payments are understated because this figure includes only payment of interest, not principal.

**The GNP figure was arrived at by taking the current value of GNP in Israeli shekels and then dividing by the average dollar/shekel exchange rate for that year.

***EIR estimate based on partial figures for period

are growing much faster than their domestic ones, and may overtake the latter in a few years.

Israel hopes to take advantage of the post-industrial switch elsewhere by providing inputs to the wired society. The Trade and Industry Ministry's post-Lebanon invasion strategy document proposes to:

- increase the share of "research and development-intensive," exports, primarily electronics and computer-oriented, to 80 percent of total industrial exports by 1990, from 30 percent today;
- raise the proportion of industrial exports to 60 percent from the current 40 percent of total [i.e. goods and services] exports. Industrial exports already comprise almost 70 percent of goods exports.
- and, raise the level of arms exports to 35 percent of total exports.

To a certain extent this path is already well under way. As noted above, Israel is now the seventh largest arms exporter in the world. During the 1970s, its electrical and electronic exports increased from a neglible $13 million to $278 million. Exports comprise half of Israel's electronics industry sales, and about 70 percent of the exports are military equipment. Other Israeli electronics firms have done well by tying into U.S. computer firms and medical technologies, e.g. CAT scanners.

Already, Israel has a very impressive level of R&D; about 1.5 percent of industrial output is spent in R&D, which the Ministry of Industry and Trade document proposes to raise to 2.5 percent, a level commensurate with countries like the United States and Japan.

Manpower development crisis

There are only two problems with this strategy. First of all, "computer revolution" hype aside, the demand for electronic goods has not been immune to the world depression. Israel's electronics-related export growth rate slowed markedly to only 8-10 percent in 1982, and actually showed a drop at a 20-25 percent annual rate during November-December.

More important, Israel lacks the capacity to create this planned "technetronic" transformation. The most serious obstacle is a manpower crisis, another victim of Begin's military budgets.

Major General Amos Horev, for the past nine years the President of Israel's prestigious Technion University, told the *Israel Economist* last October that fulfilling the Ministry of Industry and Trade's strategy requires a doubling of the number of Israeli engineers in industry from 9,500 today to 19,000 in 1991, not counting engineers in the military, service sector, educational system, etc. Under present trends, Israel cannot produce them. There has been zero growth in science and engineering graduates since 1976-77 (see **Figure 3**).

In the 1950s and 1960s, the majority of Israeli college students took science and engineering courses, but now only 25 percent do. One reason is that Begin's budget cuts have caused a deterioration in university laboratory infrastructure. In another interview, Horev pointed to a second reason: Israeli high schools no longer require physics and chemistry for graduation. Israeli economist Yoram Weiss, now working at Stanford University, told *EIR*, "A few years ago, we loosened the requirements for education in order to give the students more freedom, just as you have done in the United States. So the students decided to take business courses or computer courses rather than physics and chemistry. This is related to the shift in Israel to services." Thus the technetronic orientation itself has undermined the basis for its own continuation.

There is also the well-known problem of emigration. Sick of the living conditions in Israel, many of its brightest young people are leaving, including many engineers and scientists.

From Milton Friedman to Shmuel Flatto-Sharon

"Patinkin's Boys," they are called, the economists who dominate Israel's professoriat and bureaucracy. Don Patinkin, Hebrew University Economics faculty chief and later Hebrew University president, was trained at the Friedmanite University of Chicago. He in turn trained most of the other economists now operating in Israel's universities and bureaucracy. Other graduates of Chicago and the Chicago-allied Iowa State University include Finance Ministry director Ezra Sadan and Bank of Israel vice president Yakir Pressner.

"Patinkin is not Milton Friedman," Israelis are quick to say. "He is not for total free enterprise." Yet Friedman's hand is quite evident. He was brought to Israel in 1977 by Menachem Begin, in an attempt to handle Israel's 35 perce

of "free enterprise" including the rapid elimination of Israel's foreign exchange controls, and the turning of state-run businesses over to private ownership. The "Patinkin boys" argued that a more gradual shift was needed.

Begin followed Friedman's advice: inflation soon leaped to 130 percent, and the Israeli shekel dropped from its 1977 value of 96 cents to less than 3 cents as of this writing, with a continuing devaluation of more than 5 percent per month.

Friedmanism in not a problem only of Begin's Likud Party. Patinkin himself exercised his influence in the Labour Party. When Begin came to power, a different group of Chicago trainees came to the fore, led by Ezra Sadan.

Israel's best period of economic development was in the 1950s and early 1960s. Economic czar Pinchas Sapir, who filled various cabinet posts, used a system of state-run enterprises and governmental and semi-governmental industrial development banks to channel credit to critical development sectors, often at extra-low or even "negative" interest rates, i.e., rates less than inflation. This is the same system so successfully used by such countries as Korea and Japan.

At the same time, the Labour-allied Histadrut trade union federation ran a large number of companies through its Hevrat Ovdim holding company. One of the largest Histadrut companies, Koor Industries, at 30,000 workers, is Israel's largest employer, producing 10 percent of Israel's industrial output and 12 percent of its exports.

Even while the Labour Party was still in power, but particularly after Begin's accession, Sapir's usage of the government-associated development banks was attacked as a boondoggle partial to consumer and luxury goods. Yet, Israel's capital formation was much higher in those days than now.

In the mid-1960s, as Israel entered into balance of payments crisis, many of its Chicago-style economists argued that Israel must cut imports—by cutting economic growth! Labour Prime Minister Levi Eshkol followed this advice.

nt inflati

When Begin came to power, he steadily reduced the power of the directed credit institutions, giving much more control of credit allocation to the three giant banks: Bank Leumi, Israel Discount Bank, and Bank Hapoalim. Indeed, according to the *Jerusalem Post*, the 24 percent stock-market crash just engineered by Finance Minister Yoram Aridor is aimed at raising the banks' control of stock market investment from a 50 percent share to 75 percent.

Perhaps the most dangerous application of Chicago economics is the possible turning of state enterprises over to Dope, Inc., epitomized by the attempt, now aborted, to sell off El Al Airline to "private ownership." Israeli sources say a prime contender to purchase it was Marcus Katz, a crony of convicted drug-runner Shmuel Flatto-Sharon. Flatto-Sharon is a member of parliament in Begin's Likud bloc.

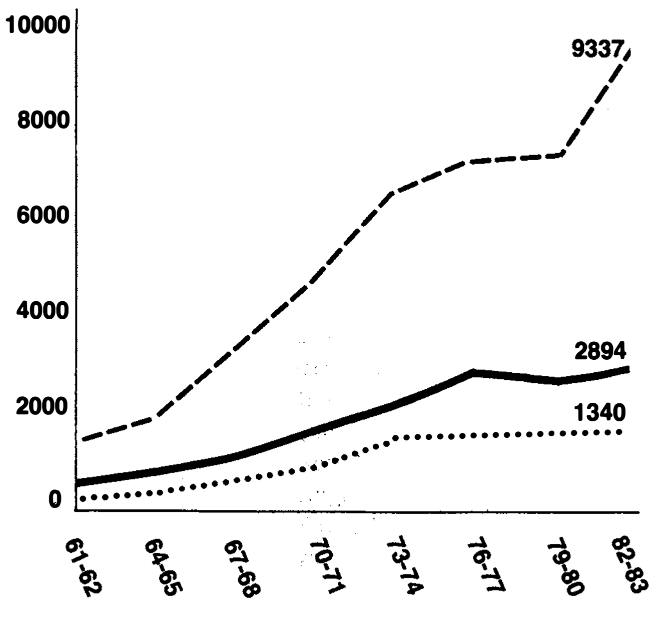
In 1981, emigration topped immigration for the first time, as 26,000 people left Israel and only 15,000 immigrated, compared to 55,000 immigrants in 1973. Indeed, from 1977 through at least 1980 (the latest figures available) the total number of Israeli Jews between the ages of 15 and 30 stayed absolutely the same at 830,000, and in 1980 the Israeli civilian labor force actually *declined* 1.6 percent.

The newcomers are highly skilled. More than 40 percent of them are professionals, academics, scientists, engineers, or technicians. But Horev complains, "though there are many engineers among the Russian immigrants, they are not in the fields of computers and electronics where most of the action is. As for the West, we have not yet been successful in winning back those Israelis who have left."

Ashkenazim versus Sephardim

The crisis of skilled manpower is exacerbated by a great social shift in Israel. Israel is changing from a nation of Ashkenazim (European-American descended Jews) into one of Sephardim, that is Jews from the Arab culture lands of Iraq, North Yemen, Egypt, North Africa, etc. Only 25 percent of the Israeli population in 1948, Sephardim today comprise 65 percent.

Figure 3
Zero growth in science and engineering graduates. First degree graduates in academic institutions per year



--- **Total (scientists, engineers and liberal arts)**

____ **Engineers and scientists**

.... **Engineers**

Source: Technion, *Manpower Development Survey*

The Sephardim for the most part are culturally more Arabic than Jewish, at least as the Jew is known in Europe or America. The social contrast between the two groups has produced an ethnic tension akin to the racial conflict in the United States, with similar degradation of the Sephardim. Of all Israeli elementary school children, 75 percent are Sephardim, 35 percent of all high school students, 12 percent of college students, and only 4 percent of post-graduate students. "Prisons have the highest percentage of Sephardim; universities the lowest," said one study of the problem. Recently, a Sephardic supporter of Begin shouted at mostly Ashkenazi anti-Begin demonstrators: "They're do-gooders; they're educated." Not only the Sephardic immigrants themselves, but their children and grandchildren suffer the disadvantages.

This ethnic conflict and lack of cultural development of the Sephardim means that Israel will have difficulty developing the manpower it needs to carry out either a technetronic orientation, or a more healthy scientific-engineering one.

There is no choice for Israel but peace. Israel should be a radiating point of science and engineering to its neighbors. Years ago, Israel became a major exporter of agricultural technology, a role which should be expanded to its own neighbors.

General Horev now heads a committee proposing that Israel develop nuclear energy. Technion Professor Arnon Dar, a member of the committee, says that Israel could also become a big exporter of nuclear technology by subcontracting on other countries' projects. Though Dar did not add this, Israel's own neighbors should be among the purchasers.

At one point Israel was working on a project for large-scale desalination of sea water using nuclear energy. The project was scrapped, supposedly for cost reasons; but this is exactly the unique kind of role for which the Arabs need Israel's talented people, whether the Arabs know it or not. One Israeli official described to *EIR* that during the initial flush of enthusiasm following the Camp David agreements, Israeli technicians and businessmen prepared projects to enable the Egyptians to modernize their textile factories with synthetics, modern processes, and so forth just as Israel had done in the 1960s. Now this project is dead, along with many others due to the collapse of Israeli-Egyptian détente, a collapse provided in large part, though not solely, by the intransigence of the "Greater Israel"-seeking Begin regime. As an Egyptian developer told *EIR* (see *EIR*, Jan. 25), "We want peace with Israel, we need peace to develop our country. The only war we want to fight is against the desert." Excitement around these kind of challenges should get Israeli youngsters back into physics, chemistry, and engineering.

This is Israel's mission. It does not have much time to decide to fulfill it. The other path now being followed leads to national suicide—a slow Masada.