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Export-Led Growth and the Geopolitical Hypothesis: Israel's Regime Change after the Second Intifada

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Abstract: In recent decades, neo-mercantilism has become a fashionable trend. The appeal of an export-led growth regime is often explained based on the material interests of the domestic growth coalition. This article offers an alternative explanation based on the geopolitical territorial interests of the state. It argues that states may endorse an export-led growth model not because of the demands of social groups but because the political elite believes a neo-mercantilist strategy is more consistent with the state's geopolitical preferences. The article defines this claim as the *geopolitical hypothesis* of regime change. The geopolitical hypothesis does not imply that social groups are irrelevant to the process. Social groups, the article argues, can play the role of *ex-ante transformative actors* or of *ex-post stabilizing actors*. Whereas society-centered theories underline the ex-ante transformative role of social groups, the geopolitical hypothesis argues that social groups can also play an ex-post stabilizing role. Based on the case of Israel, the article argues that during the early 2000s, after the outbreak of the second Intifada, Israel shifted from a consumption-led growth regime to an export-led growth regime. The transition, the article argues, was driven by the hawkish political elite, which prioritized nationalist objectives associated with the continuation and expansion of the occupation. The article concludes by arguing that the case of Israel is exemplary and not unique and that the geopolitical hypothesis can explain the adoption of export-led growth models in other cases.

Keywords: Export-led growth strategy; neo-mercantilism; growth coalition; territorial logic of capitalism.

JEL: 053; O43; N15; E12

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Introduction

In recent decades neo-mercantilism has become a fashionable trend. Not only large economies such as Germany and China have aligned themselves towards foreign demand, but also smaller economies (Güvercin 2020; Rapidis 2010; Kuus 2002; Gray 2011). The appeal of neo-mercantilism is puzzling, given evidence that the model does not always guarantee a higher growth rate (Höpner 2019), that it is likely to increase income inequality and may contribute to international imbalances (Palley 2003). What are the political drivers that explain this trend?

Several authors suggest that this trend can be explained by the distributive consequences of the export-led growth model. This explanation rests on society-centered theories according to which societal actors that benefit from export-led growth regimes give rise to them and stabilize them (For a review, see Clift 2014; Oatley 2015). This article examines an alternative explanation, which treats the export-led growth model as a neo-mercantilist strategy that is driven by the geopolitical preferences of the state. According to this approach, a country's growth model is shaped by the interaction between economic logic and the territorial logic of capitalism, which gives rise to complementarities and contradictions between domestic politics and international geopolitics.

The article focuses on the case of Israel, a medium-sized economy in an unstable region. Given its location, the complementarities and contradictions between the economic and the territorial logic have always been more significant than in the Western European economies. Particularly, in the early 2000s, Israel underwent a radical economic change simultaneously with a geopolitical crisis. It shifted from consumption-led growth during the 1990s to export-led growth until the global financial crisis, immediately after the termination of the peace process with the Palestinian Authority and the outbreak of the Palestinian revolt, known as the Second Intifada. In this article, I argue that these two events were linked causally. The article offers a detailed analysis of this causal mechanism.

The historical analysis is based on quantitative and qualitative evidence. The quantitative evidence consists of six sets of indicators that capture various aspects of Israel's growth model during the Peace Economy period (1991-1999) and the post-Intifada period (2003-2008). The qualitative evidence draws on extensive research of primary documents. The documents were compiled with a text analysis program (MAXQDA) and then read manually. A selection of quotes is presented in the text.

The article consists of two parts. The first part—the theoretical part—starts with a historical survey of the concept of mercantilism that highlights the different meanings of the term and its vicissitude. It highlights the distinction between the *economic logic of mercantilism* and *its territorial logic.* Then, it moves to expand on the territorial logic of mercantilism, and to formulate the *geopolitical hypothesis*, according to which a mercantilist regime is driven by the state's territorial interests rather than by the interests of societal actors. As for the role of social groups, the first part concludes by distinguishing between *ex-ante transformative actors* and *ex-post stabilizing actors*. Accordingly, the geopolitical hypothesis argues that in some cases, social groups play the role of ex-post-stabilizers rather than then ex-ante transformative actors.

The second part presents the historical case of Israel. It consists of three sections. The first demonstrates the descriptive claim that Israel's growth regime changed from consumption-led to export-led after the second Intifada. The second section rejects the hypothesis that social groups played an ex-ante transformative role in this change. The third section in the second part examines the geopolitical hypothesis, according to which hawkish political-elite perceptions of state interests drove regime change. The discussion assesses the strength of the geopolitical hypothesis as well as its generalization.

Part 1: Theory

Mercantilism: a history of a concept

In its early phase in the sixteen century, mercantilism was associated with *bullionism*, a policy approach according to which states should hoard large quantities of precious metals. This type of proto-mercantilism is similar to current strategies designed to attract foreign capital. With the rise of the trade empires of the Netherlands and England, mercantilist thinkers advocated policies that encouraged exports and minimized imports. Having a trade surplus was a manifestation of both economic and political power. After the British Empire abandoned mercantilism in the nineteenth century, mercantilism—now known as economic nationalism—was adopted by the two largest late-industrializers, Germany and the US (Helleiner 2021). Economic nationalism was perceived as a necessary transitional phase in the life cycle of a late-developing economy. With the retreat of colonialism after World War II, developmental economists advocated mercantilist policies as a developmental strategy. Late-developing economies used protectionist methods—tariffs and subsidies—to target their balance of payments to protect domestic production (Thirlwall and Hussain 1982).

The term export-led growth models were introduced in the 1980s by orthodox economists as an alternative to developing economies' protectionist strategies (import-substitution policies). Within this context, export-led growth models meant simply liberalization of the economy and economic integration: "the absence of policies that discriminate in favor of sales in the domestic market" (Krueger 1985, 20; Sachs et al. 1995, 22–23). The new policy paradigm legitimized the export-led model based on the assumption that de-jure openness—elimination of duties and subsidies—improves efficiency and optimizes growth (Palley 2003; Onaran and Stockhammer 2005, 66). Hence, within this context, export-led growth models implied a shift from mercantilism toward liberalized markets.

Recently, Post-Keynesian economists have employed the term export-led growth model as an alternative to consumption-led growth. They argue that even if states liberalize trade and capital flows, growth models may differ based on the contribution of domestic consumption and exports to growth (Baccaro and Benassi 2017; Hein 2022). From a Post-Keynesian perspective, an export-led growth model is defined as one based on a high level of export contribution to growth. The literature distinguishes between growth models, strategies, and regimes. Whereas the distinction is not always clear, it is useful to distinguish between the structural features which are stable in the short-term (model), government policies, which are one of the drivers of change (strategy), and the broader institutional impact of the growth model and strategy (regime) (Hassel and Palier 2021).

Financial liberalization in the post-Fordist era added another aspect, highlighting financial dependence, vulnerability, and the need for protection against global financial markets. Whereas in the Fordist/Bretton Woods era, mercantilist regimes targeted their current account (primarily the trade balance), in the post-Fordist/neoliberal era, states also started to target their financial and capital accounts. Hence, economic nationalism and financial nationalism interacted, giving rise to complex patterns. For example, by attracting foreign investment, countries could finance their trade deficit, and in that sense, the export-led and FDI strategies can be perceived as substitutes or complementary. The FDI-led growth strategy, also referred to as financial mercantilism (see, Aizenman and Lee 2006; Aromí 2021) or dependent market economies (Nölke and Vliegenthart 2009), enabled economies to poach foreign saving rather than foreign demand for goods. According to Stockhammer, an export-led growth strategy can contribute to financial stability as it externalizes financial instability (Stockhammer 2020, 31). In some cases—such as the case of the China-US interaction, the exporting country becomes the lending country, and therefore an export-led growth strategy requires "external financialization" (Stockhammer 2020, 31). The complementarities between export-led and FDI-led growth models are far from simple, but there is enough evidence to suggest that they are not independent.

The murky history of mercantilism demonstrates that neo-mercantilism is not a unitary concept. We can identify four different but related aspects of neo-mercantilism: the traditional, developmental, orthodox and Post-Keynesian conceptions. In addition, there is the financial aspect of mercantilism. Whereas Post-Keyensians present the economic rationale of export-led mercantilism, the developmental and financial aspects demonstrate the regime's territorial aspects must be taken into account.

The geopolitical hypothesis

Society-centered CPE theories assume that domestic societal actors—social groups and economic interest groups—are the primary movers of the domestic economic regime (For a review, see Clift 2014; Oatley 2015). Those groups are motivated primarily by their material interests, and they form social blocs (Amable 2017, 5) or growth coalitions, which promote regime changes or stabilize regimes once they are created (Baccaro, Blyth, and Pontusson 2022).

However, if an export-led growth model is part of a neo-mercantilist strategy, it will likely be driven by state actors whose perceptions of the state's territorial interests are shaped by external geopolitical factors. This approach draws on IR and IPE scholars who highlight the impact of external systemic factors on the national economic regime (Oatley 2019; Herman Mark Schwartz and Blyth 2022; Herman M. Schwartz 2009). According to this approach, growth models are the outcome of complementarities and contradictions between capitalism's economic and territorial logic. Harvey defines territorial logic as "the political, diplomatic, and military strategies invoked and used by a territorially defined entity such as a state as it struggles to assert its interests and accumulate power in its own right." The economic logic focuses on how economic power "flows across and through continuous space, towards or away from territorial entities" (Harvey 2005, 82). The literature on the territorial logic of capitalism usually focuses on the economic statecraft of hegemons, which employ their economic clout as geopolitical weapons. However, small and medium-sized states also use trade and finance policies as defensive strategies. This article suggests that small states' economic statecraft strategies should explain export-led growth strategies. According to this view, states may adopt an export-led neo-mercantilist regime even if it does not contribute to growth in the short run when and if the political elite believes it serves the state's interests. This argument will be referred to as *the geopolitical hypothesis*.

The geopolitical hypothesis suggests that external systemic factors shape a country's growth model. However, it does not do away with domestic politics. Rather, it assigns a different role to domestic growth coalitions and social blocs. Whereas according to society-centered CPE theories, group interests are the primary movers of an economic regime change and the state responds to them, according to the geopolitical hypothesis, the political elite is the primary mover and societal actors respond to it by realigning their interests and behavior. To put it in simple terms, according to society-centered theories, social groups transform the growth model *ex-ante*, whereas according to the geopolitical hypothesis, they stabilize it *ex-post*. They stabilize the growth model by realigning their behavior and interests with the regime shaped by the political elite. The distinction between the *ex-ante transformative role* of social groups and their *ex-post stabilizing role* is a critical difference that is often overlooked in comparative political economy research.

The geopolitical hypothesis assumes, therefore, that the state constitutes the social groups rather than is shaped by them. This approach is discussed by scholars such as Nicos Poulantzas (Poulantzas 1978, 97), Bob Jessop (Jessop 2003, 41) and Karl Polanyi. Karl Polanyi alludes to this possibility when he claims that the "birth" and "death of classes" may be the outcome of "the interests of society, given by its situation as a whole" (Polanyi 2001, 159). Given that social groups are less concerned by the state's territorial interests than the political elite, a contradiction between the territorial and the economic logic can give rise to tensions between the political elite and the social groups. In this case, the political elite may enhance the legitimacy of its perception of the state's interests through a discourse of legitimacy (Baccaro and Pontusson 2019, 18; Baccaro, Blyth, and Pontusson 2022, 35).

Therefore, the geopolitical hypothesis regarding the adoption of an export-led growth strategy consists of two mechanisms: the mechanism that links the geopolitical factors and the domestic political elite perceptions of the state's preferences and the mechanism that focuses on the interaction between the state and domestic societal actors. The historical section demonstrates that both mechanisms can explain the transition of Israel from a consumption-led growth strategy in the 1990s to an export-led growth strategy after the Intifada.

Part 2: Historical Analysis

This section of the article examines the shift in Israel's growth strategy from consumption-led to export-led during the 1990s and 2000s. The analysis establishes a causal connection between the outbreak of the second Intifada and the change in growth strategy by drawing on the geopolitical hypothesis. The historical portion begins with an overview of the historical argument and subsequently delves into a comprehensive analysis of the historical context.

Israel's transition from a consumption-led growth to a neo-mercantilist regime: the argument

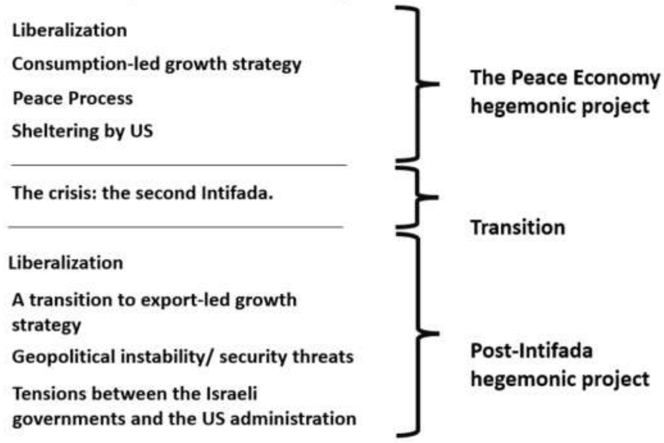
Since its establishment, Israel has been characterized by a top-down political culture, which was an outcome of its economic history and geopolitical circumstances. During the first three decades of its existence, from the 1950s to the 1970s, Israel was ruled by one dominant party (*Mapay*). The party maintained close ties with the Labor Union, the *Histadrut*, which controlled 20 percent of Israel's productive capacity through ownership (Krampf 2018; Shalev 1984; Maron and Shalev 2017). During this period, the national purpose of industrialization overshadowed the conflict between societal actors. In that sense, in Israel, social classes were created by the state rather than shaped by the state.

The centrality of the national purpose was exacerbated by the continual territorial conflicts between Israel and its neighbors. Security issues have dominated the public discourse and often set aside socio-economic issues (Abulof 2014). In the 1990s and the 2000s, Israeli governments liberalized trade and capital flows and privatized state-owned enterprises. However, the top-down political culture persisted (Shalev 1998). Israel's democracy ranking, according to V-Dem, is in the third decile (20-30 percent) compared to Western European countries, which are at the top decile (V-Dem 2023). Hence, Israel is selected as a deviant case with respect to the Western European liberal democracies. In Israel, it is more likely that the regime change was driven by territorial logic and that the growth coalition played an *ex-post* stabilizing role.

In 1985 the Israeli government implemented the Stabilization Plan, which was a transformative moment in Israel's economic history. During the next five years (1986-1990), the key purpose of the government was to stabilize the Israeli economy. During the 1990s (1991-2000), the Israeli economy went through a rapid process of liberalization, privatization, and globalization. At the same time, Israel participated in peace negotiations with the Palestinians. The outbreak of the second Intifada marked the end of the Peace Economy period. After a short transition period (2001-2002), the post-Intifada economic model emerged (2003-2008), which lasted until the global financial crisis. This article focuses on the Peace Economy period and the post-Intifada period.

During the Peace Economy period, Israel's growth model was consumption-led. This strategy was enabled, the article will argue, by two territorial factors: the peace process and financial assistance from the US. After the second Intifada broke out in 2000, the Israeli government shifted to an export-led growth strategy. Between 2002 and 2008, the growth model of Israel was export-led, and it was accompanied by an increase in foreign direct investment. The article suggests that this change was driven by the termination of the peace process and the concern of the hawkish government about Israel's dependency on the US. The historical narrative is summarized in Figure 1.

Figure 1: The Empirical Narrative



Source: author.

The historical argument is broken down into three claims:

1. A growth regime change took place between 2000 and 2002: the government shifted from a consumption-led growth model (1991-2000) to an export-led growth model (2003-2008).
2. The consumption-led growth model was feasible due to two non-economic—territorial— enabling preconditions: the peace process and financial support from the US. After the second Intifada, consumption-led growth was no longer feasible because of the escalation of the conflict and the growing gap between Israeli and US interests.
3. During the transition period, none of the dominant societal actors in Israel advocated a growth model change. Rather, the advocate of a regime change were right-wing (hawkish) politicians who were concerned by the dependence of Israel on US support.

These claims are examined in part 2 of the article.

The Peace Economy hegemonic project

As of 1985, after the execution of the *Emergency Stabilization Plan*, Israel entered an era characterized by liberalization and economic integration. However, until 1992 trade liberalization was incremental. Only after the election of Yitzhak Rabin's government (1992-1996) was the liberalization and integration process accelerated (Krampf 2018; Krampf, Ansenberg, and Zur 2022).

The rapid liberalization process is demonstrated by the indicators presented in Table 1. Revenue from import taxes fell from an average of 6.6 percent of GDP during the Stabilization Period to 4.8 percent during the Peace Economy period (1991-2000). Export subsidies dropped from 1.14 percent to 0.21 percent, and corporate tax rates from 52 percent to 38. Rabin's government accelerated the privatization process. The annual average income of the state from the selling of state-owned enterprises during the Peace Economy period was ten times higher than in the previous period and reached more than $800 million (Table 1).

Table 1: Indicators of Liberalization and Integration (Annual averages for each period)

	Net taxes on imports[3] (GDP %)	Export Subsidies[1] (GDP %)	Corporate tax rates[5] (GDP %)	Total income tax on non-wage income[3] (GDP %)	Privatization: State income from privatization (annual average; $ million)[4]
Stabilization Period	6.6	1.14	52.4	8.1	85.0
Peace-Economy	4.8	0.21	38.0	6.6	832.7
Intifada[B]	3.6	0.10	36.0	6.3	72.0
post-Intifada[B]	3.8	0.00	33.0	6.6	1104.8

[B] Stabilization period: 1986-1990; Peace-Economy: 1991-2000; Intifada: 2001-2002; post-Intifada: 2003-2008

Sources:

[1, 2, 3, 5] Bank of Israel.

[4] Assaf Shapira, "Key Privatization Processses in Israel," *Parliament* 64 (2010).

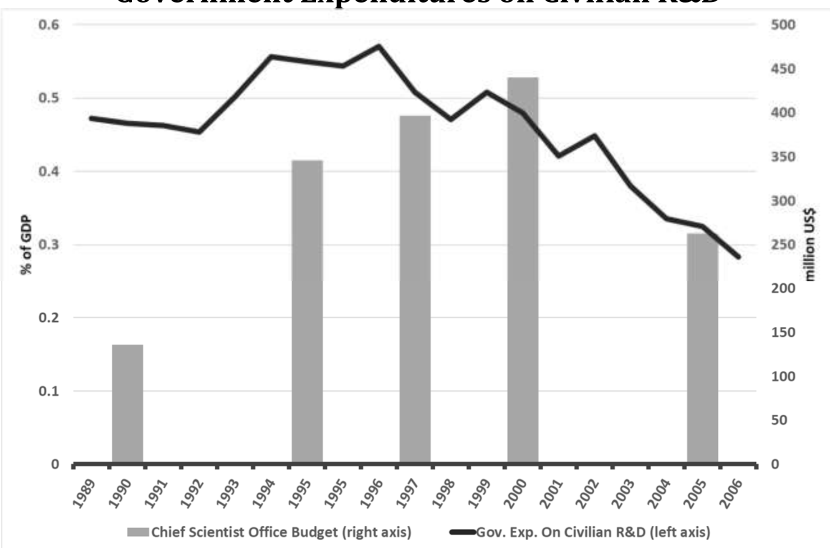
Passive liberalization was not associated with an export-led growth strategy. Despite trade liberalization, the relative size of imports and exports shrank during the 1990s from 66 percent during the Stabilization Era to 64 percent during the 1990s. The ratio of exports to GDP was 27 percent during the Peace Economy compared to 29 percent during the Stabilization era. This claim is supported by the fact that the contribution of net exports to growth during the 1990s was negative—minus 0.7 percent compared to minus 0.21 percent during the stabilization era (Table 2).

Table 2: Indices of growth model and economic openness

	Growth Contribution of				Economic openness (%)	Export share of GDP (%)
	Net Export[1]	Private Consumption	Gross Domestic Investment	Government Spending		
Stabilization period	-0.21%	2.99%	0.59%	0.31%	66	29
Peace-Economy	-0.69%	3.47%	1.71%	0.70%	64	27
Intifada	-1.29%	1.13%	-1.49%	1.21%	60	30
Post-Intifada	1.13%	2.03%	0.80%	0.20%	62	33

[1] Growth contribution of component X is defined as $\Delta X/Y$ when Y is GDP.
Source: Israel Central Bureau of Statistics.

Figure 2: Chief Scientist's Office's Budget and Government Expenditures on Civilian R&D



Source: Author; Data: (Avnimelech 2009).

Moreover, the annual average of the current account deficit during the 1990s was 2.7 percent compared to 0.1 percent during the previous period (Table 6 (3)). The high growth rate during the decade accounted for the growth in private consumption and public spending (an annual average of 7.4 percent) (table 2). The contribution of consumption to growth during the peace economy reached 3.5 percent, and that of investment was 1.7 percent compared to 3 and 0.3 percent during the stabilization era (Table 2).

The government took supply-side measures to assist exporters in the nascent high-tech industry. The government used the Capital Investment Encouragement Law (CIEL) to channel subsidies to exporting firms. It also channeled support to high-tech firms through the Chief Scientist's Office, which was responsible for state-funded private R&D (FC 1994). Throughout the 1990s, the government shifted resources to exporting industries. The Chief Scientist Office's budget more than tripled throughout the decade, from less than $150 million to $450 million. Total government expenditure on civilian R&D reached a peak of 0.57 percent of GDP in 1996 (Figure 2).

Despite the support for exporting industries, the current account and trade deficits during the Peace Economy continued to increase (Table 3). The growing external deficits thus had to be financed by foreign capital. During the 1990s, capital flows were liberalized, and Israel was able to attract foreign investment (Table 4). At the beginning of the decade, capital inflows—portfolio and FDI combined—reached less than one percent of GDP; by the end of the decade, capital inflows reached 5 percent of GDP, and capital outflows almost 10 percent. The share of foreign investment to total investment grew throughout the decade, from less than 15 percent to more than 50 percent (Figure 3).

Table 3: External Vulnerability Indices

	GDP Growth[1] (%)	Current Account: Export, Annual growth (%)[1]	Export (% of GDP)[2]	Balance of Trade (% of GDP)[2]	Import (% of GDP)[2]	Current account (% of GDP)[2]	External Debt (% GDP)
Stabilization Period	4.6	5.7	31.1	-5.3	36.4	-0.1	41.1
Peace-Economy	7.4	9.7	28.6	-5.4	34.0	-2.7	25.5
Intifada	-1.2	-3.9	32.1	-2.7	34.7	-1.3	22.6
Post-Intifada	5.4	7.6	39.2	-0.3	39.5	2.6	20.8

[1] Bank of Israel, Table 2.A.40 (2) and table 2.A.47
[2] World Bank Data.

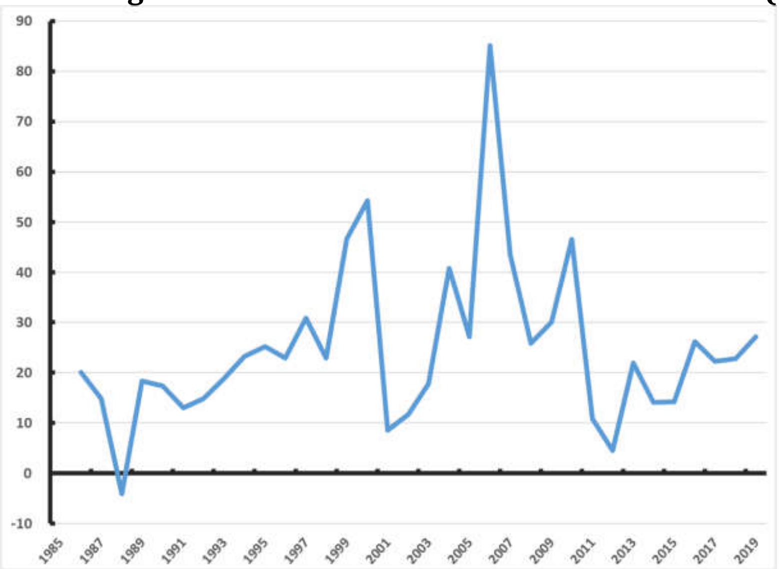
The capacity of Israel to finance the growing trade deficit through foreign investment was conditioned by the continuation of the peace process and the shelter from the US. As long as the peace process continued and Israel received loan guarantees from the United States, foreign private investors channeled their investment to the growing Israeli economy. Implementing a consumption-led growth strategy based on high public spending and high real wages while liberalizing the economy increased the current account deficit, which was financed by an inflow of capital that was highly susceptible to geopolitical circumstances.

The financial shelter Israel received from the US was not without strings attached: there was a clear link between the loan guarantees and Israel's dovish ideology. Prior to the inauguration of the peace process—during Shamir's government—President Bush rejected Israel's request for $10 billion in loan guarantees from the US and $5 billion in guarantees from Germany. Bush stated that the US would veto any Congressional decision to grant the guarantees unless Israel froze the expansion of settlements in the occupied territories (Diehl 1991). Shamir refused to agree to Bush's terms, and Israel did not receive the guarantees (Reuters 1991). However, when Rabin's government was elected, it accepted Bush's conditions, and the guarantees were approved.

In sum, the stability of the consumption-led growth model during the peace economy period rested on two non-economic—geopolitical—factors: the continuation of the peace process and the US financial assistance. The growth regime benefitted the workers as well as the business community. Even after the assassination of Rabin and the election of Benjamin Netanyahu in 1996, the center-right wing government was not able to change the regime, despite ideological differences.

In the post-Intifada period, the liberalization process did not stop but even deepened. During that period, revenue from import taxes decreased to an average of 3.8 percent of GDP compared to 4.8 percent during the Peace Economy. Corporate tax rates dropped from 38 to 33 percent, and export subsidies were eliminated. State income from privatization increased from a yearly average of 830 million dollars to 1.1 billion (Table 1).

Figure 3: Foreign investment as a share of total investment (%)



Data: Calculated from Bank of Israel Annual Report 2019 and Central Bureau of Statistics.
Source: Author.

However, in the post-Intifada period, the government shifted to an austerity-based neo-mercantilist strategy. Net-export contribution to growth rose from minus 1.3 percent during the Intifada to 1.1 percent in the post-Intifada period. Consumption contribution fell from 3.5 during the Peace Economy period to 2 percent, and the contribution of investment from 1.7 to 0.8 percent (Table 2). The export share of GDP rose from 27 percent to 33 percent (Table 2). During the period following the Intifada, the average budget deficit was less than half of what it was during the Peace Economy era.Private consumption per capita was 4 percent lower, government spending on wages was almost halved, and domestic civilian expenditure was three-quarters of its volume during the Peace Economy period (Table 5).

In terms of Israel's external position, the austerity policy was successful. Gross capital inflow almost doubled compared to the Peace Economy period (Table 4). Israel's invasion of Lebanon in 2006 had no significant impact on foreign investment. During the operation, foreign investment peaked at 80 percent of total investments and 16 percent of GDP (BoI 2019). The governor of the Bank of Israel pointed out that between 2003 and 2006, Israel's risk premium, as measured by Israel's Credit Default Swaps, improved rather than declined (FC 2006b). In 2006 Israel was ranked 85th in its exports to GDP ratio, three places below Germany. In that year, Israel's current account balance reached a surplus of 4.5 percent (calculated based on World Bank data).

Table 4: Financial Liberalization Indicators

	Portfolio						Foreign Direct Investment					
	Inflow			Outflow			Inflow			Outflow		
	Volume ($ million)	Change (%)	Per GDP (%)	Volume ($ million)	Change (%)	Per GDP (%)	Volume ($ million)	Change (%)	Per GDP (%)	Volume ($ million)	Change (%)	Per GDP (%)
Stabilization period	887	-5.9	1.8	15	-173.6	0.3	189	11.5	0.4	150	21.7	0.3
Peace-Economy	2,384	50.2	2.2	65	134.0	0.6	2,030	64.0	1.8	1,012	48.9	0.9
Intifada	251	-40.6	0.2	228	25.4	1.6	1,677	-44.3	1.3	2,011	-18.3	0.7
post-Intifada	3,624	53.6	2.5	471	23.8	3.2	6,857	64.4	4.5	5,766	115.0	4.4

Source: Bank of Israel Annual Report 2019.

Table 5: Government Spending (annual averages for each period)

	Domestic Expenditure (% of GDP)[1]	Government spending on wages (% of GDP)	Public Civilian Consumption per capita(100=1995)	Government deficit (% GDP)
Stabilization Period	22.06	1.0	88.2	-2.6
Peace-Economy	20.23	2.9	97.3	-6.3
Intifada	18.20	2.2	96.5	-6.4
Post-Intifada	14.90	1.5	93.4	-2.8

[1] Includes Transfer payments, direct allowances, credit benefits, and nominal interest rate payments.
Source: Bank of Israel Annual Report 2019.

The implementation of the austerity policy started in December 2002, when Arik Sharon's government declared the *Economic Defense Shield Program*, and was completed in April 2003, a month after the appointment of Benjamin Netanyahu as a Minister of Finance, when the government announced the *Economic Recovery Plan* (Knesset 2003).

The social-bloc hypothesis examined

According to society-centered CPE theories, the primary driver of a growth strategy change is social groups that expect to benefit from it. As the article pointed out above, social groups may play an *ex-ante* transformative or *ex-post* stabilizing role. This section examines whether domestic social groups played an ex-ante transformative role.

According to Avigue-Eshel and Filc, the lower tier of the middle class improved its material position relative to other groups within the working middle class after the reform (Avigur-Eshel and Filc – 2018: 511). Accordingly, they argue, this group was part of the social bloc that promoted the transition from the consumption-led growth model to the neo-mercantilism growth model. However, the social welfare of the middle class as a whole deteriorated (Dagan-Buzaglo and Konor-Atias, 2013). Moreover, most welfare indicators show that the average wage earner was better off during the Peace Economy period: during the 1990s, real wages increased at an annual pace of 2.4 percent compared to 0.4 percent during the post-Intifada period. Private consumption increased annually by 7.1 percent during the Peace Economy period compared to 3.4 percent during the post-Intifada period. Transfer payments to households dropped from 9.8 percent of GDP to 9.4 percent, and government spending on social security and welfare from 26.6 percent to 24.8 percent (Table 6).

Return to labor between 1993 and 2000 was above 58 percent and close to the OECD average. From 2000 onwards, the return to labor fell rapidly (Figure 4). The inequality of disposable income after taxes and transfers was below 0.32 percent in 1995 and above 0.37 percent after 2005 (Bleikh 2015 Figure 2-B). The poverty rate of households (by disposable income) was below 7 percent until 2000, surged above 10 percent in 2005, and reached 12 percent in 2010 (Bleikh 2015 Figure 8-B).

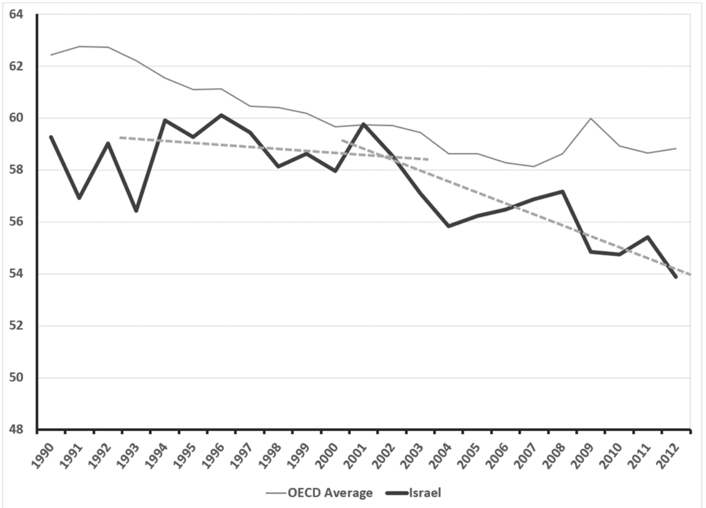
Table 6: Redistribution Indicators (annual averages for each period)

	Transfer payments to Firms (% GDP)	**Transfer payments to households (% GDP)**	**Social security, welfare and semi-public goods (% of GDP)**	**Current Private Consumption (Annual change, %)**	**Real wage (annual change, %)**
Stabilization Period	1.2	9.2	23.3	6.6	1.2
Peace-Economy	1.9	9.8	26.6	7.1	2.4
Intifada	1.1	10.8	27.6	7.5	-3.9
Post-Intifada	1.5	9.4	24.8	3.4	0.4

Source: Bank of Israel Annual Report 2019.

According to this data, even if certain social groups within the working class improved their relative position vis-à-vis other groups, the material conditions of the working class as a whole deteriorated due to the growth model change. Certainly, there was nothing in the hawkish government's economic reform which offered any compensation for the working class. Hence, it is concluded that the support of the working class cannot explain the transition to an export-led growth model.

Figure 4: Return to Labor in Israel and the OECD Average (% of GDP)



Source: Bank of Israel Annual Report, 2017. Figure E1, p. 125

Another group that could have played an *ex-ante* transformative role is the business community. There is extensive evidence that the business community was highly supportive of the Peace Economy regime (Ben-Porat 2006). Not only because it benefits from the opening of new markets for Israeli products and from the pouring in of capital, but also because of generous government support to firms.

When Netanyahu's reforms were discussed, many still adhered to the view that the Israeli economy would not be able to take off without a peace process. Avraham Shochat, the former Minister of Finance, formulated this logic succinctly: "There is one thing that everyone understands… the platform that produces economic growth is geopolitical [*medinit*]" (FC 2002b, 5). The business community warned that without a peace process, the "industries will collapse, and foreign and domestic investments will cease" (Hermony 2002).

During the recession caused by the second Intifada and the Dot.Com global crisis, the president of the Manufacturers Association called for more support for the private sector: "We should be thinking about increasing budgets, not how to reduce them." "I beg you," he addressed Netanyahu, the Ministry of Finance, "you have to encourage growth engines, not weaken them" (FC 2003b). These demands were voiced amid the intention of the Ministry of Finance to curb support to businesses. The Ministry of Trade and Manufacturing supported the manufacturers' position, warning that manufacturers needed more assistance from the government (FC 2003b). Netanyahu sought to improve Israel's external competitiveness and attract foreign investment (FC 2003c). Contrary to the Peace Economy approach, he rejected the idea of direct support to exporting industries. (FC 2003d, 2004).

To summarize, whereas the transition to an export-led growth model benefitted the exporting industries, there is no evidence that they supported the change *ex-ante*. The reforms, therefore, must be explained based on a top-down process in which state actors and the political elite—mainly the government—impose the change on the societal actors.

The Geopolitical hypothesis examined

A state-centered top-down policy-making mechanism assumes that certain domestic actors—the political elite—have the capacity to impose their preferences on domestic societal actors. However, the question persists of how to explain the preferences of the political elite. Maron and Shalev argue that the Israeli government implemented neoliberal reforms to restore its autonomy (Maron and Shalev 2017). Along similar lines of argument, Guy Ben-Porath argues that Netanyahu's reforms were supported by the state bureaucracy and were opposed by the majority of the population (Ben-Porat 2005, 240–41). Those studies highlight the top-down political culture in Israel, but they do address the question of the political elite preferences formation. This section argues that the political elite was driven by a national geopolitical purpose. It sought to restore growth but also to improve Israel's capacity to endorse a hawkish foreign policy.

Since its inception, the political elite perceived Israel's dependence on foreign capital as a strategic threat to its sovereignty. The reliance on external financial assistance made the state vulnerable to external economic shock and to eternal political pressure. The dependence of Israel on foreign assistance was a structural feature of the Israeli economy. However, the Israeli government employed strategies to lower the political costs associated with financial dependence.

During the 1970s, Israel enjoyed generous and practically unlimited financial support from the US, which financed Israel's militarization and its welfare policies. In the 1980s, the US started to be more selective in its financial support, and it exerted soft pressure on Israel to reach peace agreements with its neighboring countries and with the Palestinians. The dovish left-wing camp saw the US assistance to Israel as one of Israel's key assets, which secured Israel's sovereignty if not existence.

The hawkish right-wing camp interpreted the reliance of Israel on US assistance as a menace to Israel's sovereignty. During Yitzhak Shamir's government (Likud center-right government) in the early 1990s, the US conditioned financial assistance to Israel by restricting the expansion of the settlements. When Netanyahu won the election in 1996, one of his first initiatives was to declare that Israel was "going to achieve economic independence… self-reliance and great economic strength" (Netanyahu 1996). Hence, Israel’s trade deficit was perceived as a territorial issue rather than a purely economic one.

In 2001, after the election in Israel and before embarking on *Operation Defensive Shield* in Gaza, Ariel Sharon, now the Prime Minister, declared that "we," Israel, "have only ourselves to rely on." (quoted in Barnea and Kastner 2006, 20). Sharon's declaration referred to Israel's intention to reject the Road Map multilateral peace negotiation track endorsed by Bush and shift to a unilateral track. When Sharon rejected the plan, the left-wing parties warned that it would have devastating implications for the US-Israel relationship (FC 2002a). The right-wing camp hailed Sharon's approach.

In the post-Intifada period, the hawkish government faced the problem of how to stimulate the economy without renewing the peace process and without deepening Israel's dependence on US assistance. Benjamin Netanyahu, the Minister of Finance in Sharon's government since March 2003, laid down an economic strategy designed to enable Israel to overcome the economic recession without restoring the peace process (FC 2003d). Netanyahu's new model was designed to spur growth by improving Israel's external competitiveness and attracting foreign investment (FC 2003c). Contrary to the Peace Economy approach, he rejected the idea of direct support to exporting industries (FC 2003d, 2004).

Netanyahu wanted to eliminate not only the welfare state for workers but also the welfare state for businesses. Accordingly, between 2000 and 2005, the Chief Scientist's Office budget decreased from $440 million to $270 million (Figure 2). The Ministry of Finance explained that government support for high-tech companies is ineffective in terms of foreign investment because the inflow of investment is determined by global trends (FC 2006a). All in all, the government reduced transfer payments to firms from an average of 1.9 percent of GDP during the Peace Economy period to 1.5 percent (Table 6).

Netanyahu's strategy was supported by David Klein, the governor of the Bank of Israel. When the economy entered a recession in the early 2000s, the bank was very slow to lower interest rates. The bank justified the high-interest rates based on the need to maintain "stability in the financial and foreign currency markets" and to maintain Israel's credit rating (Klein 2001). The governor also justified his tight policy based on precarious security conditions (Klein 2001, iii). Klein's formulation discloses the logic that linked the economic and the territorial logics: the high geopolitical risks required the government to follow stricter macroeconomic rules than during the Peace Economy period in order to compensate global investors.

The hawkish government's key problem was how to pursue the liberalization process during a period of intensified security conditions and without making territorial concessions. During the Intifada, Israel suffered from terror attacks within its legal borders. Experts agreed that these attacks posed a strategic threat to the economy (Meridor et al. 2002; Eckstein et al. 2003). The Institute for National Security Studies stated that the government must "externalize the conflict" by pushing the fighting outside its borders (Tov 2003). Netanyahu advocated the building of a separation barrier (FC 2003a). The externalization of the conflict turned out to be a critical non-economic precondition for Israel's growth regime.

For the hawkish political elite, the separation barrier was an essential element in Israel's new "self-help" security strategy. Bush, however, saw the building of the barrier as a unilateral move that undermined the multilateral peace negotiation that he tried to revive. Influenced by the moderate camp in his administration led by the Secretary of State Colin Powell, Bush declared that the US would deduct the separation barriers costs—$300 million—from Israel's loan guarantees (Zoughbie 2014, 67–68). The divergence between the US and Israel deepened following the 9/11 terror attacks when Bush struggled to put together an international coalition to invade Iraq that included Saudi Arabia. Bush had to distance himself from Israel to maintain the cohesiveness of the coalition (Barnea and Kastner 2006, 40). At the same time, voices within the Israeli right-wing parties called for substituting US financial assistance with Israeli bonds issued in the US (FC 2004).

During the 2000s, Israel was still dependent on the US. In absolute terms, the annual financial assistance of the US to Israel has not changed since 1985. However, the volume of financial assistance in terms of Israel's GDP declined significantly (Figures 5a and 5b). Whereas in 1985, US economic and military assistance accounted for 10 percent of Israel's GDP, in the early 2000s, it was less than 3 percent. In 2007, it dropped to 1.4 percent, and in 2016, it to less than 1 percent. Therefore, the capacity of the US to use Israel's financial subordination for its geopolitical purposes declined. In 2016, Barak Obama pointed out, "In some ways, because Israeli society has been so successful economically, it has, I think, from a position of strength been less willing to make concessions" (Obama 2016).

Figure 5a: US Financial Aid to Israel (US$ Million)

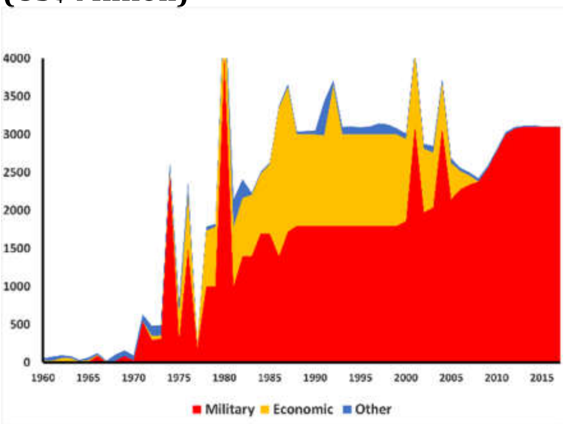
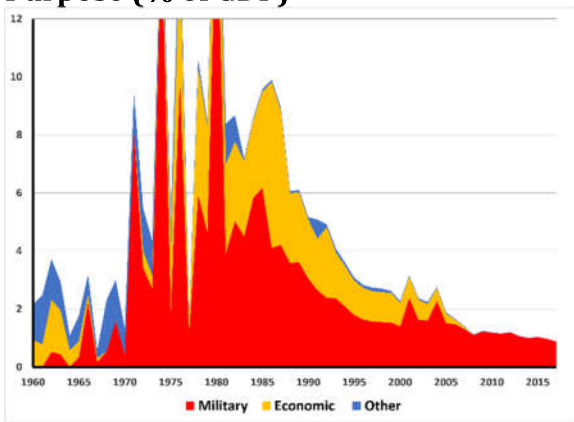


Figure 5b: US Financial Aid by Purpose (% of GDP)



Data: (Sharp 2015). Source: Author.

Discussion

The historical part of the article made three key claims. The first is that during the early 2000s, Israel shifted from a consumption-led growth regime to an export-led regime. This claim is strongly supported by the growth contribution indicators as well as the other quantitative data regarding Israel's economic policy and performance. It is also supported by previous research (Krampf, Ansenberg, and Zur 2022; Avigur-Eshel and Filc 2018).

The second claim concerns the interaction between the economic logic and the territorial logic of the growth regime during the Peace Economy and the post-Intifada period. The article argued that the consumption-led growth regime was preconditioned by two non-economic factors: the peace process and US financial aid. The rapid liberalization and privatization process, which was coupled with expansionary monetary and fiscal policies, increases Israel's external vulnerabilities and dependencies. The peace process enabled Israel to penetrate new markets that hitherto had been closed to it, and the financial backup of the US contributed to Israel's capacity to attract foreign investors. This claim is supported by the policy makers' perceptions regarding the importance of the peace process and the US assistance during the 1990s for Israel's growth regime, as well as claims made after the second Intifada regarding the unlikelihood of Israel's capacity to restore growth without a peace process. Netanyahu, who designed the transition to an export-led growth regime, acknowledged that within the new geopolitical circumstances, Israel would need a new growth strategy.

The third claim concerns the role of social groups. The article argued that there are no indications that any social groups played a transformative role ex-ante in the change to export-led growth. The business sector was highly worried about the consequences of the austerity policies and the expected cut in state support in R&D. However, there were social groups that benefitted from the change *ex-post*, and therefore they played a stabilizing role.

The general implication of the Israeli case is that the emergence and stability of the growth regime need to be examined not only from the perspective of their contribution to the material benefit of societal groups—workers and firms—but also from the perspective of their impact on the state's territorial interests. The state has preferences that cannot be reduced to short-term pecuniary interests or social groups, and it has the capacity to act upon those preferences. Those preferences are formed in the international geopolitical context rather than the domestic socio-economic context.

However, the question arises as to the mechanism and the actors that mediate between the external and the domestic contexts. In the case of Israel, the article argued that in a country characterized by a top-down political culture, the political elite, manifested by the ruling government, has the capacity to shape the growth regime according to its perception of the state's preferences, despite the opposition of the social classes. In such cases, the driver of change is the state—or the political elite—rather than the social groups. However, the article argues that in such cases, social groups may play an ex-post stabilizing role: social groups will realign themselves with the new growth regime.

A second question that arises is to what extent an export-led neo-mercantilism regime actually serves the interests of a small or medium-sized economy. A small economy in the post-Fordist era is exposed to vulnerabilities and dependencies. Such states are often characterized by trade or current account deficits, which have to be financed by foreign capital. Such states often need high doses of foreign investment to finance their growth. Export-led or neo-mercantilist models cannot transform a vulnerable and dependent economy into a powerful one. Vulnerability is a structural feature of a small economy.

Therefore, whereas an export-led growth model may address certain types of vulnerabilities and dependencies, it may also expose the economy to new types of vulnerabilities and dependencies. Hence, an export-led growth model, in the context of small economies, should be conceived as a transitional strategy rather than a sustainable growth regime.

To what extent the geopolitical hypothesis of the export-led growth strategy can be generalized to other countries? The geopolitical hypothesis is likely to serve as a robust explanatory factor given two scope conditions. First, the geopolitical mechanism of change is likely to be dominant in countries characterized by a top-down political culture, that is, in countries in which the civil society is relatively weak vis-à-vis state actors. Second, the geopolitical mechanism of change is likely to be dominant in countries that face real or perceived external security threats. In such cases, the external perceived threats are likely to overshadow the legitimacy of social groups to make demands based on socio-economic considerations.

Those conditions are satisfied by Turkey and South Korea. Ziya Önis argues that Turkey is characterized by a "top-down culture" and, therefore, policy changes "have not been initiated on the basis of a broad social consensus" (Öniş 2003, 3). During the second period of the Justice and Development Party (AKP) (2011 onwards), the government implemented elements of an export-led growth strategy (Altınörs and Akçay 2022). During the same period, it was struggling to position itself as a regional power (Güvercin 2020; Rapidis 2010). Akcay and Güngen show that in Turkey, the state and the military establishment shaped the growth model by creating an alliance with the capital elite (Güngen and Akcay, 2023).

South Korea is another case in which external state preferences played a key role in shaping the economic regime. Throughout the second half of the twentieth century, Korea enjoyed generous financial support from the US, and it faced a continuous existential threat from the North. Recently, with the rise of China and the declining power of the US, Korea internationalized the economy in order to lower its dependence on the US (Gray 2011). In that sense, the growth strategy of Korea cannot be understood without reference to the "vicissitudes of the post-war US hegemonic project in East Asia" (Gray 2011, p. 304).

Conclusion

This article examined the geopolitical hypothesis regarding the formation, stability and change of growth models. The hypothesis suggests that economic regimes are shaped by external systemic factors, which influence the political elite's perceptions of state preferences. Based on those perceptions, the political elite makes policy decisions that affect the growth regime, even if those decisions are not consistent with the material interests of domestic social groups. The geopolitical hypothesis further argues that after the growth regime changes, social groups may realign their behavior and interests with the change, and therefore they stabilize the regime *ex-post*, despite the fact that they were not drivers of change. The geopolitical hypothesis offers an alternative to comparative political, economic theories, according to which social groups play an ex-ante transformative role.

The article demonstrates the argument by studying the transition of Israel from a consumption-led growth strategy to an export-led growth strategy. It argues that Israel adopted an export-led growth strategy after the second Intifada, not because it was the best way to achieve growth but because it was more consistent with its geopolitical circumstances. Given the escalation of the security situation and the growing tension between Israel and the US, the continuation of the consumption-led growth model was not viable.

The analysis of the case of Israel implies that, in certain cases, export-led growth strategies should be studied as forms of neo-mercantilism. Neo-mercantilism is not designed to maximize growth or the material welfare of societal actors but to serve the geopolitical interests of the state. Therefore, in order to explain the adoption of an export-led strategy, one must not dissociate between the economic and territorial logic of the regime. The interaction between the two logics gives rise to internal complementarities and contradictions within the export-led growth regime.

However, it must be kept in mind that a neo-mercantilist export-led growth strategy has a limit. Even if successful in the short and medium term, it amasses domestic resources and channels them to high-productivity industries at the expense of low-productivity industries. This strategy deepens the internal productivity in the economy and reproduces inequality and poverty. Moreover, whereas an export-led growth strategy, if successful, may lower the state's reliance on foreign financial support, it increases the vulnerability of the economy to a global economic downturn. Therefore, in the long term, a neo-mercantilist export-led growth strategy is not likely to be sustainable, and it is expected to be highly susceptible to global growth cycles.

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