Sam Peltzman

The founders of the Jewish state had a specific secular vision of what it meant to be a "light unto the nations." Israel was to be a socialist state that would provide an exemplar for all mankind. That vision was never fully implemented in the classic sense of government ownership of the means of production (though there was much of that). However, the role of the state in the first fifty years of Israel's economic life has been pervasive. This will be much less true in the next fifty years.

While Israel's founders never eradicated capitalism, they did establish a principle that no important economic problem could be solved without heavy government involvement. Wasn't building industry important? Then the state should encourage it. Shouldn't exports be promoted? Then the state should subsidize them. And was not immigration the *raison d'être* of Israel? Then the state should subsidize that as well. How to house all these immigrants? Much too important a task to be left to the market. Housing would be the state's responsibility. Indeed, in its first fifty years Israel became identified with the Israeli *state* in the minds of many diaspora Jews and Israelis. For example, the Israel Bond Committee ingrained the idea that lending to the *medina*—not to Israel the country, but to the State of Israel—was the most important way diaspora Jews could identify tangibly with Israel. And even sophisticated Israelis still cling to an exceptionalist vision, which justifies continued heavy state involvement in the economy.

One reason for the durable hold of the founders' socialism is its putative success. After all, the fragile enterprise has survived and flourished against great odds. The old order is, however, slowly decaying, and very little of it will survive the next fifty years. Israel is now a developed economy that has to compete in a world economy. Its founding institutions have become a millstone that will be cast off, either by explicit decision or by the working out of market forces that the Israeli state cannot control. Consider, for example, the development of Israeli industry. From the beginning, the decision on which industries were to grow was heavily influenced by state subsidies and controls over the allocation of credit. In many cases this led to the establishment and perpetuation of uneconomic industries which continue to drag down per capita incomes. Perhaps more important, the pervasive state involvement created a culture of "rent seeking." The successful Israeli was the one who figured out how to get the biggest subsidy, not the one who invented the better mousetrap. From the point of view of the whole economy, this pitting of the best minds against one another in a race for state favors is a waste.

The result of the predictable inefficiency of Israeli economic policy has been a continued gap in per capita incomes between Israel and most of the developed world, where Jews have to make their own way in the marketplace. That gap has essentially nullified the founders' dream of massive Aliya from the developed world, and it continues to exert a powerful pull on talented Israelis to seek their fortunes elsewhere.

In a world where talent is increasingly mobile, perpetuation of this income gap would have portentous implications for Israel. But the same market forces work against the status quo. They are slowly changing it and, I believe, will ultimately reduce the role of the state to approximately what it is in the rest of the developed world—which is to say very large but not primary.

The most visible example of what I am talking about is the recent growth of Israeli high-tech industry. While state subsidies for this have not been trivial—they never are in Israel—they have not been decisive. The Israeli inventor of the better mousetrap can now secure capital from venture capitalists in California perhaps more easily than in Israel. And the mousetrap will have to survive worldwide competition. But if the capital is secured and the product succeeds in the marketplace, this Israeli can expect rewards about as large as a similarly talented individual anywhere. For this individual, the continued tight grip of the Israeli state on local capital markets, and the continued protection by the state of domestic industry, become mainly irrelevant.

It is not fully appreciated how far this marginalization of the state in Israel has already proceeded. One indicator is the increased inequality of income, which now approximates that in the rest of the developed world. The tendency of markets to equalize the reward to mobile talent is an important reason for this. Thus market forces have already rent asunder the passionate egalitarianism of Israel's founders.

Fifty years from now, Israel's integration into the world economy will likely be complete. There is simply very little the state can now do to stop this without severely compromising the viability of the entire Zionist enterprise. It could, for example, try to lay heavy taxes on high incomes. But this will only encourage a self-defeating "brain drain."

There are those who claim that these international market forces work against the unique Jewish character of Israel, by facilitating a homogeneous global culture which "knows no borders." But the "normalization" of economic life can only enhance Israel's specifically Jewish character. It will help break the connection between the Jewish community and the state, a connection that has promoted a self-perpetuating economic oligarchy and has suppressed Jewish creativity. It will help Israelis overcome a subtle, but corrosive, negative self-image ("So, why are you so crazy as to emigrate from America?"). And it will finally allow Israel to become what its founders hoped—a place to which Jews everywhere could aspire to belong, physically as well as emotionally.

Sam Peltzman is a professor of economics at the University of Chicago Graduate School of Business.