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Shir Hever

The Economy of the Occupation

A Socioeconomic Bulletin



**THE OCCUPATION THROUGH THE EYES OF
ISRAELI ECONOMISTS**

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Economy of the Occupation

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The Occupation through the Eyes of Israeli Economists

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1. A Neglected Topic

DISCUSSION OF THE OCCUPATION, the settlements, prospects of peace between Israel and the Palestinians and so on occupy a central position in the political and academic discourses in Israel (notably in departments of law, sociology and humanities). However, the economic aspects of these questions do not hold a similarly central place among Israel's economists.¹

The prominent economic journal in Israel, *Quarterly for Economics*, has published very few articles that mention the occupation. Between 1988 and 2004, only six articles discussed Israel's domination of the Occupied Palestinian Territories (OPT). Only five articles mentioned the Palestinians themselves (mainly in relation to Palestinian workers inside Israel and the dangers that they pose to Israel's economy).

However, 24 articles discussed the advantages of "peace dividends" (though not necessarily using this term), and cited economic advantages to many of the peace initiatives that emerged over those 16 years. The concept of "peace dividends" will be discussed in further detail below.

Economic writing in Israel in recent years keeps the occupation in the outer periphery of its field of vision. Even overview articles that deal with long-term economic processes in Israel often fail to mention the occupation.²

One of the central reasons for this is the thorough cognitive dissonance between the main values held by neo-liberal economists (such as the free market and extreme individuality) and the patriotism expected of Israeli economists.

2. Changed Perspectives

THOUGH TODAY IT SEEKS THAT neo-liberal ideas have hegemony over contemporary economic discourse, this has not always been the case.

In the first years of the occupation, most Israeli economists were followers of several schools of economic thought: Keynesian and neo-Keynesian, neo-classical and various schools of socialist thought (ranging from moderate, social-democratic thought to radical Marxism). The study of economics was not as monolithic then as it is today, though the figure of Dan Patenkin was extremely influential in shaping the direction taken by economics departments in Israel.³

Many Israeli economists belonging to these schools of thought generally supported the occupation.

The economic boom that followed the war (resulting especially from the massive donations of money from Jewish communities)

had a profound effect on both Israeli and Palestinian societies, and made it easier for economists to speak up in favor of the occupation.⁴ Between the early seventies and the late eighties, Economists such as Arie Bergman and Haim Barkai wrote that Israel should hold on to the OPT because of their economic value. They stressed that the occupation was not only beneficial to Israel's economy, but also to that of the Palestinians.⁵

One of the first economists who noted that the occupation can cause economic "distortions" and can eventually become a burden on Israel's economy was Eliyahu Kanovski, who wrote his book for Praeger Special Studies in International Economics and Development in 1970. Though Kanovski noted the economic income of Israel from the territories it occupied, he also said that in the long run the occupation will prove expensive.

Kanovsky also celebrated the trend of market liberalization and the reduction in the government's involvement in the economy after the war.⁶

Move to Neo-Liberalism

It is difficult, perhaps impossible, to define neo-liberalism. I do not intend to probe the intellectual biography of these thinkers, but simply to offer a selection of writers who expressed mainstream economic ideas in their publications.

The strong swing toward neo-liberal economics in the US soon

arrived in Israel. The right-wing government of Menachem Begin elected in 1977 was already backed by neo-liberal thinkers, and the "stabilization plan" of 1985 was a clear implementation of neo-liberal monetarist policy. The Israeli treasurer at the time, Simha Erlich, boasted that he consults with Milton Friedman himself in matters of economic policy.⁷

From here on, I intend to focus on the neo-liberal economists who took over mainstream economic thought in the course of the eighties, and who remain central today.

3. Peace Dividends

THE MOST COMMON THEME IN neo-liberal writing on the occupation is the theme of the profitability of peace versus the damages of war. As mentioned before, *Quarterly for Economics* published four times as many articles on peace dividends than on the occupation itself between 1988 and 2004.

Broadly speaking, the concept of peace dividends focuses on the economic benefits of peace, and is often invoked to support the peace process. This idea is expressed in several ways. For example, the writers examine losses incurred before the peace process began, speculate on the future profits of peace and assess the economic costs of conflict. The articles below do not all use the term “peace dividends” openly, but the arguments they make fit this description.

Though Kanovski is probably the first to establish the theoretical framework for the peace dividends discourse back in 1970, he wrote his

book for a non-Israeli organization and in English. In 1989, one of the first articles on the subject published in *Quarterly for Economics* lamented that the government failed to shift its focus from military industries to civilian industries.⁸

As the Oslo Process began, many economists became very optimistic about the chances for peace and for economic prosperity. In 1994, a flood of economic writing emerged on the peace dividends. Stanley Fischer (later to become the chairman of the Central Bank of Israel) and Thomas C. Schelling wrote that “Peace in the Middle East will be secured only when it takes root in the everyday lives of the people in the region. That will happen if peace brings open economic relations and economic development to the peoples and countries of the region.”⁹

Six years later, Oren Gross published a paradigmatic article on the peace dividends. The article,

“Mending Walls,” describes the benefits of peace, and why it is in Israel’s interest to improve the Palestinians’ economic conditions. “The economic dividends of peace can bolster political compromises and agreements, both on the individual and the communal-national level.” More specifically, the article suggests that raising the Palestinians’ standard of living is critical to strengthening peace. As such, it is as much an Israeli interest as it is a Palestinian one.¹⁰

Another prime example of the peace-dividends argument is a booklet on the economic effects of security threats published by the Israeli Institute for Democracy in 2002. The authors, a group of Israeli economists, suggested that the threat of terrorism causes people to expect an earlier death, and therefore to privilege the present over the future. According to the Permanent Income model,*

preferring the present makes people feel poorer and brings down their spending.¹¹

However, we must remember that the Permanent Income model is based on the assumption of an infinite lifetime, and therefore cannot be used to draw conclusions based on consumers’ expectations to die early. The authors have neglected this logical contradiction in their attempt to argue that terrorism leads to a reduction in consumption, and therefore to the slowing of the economy. As this article was written by a group of economists and not a single economist, the question of why they engaged in such logical acrobatics is even more poignant. The writers’ desire to argue for peace dividends, and the need to prove that terrorism leads to the slowing of the economy, was apparently extremely strong.¹²

A similar argument was made back in 1999 by Dorit Nevo and

* The Permanent Income Model, developed by Milton Friedman, suggests that people expect an infinite future and adjust their expenses with an expectation of income from now to eternity. Friedman argued that rational decision-making balances the desire to consume as soon as possible with the prudence of waiting for the benefits of interest to accumulate, thus choosing a smooth rate of consumption (which can gradually increase, decrease or stay the same over time).

Mordechai Shechter in their article, “Economic Estimation of the ‘Cost of Anxiety’ Following the Bombing of Kiryat Shmona.” This article estimated the economic losses inflicted by violent conflict by analyzing the effects of Hezbollah mortar attacks on real-estate prices in the targeted areas. The anxiety damage alone was estimated at about US \$0.5 billion.¹³

In 1997, Nil Gandal, Sarit Markowitz and Haim Fershtman published the article “The Israeli Car Market and the Arab Boycott: The Peace Dividend.” The article estimated that the peace dividend for car purchasers alone is about US \$1,940 per year per consumer since 1995 (for an average of US \$219 million every year since 1995). The “dividend” comes from the lifting of the Arab boycott as a result of the peace process. It is clear that the authors were hoping to prove that the peace process is beneficial to the Israeli economy. Though a strong patriotism underlies their argument, they were willing to go as far as using an argument that could draw accusations of defeatism: that

the Israeli economy benefits from the lifting of sanctions by its age-old enemies.¹⁴

An article published in 1998 by Dov Dvir, Aharon Hauftman, Zadok Hugi, Asher Tischler, Mordechai Sokolov, Yair Sharai and Aharon Shenhar, “Civilizing Military Technologies in Israel,” attacked the notion that the military industry can lead technological advances by claiming that in Israel military technology was poorly absorbed into the market. The article made a clear distinction between “real profits” – profits generated by civilian companies -- and military profits that are somehow “false” because they don’t turn into civil profits fast enough.¹⁵

In 2004, Zvi Eckstein and Daniel Tsiddon published “Macroeconomic Consequences of Terror: Theory and the Case of Israel,” where in addition to describing the various costs of the conflict with the Palestinians, they also discussed the costs accruing from the political upheavals brought on by the occupation. The two claimed that the collapse of governments and the frequent

elections in Israel is a result of the occupation.¹⁶

But the peace-dividend argument goes both ways. One side of the argument is that peace can lead to economic prosperity. The other side is that economic prosperity can lead to peace. The neo-liberal economic approach claims to be able to model human behavior according to economic factors.

An example of the other side of that argument is an article published in 2004 by Allen B. Krueger and Waytaka Malchkova. The article was titled “Education, Poverty and Terrorism: Is there a Causal Relation?” The authors tried to show that poverty correlates to participation in terror attacks. They have used survey data regarding people’s propensity to support acts of violence against Israel as an indicator for that relation.

Though their data failed to support their claim, the authors defended their argument. They admitted that the data doesn’t show

a causal relation between socio-economic conditions and political opinions associated with terrorism (according to the authors’ definition of terrorism), but were not willing to change their underlying assumption that such a connection exists.¹⁷

Economists often rely on GDP figures* to support their point. Basing their argument on the claim that GDP is a good representation of economic prosperity, they cite the rise in GDP in Israel during the nineties (between 1995 and 2000 GDP increased by 25%) as proof that the Oslo peace process contributed to the Israeli economy.¹⁸

After the outbreak of the second Intifada, there was a surge of research attempting to estimate the costs of the occupation. Such studies included research by Dror Tsabani,¹⁹ an extensive research project conducted by the *Haaretz* newspaper,²⁰ a paper by Naor Gamliel²¹ and research by the Adva Center.²² The most famous and widely-discussed study was published by Sh-

* GDP, or Gross Domestic Product, is a measurement of the total volume of economic activity in a given country (how much money changed hands). It is widely criticized because the concept doesn’t differentiate between very different kinds of transactions.

lomo Swirski in his book *The Price of Occupation*.²³

These studies suggest that the costs of the occupation apply to Israeli society as a whole, as a form of foregone utility from lost venues of investment. The implied conclusion of these studies is that Israel has a lot to gain by terminating the occupation – and the only question is how large this peace dividend really is.

The list of Israeli economists using the peace-dividend arguments would not be complete without celebrated economists such as Ariel Rubinstein, Arie Arnon, Dan Ben-David, Eitan Berglas and Haim Ben-Shachar, who pointed to the economic burden of the occupation on the Israeli economy even before the second Intifada.²⁴

When applying the peace-dividend logic, Israeli economists tend to maintain a dual perspective. Their economic ideas are often associated with the right, while their political

ideas are associated with the left (or at least the moderate left) in Israel's political framework.

The alliance between the economists and the proponents of the peace process, an alliance fortified over the nineties, is most forcefully manifest when peace dividends are discussed. Through such arguments, the economists reclaim from military commanders and "security experts" the right to decide on policy and planning. Many Israeli economists stress the urgent need for radical neo-liberal reforms to be performed as quickly as possible. Their argument is that the burden of the occupation makes the Israeli market ill-equipped to face the burden of a strong welfare system as well, and that the "emergency situation" calls for massive privatization and deregulation. Thus, the economists argue against the occupation and at the same time use the occupation to strengthen their calls for economic reform.²⁵

4. Development Logic

PARALLEL TO THE RISE OF PEACE-dividend arguments referring to the Israeli economy, development logic, which is a long-standing part of foreign-aid planning ever since the Bretton Woods agreements in 1944,* echoes similar arguments in reference to the Palestinians.²⁶

Development logic is a widespread theme of economic writing, especially popular in UN and World Bank publications. At first glance, it is no different than the logic of peace-dividends thinking. In general, development economics focuses on finding ways to create lasting economic assets which will contribute to economic prosperity in the long run.²⁷ Just like the concept of peace dividends, development economics stress that prosperity can reduce violence, but also requires a reduction of violence.²⁸

One of the main arguments repeated in development texts is that

investments, which are necessary for development, require security, and that political instability reduces the faith of investors who tend to withdraw their money until calm is restored.²⁹

Many development texts manifest a strong tension between their reliance on a neo-liberal scientific vocabulary (promoting investment, competition, reducing uncertainty etc.) and the political agenda that they promote. The texts seem to draw a clear distinction between the “economic” and the “political” spheres.

One example of such tension, Elizabeth Ruppert Bulmer’s article “The Impact of Israeli Border Policy on the Palestinian Labor Market,” attempts to apply a model usually used to describe Africa to the Palestinian case. The economic model, originally proposed by John Harris and Michael Todaro, sug-

* The agreements, signed in the wake of World War II, created the International Monetary Fund and the International Bank and established the foundation of international exchange rates.

gests that workers risk migrating to places with high unemployment because they make a calculation of their mean expected wage. This means that under certain circumstances, even a small chance to earn a very high wage can convince a worker to forego a low-paying, secure job. Bulmer claims that Palestinians seek work in Israel for the same reason, despite the fact that many of them fail to find any work in the end. The attempt to simplify the economic situation and put it in terms of a single model forced Bulmer to make an artificial division between “economic” and “political” factors, and to disregard everything that she deems “political.” Development therefore remains a “non-political” concept, relying on political factors but generally describing the transformation of one set of economic factors into different economic factors. Thus Bulmer can claim that development falls under the expertise of economists.³⁰

So what is the difference between peace dividends and development logic? The concepts seem almost identical in their content.

Yet these concepts, which are widely used around the globe, are very clearly divided when it comes to Israel and the OPT. While the peace-dividend concept is used exclusively to describe the Israeli economy, development is used almost exclusively to describe the OPT economy.

This distinction is rhetorical, and must not be underestimated. The term dividends normally applies to funds due to owners of a stock. It implies profit and ownership. The term peace dividends therefore implies that the peace is owned by Israel. The term development, however, reminds one of the distinction between “developed countries” and “developing countries.” The fact that the term applies only to Palestinians suggests that economists see the Palestinians as under-developed. Though one could argue that indeed the Palestinian economy is not as developed as the Israeli economy, the terminology also creates an image of Palestinian immaturity. While the Palestinians can only hope to develop, Israel is already reaping the profits of ownership.

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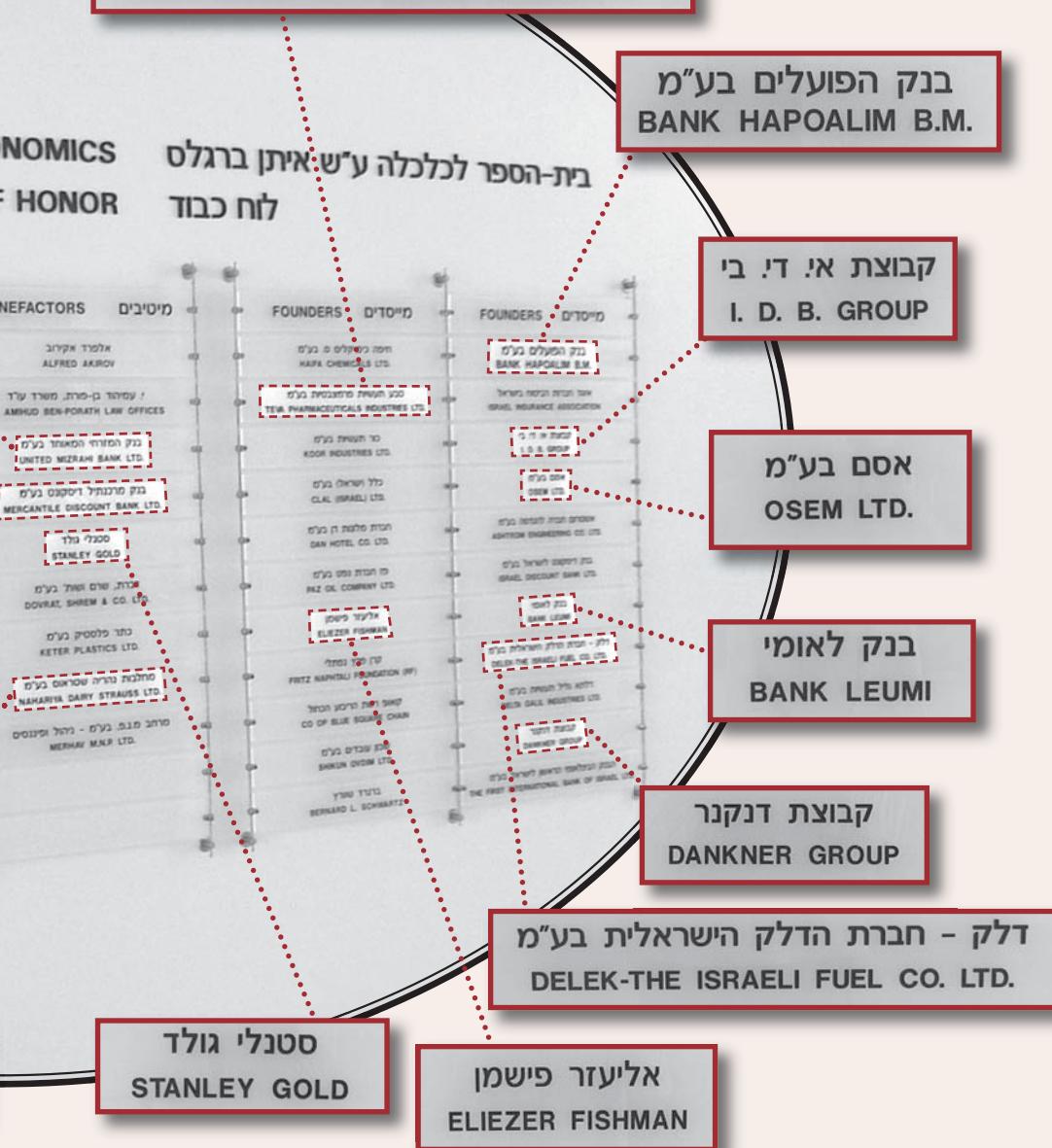
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5. Economic Union and Political Separation

THOUGH MOST CONTEMPORARY economists are staunch supporters of the peace process, there is still heated discussion as to what shape this peace should ideally take. The main source of contention is between the supporters of a union between Israel and the Palestinians, and those who support separation. The idea that the Israeli and the Palestinian economies should be united is a very old one, suggested by the UN in the 1947 resolution calling for the establishment of Israel and the Palestinian state. Israel's declaration of independence responded to that suggestion favorably.³¹ Yet after the 1948 war, closed and hostile borders stood as obstacles to economic cooperation.

Aba Lerner, one of the founding fathers of Israeli economic thought in the fifties and sixties, was also one of the first to note that the occupation of the OPT has reopened the possibility of economic unification.³²

The economic advantages to Israel from such unification are clear – access to cheap labor, a captive market for Israeli goods and improved transportation. Aba Lerner was therefore not alone in his call for economic unification.

According to Yoram Meishar, a senior professor of economics in the Hebrew University, "Economists express an almost unanimous opinion on the desirable relations between Israel and the Palestinian entity. Almost all of the Israeli, European and American Economists who participated in formulating economic plans for the region support the approach that a completely open economic border is both possible and desirable. They suggest that economic cooperation can lead to prosperity for the two peoples and for the entire Middle East, and the tighter this cooperation the better. Economic welfare gained this way will strengthen pragmatic and democratic currents and thus safe-

guard regional stability and security for Israel in the best possible way.”³³

Meishar himself, however, is highly critical of this view, and strongly opposes the idea that “co-operation can lead to prosperity.” He also stresses that the Jewish character of Israel might be jeopardized by continuous contact with the Palestinians, and that this is more important than the possible gains from trade.³⁴

Efraim Kleinman’s 1994 article “Peace and Trade with Neighbors” suggests that free economic trade can be an alternative to labor movement – cheap goods produced by Palestinians can enter Israel freely instead of Palestinian laborers.³⁵

Another example of the belief that peace should be accompanied by an economic union can be found in Yuval Elizur’s book *Economic Warfare*.³⁶

One of the strongest examples of the power of economic-union logic is the Paris Accords. The Paris Accords are the economic attachment to the Oslo Accords, and were signed in Paris in April of 1994. The accords stipulate two main

clauses of economic unification – a customs-union and the free movement of Palestinian workers into Israel. Though Israel broke the agreements, the economists who helped to formulate them left their mark on the so-called peace process to this day.³⁷

It should be noted that all of the Israeli economists mentioned here who suggested economic unification assume that this unification will reflect Israeli interests, that the Israeli government will have almost full control over the joint economy, and that the Palestinians will make none of the important decisions regarding the nature of the unification.³⁸

However, some Israeli economists thought that Israel might have only tenuous control at best over the joint economy, or were afraid that economic union can lead to an influx of Palestinians that will threaten the “Jewish majority” in Israel.³⁹

The Bruno committee, formed by the government immediately after the 1967 occupation, urged the government to prevent the move-

ment of Palestinian workers into Israel (while allowing the movement of goods). The committee's recommendation was promptly rejected in 1968 by a ministerial committee which responded to the pressure of Israeli businessmen who wanted to hire Palestinian laborers.⁴⁰

The arguments against an economic union are still prominent to this day. They are notable in the Israeli treasury's 2005 report on

"how Palestinian workers damage the Israeli economy." The report, prepared by economists working in the Israeli treasury, lists numerous undesirable results from the presence of Palestinian workers in Israel, and relies on economic theory to claim that Israel should limit their entrance. The report uses economic logic to bolster the government's political desire to cut the Palestinians out of Israel's

The Aix Group

The joint Israeli, Palestinian and International group of economists who met in Aix in France in 2004 offers a unique example of an economic discussion which is not obviously associated with specific national interests. The group published a report called the *Economic Roadmap*, which attempted to outline the economic conditions for a viable peace between Israel and the Palestinians.

The group's argument echoes the main claims of peace-dividend and development economists. The "Roadmap" openly suggests that viable economic solutions are necessary for a reduction in violence. At the same time, it assumes that a reduction in

violence will indeed occur, and consequently that their suggestions can be implemented. The "Roadmap" thus clearly belongs to the peace dividends/development logic movement in economic thought.⁴³

One example of this logic is the Aix group's claim that for Palestinians, the economic returns for education are too low because of the relatively high wages they can earn in Israel for unskilled work. The economists therefore recommend limiting the possibility of Palestinian workers' entry into Israel. Their assumption is that this will increase the return to education – a development-economics view.

Yet the group's need to stress the usefulness of a peaceful solution and

economy.⁴¹ This is one of many examples of economic reasoning adding an aura of “science” to what would otherwise be merely politically-motivated policy.

In addition to Yoram Meishar’s argument, which is an example of an Israeli-nationalist objection to economic unification, there were also economists who took Palestinian interests into consideration. Arie Arnon and Avia Spivak wrote

of economic separation has blinded them to the reduced income the Palestinians will suffer as a result of the move they propose. Preventing Palestinians from working in Israel might indeed increase the relative economic return to education, but at the cost of lowering the absolute income of the Palestinians as a whole. This point was not mentioned at all by the group.⁴⁴

The calls to lower taxes and minimize regulation that appear in the Aix Group’s publication, as well as the recommendation to lower the wages of Palestinians so as to make them more “competitive,” also identify the group as belonging to the neo-liberal school of thought. The Aix Group also assumes that the Palestinians will want

an article in 1995 about the losses to the Palestinian economy because Palestinians could not create their own separate coin.⁴²

All told, the reigning consensus among Israeli economists calls for a compromise – not a full economic union with the Palestinians but rather a return to the proposal of the Bruno Committee in 1967 – the free movement of goods but not of workers.

to become members of the World Trade Organization (WTO), and suggest adapting many of the definitions and procedures of the WTO to the agreement between Israel and the Palestinians.⁴⁵

On the question of separation vs. union, the group adopts the mainstream concept that there should be an economic union in most aspects, but that there should be a separation of labor. This is one of the rare instances wherein Palestinian economists call for a gradual halt of the movement of Palestinian workers into Israel. At the same time, the group advocates keeping a unified currency and creating a joint monetary committee to regulate the currency and share the profits gained by controlling it.⁴⁶

6. Right-Wing Economists

OF COURSE, NOT ALL ECONOMISTS are opposed to the occupation.

One anthology, a publication called *Judea and Samaria Studies*, published by the Judea and Samaria College in the occupied territories, demonstrates the researchers' efforts to justify the occupation.⁴⁷

Daniel Freeman and Hovav Tel-paz wrote an article offering a model which was intended to make it easier for Israel to decide on economic policies for the occupied territories, and to assess the damages of the first Intifada. The work invested in producing the model clearly demonstrates the writers' assumption that Israel will continue to control these areas.⁴⁸

Another article in the same anthology (by the same authors) focused on economic and demographic characteristics of the Palestinians in the OPT. The article put special emphasis on the damages of the first Intifada to the Palestinian lifestyle, but this focus is in fact a narrative chosen by the authors to support their own views. The article constructs a causal relation between the Intifada and the drop in Palestinian quality of life, though the statistical data presented there could as easily have been read to show the reverse – that the drop in Palestinian quality of life led to the outbreak of the Intifada.⁴⁹

7. Conclusions

SINCE THE OCCUPATION IS administrated by the Israeli government, it serves as a powerful force centralizing the Israeli economy.⁵⁰ The withdrawal from Gaza, the construction of the Wall of Separation, and the plans formulated for selective withdrawals in the West Bank are all large-scale economic projects implemented with government money.⁵¹

By attacking government policy and warning of the economic crisis that the occupation is creating, the economists are also fortifying their own professional prestige and their agenda for the liquidation of state control over the economy.

But Neo-liberal economists assume that humans act rationally to maximize economic gain, and that non-profitable ventures are bound to eliminate themselves.⁵² There is therefore a profound paradox in the very way contemporary economists think about the Israeli-Palestinian

conflict: if the occupation isn't economically profitable, why does it continue?

A simple way out of this paradox is to argue that the occupation is in fact profitable for Israel. But this is a very difficult argument to make because of the heavy costs of maintaining the occupation.⁵³

Such an argument has been adopted mainly by Marxist economists, who have consequently suffered from an unpatriotic image. This argument presents Israel as a colonial power and undermines the legitimacy of the occupation in the eyes of Israelis and the international community.⁵⁴

Though neo-liberal economists control the mainstream of economic thought in Israel, there is a scientific and a political price they are paying for that hegemony. They have so far failed to incorporate the occupation into their theory, and have also failed to stop it.

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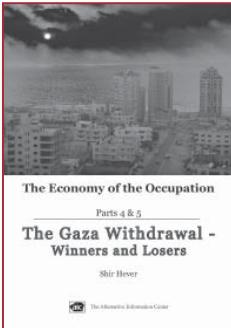
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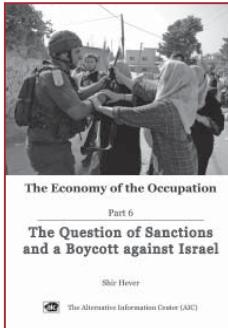
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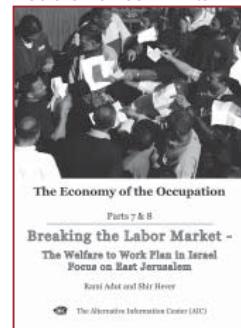
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