Revenge of The Social Lobby

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In July 1985, Israel faced the most serious economic crisis of its history. Inflation was spinning out of control, and economic growth was grinding to a halt. Over a decade of huge government deficits had created a public debt equaling more than two times the annual Gross Domestic Product (GDP). The country had nearly exhausted its international credit, which was necessary to finance essential imports of machinery and raw materials. To deal with the emergency, the national unity government under the leadership of Prime Minister Shimon Peres implemented a set of broad economic reforms known as the Economic Stabilization Program. While the immediate aim was to bring inflation under control, it was understood that long-term recovery would depend on ending the government's deep involvement in the economy, and on extensive market-based reforms to restructure the business sector. The highly successful program enjoyed widespread popular support, as well as cooperation from the business community and organized labor, and was maintained for close to a decade by a broad political consensus.

In recent years, however, the project of reform has come under sustained attack by Israel's emerging "social lobby." This unofficial coalition of members of Labor and Likud, the newer Shas and Gesher parties, members of the Yisra'el Ba'aliya immigrants' party, as well as other smaller parties and extraparliamentary groups, is fueling a resurgence of étatist economic sentiment, and with it an intensifying clamor for new, costly social programs, a loosening of fiscal restraint and general abandonment of the commitment to reform.

What unites these disparate forces is the claim that the free market has a disproportionately harsh impact upon those members of society who are least able to fend for themselves, and that as a result it alienates them from society and increases social polarization. Echoing the rhetoric of social-democratic parties in France, Germany, Sweden and elsewhere, they claim that a magnanimous government can create a society more compassionate and unified than is possible in "vicious," profit-driven economies such as those of the United States and Great Britain; they view the recent electoral victories of social-democratic parties in Europe as a harbinger of their own political triumph in Israel.

But the social lobby's arguments, both economic and social, are wrong. The European states, their model for emulation, demonstrate spectacularly just how such policies fail, and how they will fail if they are applied in Israel. Their social-democratic economic ideas have long been discarded by economists, and their policy proposals are destined to worsen the very problems they seek to alleviate: Unemployment, poverty, social solidarity. Yet despite this, the social lobby's political ability to affect economic policy has increased dramatically in recent years, undermining the resolve of those who would complete the project of market reform. Given the keys to the Treasury, they may undo all that has been gained since 1985, and place Israel back on the road to economic instability, or even disaster.

II

To understand the danger involved in undermining the reform effort, one need only consider the state of the economy prior to 1985. For decades, successive Israeli governments had pursued irresponsible fiscal policies, living well beyond their means. Spending began to rise after the Six Day War of 1967, and accelerated further after the Yom Kippur War of 1973. From 1973 to 1984, government spending averaged 76 percent of Israel's annual Gross Domestic Product. Although Israel's defense burden grew during this period, only a third of total government expenditure was directed to the military. Most of the rest was in the form of government grants and subsidies to individuals or to businesses. The budget deficit averaged a gigantic 18 percent of GDP during this period, fueling a massive rise in inflation. By mid-1985, annual inflation stood at 460 percent.

Besides running up inflation, the budget deficit also resulted in a large and growing trade deficit, which had to be funded by borrowing heavily in foreign exchange. By 1985 Israel had just about exhausted its foreign credit.[1] Had the economic profligacy continued, the international financial community might have cut off credit to Israel, abruptly halting Israel's ability to pay for imports: Food, fuel, weapons, raw materials for industry. The consequences would have been incalculable—and disastrous.

For most Israelis, the experience of the early 1980s was harrowing enough to convince them to support a program of far-reaching reform. The stabilization program of 1985 was only the first, if most urgent, step in a series of market-oriented measures. The government withdrew its subsidies in a broad range of industries. The annual deficit fell below 5 percent of GDP, and the budget gradually declined from over two-thirds of annual GDP in 1986 to the current 47 percent. This reduced the government's need to borrow, brought inflation down to single-digit figures, and encouraged private saving and investment, which became an important part of the Israeli economy. Private enterprise created whole new industries in computers and other high-tech areas. As privatization began to pick up speed during the 1990s, foreign trade was liberalized. Since 1995, most of the banking sector, which had been nationalized in 1983, has been sold into private hands. In 1997 the shekel, long subject to exchange controls, was made a fully convertible currency.

The rehabilitation of the economy which began with the 1985 reforms was responsible for the economic successes of the early 1990s, when the performance of the Israeli economy was truly remarkable. Between 1990 and 1996, investment rates rose rapidly, and the economy grew by almost 50 percent. Six hundred thousand new jobs were created, an increase of over 40 percent. In absolute terms, this was more new jobs than either the French or Italian economies, with their vastly larger populations and workforces, created in the same period.[2] This made it possible to absorb the huge wave of immigration from the former Soviet Union, which added over a quarter million new workers to Israel's labor force. Among immigrants who have been in the country for at least five years—and this now includes the majority—unemployment rates today are no higher than for other Israelis. During this period, per-capita income in Israel rose by nearly 30 percent, notwithstanding the addition of hundreds of thousands of Russian immigrants to the country's population.

For nearly a decade, the economic stabilization program enjoyed considerable prestige, even during hard times. The spirit of fiscal responsibility which had taken hold of the political community was so strong that in 1988, Finance Minister Moshe Nissim rejected the Bank of Israel's advice to devalue the shekel in the midst of a transitional recession—because he feared the political consequences of being thought soft on inflation.[3] Economic reform and privatization were popular enough for both major parties to include them in their election platforms in 1988 and 1992.

Yet beyond adhering to specific economic policies, it is significant that during the years after 1985 the political community in Israel subscribed almost universally to the *idea* of reform—that the nation's economic future, even its long-term survival, depended on the economy being transformed from one dominated by government expenditure and regulation to one where market forces and economic freedom reign, the government endeavors to live within its means, and prosperity and welfare are attained through economic growth. It is the erosion of this consensus in recent years that has cast doubt upon the entire project of reform, and upon the country's economic future.

III

The principal threat to the idea of market reform has come from an emerging political coalition that includes several new populist parties—David Levy's Gesher party, the Sephardic-religious Shas party and Natan Sharansky's Yisra'el Ba'aliya—as well as a revitalized social lobby within the Labor and Likud parties. Though differing widely in both theory and rhetoric, these political actors are united by a skepticism regarding market reform and by a political agenda that calls for increased public spending on social programs and greater government intervention in the economy—in essence reversing the commitment to reform that was the crowning achievement of 1985, and seeking a return to the economic étatism of Israel's past.

Leading the change are two parties which represent the interests of Israel's putative underclass: Gesher and Shas. Together these parties presently control fifteen seats in the 120-seat Knesset. Each stands for more spending to help the poor and traditionally disadvantaged, particularly in the development towns, and more government control over wages and employment. As a member of the government coalition in 1996-1997, Gesher wielded considerable influence in promoting social legislation, twice forcing the government to surrender important budgetary objectives in exchange for continued support. It also supported a 13-percent hike in the minimum wage in 1997. At the end of the debate over the

1998 budget, Gesher left the coalition, even though the government had in effect sacrificed its deficit target to meet this faction's demands for increased spending for the poor in development towns.[4]

Of all the social-spending parties, however, it is Shas which is most influential—and, in the long run, probably the most important. Shas currently controls the Interior Ministry and the Ministry of Labor and Welfare, and has been Israel's fastest-growing political movement over the past decade. Through its system of schools, yeshivas and social welfare programs, this relative newcomer to Israeli politics has won the allegiance of an increasing percentage of the populace, making it the third-largest faction in the Knesset, after Labor and Likud. Originally organized to serve religious interests, in recent years Shas has come to champion its constituents' material interests as well: Like Gesher, it depicts Israeli society as fundamentally divided into the "haves" and the "have-nots," the latter being, for the most part, poor Sephardim who are burdened with bad jobs, high unemployment and exposure to crime and drug abuse, and whose children go to poor schools, leading to more bad jobs and unemployment. And, like Gesher, Shas' principal economic goal is the redistribution of wealth to its constituency, ostensibly to relieve the income inequality prevalent in Israel today.

A prominent party leader, Minister of Labor and Welfare Eli Yishai, describes Shas as a party with a social agenda as well as religious and ethnic goals. Yishai was responsible for creating the "Council for the Fight Against Poverty," a committee of political, social and labor leaders dedicated to increasing government welfare programs. At the Council's well-publicized and well-attended opening session, Yishai described Israel as a "divided society" that discriminates against its weaker elements. Yishai's view is that the task of sustaining the weak falls properly on the state, as the "agent" of the public: "I believe that a determined decision by the state to reduce income differentials, backed by the funds required to achieve this, can bear fruit," Yishai stated. "If we allow market forces alone to determine the course of our lives as a society, we will find ourselves ... without a market and without a society."[5] When the government's economic goals for the 1998 fiscal year included an inflation target and a fiscal deficit target, Yishai called upon the government to adopt as well an "unemployment target" of seven percent in 1998—which would have effectively negated the government's commitment to these other targets.[6]

Yet Israel's new "social lobby" is not confined to the smaller factions. In both major parties, Likud and Labor, anti-reform ideas have been adopted by ambitious young politicians. Likud leaders such as Minister of Tourism Moshe Katzav and Finance Minister Meir Shitreet, for example, have consistently called for increased social spending. In Labor, a large number of MKs, encouraged by the recent victories of social-democratic parties in Europe, have begun advocating European-style social democracy, in which the "weakest" segments of society are systematically protected from the supposed brutality of the free market. Their most notable figure is Shlomo Ben-Ami, a professor of history at Tel Aviv University and former ambassador to Spain. Ben-Ami first entered the Knesset in 1996, at the very bottom of the Labor list, but he quickly rose in the ranks to run a close third in the 1997 election for party chairmanship, on the platform of recasting Labor as a "social party."[7] In the Labor primary which took place in February of this year, Ben-Ami won the top position on Labor's list.[8]

Ben-Ami's main message is the continuing relevance of socialism in solving the problems of cultural and social polarization in Israeli society, problems he maintains have been worsened by market reform. According to him, the free market necessarily creates poverty, unemployment and increasing income differentials; it is both unethical and a social failure.[9] Echoing the fears of his European counterparts about competitive challenge, Ben-Ami claims that "the global market has brought about social fragmentation.... A society that derives its values from the principles of the free market, as Israeli society does today, condemns itself to social destruction." Social democracy, on the other hand, means public policy with a conscience, in which government largesse reflects a unified society which takes care of its own. To this end, Ben-Ami advocates "a policy of reducing social gaps," a master plan to fight poverty through legislation that will guarantee everyone a job, provide universal public pensions, and strengthen labor unions—all in order "to prevent the penetration of market principles into social thought."[10]

Ben-Ami's line of reasoning has found favor in a number of political and intellectual circles. Ovadia Soffer, a Likud activist and former ambassador to France, adds to this viewpoint a particularly alarmist element. He writes:

> The experience of most Western countries proves that complete [economic] liberalization and the privatization of national resources hurts the economically disadvantaged, and causes unemployment and serious social problems that have caused changes of government in most European countries. Economists and thinkers [in Europe and Japan] are calling for a revision of contemporary capitalism. They identify the source of evil in the slow rate of economic growth, caused by the erosion of economic demand.... Income differentials cause tensions, conflict, and the rise of extremists. The racist party of Le Pen won 15 percent of the vote in France....[11]

This, in a nutshell, is the contemporary European social-democratic critique of the market.[12] The market causes unemployment, because international investors refuse to recognize the productive potential of Europe's highly skilled (though rather expensive) workers. Growth is slow because demand is depressed, so economic policy should be Keynesian: Spend public money, put the workers to work, and they will stimulate demand, which will spur growth. The market causes social inequality, which generates social unrest and votes for Jean-Marie Le Pen. Soffer recommends that Israel "learn the lessons" of the European experience by stimulating employment, and broadening and deepening the social safety net for the disadvantaged. Like the European politicians and publicists who are the source of his analysis, Soffer ignores nearly everything that economists have to say about the causes of Europe's high unemployment and slow growth and the remedies for them; he opts instead to repeat classic étatist formulae.

Similar beliefs have been expressed by influential movements in recent years. One of these is the Mizrahi Democratic Rainbow, or "Keshet." Keshet views Zionism as the ideology of Israel's dominant Ashkenazi elite, and the State of Israel as the political construct this elite created in order to perpetuate its hegemony. One movement spokesman, Tel Aviv University political scientist Yoav Peled, has declared that liberal economics is nothing more than an attempt by the Ashkenazi Labor elite "to free economic activity of political and social obligation and establish it on the pure profit principle."[13] Peled writes, "A policy of tax reduction and reducing social services benefits taxpayers and harms the users and administrators of public services; it is, in other words, a redistribution of resources from the have-nots to the haves…."[14] Peled summarizes one element of Keshet's underlying motivation with the observation:

> For three-quarters of a century the Zionist enterprise ... rested upon two [institutions]: A corporatist socioeconomic and political system centered on the Histadrut, whose purpose was to extract resources from Jewish society, and a military-security apparatus intended to appropriate resources from the Palestinians … both systems benefited primarily the Zionist-Ashkenazi Jewish elite….[15]

Keshet's more radical members echo this harsh analysis: Contemporary Israeli elites are the Ashkenazi masters of concentrated economic, political and cultural power, which they use to exploit the disadvantaged (chiefly Sephardim and Palestinians). Zionism is "Ashkenazi Zionism," and the establishment of the State of Israel was "the Ashkenazi revolution," which Keshet's members oppose by means of a proposed new "Mizrahi revolution."[16]

Keshet's rhetoric on economic affairs is reflexively socialist. During the movement's founding conference in early 1997, Yossi Dahan, one of the group's central figures, claimed that economic efficiency is antithetical to "just socioeconomic policy."[17] This sentiment was echoed by other prominent Keshet representatives: Neta Amar, a member of Keshet's secretariat, said, "I do not believe in a market economy ... my loyalty is to an egalitarian ideology...”; and Shlomo Vazhna, a Keshet spokesman, offered, “[Keshet] responds to the great longing in Israeli society for social solidarity.… I believe in social democracy, not in an unrestricted free market.”[18]

While not a political party—at least not yet—Keshet is clearly determined to effect political goals. In 1997 and 1998, it campaigned for the passage of a far-reaching housing law allowing the low-income tenants of public housing units to purchase their apartments at drastically reduced prices. Keshet’s demand aroused support among mainstream members of Knesset, who submitted a draft bill providing for the sale of 100,000 public housing units—a giveaway which may cost taxpayers as much as $2 billion.[19] In October 1998, the bill passed into law.[20]

The success of popular groups such as Keshet reflects a growing trend in the public debate to challenge the entire idea of market reform. “Thatcherism” has become something of a dirty word in many circles, synonymous with cruelty to the weak, lust for profit at the expense of all else, and the rupture of society’s sense of unity.[21] A typical example of this was a feature article in the daily newspaper *Ma’ariv* last fall, entitled “The Iron Lady’s Victims,” in which reporter Dafna Vardi launched a no-holds-barred assault on the policies of Margaret Thatcher, and on Prime Minister Benjamin Netanyahu’s looking to British economic policy of the 1980s as a model. Britain under Thatcher, writes Vardi, was a country where “compassion and hope were words without meaning to many thousands of people.… Anyone who lived in Britain during the era of Thatcherism will remember the tremendous divide which opened up between those with the highest incomes and those with the lowest.…”[22] In order to leave no doubt as to how the editors felt about it, *Ma’ariv* chose to publish the piece in its special Yom Kippur supplement, with a subtitle making deliberate reference to the Yom Kippur confessional liturgy—“For the Sins Which We Have Sinned: Hurting the Needy.” Appended to the feature was an opinion piece entitled “To Hell with Society, What Counts Is the Numbers,” a blistering attack on Thatcher and Netanyahu written by none other than Shlomo Ben-Ami.[23]

The social lobby's success, therefore, has been driven not only by the traditionalist impulse of Shas or the windfalls to smaller parties resulting from the new election law, but to a large extent by an overall shift in the public discourse. As memories of the economic turmoil of the early 1980s recede, a new generation of leaders has emerged which does not recall the urgency of those days, and seems to lack any idea of why the reforms were needed in the first place. In their eyes, Israel has become uncaring, polarized and plagued by income disparities, and they are seeking to correct this through a massive increase in welfare spending, let the chips fall where they may. In the last three years, they have made troubling strides toward realizing their vision.

IV

In recent years, the social lobby has become the bane of economic reform, effectively thwarting efforts to hold the line on government spending. Its role has been especially problematic in light of the difficult economic circumstances which faced the Likud-led government of Benjamin Netanyahu when he took office in mid-1996. The preceding government had pursued an irresponsible fiscal policy, pumping up expenditure to prolong the economic boom of the early 1990s. This increased Israel's budget deficit and current account deficit (the difference between the economy's earnings and its expenditures of foreign currency), both of which exceeded five percent of Israel's GDP in 1996.[24] At the same time, excess government spending undermined the efficiency of the economy as a whole, preparing the way for the boom of the early 1990s to end in a recession. Economic growth began to falter in the summer of 1996, just as the new government took power.

The Netanyahu government was faced with a difficult task: Even as the recession began to bite, the government needed to cut its expenditures to balance the budget, and take steps to increase the economy's efficiency. Good policy required convincing politicians to sacrifice present outlays for the sake of future growth. But this prospect was made next to impossible by the stunning success of the social lobby in the same elections. The new coalition relied heavily upon social-lobby parties: Shas (ten seats), Gesher (five) and Yisra'el Ba'aliya (seven). Thus, even as Netanyahu was elected on a reform-minded platform, including privatization of numerous state-owned enterprises and deregulation of a variety of economic activities, the lack of political consensus on reform meant that it would be far more difficult than in previous years.

On privatization, the government did make more progress than any of its predecessors. On deregulation, the government promised little and delivered less. It was in the area of fiscal policy, however, that the greatest threat to the country's economic future emerged.[25] Soon after entering office, the Netanyahu government adopted a multi-year deficit reduction program. Its objectives were quite moderate but they required a fairly large cut in expenditure of about 2.3 percent of GDP in 1997 and another cut of up to one percent in 1998.[26] The fiscal objective in the 1997 budget was to cut expenditure by about NIS 7 billion. In the end, only five billion was cut; the other two billion was to be raised in extra taxes (despite the government's pledge to leave the tax burden unchanged), a development particularly regrettable at the start of a recession.[27] These included excise taxes on commonly consumed products such as tobacco and fuel, measures that hurt the poor disproportionately.

In December 1997, the government's economic program for 1998 was also effectively sabotaged by several of its coalition partners, and the outcome that year was even worse. In August 1997, the government had settled on a target of NIS 2.3 billion in cuts in the 1998 budget, but when the budget finally passed on January 5, 1998, it included over a billion shekels of new, unfunded commitments to various elements of the coalition, to be balanced by vague, unspecified cuts.[28] In other words, the government failed to meet its targets for cutting domestic spending in both 1997 and 1998, and it managed to keep within its stated goals for the budget deficit only by virtue of unforeseen windfalls in overseas receipts.[29]

The year 1997 also saw the passage in April of an amended minimum wage law, increasing the minimum wage from 40 percent to 45 percent of the average wage in the economy. Backed by Gesher, this measure also received the strident support of Labor Minister Eli Yishai of Shas, who had initially sought a much larger increase. The increase that did pass was only the latest in a series of increases since 1993, which together raised the minimum wage by 60 percent, in dollar terms. As the law's opponents predicted, the latest increase led to widespread firings of workers in marginal, low-wage industries, wreaking havoc on the social-spending parties' own constituents in development towns across Israel—and greatly contributing to the rise in unemployment in 1998.

Another sign of the erosion of economic discipline was the Histadrut strike of December 1997. In the summer of that year, the Histadrut, Israel's massive labor federation, decided to challenge the government's reform program, even though the union had not made economic reform a significant issue in advance of the 1996 election.[30] From August 1997 onward, the Histadrut made several attempts to precipitate a nationwide strike. On December 3, 1997, the Histadrut seized upon the issues of proposed pension reform, privatization and economic reform, and succeeded in leading 700,000 public- and financial-sector workers out on strike.[31] Within days, despite the strike's general unpopularity and the strikers' defiance of a court injunction, the government felt constrained to bring the strike to an end by making far-reaching concessions on pensions. The government received nothing substantive in return; the Histadrut merely agreed to negotiate other pending issues, reserving the option of resuming the strike if they were not resolved to its satisfaction.[32]

The strike represents the first time since the reform of 1985—which had been undertaken with the Histadrut's cooperation—that the labor federation successfully opposed a major element of an Israeli government's economic reform program. Both the issue on which the Histadrut won its victory and the manner in which it did so are significant. For the time being, all further economic reform must be considered hostage to the Histadrut.

Although the strike itself was unpopular, the position the Histadrut claimed to be defending was not. Many of the factions constituting the government's coalition had staked their political future on posing as advocates of social policy, which they interpret as increasing government expenditure for their pet constituencies and opposing any cuts in social programs. Ten years ago, the conventional wisdom in Israel accepted that economic reform, with its sometimes painful consequences, was in their own long-term interest. Today, attitudes have shifted. The Histadrut's rhetoric of class conflict enjoys a new legitimacy, which it did not create, but does not hesitate to exploit.

In 1998, the budget debate took an even more pronounced turn, as the social lobby grew more confident, and therefore more avaricious, in its demands. In the midst of the budget debate, with the coalition on the brink of rupture, Netanyahu called for new elections, which are scheduled for May 1999. Few things are worse for fiscal prudence than an election. At one point, the Likud's erstwhile coalition partners among the small parties were demanding a total of NIS 5.5 billion ($1.35 billion) in additional spending, as the price of their votes to pass the budget. Netanyahu turned in desperation to the Labor opposition for support in passing the budget with no additional spending. Only the threat of getting nothing at all convinced the smaller parties to moderate their demands. The 1999 budget was finally approved, five weeks into the new year.

The government's increasing difficulty in implementing economic reforms is largely attributable to the dramatic rise of political parties such as Shas and Gesher, and to the newfound confidence of extraparliamentary groups like Keshet and the Histadrut. Increasingly, these groups are discovering the appeal of the vision offered by Shlomo Ben-Ami and the new Left, who are pushing the only real alternative to market reform which has any likelihood of being adopted by the mainstream political parties: The European model, the idea of a "social democracy" which purports to maintain cultural cohesion and economic vitality through taxation and social programs.

The vision of European-style social democracy has great instinctive appeal, so great that many neglect to ask the most important question about it:

Does it work? To understand just what is wrong with the vision of Israel's social democrats, one need only take a sober look at what is taking place in Europe—and has not taken place in the countries that offer the chief alternative to the European model, the market-oriented economies of the United States and Great Britain.

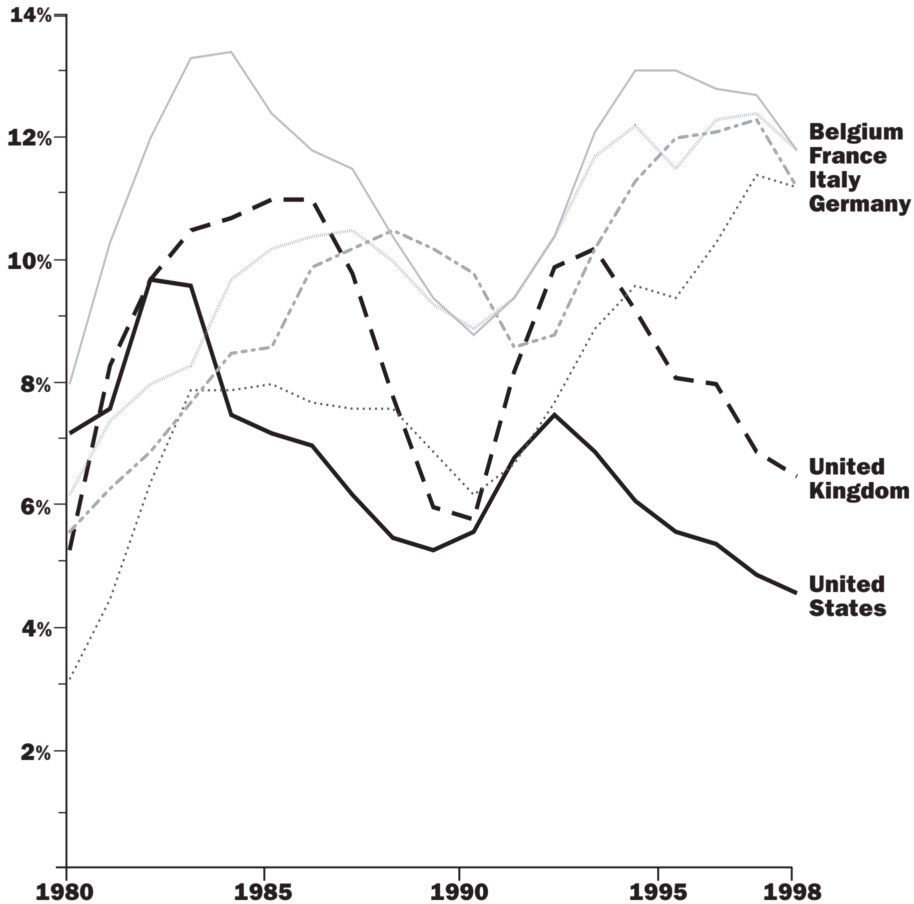
V

The last twenty years have served as an important experiment in economic theory. While Continental economies have maintained a fairly consistent loyalty to their "mixed" economic traditions, the United States and Great Britain have adhered to market-based policies through successive changes of government.[33] The results are now open for the world to see: Whether you are rich or poor, it is better to live in a free, market economy.

European economies today are in a state of more or less permanent crisis. Unemployment rates throughout continental Europe are consistently high: Eleven to twelve percent in Germany, France and Italy, and over eight percent in Sweden, which was once thought the acme of a working social-democratic polity.[34] Figure 1, which shows unemployment trends in various developed countries, begins with the year 1980, which was the year after the second major oil shock, and therefore a good starting point for examining how different industrialized economies adjusted to the oil shock and, over the long term, to an increasingly integrated and competitive world economy. Unemployment rates in most European countries have risen slowly but surely, going up during recessions, declining during periods of economic expansion, but never quite making up for lost ground.

Many of those not working are the long-term, hard-core unemployed who have fallen out of the working lifestyle and probably will never work

Fig. 1. Unemployment in Selected Countries, 1980-1998



Source: *OECD Economic Outlook* #64, December 1998, Annex Table 21, "Unemployment Rates," p. 211.

again. In 1991, these constituted less than one-third of the unemployed in Britain, but close to half in France, Germany and Spain and over two-thirds in Italy. Moreover, their proportion tends to rise over time, even as the total number of unemployed rises.[35] Unemployment among youth in these countries is about twice as high as national averages. GDP growth per capita has been acceptable since 1985, averaging 1.5–2 percent per year, but the benefit of this growth has redounded largely to those who have jobs. France, Italy, Spain, Belgium and other countries have large and growing excluded populations.

The consistent rise of unemployment during the last twenty years has caused much concern among European policymakers, and has generated much research. The causes of European unemployment are now thought to be well understood. Unemployment is largely due to high taxes on labor, including social-security taxes to pay for pensions and other benefits, which make labor more expensive for employers; regulatory constraints on hiring and firing, whether imposed by legislation or union rules, which effectively prevent employers from implementing rational workforce decisions; and minimum-wage legislation, which contributes directly to youth unemployment and indirectly places a "floor" under the entire wage scale, raising the cost of labor and thereby reducing employment. In addition, generous unemployment benefits are found to encourage long-term unemployment.[36] In other words, welfare policies meant to help poorer workers, or to provide security for workers in danger of losing their jobs, do exactly the opposite, by preventing would-be workers from getting jobs and leaving many of them in the desert of long-term unemployment. And, the more public funds are spent on pensions, unemployment benefits and subsidies to preserve jobs in failing industries, the less there is for truly important things such as employment retraining—investment in creating advanced skills among the unemployed—which is the key to reducing both unemployment and poverty.

The contrast with Britain and the United States is striking. In 1979, the year Margaret Thatcher came to power, British unemployment was about mid-range among European countries[37]—though to the British it was high enough to be considered unprecedented (Thatcher and the Tories campaigned successfully on the slogan "Labor Isn't Working"). Thatcher ended thirty-five years of restrictive union power, and made the economy and the labor market much more efficient. The immediate effect of the adjustment was a rise in unemployment which lasted through the early 1980s, with another significant rise in the early 1990s. Since then, however, unemployment in Britain has dropped considerably, and by 1998 stood at around 6.5 percent—as opposed to 11.2 percent in Germany, 11.8 percent in France and 12.2 percent in Italy.[38]

In the United States, where the economy is even less subject to government controls than in the United Kingdom, the picture is that much clearer. The U.S. was not immune to the second oil shock in 1979, which raised production costs and prompted a recession throughout the Western world, costing many workers their jobs. In 1980, U.S. unemployment was high relative to most European economies; it would peak in 1982 at 9.7 percent. The 1980s and early 1990s were years of downsizing and restructuring; hundreds of American companies fired millions of blue- and white-collar workers. During the same period, however, the economy also *created* millions more new jobs than were lost. The market, especially the labor market, worked exactly as economic theory predicted it should: The economy as a whole became more efficient and productive, as resources released by some companies were taken up by others, new and old, which produced more goods and services. This has created a more inclusive economy: In the U.S., someone who wants to work is likely to find work in short order.[39] Far more than in Europe, a worker in America can be confident of attaining the security and dignity inherent in having a job.

Yet unemployment is only one factor in judging an economy's health; another is the government's financial soundness. The commitments implied by welfare programs are gradually undermining the finances of European social democracies. Europe's population is aging, leading to ever increasing health and pension costs. Since 1980, government expenditure in most European economies has grown considerably, Britain being a refreshing exception. As illustrated in Figure 2, spending by European governments today stands at fifty to sixty percent or more of annual Gross Domestic Product—very much like the pre-1985 levels of Israeli government spending.[40] (Compare this with Britain, where government spending stayed just under 39.9 percent in 1998, and the U.S., where spending in 1998 was as low as 30.9 percent of GDP.)[41] Even these monumental amounts have been insufficient to finance the welfare commitments of European countries, so they have borrowed heavily: Public debt in Europe's social democracies now amounts to anywhere from two-thirds of annual GDP to well over one hundred percent in some countries—119.4 percent in Italy and 117.3 percent in Belgium in 1998 (as opposed to 57.2 percent in Britain and 57.4 percent in the United States).[42]

Yet these "official" figures of public debt tell only part of the story. Future receipts of most state pension systems are inadequate to fund future pension obligations. Governments will have to make up the difference from other sources, by imposing additional taxes on top of ordinary social security taxes. This implicit obligation ought to be counted as government debt, but it usually is not. An authoritative study by the International Monetary Fund, based on data from 1994, attempted to calculate the burden of public debt including pension fund liabilities for a number of developed economies. The results were ominous: In France, for example, the projected total was 156 percent of GDP, in Germany, 163.2 percent, and in Italy, 188.4 percent.[43] Compare these with 89 percent in the United States, and only 42.3 percent in Britain. It seems governments can neither tax nor borrow enough to meet pension commitments of this magnitude, since borrowing means increasing the interest payments on the public debt, interest payments that also must be funded by taxation.

Unemployment and fiscal insecurity in the European welfare state constitute a vicious cycle, as most pensions and many other public social services are funded by payroll taxes. The unemployed make no contribution to these taxes; as their numbers increase, the burden of paying for the welfare

Fig. 2. Government Expenditure and Debt as Percentages of GDP (1998)

	Total Expenditure	Total Debt	Debt Including Pension Liabilities*
United States	30.9	57.4	89.0
United Kingdom	39.9	57.2	42.3
France	54.2	66.4	156.0
Germany	47.1	62.6	163.2
Italy	50.1	119.4	188.4
Sweden	59.8	73.1	N/A
Belgium	51.0	117.3	N/A

* These figures take into account the positive balances currently built up in the American and British pension schemes. The IMF study projected pension liabilities out to 2050.

Sources:
OECD Economic Outlook #64, December 1998, Annex Table 28, "General Government Total Outlays," p. 218, and Annex Table 34, "General Government Gross Financial Liabilities," p. 224. Last column: Sheetal K. Chand and Albert Jaeger, "Aging Populations and Public Pension Schemes," *IMF Occasional Paper* #147, December 1996.

state falls upon a smaller and smaller base. This causes tax rates to rise, which deters employers from hiring workers, increasing the ranks of the unemployed further still. The result is that more people become poorer, and more become permanently alienated from society due to unemployment. In other words, the policies social democrats have pursued for the sake of "social solidarity" end up having just the opposite effect.

Do France, Germany and Italy enjoy a greater measure of "social solidarity" than Great Britain and the United States? Solidarity is not an easy thing to quantify, yet one measure is the electoral success of extremist political parties, which can reflect the extent of discord within a society. Extremist parties, it turns out, have gained strength and legitimacy in precisely those countries which boast a "unifying" social-democratic system. In the 1980s such parties gained strength in many West European countries, and by the end of the decade were playing significant roles in national politics throughout Europe. In France, the National Front of Jean-Marie Le Pen grew from a marginal force to regularly take twelve to fifteen percent of the electorate; as the recent elections showed, in close elections the Front now has the power to make or break governments. In Germany, stringent anti-Nazi laws have not prevented the neofascist Republikaner from gaining seats in local and regional (Land) elections and coming close to winning seats in the Bundestag in 1989. In Italy, the extremist, secessionist Northern League has become a prominent political movement, and was one of the chief coalition partners in Silvio Berlusconi's right-wing coalition in 1994. In Austria, the far-right Austrian Freedom Party (FPO) has become one of the main political parties, receiving almost 25 percent of the vote. The contrast with the United States and Britain is remarkable: In both countries, extremist groups are marginalized, and the electoral power of extremist political parties is negligible. While radical militia organizations in the U.S. are a source of concern for many Americans, they enjoy nothing like the public legitimacy and political standing of their counterparts in Europe.

Why are increasing numbers of Europeans voting for xenophobic, illiberal parties? It is too simple to see their success as the result of marginalized social groups, such as the unemployed. The electorate of the extremist parties is drawn from all levels of society, including well-educated professionals belonging to the contemporary "knowledge elite," as well as small businessmen and workers.[44] While there are national differences in the composition of Europe's various extremist constituencies, the one recurrent, unifying characteristic is *uncertainty*: A profound lack of confidence in the ability of established parties and institutions to provide a secure future.[45] The growth of neofascism thus reflects, not surprisingly, a vote of no-confidence in the modern European democratic state, including the welfare state's promises of cradle-to-grave security. Given the state of European economies and the status of public finances, both rich and poor there have reason to be worried. The failure of the welfare state contributes to the loss of confidence in democratic institutions as a whole.[46]

What Europe's social democrats perceive in all this is societies in crisis, with high unemployment, slack growth, resurgent racism and what they consider a slavish devotion to fiscal orthodoxy that aggravates all three problems. They recommend "direct action" to fix the problem: Spend more public money to create jobs, sustain the unemployed and prevent workplaces from closing. In other words, their answer to the current crisis of the welfare state in Europe is more welfare. This approach ignores a staggering amount of evidence: The road European welfare states followed to arrive at their present pass, the unaffordability of current welfare commitments, and the impracticability in the long run of adding to those commitments.

The lesson of Europe's welfare economies over the last twenty years is that étatist economic policies do not work, while market-oriented policies do. The welfare state contains the seeds of its own destruction. Its policies for succoring the poor lead to their permanent exclusion from society, and its policies for providing universal economic security threaten that security, not only for the poor but for all.[47]

VI

There are important differences between Israel's economy and that of the European welfare states, differences which make Israel all the more vulnerable to the dangers of a return to étatism. Israeli society is younger than that of the United States and most European countries, but like all Western societies, it is aging.[48] In many European countries, the number of dependent old people per active worker (the "dependency ratio") is likely to double within the next generation or so; in Israel this will come about more slowly. By the same token, however, Israel is far more vulnerable than Europe to the threat of mass unemployment: *Because* Israeli society is younger, relatively more young people join the labor force each year, and relatively fewer leave it through retirement. In addition, immigration continues to inject many new workers into the job market each year, almost as many as the number of native youth entering the workforce. In other words, Israel's labor force grows far more rapidly than in Europe and, as a result, Israel must create proportionally more jobs every year than most European countries. Over the course of a generation, the failure of European economies to create jobs has brought about an unemployment problem of crisis proportions. In Israel, it would take far less than a decade to create a similar crisis, which would have grave social and political implications.

The problem might be further exacerbated by Israel's still-restricted capital market. Creating new jobs means creating the capital necessary to employ new workers. This means, in turn, that the Israeli economy must create attractive, competitive and efficient capital markets in order to sustain the high level of savings and investment needed for large-scale job creation—particularly if the jobs being created are to provide their holders with a standard of living similar to that of Israelis who are already employed.

It also means doing as much as possible to remove other impediments to the creation of new jobs, such as high taxes on labor and restrictions on labor mobility that deter employers from hiring workers. Policies that threaten the rate of savings and investment (such as excessive taxation), or that make the Israeli labor market even less flexible than it is now (such as protectionist tariffs and minimum-wage legislation), threaten not only the livelihood of hundreds of thousands of young people and immigrants, but also the economic and social stability of the country as a whole.

Moreover, the Israeli economy is changing rapidly. It is not just bigger than it was in 1990, it is also very different. High-technology industries are expanding rapidly, so much so that unemployment among highly qualified, technically trained people is, practically speaking, zero. Traditional, low-technology industries such as textiles and food processing are well on their way to extinction, undercut by cheap foreign labor. It is precisely such changes that European economies are poor at implementing because of their inflexible labor markets—which are a major cause of Europe's high unemployment.[49] Little purpose will be served if Israel tries to hold on to jobs making canned pickles or sweaters: In the face of growing global competition, no government policy will ever be able to increase employment substantially in these industries. National subsidies and tariffs that are designed to preserve jobs in declining industries end up imposing these costs on more dynamic sectors of the economy where the majority of Israel's new jobs must be created in the future. Yet part of what market opponents in Israel want is to hold back economic change, and most of the policies they advocate would undermine the economic dynamic Israel must maintain in order to keep job growth high.

Over the last three years, Israel's economic growth has slowed, reaching only 1.9 percent of GDP in 1998. Investment in 1997 fell by about nine percent, to 19–20 percent of GDP, and 1998 saw a 9-percent increase in the number of businesses that experienced financial difficulties serious enough to affect their ability to maintain their workforce or even stay in business. Meanwhile, unemployment rose by almost two percentage points. The point is that even with a 1.9-percent growth rate, which in many European countries would be considered an average year, in Israel this *looks* and *feels* like a recession. With a European-style growth rate of two or three percent, Israel can expect to create new jobs at about the rate European countries do, but this is simply unacceptable given the character of Israel's workforce. In Europe, moderate growth at these levels means a gradual rise in unemployment; in Israel the rise will be rapid and socially disastrous. Israel cannot afford a European-style economy—economically, socially or politically.

VII

The dysfunction of the European welfare state should give pause to Israel's social-democratic Left in its hasty push for more state intervention in the economy. The evidence reflects heavily, and poorly, on the effectiveness of the policies these groups advocate in achieving the goals they say they support. The prospect of Israel returning to this path bodes ill for those of its citizens who are poor, unemployed and ill-educated, the very people whose inclusion in mainstream society must be reinforced. But the new social democrats are growing in strength, and may succeed in stopping or undoing the 1985 reforms. If they do, Israel will become enmeshed in a deepening economic crisis: More Israelis will suffer economically than otherwise would have, and a dark cloud of economic uncertainty will hover over the nation's future—contributing further to the extremism and polarization that currently characterize much of Israeli society and politics.

During the 1930s, in the depths of a worldwide economic depression, advocates of state intervention in the economy enjoyed the support of a considerable body of economic theory. Soviet economists invented the foundations of modern econometric modeling. Prominent Western economists set forth the theoretical underpinnings of what was considered a viable model of the centrally planned economy, as Keynes and his disciples developed the theory of demand management. This body of theory was of crucial importance: It seemed to explain the way the world worked, and it prescribed what to do, and why. But it has long been discredited, and nothing similar has taken its place. Having lost the tone of conviction a robust economic theory carries, étatist discourse on economics has been reduced to demonology: It knows what it is against more than what it is for.

In place of theory has come narrative, the modern economics morality play. According to this narrative, because international competition costs Israeli jobs, competition should be limited. Privatization and competition both lead to downsizing (a heartless American import) and increased unemployment. Tight macroeconomic policies mandate small deficits and high interest rates, and therefore hold back growth while increasing unemployment. The attempt to squeeze deficits within fiscally responsible limits jeopardizes social insurance, particularly public pensions and, to a lesser degree, health care. This social-democratic narrative on the evils of the free market turns on its head standard economic analysis of European development during the last two decades. Based as it is on a superficial reading of the economic and social history of Europe during the past twenty years, its very superficiality makes it appealing to a mass electorate.

Narrative, alas, is no substitute for analysis, nor is it a basis for policies that work. None of the arguments in favor of étatist economic policies is substantiated by economic evidence—neither Ovadia Soffer's argument that the market economy causes unemployment and income differentials, nor Ben-Ami's position that unemployment is caused by insufficient demand, which only government stimulus can dependably reverse.[50] True, when an inefficient economy changes its rules in an effort to become more efficient, it will experience a temporary period of higher unemployment. This transitional unemployment is only to be expected, as some firms shed excess labor, before other, more efficient firms take up the slack and put these workers to use. But, if accompanied by appropriate fiscal and monetary policy, the free market does not create long-term, rising, intractable unemployment. That requires the welfare state.

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Notes

1. Michael Bruno, *Crisis, Stabilization and Economic Reform: Therapy by Consensus* (Oxford: Clarendon, 1993), p. 100.

2. Between 1990 and 1995 the West German economy created approximately 1.8 million jobs. A subsequent economic downturn eliminated an equal number, however. For data, see Organization for Economic Cooperation and Development (hereafter OECD), *OECD Economic Outlook* #61, June 1997, Table A20, "Employment," p. A23.

3. Amnon Neubach, Ephraim Zadka and Assaf Razin, *Challenges to the Israeli Economy: Aliya, Growth and Global Integration* (Tel Aviv: Ma'ariv, 1989), pp. 82-87. [Hebrew]

4. *Ha'aretz*, January 5, 1998.

5. *Ha'aretz*, May 27, 1997.

6. *Globes*, July 31-August 1, 1997.

7. See *Ha'aretz*, June 4, 1997.

8. Party chairman Ehud Barak was selected to be the party's prime-ministerial candidate, and therefore will enter automatically at the top of the Knesset list, with the second spot reserved for Shimon Peres; Ben-Ami actually took first place, therefore, in a competition which did not include Barak or Peres.

9. *Ma'ariv*, July 8, 1996. Ben-Ami is very clear on what he opposes: "Netanyahu's 'era of excellence' has turned into an era of the greatest social obtuseness Israel has ever known.… A hard-core Reaganite ideology, an overtly anti-social philosophy, dictated by him and the Governor of the Bank of Israel." To Ben-Ami, "wholesale privatization" means only profits for shareholders and higher prices for consumers. *Ha'aretz* Supplement, May 23, 1997.

10. *Ha'aretz* Supplement, May 23, 1997.

11. Ovadia Soffer, "Enlightened Privatization," *Ma'ariv* Supplement, June 16, 1997, p. 6.

12. It is surprising how similar it is to earlier socialist critiques of the market: Change "the end of the twentieth century" to "the end of the nineteenth century" and the words might have been taken from a left-wing publication in France a hundred years ago.

13. Yoav Peled, "The Liberal Manifesto," *Ha'aretz* Books Supplement, September 24, 1997, p. 4. It is interesting to note Peled's interpretation of the genesis of the "peace process." He writes that "a precondition of the liberalization process is the discovery of some solution to the Arab-Israeli conflict," and concludes that "it is no surprise, therefore, that those hurt by the liberalist redistribution struggle against liberalization as well as the Oslo process, which they view, justly, as one of its essential components." Peled himself is of Ashkenazic background.

14. Peled, "Manifesto."

15. Peled, "Manifesto."

16. The depth of their bitterness can be gauged from the following passage by another member of Keshet's secretariat, Sami Shalom Shitreet: "When an Ashkenazi slaps me on the shoulder and tells me we are brothers, does he have in mind anything we truly share, other than thirty days' reserve duty a year? Will he share with me his plot of land, whose price is soaring into the millions? Will he share his reparations from Germany? Will he give up a single place in the university for my son? Will he forgive my heavy debts, as his own were forgiven? … He is interested in only one form of partnership, in which my poverty creates his wealth." Sami Shalom Shitreet, "Cracks in the Ashkenazic Revolution," *Ha'ir*, July 5, 1996, p. 53.

17. *Kol Ha'ir*, June 6, 1997.

18. *Kol Ha'ir*, June 6, 1997.

19. *Ha'aretz*, July 6, 1997.

20. The government's decision to withhold implementation of this law until the year 2000 or later prompted several of its "social" coalition members to threaten to vote against the 1999 budget when it was presented for a vote in late December. *Ha'aretz*, December 31, 1998. The measure was finally approved in part in the budget passed on February 5, 1999, adding some $135 million in additional spending to the budget. *The Jerusalem Post*, February 7, 1999.

21. The notable exception is journalists covering economics issues who, reflecting the sentiments of most economists, continue to support the project of market reforms.

22. Dafna Vardi, "The Iron Lady's Victims," *Ma'ariv* Yom Kippur Supplement, September 29, 1998, p. 26.

23. Shlomo Ben-Ami, "To Hell With Society, What Counts Is the Numbers," *Ma'ariv* Yom Kippur Supplement, September 29, 1998, p. 27.

24. Bank of Israel, *1996 Annual Report*, Chart 1a, "The Israeli Market: Basic Facts 1986-1996," p. 3; Chart 5a, "Fiscal Policy, Main Indicators 1990-1996," pp. 3, 11. [Hebrew]

25. The government's weakness in this area is in no small measure attributable to the form of the 1996 elections. These were the first national elections to take place under the new law for the direct election of the prime minister. Meant to strengthen the prime minister's authority, this election procedure paradoxically has had the opposite effect of fragmenting the vote among different parties: Because voters could give voice to their larger, national-level concerns through their prime-ministerial ballot, many more votes on the Knesset ballot went to smaller, single-issue or special-interest parties. Today, the Likud and Labor together account for about half the Knesset seats, as opposed to nearly two-thirds in the previous Knesset. Even under the new regime, governments still depend for their survival upon the maintenance of a coalition making up a majority in the Knesset, so this has meant a great deal more leverage for the smaller parties in a coalition—most of which actively campaign for increased governmental outlays for their particular interests.

26. The 1997 figure includes not only the budget reduction for 1997 passed in December 1996 but an additional NIS 600-million cut in mid-1997, when it became clear that otherwise the deficit target would not be met. Regarding the 1998 figure: The Finance Ministry proposed a budget cut of NIS 2.3 billion for 1998, an estimate based on unrealistically optimistic assumptions about interest rates and the state of the economy. There was little doubt that, as in 1997, the government would have to propose an additional cut of half a billion to a billion shekels to meet its deficit target.

27. *Ha'aretz*, January 2, 1997.

28. *Ha'aretz*, January 6, 1998.

29. High domestic interest rates led to an inflow of billions of dollars into the Israeli economy, as the public borrowed dollars abroad at low interest rates and exchanged them for shekels, which they then deposited in Israeli accounts bearing much higher rates. The Bank of Israel accepted the dollars, investing them in dollar-denominated bonds issued in the United States and Europe. In an unusual move the Bank paid its owner, the Government of Israel, an NIS 5-billion ($1.25-billion) "dividend" on its foreign-currency earnings in 1998. Were it not

for this unusual development, the deficit target would have been exceeded by that amount, about 1.5 percent of Israel's GDP.

30. *Ha'aretz*, August 18, 1997.

31. *Ha'aretz*, December 4, 1997.

32. *Ha'aretz*, December 8, 1997.

33. In Israel, one hears from time to time the argument that the popularity of ostensibly "left-leaning" leaders such as Bill Clinton and Tony Blair demonstrates their public's rejection of the economic ideas of Reagan and Thatcher. Yet in the U.S. and Britain, and in Europe as well, their success is widely understood to reflect the exact opposite: Clinton and Blair have both adopted economic policies that are conservative in all but name, and in both countries their popularity reflects a resounding triumph for market reform in the popular sentiment. See, for example, "Europe's Right," *The Economist*, January 23, 1999. In both countries, the general public has witnessed dramatic economic success despite initial difficult periods, and simultaneously has seen Europe's social democracies struggle to maintain stable, consistent economic growth.

34. Unemployment in Spain has been omitted from this discussion, as it is extreme even in European terms: Currently over 19 percent, it has been as high as 23.7 percent this decade. *OECD Economic Outlook* #64, December 1998, Annex Table 21, p. 211.

35. *The OECD Jobs Study: Facts, Analysis, Strategies. Policy Report to Ministers*, June, 1994, Chart 1.17, "Long-Term Unemployed and Inflows, 1979 and 1991," Part I, p. 48. Even though the definition of the term "workforce" includes only people working or actively looking for work, many long-term unemployed receive unemployment benefits and therefore go through the motions of looking for work—registering at unemployment offices, etc. In practice most will work seldom or never.

36. *The OECD Jobs Study: Evidence and Explanations*, June 1994, Chart 1.13, "Unemployment Rates in Individual OECD Countries, 1950-1995," Part 1, p. 36.

37. *The OECD Jobs Study: Facts, Analysis, Strategies. Policy Report to Ministers*, June 1994. See also *The OECD Jobs Study: Evidence and Explanations, Part II: The Adjustment Potential of the Labour Market*, 1994.

38. *OECD Economic Outlook* #64, December, 1998, Annex Table 21, "Unemployment Rates," p. 211.

39. Both economic and general media reports in the United States are replete with stories of industry- and sometimes economy-wide shortages of labor. This is particularly true in information technology industries (where trained workers are at a premium), but is also found in the building trades, heavy industries, most

engineering fields, and the whole range of service industries. In many parts of the country, worker shortages have prompted companies, and sometimes entire cities, towns or counties, to develop employment packages that include hefty hiring bonuses, relocation costs and other perks—which in the old days would have been reserved for top management and professional positions—to tempt prospective mid- and lower-level employees.

40. *OECD Economic Outlook* #64, December 1998, Annex Table 28, "General Government Total Outlays," p. 218.

41. *OECD Outlook* #64, Annex Table 28, p. 218.

42. *OECD Outlook* #64, Annex Table 34, "General Government Gross Financial Liabilities," p. 224.

43. Sheetal K. Chand and Albert Jaeger, "Aging Populations and Public Pension Schemes," *IMF Occasional Paper* #147, December 1996. This study projected pension liabilities out to 2050.

44. See Roger Eatwell, "Why Are Fascism and Racism Reviving in Western Europe?" *Political Quarterly*, 65:3, July-September 1994, pp. 313-325, especially pp. 319-320; Bettina Westle and Oskar Niedermayer, "Contemporary Right-Wing Extremism in West Germany: 'The Republicans' and Their Electorate," *European Journal of Political Research*, 22, 1992, pp. 83-100, especially p. 96.

45. See Nonna Mayer and Pascal Perrineau, "Why Do They Vote for Le Pen?" *European Journal of Political Research*, 22, 1992, pp. 132-133; Eatwell, "Fascism and Racism"; Robert Knight, "Haider, the Freedom Party, and the Extreme Right in Austria," *Parliamentary Affairs*, July 1992, pp. 285-299.

46. Françoise Gaspard, a historian and former Socialist mayor of the town of Dreux, provides a poignant record of the decline in prestige of the liberal political order in the wake of economic dysfunction, in *A Small City in France* (Cambridge: Harvard, 1995). Dreux was the first French town of any size where the National Front became an electoral power, and one of the first to elect a National Front mayor. Gaspard notes that twenty-five years of economic prosperity in France after World War II were followed by "fifteen years of deep recession." This is her view of the French economy since 1980, when François Mitterand was president and the Socialists controlled the government. During this period Dreux was pushed to the margins of French society and the French economy. Gaspard notes that the burden of the failure of French public policy fell equally on all parts of the working class: "Native" Frenchmen as well as first- and second-generation immigrants. The response of many in Dreux and elsewhere was to lose faith in the state and its policies, coupled with a turn to xenophobia. Gaspard describes but fails to note the significance of the fact that the National Front leadership and many of its voters in Dreux were not unemployed members of the working class, the natural constituency of Gaspard's party, but were

instead from all social classes. Gaspard is well aware of the state's failure; what she fails to grasp is that the welfare state may have been its cause, and therefore cannot remedy it.

47. It is not only the Anglo-Saxon countries that provide a sharp contrast with the performance of most European economies: So does the performance of the Israeli economy during the decade of economic reform (1985-1995). As in Britain, the era of reform in Israel produced an initial rise in unemployment and a couple of years of slow growth. Beginning in 1990 the contrast sharpens, with growth and job creation in Israel booming. The recent re-departure from economic prudence created Israel's current recession and threatens to prolong it.

48. The annual report *Children in Israel: 1998* notes that in 1997, 34.4 percent of Israel's population were children, the sixth-highest percentage in the world, after such countries as Syria, Jordan and Egypt. *Ha'aretz*, December 29, 1998.

49. See note 34 above.

50. Marx was never guilty of this sin commonly committed by his latter-day heirs. He had respect for economic theory and based his work on the best theory available in his time. At the heart of Marx's thesis was a plausible economic model of what exploitation meant and how it functioned. His theory began to fade in the 1870s, however, when the marginal theory of value supplanted the labor theory on which Marx had based his work.