

# Labor, State, and Crisis: An Israeli Case Study

FORTY YEARS AGO, Michal Kalecki argued forcefully that while the goal of full employment was economically achievable, it would come aground on a political bedrock: the opposition of employers (and consequently the state') to losing the power hitherto afforded by the presence of a jobless reserve army. Kalecki's prediction is mirrored, albeit in very different terms, in the Philips Curve assumption of tradeoff between unemployment and labor "pushfulness." More recently, though, many observers of the European scene claim to have discerned a seemingly painless alternative to the discipline of recession for regulating trade union power. This alternative—corporatism— involves explicit or implicit bargaining between strong union peak organizations and the state, in which the unions agree to restrain worker demands and actions in return for supportive public policies. In addition to the presence of an authoritative union confederation with a broad membership base, corporatist "political exchange" is thought to be fostered by the stable presence in government of a political party with strong ties to the union movement. Generalized across nations, the argument is that both the degree to which labor market conditions approach full employment, and the degree to which trade unions are oriented to self-restraint and partnership with employers, are a function of just a few institutional and political variables—the scope, unity, and centralization of the unions, the political power of Labor or Social Democratic parties, and the ties that bind party and union.<sup>2</sup>

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<sup>2</sup>Throughout this paper "the state" is treated in a deliberately fictionalized way, as an impersonal and internally homogeneous entity. In principle, the institutions of state include not only its political and administrative arms, but also the judiciary, the military, etc. Defining the boundaries of the Israeli state is particularly difficult (Sharkansky, 1979). In the context of this study, the critical agents are the economics ministers and their senior bureaucratic advisors, together with key figures in the central bank and in the relevant parliamentary committees.

<sup>3</sup>Examples of this genre in political sociology include Headey (1970), Korpi and Shalev (1980), and Marks (1983). A similar interpretation by an economist will be found in a forthcoming volume by Ezio Tarantelli. See also the surveys of related literature in Shalev (1983a,b).

Few theoreticians of Social Democratic corporatism have considered the Israeli case, yet on the face of it Israel ought to provide resounding confirmation of the theory's predictions. The Histadrut labor center is probably the most broadly based, monopolistic, and hierarchical to be found in any democratic nation. In politics, until the electoral turnaround of 1977, the Israeli Labor Party had dominated every Israeli government since independence. And from a structural perspective, the intimacy between the party and the Histadrut could hardly have been greater. This paper focuses primarily on Israel's performance with respect to the unemployment variable, for which the record is at first sight highly supportive of the corporatist hypothesis. Ever since quarterly labor force surveys (similar to the Current Population Survey) were instituted in 1958, the annual unemployment rate has, with one exception (1966-1967), never risen above 6 per cent. In fact, it has typically fluctuated between 3 and 4 per cent—a level which, in view of conditions in the "development towns" on the country's geographical periphery, has been widely perceived as full (or even "overfull") employment.

This record is all the more impressive given certain structural weaknesses of the Israeli economy and its vulnerability to debilitating trends in the world economy since the early seventies. On the other hand, the history of unemployment in Israel also contains a sharp deviation from full employment during the recession of the mid-sixties, when unemployment rose to double-digit levels. This was a period in which—under the stewardship of a Labor-dominated government—both Labor and the Histadrut consciously and even enthusiastically embraced unemployment as a policy instrument to restore discipline to the labor market.

By examining both the background to the full employment norm and the reasons for the 1966-1967 deviation, this paper exposes three ways in which the corporatist theory of full employment is wanting in application to the Israeli case.<sup>3</sup> First, both the capacity and the motivation to implement a policy of full employment have to an important extent been unrelated to the "labor problem." Second, in addition to corporatist accommodation, a variety of other mechanisms have been developed by the state to counteract the potential for full employment to heighten distributive conflict in the labor market. Third, recession and corporatist accommodation are not necessarily mutually exclusive responses to the problem of political regulation of labor militancy under conditions of full employment. The Israeli experience illustrates

<sup>3</sup>The author gratefully acknowledges financial support from the Ford Foundation (Israel Trustees), the Bertelsman Foundation (Germany), and the Institute for Social and Labor Research (Israel). Detailed documentation and sources cited in an original working paper are available from the author (specify English or Hebrew). A fuller exposition of the Israeli case will become available in a book-length study currently in preparation.

both that "strategies of regulation" (for short) change over time, and that the stick of unemployment may paradoxically be brought to bear in order to enhance the carrot of corporatist accommodation.

To sustain these arguments requires delving into the background to and consequences of Israel's mid-sixties recession—a venture with greater contemporary interest than might first be imagined. Without an historical perspective, it is impossible to comprehend current Israeli developments, especially the failure of unemployment to rise in the post-1973 period of economic crisis and, on the other hand, the distinct possibility in the post-1983 era of a return to a policy of recession and unemployment. This study also has more far-reaching implications. If we accept that Israel is a "crucial case" for the corporatist hypothesis, then it clearly casts doubt on the validity of some of the theory's key predictions.

### Full Employment as a Structural Predisposition

There is a structural bias towards full employment in the Israeli political economy. Crucial national and geopolitical factors have generated both motives and resources which offset inherent economic weaknesses. Among the long-term infirmities suffered by the economy, we may note the following: (a) the limited size of the domestic market and the existence of political barriers to penetration of regional markets; (b) a relative poverty of natural resources; (c) a post-statehood endowment characterized by a limited industrial economy, based on predominantly small-scale and uncompetitive operations, and lacking international comparative advantages in most sectors; (d) substantial dependence on imports for (in changing proportions) basic consumption goods, production inputs, and military materiel; and (e) relative unattractiveness to foreign investors, owing to geopolitical insecurity and direct pressure by Arab states, high labor costs compared with other peripheral economies, and a small domestic market.

In view of these handicaps, Israel would at first appear an unlikely candidate for full employment (except insofar as the state succeeded in adopting a repressive "Third World strategy" favorable to foreign corporate investment). Nevertheless, since Israel's establishment in 1948, as well as during the preceding era of colonization, unemployment has been viewed by elite figures as inimical to fulfillment of the Zionist program. Particular fears have been voiced concerning its implications for the flow of Jews into and out of the country. In periods of mass immigration, rapid employment growth has been regarded as essential to the economic absorption of newcomers. Conversely, joblessness is seen as a dangerous disincentive for Jewish citizens to remain in Israel. These perceptions are built on the importance of sheer numbers

for staffing the citizens' army and regulating the demographic and territorial balance between Arabs and Jews: They are also explained by the fact that the legitimacy of the Israeli state is closely bound up with its demonstrated ability to provide a viable Jewish national home. Finally, given Israel's potentially explosive socioeconomic cleavages, and (especially since the early seventies) a strongly competitive political climate, governments have also been acutely aware of the social and political costs of unemployment. Nevertheless, to grasp how the aspiration for full employment was converted into a reality, it is necessary to note several other unusual features of the Israeli case.

Ramifications of the geopolitical setting. Israel's military commitments would seemingly have drained off the resources necessary for creating and maintaining jobs. However, prior to 1967, direct defense costs—at no more than a tenth of GNP except in the year of the Sinai campaign—were a relatively manageable constraint on a growing economy. Since then, this burden has grown to reach a modal level of about one-quarter of the national product. The cost of the sizable import component of increased defense expenditures has been roughly covered by the American aid package (which is to a great extent conditional on arms purchases from U.S. manufacturers). Furthermore, spiralling military spending has largely been financed by running deficits rather than by higher taxes or a tradeoff with consumption.

The Arab-Israeli dispute has other profound consequences for the political economy besides its fiscal dimensions. Three of these are particularly relevant to the issue of full employment. First, Arab-Israeli hostility has provided an ideological foundation for the erection of severe limitations on the social, political, and economic activities of Israel's Palestinian-Arab citizens. The subordination and dependence (in different ways) of both citizen Arabs and the inhabitants of the occupied territories, has been of particular importance for the formation of a flexible Arab labor force occupying the least favorable positions in the labor market. One other salient implication of the "garrison state" is the role of the army and the wider military economy as sources of employment. The standing army alone absorbed the equivalent of 7 per cent of the civilian labor force in 1966, rising to 13 per cent by 1979. Labor force surveys for recent years indicate that in a typical week about 5 per cent of eligible employed males are absent because of reserve duty. In addition, it has been estimated that the proportion of the labor force employed in economic enterprises dependent on military demand already approached one-tenth prior to 1967, and has now reached one-quarter.

International economic relations. The condition of permanent geopolitical tension has contributed greatly to both the need for foreign aid and its pro-

duction. So has Israel's Jewish-Zionist character. As a consequence, large-scale inflow of financial capital—especially unilateral transfers and long-term loans from the United States, Germany, and Jewish communities abroad—have made it possible to sustain a chronic trade deficit. Significantly, while the sources and character of these inflows have varied over time, direct foreign investment—particularly that part which is not disguised charity—has typically constituted only a minor component. Although the value of exports relative to imports has risen in the long term, absolute expansion of imports and a rising burden of debt service have prevented any secular decline in economic dependence. But in the context of this dependence, the Israeli economy has been able to sustain levels of investment (and therefore employment) far in excess of domestically generated resources.

The engines of economic growth. In varying combinations at different times, capital inflow, mass immigration, military-industrial activity, and territorial expansion may be designated the mainsprings of the long cycle of economic growth which began in 1954 and ended with the Yom Kippur War. The first of these factors, capital inflow, had a variety of impacts. Transfers to and by individuals helped feed consumer demand, but even more notable has been the stimulation effected by the state's redistribution of its own foreign receipts. This has taken innumerable forms, including subsidies to producers and consumers, direct and indirect public employment, and large-scale expenditures on economic development and immigrant absorption. Acting as a conduit for both domestic savings and imported capital, the state has also dominated the private sector investment process.

The second key ingredient of rapid growth was the mass immigration of the first decade of statehood, during which the population rose two-and-a-half times. In the product market, newcomers injected demand for basic consumer goods and services, notably construction. Those immigrants who entered the labor market, and in particular male workers of non-European origin, provided a ready-made and relatively cheap labor force when rapid construction and industrialization efforts commenced in the mid-fifties. More-over, the burdens of mass immigration provided an essential basis for appeals to foreign philanthropy. Territorial expansion, thirdly, has taken place both internally and externally. Particularly in the first decade, there were large-scale state takeovers of land formerly or currently occupied by Arabs. This appropriation provided a substantial basis for extending activity in agriculture and construction. Finally, the coupling of territorial enlargement through conquest with extension of the military economy has been the major new ingredient in the growth process since the decline of mass immigration.

## Buffers Against the Consequences of Declining Unemployment

At the end of roughly the first five post-independence years, there followed a pronounced trend towards full employment. In 1954, the Israeli economy entered a phase of remarkable expansion: for more than a decade there was positive real growth in per capita GNP (10 per cent a year between 1953-1965). Correspondingly, unemployment fell progressively, from an estimated 11.5 per cent to only 3.5 per cent by 1961. This low level was maintained or even bettered over a five-year period which was succeeded by the recession of 1966-1967. The thesis of this section is that prior to the recession, a variety of state strategies and concrete policies formed a regulatory framework capable of (temporarily) overcoming Kalecki's 1943 prediction that "political business cycles" would be periodically invoked to counteract the augmentation of labor's power and militancy associated with full employment, and thus protect the interests of employers and private investors.

Patterns of state subsidy. The capacity of the Israeli state (circa the late fifties) to erect buffers against the destabilizing consequences of tight labor markets had much to do with its dominant role in literally constructing the systems of stratification and distribution—creating investment and jobs, allocating individuals into economic (and political) roles, and determining living standards. This dominance in turn stemmed from the state's extensive access to foreign grants and loans on the one hand, and the weakness of both private capital and a large segment of the citizenry (the newcomers) on the other.

From the outset, there were strong biases in the way the state managed these activities. Those who were ethnically, temporally (in terms of arrival), and politically closest to the labor movement elite enjoyed definite advantages. That this was true for the veteran working class which led the state-building effort is not surprising. But there was also an enduring split within the post-independence mass migration, very roughly along "Eastern" (those of Middle Eastern or North African origin) versus "Western" (mainly European) lines. This had to do with the fact that a larger proportion of the Westerners enjoyed independent means and/or ties (cultural, familial, organizational) with the pre-statehood Jewish population, and that they were not handicapped by being perceived as alien and "primitive." The veteran working class and the more advantaged (and primarily Western) newcomers were offered several avenues of access to the "state-made middle class" (Rosenfeld and Carmi, 1976). These included mobility into skilled and supervisory jobs in the productive sectors, the opening up of managerial and professional positions in expanding public bureaucracies, and expansion of the petit-bourgeoisie and bourgeoisie in response to expanding consumer and state demand.

Employers, who in theory stood to lose most from full employment, were handsomely compensated by protected markets, access to cheap credit and machinery, and a variety of other forms of state subsidy. Included were subsidies to private consumption which were generally—although not uniformly—made available to Jewish workers. Newcomers were provided (often with political strings attached) with the basic means of existence. This helped persuade many of them to accept marginal locations in the spatial, economic, and political systems, thus protecting vital interests of the state and its veteran supporters. Meanwhile, the occupants of entrepreneurial, managerial, and other well-remunerated positions were freed of the obligation to convert their profits/incomes into the savings normally necessary for capital formation (Pack, 1971). The state thus succeeded in simultaneously creating stratificational disparities and easing distributional conflicts.

But by the same token, the problems of full employment were primarily problems for the state. The more that labor was protected from market forces and employer discipline, the greater the cost of subsidizing business, and the greater the dependence on outside support to finance this largesse. And the more that workers were allowed to become independent of labor market dictates, the harder it was to sustain both their material dependence on the ruling party and the territorial and economic roles assigned to them in state-building strategies. Nevertheless, these effects were mitigated for a time by institutional mechanisms which (a) confined marginal groups within secondary labor markets, and (b) allowed for a large measure of politically engineered restraint of labor militancy.

Labor market segmentation. The core assumption of the segmentation literature is the existence of qualitatively distinct, bounded, and sectorally based clusters of job locations. Typically, a distinction is posited between primary and secondary labor markets, with the latter consisting of jobs characterized by instability of occupancy, low pay, limited intraorganizational career prospects, and lack of institutionalized job rights. While the effects of segmentation in Israel (e.g., on income and occupational inequality) have been much discussed, very little is known about its institutional features. On the other hand, we have a good idea of the type of people who fill secondary job slots. In particular, as Bernstein and Swirsky (1982) have shown, industrialization and economic growth were accompanied in the labor market by a strong bias towards assigning Eastern newcomers to less skilled, less rewarding, and less secure jobs. Without the protection of severance pay, in the absence of reliable and adequate entitlements to income replacement, and given their characteristic poverty and disorganization on arrival in Israel, Easterners were

much more vulnerable vis-a-vis both employers and the state. Furthermore, labor market marginality was often tied up with and reinforced by spatial marginality, especially for those who ended up in the development towns planted in outlying areas.

Israel's Arab citizens' vulnerability was even greater than that of the Eastern Jews, but they were not permitted to work in Jewish areas until the labor market had accommodated the bulk of the new immigrants, in the late fifties. Subsequently, primarily unskilled and poorly paying job slots (initially in construction and agriculture) opened up to Arabs willing to commute from their towns and villages to the Jewish economy. The existence of secondary sector jobs held by both Arabs and Jews made important contributions to protecting employer profitability, and to sustaining the privileges enjoyed by workers in the primary sector. Labor market segmentation performed more than an economic function, however; it also contributed to other objectives of the state. In the case of Arabs, employment as "proletarian commuters" served both to ease the economic pressure generated by confiscation of much of their agricultural lands, and to cement their fate to that of the state by making them dependent on the Jewish economy. Labor market marginalization of Eastern Jews neutralized the competitive threat which they potentially posed to the veteran working class, whose leaders were at the helm of the state apparatus. At the same time, the ruling party was able to forestall challenges to its legitimacy in the eyes of the Easterners by providing for their consumption needs in return for electoral loyalty. In the development towns, where jobs were not only insecure but also scarce, unemployed men were provided with relief work—to keep them in place (to further the objective of dispersing Jews territorially), and to keep them in the habits of manual labor (for the developing industrial economy).

### The Golden Age of Corporatism

Labor market segmentation and state subsidy were not the only forces mitigating against the emergence of distributional conflicts when, after 1953, unemployment began to fall. Another major factor was the influence enjoyed by the ruling party in worker institutions, principally the peak labor organization, the Histadrut. Indeed, this body was originally created largely at the initiative of the party which later evolved into Mapai and then Labor. At that time there was little trade union organization among the Jewish settlers, outside of the self-styled pioneers in agriculture.

The character of the Histadrut. Consistent with its title (literally rendered as organization, not federation), the Histadrut was—and is—far from constituting



a roof organization of trade unions.' When it was founded in 1920, the Histadrut's mission was seen as the creation of a disciplined working-class vanguard of Zionist colonization. Its immediate task was to provide all of the services necessary to the economic and political integration of newcomers—from job creation and allocation to health, housing, education, and consumers' cooperatives. The parties which presided over the Histadrut's creation had previously attempted to meet these needs on a partisan basis. They hoped that the labor organization would free them from this competition, while providing a more effective power base one that could be expanded as opportunities (for example, to extend the trade union function) developed. In a compromise which ultimately served the interests of the ruling labor party in-the-making, a complex system of governance was developed characterized by (a) centralized direction; (b) accountability of both elected officers and functionaries to their nominating parties rather than the membership; and (c) internal representation of all the labor parties in accordance with their proportional standing in general Histadrut elections; while (d) in practice a controlling position was assured to whatever party could secure a majority, alone or in coalition.

By the fifties, collective bargaining had become an important and centralized Histadrut function, while on the other hand, the mainstream leadership of the labor movement had abandoned much of the socialist content of its collectivist orientation and become reconciled to the capitalist economy. In terms of conventional indicators of the strength of labor organizations, the Histadrut could boast impressive credentials. By the late fifties (as in recent years), it could plausibly claim to represent some 85 per cent of all wage and salary earners in national and industry-wide collective bargaining, and to serve about 70 per cent of the entire population through its Sick Fund. In social services, the Histadrut not only dominated primary health care, but also the field of supplementary pensions. It played a major role in numerous spheres from sports to daycare. Agricultural, industrial, and commercial enterprises and cooperatives owned by or affiliated to the Histadrut occupied a quarter of the working population.

Yet the Histadrut did not perform these activities essentially as a labor organization. The frame of reference embraced by its leaders was the fused trinity of the nation, the state, and the party. Histadrut policy was set in Mapai party forums, where those of its emissaries located on the commanding heights of state institutions pulled the greatest weight. Most Histadrut members were (and still are) not affiliated by choice, but for reasons largely extraneous to their interests as trade unionists (often because they were in need of

<sup>1</sup>The existing English-language literature on the Histadrut is often outdated and oversimplified, but for some useful treatments see Zweig (1959), Shirom (1980), and Medding (1972).

medical services, or were employed in closed-shop labor movement institutions). It is indicative that members affiliate directly to the peak organization, which then determines to which unions they will be assigned. Moreover, the leaders of these national unions are, like the officers of the Histadrut center, party appointees (except in unions of professional employees).

The first decade of statehood was a period in which Mapai not only used its majority of the Histadrut vote to gain almost complete control of the organization's key central and regional bodies, but also succeeded in dominating the majority of the workplace-based Workers' Committees. These committees—bearers of an ill-defined constitutional mission to act as the Histadrut's shopfloor arm—were a natural vehicle for spontaneous trade union activity. But politicization extended even to this level, and Mapai quickly succeeded in ousting militants of the parties to its left from the leadership of a large minority of the Workers' Committees of the veteran working class, while implanting its own bosses as committee heads in new-immigrant workforces. Once in office, the party's delegates were able to use the spoils controlled by the committees—like dispensation of loans and the power to give or withhold recommendations for promotions—in order to perpetuate their influence.

*Corporatism and its discontents.* Along with a myriad of other Histadrut organs and resources, Workers' Committees thus played their part in enabling the party to distribute patronage, create bonds of material dependence, recruit activists, disseminate propaganda, and punish or coopt dissenters. These capacities were essential not only to the perpetuation of Mapai's political hegemony, but also as the basis for the Histadrut's integration into the state in its trade union persona. Under Mapai's joint stewardship of both institutions, the party played a decisive role in determining the content of the periodic economy-wide collective agreements concluded by the Histadrut and the ineffectual private-sector Manufacturers' Association. Acting determinedly in the "national interest," the Histadrut embraced the view that labor discipline (wage restraint, strike avoidance, and increased productivity) is the essential basis for profitability, and in turn, for economic growth. Thus, it periodically acceded to government demands to freeze wages and/or limit the operation of the Cost of Living Allowance, by which wages are indexed to inflation. It also supported the principle of linking pay to productivity, both at the individual level (through incentive schemes) and at the macro level (in overall wage policy).

The Histadrut thus appears to be classically corporatist, both in its organizational form, and in the intermediary nature of its position between labor

and the state.<sup>5</sup> But this did not prevent the emergence of significant oppositional tendencies within the system. Indications of rank-and-file revolt emerged both among industrial workers (often with the active encouragement of Mapai's leftist rivals within the Histadrut) and salaried employees (especially professionals) concentrated in the public sector. In view of this, the practical effectiveness of Histadrut wage policy in preventing labor cost increases must be questioned. There is econometric evidence for Israel showing that in periods of labor market tightness, declining unemployment has been a powerful factor behind wage drift, although it also appears that severe wage freezes have been able to counteract market forces, at least in the short term (Artstein and Sussman, 1977). While such findings are suggestive, they cannot tell us anything about what might have happened in the *absence* of Histadrut restraint. In fact, the pattern of industrial relations which developed during the fifties effectively preempted a number of counterfactual scenarios which would have transformed the labor organization into a more militant force.

In principle, the Histadrut might have used its organizational power in the interests of the relatively powerless workers in the secondary labor market, or else left the field open to uncoordinated economic trade unionism. Instead, despite a programmatic commitment to solidarism, the Histadrut made important contributions to labor market segmentation, in its *de facto* treatment of wage differentials, for instance. It was also successful in preempting the alternative scenario of unbridled militancy, as is clear from strike statistics for the fifties. These indicate both a low rate of worker involvement in disputes (only half the level which prevailed during the decade before independence), and a very low proportion (10 per cent) of strikes without Histadrut authorization. Finally, an assessment of the effectiveness of corporatist restraint would be incomplete without recognizing its purely political dimensions. In particular, without the Histadrut's role as the workers' "nationally responsible" representative in peak wage bargaining, the rationale for such a comprehensive and centralized roof organization might have been challenged, endangering its viability as an agent of political socialization and mobilization for Mapai.

### The Origins of the Mid-sixties Crisis

In the sixties, the state strategies for preserving full employment discussed above proved to be self-destructive in part and in part were un-

<sup>5</sup>In the context of trade unionism, corporatism is here taken (in an adaptation of Schmitter, 1974) to denote: (a) the existence of a central labor body organized as the internally and externally authoritative representative of the entire working class or a major sector thereof, and (b) the delegation to this body of responsibilities for the formulation and especially the implementation of public policy concerning wages and industrial relations. Corporatism has usually been associated with an ideology of partnership between labor and management and the consistent practice of self-restraint by unions. These outcomes are, however, not inherent in corporatism as defined here, and if present they may (as in Israel) derive from a variety of sources.

dermined by exogenous dynamics which weakened their viability. The problems thus confronted were not limited to the sphere of industrial relations. They also concerned the economic mechanisms which had hitherto provided the material basis for full employment, and particularly the paternalistic role of the state.

*Limits of the paternalistic growth model.* The state's role in the economy had been threefold: first, it was an enormous direct and indirect source of demand; second, it provided diffuse subsidies to promote a favorable "climate" for the business sector generally; and third, it formulated more selective incentives designed to stimulate the production of exports and import substitutes and the flow of private (especially foreign) investment. For the state to sustain the massive scale of these activities as consumer, investor, and subsidizer, it needed both the special policy problems of the fifties (population expansion) and a hard currency income sufficient to cover the bill. In the early sixties, these exogenous prerequisites began to fail. *Aliyah* (Jewish immigration) fell sharply in 1964 and 1965, and there was little prospect of either "push" or "pull" leading to any large-scale exodus of diaspora Jews in the foreseeable future. Meanwhile, unilateral transfers and long-term loans—on which the state relied for cheap capital inflow—had reached a plateau. And two of the most attractive sources (U.S. aid and German reparations) were in the process of drying up altogether.

The alarm-bells rang in 1962 and again in 1964, when the trade deficit jumped 30 per cent. Even though by 1960 revenues from exports had risen to the equivalent of half the cost of imports, it became necessary to resort to short-term loans and/or foreign exchange reserves in order to fill the gap. The trade crisis served notice on policymakers of the inadequacy of their past efforts to foster an industrial economy with import-saving and export-augmenting biases. Industry was generally overcapitalized (as a result of the state's generosity), undercompetitive internationally (in part because of the dual policy of domestic protection and export subsidy), and inefficient (the consequence of small scale and poor management, as well as labor problems).

An economic system which, regardless of formal ownership, was nurtured and protected by the state evidently could not operate cost-efficiently. Moreover, it imposed distinct liabilities on the state. Among those noted by contemporary observers were: demands for bailouts when managerial incompetence threatened jobs, pressure on state planners to grant incentives not justified by national priorities, the failure of most firms to honor commitments given in exchange for export subsidies, and a tendency for only the weakest industries to locate in the outlying areas where public subsidy was greatest. With both private

and Histadrut investment dependent mainly on government-directed credits and grants, rather than on the (very limited) capital market or on reinvestment of undistributed profits, economic growth was painfully nonself-sustaining. The Labor elite had long recognized this weakness, but pinned its hope on attracting overseas (especially Jewish) investors. Little came of this until the first half of the sixties, when direct foreign investment surged to a quarter and more of the level of unilateral transfers. In 1965, however, net direct investment fell by half, just at the point when it was needed most. The desire to restore and enhance this source of capital inflow may thus be assumed to have helped shape the new economic strategy behind the slowdown.

*The rise of labor in the market.* While most Israeli economists felt that the state's largesse and neutralization of market forces lay at the heart of the country's economic difficulties, there was also widespread condemnation of what was viewed as excessive worker power. Strikes, absenteeism, "uncooperative attitudes," and a steadfast holding to established protective devices (indexation, seniority provisions, job tenure) were singled out for attack. They were seen as sabotaging the prospects for export-led growth by pushing labor costs above those of Israel's competitors and preventing more productive allocation of labor. This critique is sustained by data on labor costs in industry which show that their rate of growth intensified between 1955–1960 and 1960–1965. Prior to the sixties, wages had been restrained while government subsidies simultaneously kept profit rates high. In contrast, in the first half of the new decade, "wage increases accelerated while the growth of the profit rate slackened off" (Gaathon, 1971, p. 115). The capacity of employers to counteract wage push by raising productivity was apparently limited, since *unit* labor costs rose sharply until well into the recession.

In sum, there were indications of the very consequences of full employment that Kalecki had foreseen—profit squeeze and eroding employer control of the labor process. This was due not only to the direct effects of declining unemployment, but also to the failure of the mechanisms discussed earlier—labor market segmentation and corporatist industrial relations. The main source of the weakening of the first of these two buffers was that various groups of Eastern Jews, predominantly males, had been drifting out of the secondary labor market. This exodus took several forms. Some secondary locations—notably in the construction industry—became characterized by labor shortages, high pay, and opportunities to move into self-employment. Some sections of the new-immigrant working class began to utilize media of collective action at the workplace level, successfully demanding the benefits of the primary market. Still others left the proletarian labor pool by entering

clerical and service jobs at the lower levels of the expanding public bureaucracies. Finally, particularly in the development towns and on the urban periphery, there emerged a "lumpenproletariat" on the margins of or totally outside conventional labor markets.

The last of these developments was in part the consequence of expanded welfare state provisions targeted to Eastern Jews, particularly following a serious episode of insurgency in urban slum areas in 1959. The problem of Jewish rejection of secondary jobs also became more acute with the emergence of an Israeli-born generation led to expect upward mobility by the ideology of integration propagated by the schools, the army, and other organs of the state. It is true that new marginal groups (non-Jews, women, the aged, the handicapped) were to some extent counteracting the loss of secondary labor. But many of these groups were "misallocated." Most of the Arabs (virtually all males) entering the labor force were drawn into construction, and the sharpest growth in female employment was in service jobs. It seems likely that the industrial economy's appetite for secondary labor grew over the period', and that this hunger increasingly went unsatisfied.

*The challenge to corporatism.* The Histadrut's centralized structure and multi-level politicization, built up so assiduously during Israel's first decade, were both severely undermined during the second. In a context in which labor organization and representation were organized from above by a leadership thoroughly committed to restraint, full employment gave a tremendous boost to processes of grass roots self-organization. Quantitatively, this was translated into a 150 per cent increase in the number of Workers' Committees between 1960 and 1965. Concurrently, direct party control of the committees disintegrated. By 1964, more than 80 per cent of Histadrut members reported nonpartisan elections in their workplaces. There remained settings—such as localities with strong and coordinated municipal and Histadrut machines, or Histadrut-owned industry—where the party retained a virile and explicit presence. But even in these cases, pressures from below obliged Mapai's delegates either to defy Histadrut wage policy themselves, or to see it challenged by an alternative form of workplace representation, the "Action Committee." Wage drift, in the form of supplements negotiated by Workers' Committees, was rife, especially in large factories. And there was an upsurge of rank-and-file militancy, with the share of unauthorized strikes in the total rising from a quarter in 1960 to an average of 60 per cent during the full-employment years (1961-1965).

Another revealing feature of the new conflicts is that they were increasingly directed towards Mapai's own dominion—that is, the Histadrut and state

sectors of employment. The unrest among public employees was sparked both by the issue of equity *between* sectors (because of the greater effectiveness of wage freezes in the public service), and *intrasectoral* differentials (professional and managerial workers complained that the pay structure was far too flat). "Academic" workers had become increasingly proficient at using their relative advantage in the labor market and the threat of secession from the Histadrut, in order to openly challenge official wage policy. The government was also susceptible to their pressure, since it was anxious not to alienate the professionals politically, and was not insensitive to the wishes of its senior bureaucrats.

These inter- and intrasectoral grievances accumulated. By the early sixties, the government faced the wrath of both the contending groups in its employ—the large mass of clerical and manual workers, and the managerial and professional elite. An attempt to devolve the responsibility onto a commission of enquiry created a mechanism ("reclassification" committees) which sanctioned very high pay increases for workers in the nonprofessional grades. For their part, the "academics" were promised retroactive restoration of their former advantages. The result was a massive increase in the wage bill, due to stretch over 1965-1966, which placed a weighty new burden on the fiscal system. The affair clearly exposed the inherent weakness of extreme corporatist centralization of wage determination, in the absence of effective Histadrut control over members with their own economic and/or organizational power base.

*Threatening political developments.* Students of Israeli politics generally agree that the most important reason for Mapai's initial success in attracting its most unlikely post-1948 constituency (i.e., the Eastern new immigrants) was these workers' material dependence on the bounties of the Mapai-Histadrut machine. However, by the sixties, most of the newcomers had acquired the necessities of life, economic growth had opened up opportunities for their autonomous advancement, an indigenous leadership was developing (especially in local politics), and the public bureaucracies had become less particularistic. These circumstances—and not full employment alone—were behind the rise of rank-and-file revolt. They also made themselves felt in the 1965 Histadrut elections, in which Mapai barely sustained its traditional majority, even after having entered into an electoral alignment with one of its rivals on the left. It was hardly surprising, then, that Mapai's economic ministers felt powerless to prevent the wage explosion noted above, since the demands were raised in an election year.

Two further factors which had facilitated Mapai hegemony were strong leadership and internal unity, on the one hand, and the weakness and fragmentation of the right-wing opposition parties on the other hand. Both of

these props had weakened by the time of the 1965 Histadrut and Knesset elections. Ben Gurion and a coterie of ambitious younger men broke away from Mapai to form the Rafi party. And Menahem Begin's Herut left the political wilderness by merging with the middle-class Liberal party to create Gahal, the forerunner of the Likud. Both of these dissident forces were opposed to the existing structure of labor representation. Independently, they called for depoliticization of the Histadrut, transfer of its nonunion functions to the state, and statutory controls over labor disputes. Corporatism thus came under attack from the outside as well as from within.

Despite these threats to Mapai, the Knesset elections ironically strengthened the government's capacity to attack the new state agenda, including the reform of corporatism. For while the two new parties together ate away nearly five percentage points from the Labor Alignment's vote share, they also succeeded in scaring the most leftist Zionist party (Mapam) and the Liberals' breakaway left wing, into entering the cabinet. With a healthy 73-member government coalition (out of a total of 120 seats), now encompassing both of Mapai's more radical rivals, the state's economic managers could contemplate the pursuit of unpopular policies with relative equanimity.

## Recession as Problem-Solving Behavior

To review the argument, full employment both gave expression to and aggravated the degeneration of prevailing state strategies of economic, social, and political management. Under circumstances in which organized labor was able to push costs upwards and resist attempts to raise productivity, and in which the supply of cheap marginal labor was insufficient or at risk, the weakness of state-subsidized capitalism became strikingly evident. The problem was particularly acute because "hard" means of meeting external obligations (exports and direct investment) were insufficient to compensate for declining "soft" sources of capital inflow. Moreover, immigration could no longer be expected to act as a catalyst to growth. But the developing crisis was not only related to the state indirectly, because of its central role in steering the economy. It also encompassed the state's administration of its own economic affairs—particularly, the high price of trying to buy political popularity through wage inflation, in a context of declining intergovernmental transfers. Beyond this, state managers were forced to confront the damage done by full employment and political realignments to the power of the Histadrut and its corporatist integration into the state. (A statistical rendering of these dilemmas and their contemporary counterparts is provided in Table 1.)



TABLE I  
TRENDS IN SELECTED ECONOMIC INDICATORS:  
ISRAEL, 1960-1982 (ANNUAL AVERAGES)

	1960-1961	1962-1965	1966	1967	1968-1971	1972-1976	1977-1979	1980-1982
Unemployment (%)	4.1	3.5	7.4	10.4	4.5	3.0	3.5	5.0
Unauthorized strikes (%)	34	63	55	45	69	65	70	50
Real unit labor costs (1960 = 100)	101	112	126	125	109	104	123	117
Price inflation (% change)	4	7	8	2	6	29	55	123
Trade deficit (\$B)	.39	.49	.45	.54	1.00	2.85	3.05	4.28
Unilateral transfers (\$B)	.32	.33	.29	.52	.58	1.79	2.36	2.84

Sources: Unemployment rate: Statistical Abstract of Israel 1982, p. 321. Proportion of strikes authorized by the Histadrut: Reports of the Chief Labor Relations Office, and Statistical Yearbooks of the Histadrut's Institute for Social and Economic Research, various years. Real labor costs per unit of business sector product: 1963-1982 from the Bank of Israel's Annual Report for 1982 (p. 57 of the Hebrew edition); 1960-1962 estimated on the basis of the ratio of wages to output per man-day, from the Bank's 1967 report (p. 301). Inflation (rate of growth of the CPI): Statistical Abstract for 1982, p. 246. Trade deficit (net credit on the goods and services account) and net unilateral transfers: 1960-1976 from Falk Institute Discussion Paper No. 83.02 (Jerusalem, 1983, p. 77); 1977-1982 from the Bank of Israel's 1982 report (p. 172 of the Hebrew edition).

The essence of the slowdown policy was a two-pronged response to the above problems: on the one hand, ending "over-employment" in order to break workers' grassroots power and strengthen the hands of both the Histadrut and employers; and on the other, a shake-up of business to squeeze out redundant and uncompetitive industries and employers. This interpretation is demonstrably plausible in several specific respects.

First, unemployment was the only practical solution to the crisis, since alternative policy responses would have been vitiated by their failure to neutralize labor militancy (cf. Greenwald, 1972). A good example of the dilemma facing policymakers occurred in 1966, when there was a failed attempt to compensate for the pre-election concessions to public employees by denying similar rises to the business sector, and by raising indirect taxation. The result was a rash of strikes, the re-emergence of multi-plant Action Committees, and effective resistance to having the new taxes kept out of the linkage system. A consensual agreement capable of countering these forces was impossible given the Histadrut's diminishing authority, erosion of Mapai's influence, and the competitive tensions between different groups of workers. Devaluation was advocated by many experts, but unless labor militancy had already been stilled by unemployment, a rise in import prices would have been quickly translated into wage increases by indexation and/or unauthorized bargaining and strikes.

Second, the state explicitly sought a "political business cycle" solution. Leading official spokesmen stated publicly that labor militancy was a (if not the) fundamental cause of Israel's economic malaise, and that a dose of unemployment would be the most effective cure. It is true that merely the running down of immigration and capital inflow made a recession inevitable. The critical question is how policy responded to these trends, and the evidence is unambiguous. In July 1966, when 40,000 work-seekers were already registered at the labor exchanges, the Minister of Finance was reported as stating that his economic program would require 95,000 unemployed. Moreover, for roughly a year the authorities delayed the adoption of counter-cyclical policies oriented towards easing unemployment, which had by then passed a quarterly peak of 12.5 per cent.

Lastly, to some extent the recession was intended to discipline business as well as labor. It is true that unemployment could be expected to serve employer interests by halting the growth of wages, increasing labor supply, and re-establishing managerial authority. At the same time, the highly profitable construction and kindred industries were intentionally restricted, and domestic demand in general was deliberately run down (or not revived). There was much talk of exposing industry to the whip of international competition, and

insistence that the paternalistic subsidies of the past would no longer be made available to lame ducks.

## Recasting the Political Economy Through Crisis

The implementation of the state's strategy for using crisis to reformulate key elements of the political economy throws considerable light on the strengths and limitations of recession as a policy instrument. One noteworthy outcome was the state's lack of success in using the domestic slowdown to pressure industrialists into voluntarily embarking on an export drive. On the contrary, only positive rather than negative incentives turned out to have the desired effects. Apparently for this reason, no serious practical steps towards trade liberalization were taken during the recession. Moreover, policy towards business was softened relatively early, towards the end of 1966. Even so, improvements in both investment and trade were not discernible until after the June 1967 war. It is doubtful that this can be attributed to a lag in the working through of recessionary incentives. Basically, it took a postwar devaluation to make production for export attractive enough to yield the desired response. This was also the time when the government adopted a range of new and expanded incentives aimed at encouraging private investment generally. Finally, without the stepped-up militarization of the industrial economy which the state initiated after 1967, neither foreign investment nor exports would have grown as fast as they did.

The discipline of the market proved to be much more effective on the labor side. As the Bank of Israel concluded in its annual report for 1966, the recession undoubtedly induced workers to adapt themselves to employers' demands and to tone down their own demands. In part this reflected the declining ability of workers in direct confrontation with employers to resist wage cuts, layoffs, and deterioration of working conditions. Starting in construction, wage drift ceased and even became negative. In addition, labor effort was intensified by the raising of production quotas, lowered absenteeism and turnover, and enforced cooperation with efficiency measures. The figures for industrial disputes parallel those for labor costs in indicating a sharp turnaround from early in 1967, when the number of both strikes and strikers fell substantially, remaining below earlier levels for several years. Simultaneously, the causes of conflict altered radically in favor of more defensive issues, and there was a dramatic falloff in worker recourse to strikes without Histadrut backing.<sup>6</sup>

<sup>6</sup>The trend in strike authorization comes out more sharply in terms of "strikers" than strikes. Whereas in the first half of the sixties only 20 per cent (at most) of each year's total were involved in authorized actions, by 1968—1970 this proportion had risen to 70 per cent or more.

While the trends detailed so far represent the direct effects of the recession in reducing worker leverage over employers, there were equally important indirect effects resulting from enhancement of the Histadrut's capacity to implement a policy of restraint. The state, with the cooperation of the Histadrut's Mapai leadership, used the labor organization's renewed influence to implement formally sanctioned wage cuts. But the Histadrut's extended corporatist role was not confined to giving its blessing to the pay reductions demanded by both the Treasury and the newly confident Manufacturers' Association. The Histadrut performed an additional shock-absorbing function for the state, shielding it from the workers' wrath by (a) publicly supporting official economic policy, (b) trying to reassure rank-and-file members that the Histadrut was safeguarding their interests, and (c) actively discouraging protest actions. Finally, the Histadrut also set about turning the recession to its own advantage. Thus, the head of the gigantic holding company which formally controls the "Workers' Economy" made no secret of his intention to increase the profitability of labor-controlled industry by tightening worker discipline. The other strategic advantage of the recession was, of course, the opportunity it offered to re-centralize effective control over collective bargaining and strikes. In several celebrated cases, it was forcefully made clear that henceforth no deviations from official policy by hitherto powerful rank-and-file groups would be tolerated. It thus appears that the recession was not only instrumental in producing the outcomes desired of corporatism, but also in recreating the essential preconditions for the Histadrut's participation in corporatist intermediation between labor and state.

### Towards a New Political Business Cycle?

It is impossible here to trace in any detail developments over the period of more than a decade-and-a-half since the mid-sixties slowdown. Instead, we shall mention only a few significant changes in the parameters on which the previous analysis focused. The first milestone is the war of June 1967. The political forces unleashed by the war (patriotism, subordination of domestic to geopolitical issues) served to complement the legacy of the recession in strengthening the Histadrut's corporatist capacities, even as the economic aftermath of the war brought about recovery and a return to full employment. The markets, natural resources, and cheap labor furnished by territorial expansion combined with expanded military requirements and capital inflow to recreate conditions for rapid growth. In the industrial sector, both employers and the Histadrut succeeded in regaining control over workplace trade unionism. Coupled with the prosperity shared by workers in the primary labor market

and renewal of the secondary labor force, this made it possible to implement policies of labor restraint in this sector into the seventies and beyond.

In other respects, however, the viability of corporatist industrial relations was undermined in the post-slowdown period. Both the Histadrut and the government were unsuccessful in imposing their authority on workers in the politically sensitive state monopolies, and there have been chronic outbreaks of public employee disputes., especially among professional employees. The hegemony of the Labor Party progressively weakened, not only among the electorate but also in political practice, including the party's mediation of the relationship between the Histadrut and the state. From the late sixties, this relationship became increasingly adversarial, and corporatist bargaining became increasingly tripartite in structure and formalized in style. Still, both unemployment and unit labor costs were effectively held down, even in the first few years following the oil crisis and the Yom Kippur War.

It is remarkable that unemployment remained at roughly its low pre-crisis level throughout the seventies, despite massive increases in both domestic inflation and external indebtedness. This reflected the extreme reluctance of the state to depart from full employment, not only for traditional Zionist reasons but also because of the political risks. Widespread disillusionment with Labor followed the 1973 war and a series of party scandals. The government had particular reason to fear the impact of unemployment on Easterners, who remained the economically most vulnerable sector of the Jewish citizenry and who were turning against the political establishment in both parliamentary and extra-parliamentary politics. Thus, despite conditions of economic stag-nation, labor demand was maintained, in large part by expansion of state employment to absorb enormous increments to the educated labor force. The fiscal burdens of continuing full employment were carried by stepped-up American aid, long-term loans abroad, and inflationary deficit financing.

The second half of the seventies saw wage and price explosions and growing external and internal indebtedness, and at the end of the decade mildly deflationary policies (which edged unemployment up from 3.5 per cent to 5 per cent) were adopted to encourage exports and curtail imports, spending, and wages. The period of austerity was short-lived. Yet even though both private and public consumption continued to grow after 1980, with severe consequences for both price stability and the trade deficit, neither the fiscal position of the state nor the balance of payments reached the point of collapse until well into 1983. Consumer and stock market booms (both stimulated by government policies) served indirectly to prop up public revenues. External obligations were met by loans, continuing U.S. aid, and income from a surge in arms-related exports.

On the wage front in the seventies and early eighties, exercise of self-restraint by the Histadrut was episodically successful (more so in industry than the public sector) in holding back labor costs. It might seem puzzling that there have been recurrent outbreaks of corporatist cooperation between the Histadrut and the anti-labor movement governments which have ruled Israel since 1977. But, stripped of its role in peak wage bargaining, the Histadrut would have found it difficult to defend the "corporate-ness" which is its essence as an institution. By withholding its consent to policies of restraint, the Histadrut would also have added to the risk of inroads by the state into its nonunion power bases in the industrial economy and the social services. Finally, the Histadrut is willy-nilly drawn into an unholy alliance with the government against the most insurgent sections of its membership, since these are uniformly in the state's own employ.

Histadrut cooperation with state aspirations for wage restraint has become particularly important since the economic policy U-turn which followed the crisis of 1983. In the latter half of that year, it became evident that falling export revenues and exponentially growing debt service were bringing the balance of payments and the condition of the nation's foreign reserves to critical thresholds. Fiscal strain also became critical due to declines in private savings and public revenues, coupled with the cost of the war in Lebanon and political immobilization on the issue of public expenditure cuts. The crash of the stock exchange in October 1983 officially ushered in the crisis in political terms. The new Finance Minister appointed at that time centered most of his hopes for economic stabilization on real wage cuts, particularly in the public sector. This was expected to lower demand for imports, increase export competitiveness, and reduce the state's wage bill.

However, the new wage policy was implemented by securing the Histadrut's consent to limited compensation for inflation while prices were pushed upwards, rather than via the discipline of recession. As of mid-1984, and even before the announcement of early elections, there was no sign of measures which would push unemployment *sharply* upwards in the manner of the 1966–1967 slowdown. The reasons for this are ambiguous. The government's failure to seriously retrench public spending could be attributed to the internal barriers to retrenchment faced by a fragile coalition government, and a wish to maintain the legitimacy of the state and the ruling party in the eyes of the mass public—as well (and more than) to any desire to hold unemployment down as a *quid pro quo* for the Histadrut. Whatever the future brings, the experience of the last decade is an object lesson in the capacity of Israeli governments to call upon a variety of resources and strategic choices in order to prevent renewed recourse to the political business cycle, even under conditions in which

corporatist discipline of labor is insufficiently strong to head off major risks of economic destabilization.

## Conclusion

In a handful of nations (Sweden, Norway, Austria) where the labor movement has enjoyed sufficient organizational and political power to simultaneously exert control over both worker behavior and the state executive, there appears to have been a genuine tradeoff of labor restraint for favorable public policies (including full employment). But it does not follow that the distinctive features of these labor movements and their relationship to the state may be abstracted into variables from which generalized cross-national predictions may be made (of the form, "the more corporate the unions and the closer their links to a Social Democratic government, the lower will be both unemployment and inflation"). This study of Israel underlines the fact that even the conditions for and the functions of full employment (or unemployment) are nationally and historically specific. In the Israeli setting during the late fifties, a transition to full employment was made *necessary* by considerations of state-building and domestic politics, and *possible* by a unique combination of exogenous factors favoring economic expansion.

A second element of our analysis which has wider significance, is the notion of multiple mechanisms for "regulating" labor. It was shown that in Israel the state utilized a variety of strategic devices which prevented recourse to deflation as an antidote to the consequences of full employment for industrial relations. These devices included the state's intervention in stratification, distribution, and labor market segmentation, as well as its corporatist relationship with the Histadrut. Moreover, once corporatism itself was placed in the context of the Histadrut's subordination to the ruling party and its powerful commitment to nation-building (as well as to labor representation), then both causes and consequences in the nexus between unions and the state were seen to stretch far beyond the conventional boundaries of "social contract" bargaining.

A third critical lesson of the present account is the potential fragility of all mechanisms of regulation. Israel's experience in the early sixties shows that corporatism and other buffers against the Kaleckian consequences of full employment are vulnerable to contradictory internal dynamics and to external threat. The approach to a full-employment welfare state undermined the effectiveness of both labor market segmentation and political control of industrial relations, while a weakened exogenous basis for state subsidy and rapid growth brought considerations of economic efficiency and fiscal propriety to the fore. In two important senses, the resulting political business cycle was not just a

new phase in the regulation of labor in which market discipline replaced consensus. For one thing, unemployment was intended (and did serve) to strengthen corporatism, and to revive the other mechanisms which had earlier helped to contain full employment's destabilizing potential. Further, recession as a policy instrument had broader objectives than the reimposition of labor restraint. The Histadrut's institutional integrity and potency as a political transmission-belt, the electoral strength of the ruling party, the fiscal health of the state, and the viability of national-territorial objectives were all at stake.

We have argued here for the inevitability of change in "modes of regulation" (Schmidt, 1982) and their multidimensional nature; the necessity of placing abstractions like corporatism and full employment in context; and the inherent interconnection between the political and the economic preconditions and motives for the behavior of the state. If these arguments are correct, then in the study of how and why the interface between labor organizations and the state matters for economic performance, future progress will require greater reliance methodologically on historically grounded case studies, and theoretically on a broadly conceived political-economy approach.

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