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The Great U-Turn

Restructuring in Israel and South Africa

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Israel and South Africa are often considered to have many characteristics in common. Both are lands of immigration, whose states were founded by European minorities who adopted a policy of planned colonization. Both were occupied by Great Britain, which saw the areas as imperial assets. Both of them obtained independence after the World War II and adopted a pro-American policy. The elites of both societies cultivated the self-image of leading, advanced Western states surrounded by hostile, primitive environs.

Both Israel and South Africa developed domestic, state-subsidized arms industries, including joint projects involving the manufacture of tanks, planes, and missiles - with exchangeable parts. Both developed secret atomic weapons projects which frequently involved joint testing. Both adopted discriminatory policies against the colonized population, including not only the deprivation of civil rights but also special measures pertaining to the labor market – arrangements which were willingly accepted by both employers and the trade unions.

Both states, since the late 1980's, have undergone a fundamental transformation in their economic structures and foreign relations. As we shall see, this change was impelled by the decline in profitability suffered by the military-industrial sector in both countries in the mid-1980's. In response, both countries declared their intentions to achieve regional detente and open a new page in their relations with their neighbors. Both of them began to dismantle their local monopolistic economic structures and opened their economies to the world. The process of liberalization hurt the middle strata of wage-earners: the very layers which, in both countries, had until then been considered the hard core of the regnant racist consensus. In both countries, formerly demonized enemies, such as Mandela and Arafat, became desired guests, along with transnational corporations and foreign investors.

Decline of Corporate Profits in Israel in the 1980's

A brief graphic illustration helps depict the process which both economies had been undergoing — a process which may be summarized as a differential decline suffered by the monopolistic-military sector; that is, a decline in the profitability of this once leading sector (in both countries) in relation to other sectors of the economy. This led, in both countries, to a decision to attempt a shift from a monopolistic war economy to an open peace economy - and this structural economic change had, of course, to be accompanied by concomitant changes in political policy: in both countries, the political reconciliation with former enemies - once nearly unthinkable - reflected the need to liberalize and. to a degree, 'demilitarize' their economies.

Figures 1 and 2 chart data pertaining to the return to capital in Israel. Figure 1 depicts the share of Gross and Net Capital Income as a share of total Gross Domestic Product (GDP), as well as Gross return on capital.[1] Figure 1 illuminates the marked deterioration in the position of capital during much of the 1980's. The share of gross capital income in GDP fell from nearly 18 percent in 1981 to less than six percent in 1987.[2] Figure 2 illustrates the contrast between the behavior of overall capital income with that of the profits of Israel's five largest conglomerates.[3]

Beyond the cyclical similarities of the two ratios - that of overall capital income and that of the five largest conglomerates - there are also some interesting differences. The data for All Capital Income include, in addition to the profits of the five largest conglomerates, those of smaller firms, as

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Income from Capital in Israel (percent)

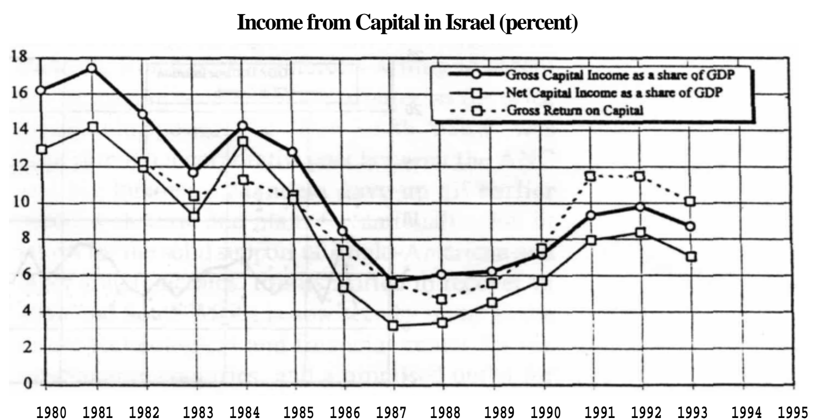

FIGURE 1

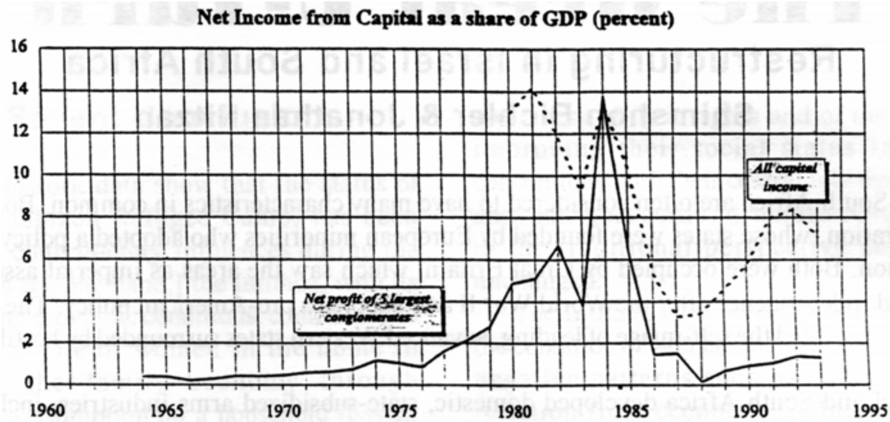

FIGURE 2

well as interest payments. As a result, differences in the relative magnitude of the two series denote a process of redistribution between the different components of the business sector (the large conglomerate relative to the rest of the corporate sector and the rentiers). Figure 2 illustrates the spectacular growth of the conglomerate group which began in the mid-1970's and reached its peak in 1984, during the stagflation era of military spending.[4]

However, following this rapid differential accumulation by the large conglomerates came an equally rapid differential decline. Since 1984, the net profits of the large conglomerates fell much more rapidly than those of the business sector as a whole. The reasons were more or less symmetrical to those which brought their earlier rise and included the winding down of the intense phase of the War in Lebanon and the after-effects of the Tel Aviv stock market crisis at the end of 1983.[5]

Moreover, military purchases were curtailed both in real terms as well as a share of GDP while military exports, since the mid-1990's have declined significantly. Some of the large conglomerates faced threats to their continued existence, and Koor was close to bankruptcy. By 1988, their combined net profits fell below 0.5 percent of GDP, down from close to 14 percent only four years earlier. These data serve to explain, at least in part, the fundamental change of heart lying behind the shift from a monopolistic war economy toward an open peace economy. If a move to a peace economy was perceived by the monopolistic conglomerates as necessary medicine for their ills, the peace process became a perquisite for the administration of the therapy.

The Response: Perestroika Israeli-Style - Economic and Political Restructuring

During the mid-1980's, it must have dawned on the owners and managers of the large conglomerates that the era of monopolistic militarism had come to an end and that if they were to survive they had to embark on an entirely new path, and quickly. They also had to explain their new set of needs to the politicians and expected them to respond appropriately, with more liberal

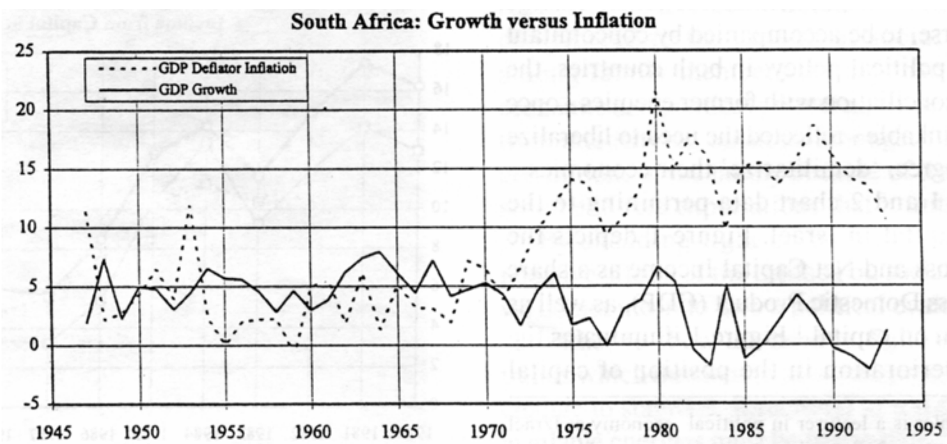

FIGURE 3

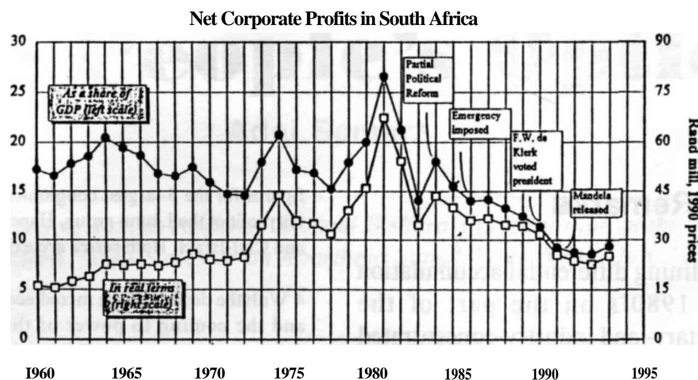

FIGURE 4

policies in both the economic and foreign relations fields.

The record since 1989 would seem to indicate that the expectations on the part of the Israeli elite are being met. Capital income has recovered significantly, due to very rapid growth as well as to falling real wages in the wake of more open markets. Russian immigration and the dismantling of labor organizations in Israel. The recovery of the big conglomerates was more moderate however, partly because they are now operating in a more open environment of global competition, and also because of the rapid growth of the small economy, particularly in the high-tech sector. Nevertheless, it is the big corporations which will probably benefit the most from the peace process, given their greater ability to move abroad and to enter neighboring Middle East markets.

The Case of South Africa: Similar Disease, Similar Medicine

The structural economic situation of South Africa was in many ways similar to that of Israel. A large oligopolistic high-tech sector under government protection coexisted with a labor-intensive, low-technology economy based on cheap Black labor (just as large parts of Israel's economy came to rely on cheap Palestinian labor). Chart 3 shows that, beginning in the 1970"s. South Africa - much like Israel - suffered from stagflation (negative correlation between growth and inflation), which is what one would expect from a closed war economy with tight monopolistic arrangements. Figure 4 provides data on the evolution of net corporate profit after taxes, both in real terms as well as a share of GDP between 1960 and 1993.[6] The data show a significant change occurring in 1980. Until that period, corporate profits were rising in real terms while maintaining their share in GDP around an average of 17 percent (and even growing to over 25 percent in the late 1970's).

In the 1980's, however, net profits began to plummet rapidly, falling from 26.6 percent of GDP in 1980 to 8.5 percent in 1992 – reflecting a real decline of 63 percent. The large South African corporations were always ambivalent about Apartheid – although it was their industrialization of South Africa which impoverished the Afrikaners and generated the Afrikaner backlash which led to the imposition of Apartheid by the Nationalist government in the late 1940's. On the one hand, these companies enjoyed cheap Black labor; but on the other, the poverty of the Black majority exacerbated South Africa's chronic stagnation (real GDP per capita began dropping since the early 1980's), and by leading to the intensification of the armed struggle, also brought international sanctions. However, until 1980, there was no compelling reason to act. Profits maintained their previous share of the GDP, or even grew relative to the national economy, and they rose considerably in real terms. Hence, it was only in the early 1990's that the large, predominantly "Anglo" conglomerates began to move more openly against the racist regime in Pretoria, which at that time was willing to accept the increasing isolation of the country, as the price for retaining power. The "New South Africa" was born through a corporatist pact between the ANC and big business. Mandela gave up all earlier socialist rhetoric and plans for nationalization in return for the solid support of Anglo-American and other conglomerates. Profits started to recover in 1993 and South Africa is now seen by many as the future technological and financial center for the sub-Saharan countries, and a promised outlet for the big international investors in the emerging countries.

Concluding Remarks

In conclusion, declining differential accumulation throughout the 1980's on the part of the monopolistic, military- and industry-concentrated conglomerates, historically the mainstays of the economies in both South Africa and Israel, forced structural economic - and, as a consequence, political - changes in both countries. Whether these will ultimately prove viable, only time will tell. ■

Endnotes

1 Gross Capital Income denotes the sum of corporate profit (from both domestic and foreign sources) and interest accruing to individuals (rent and income of incorporated business are excluded). Net Capital Income is given by Gross Capital Income less corporate taxes. Both measurements are expressed as a share of GDP. Gross return on capital is computed as a ratio of Operating Surplus corporate profit, interest and rent to the outstanding capital stock.

See *the National Accounts 1993,* Preliminary Estimates, Central Bureau of Statistics, Jerusalem, table 17, p. 40.

2 The problem was further aggravated by the effect on taxes of fluctuating rates of inflation. During the early 1980's, rising inflation reduced corporate profits from about 3 percent of GDP in 1980 (when the consumer price index indicated 131 percent inflation), to about 0.5 percent in 1984 (when CPI inflation reached 444 percent). The decline in inflation since then has had the opposite effect and corporate taxes have risen to over 2.5 percent of GDP by 1987 - but, this time the pain was much larger than during the earlier period since, in relations to GDP, Gross Capital Income was now 2/3 lower than it was in 1981. The years of 1988 and 1989 were difficult years for capital with gross capital income hovering around 6 percent of GDP. The picture for net income was somewhat better as the government moved to alleviate the tax burden: after tax income rose to about 3.5 percent of GDP; the big boost, however, arrived only in 1990, first with the massive immigration from the former Soviet Union and then, with the 'animal spirits' of the peace process pushing up investment and pulling the Israeli economy from its protracted recession. Gross Capital Income rose from 6 percent to 10 percent of GDP, while Net Capital Income, assisted by further reduction in taxes, climbed from 3.5 percent of GDP to over 8 percent of GDP in 1992. The process is mirrored in the series of gross return on capital with the ratio falling from over 12 percent in 1982 to 4.5 percent in 1988 and then recovering rapidly to its early 1980's levels. The reason why this index rose proportionately more than the previous two is that the capital stock was growing less rapidly than national income. This is to be expected given that the growth of NET investment in Israel has until recently lagged significantly behind the growth of GDP.

3 The data for all capital income denote the sum of interest payments to individuals plus corporate profits less taxes. The figures for the 5 largest conglomerates give the aggregate after tax profit of the Leumi group, Hapoalim group, IDB group, Koor and Clal-Israel. Both series are expressed as a share of GDP.

4 With the decline of the mixed economy since the early 1970's and the coming to power of the Likud in 1977, the five conglomerates began to appropriate a rapidly growing share not only of the GDP, but also of the net capital income. Thus, the net profits of these conglomerates rose from about 1 percent of GDP, during the early 1970's, to a stunning 14 percent by 1984, which was more than the overall net income from capital!! Part of this development is probably rooted in the inaccuracies of reported profits during the hyperinflation of the 1980 's (although the GDP accounts in that period were not that accurate either. In spite of some inexactitude in the data, it is clear that the process of redistribution was a real one. During that period, the small economy was squeezed by skyrocketing interest rates and massive losses from severely restricted effective demand. For the big economy, however, higher interest rates meant larger, not lower, profits. During the mid 1980's, real lending rates were over 40 percent, while real deposit rates were less than 10 percent, leaving a 30 percent real margin for the large lenders. Furthermore, rising military spending until the mid 1980's was disproportionately beneficial for the large industrial conglomerates.

5 Further, lower inflation meant declining real interest margins (the differential rate of interests on loans and deposits), for the large banks' real margins (taking account of the CPI and other indices) dropped to less 10 percent in the late 1980 's and further to a thin 5 percent by the early 1990's).