
Article

Sources of state discipline: lessons from Israel's developmental state, 1948–1973

Erez Maggor*

Department of Sociology, New York University, 295 Lafayette St., 4th Floor NY 10012, New York

*Correspondence: Erez.maggor@nyu.edu

Abstract

Both the classic literature on the developmental state and more recent accounts of rapid-innovation-based (RIB) development highlight the importance of the state's capacity to discipline underperforming firms. Although long acknowledged, the sources of this capacity remain relatively understudied, and existing knowledge draws almost exclusively on the East Asian experience. To address this lacuna, I examine the successful industrialization experience of Israel in the two and a half decades following its independence (1948–1973). Drawing on archival materials and other original sources, I identify a novel path to state discipline. Whereas East Asian developmental states became disciplinarian through their engagement with export competition, in Israel, state elites generated discipline by leveraging their embedded relations with collectively owned enterprises to foster a competitive domestic market. In the conclusion, I explore the relevance of this model for more contemporary cases of RIB development in both developed and late-developing economies.

Key words: economic development, discipline, elites, embeddedness, industrialization, state capacity

JEL classification: O25 Industrial Policy, O140 Industrialization, H11 Structure, Scope, and Performance of Government

1. Introduction

It has long been assumed that in the neoliberal era, policy makers in both developed and developing countries have eschewed government policies that target the promotion of particular firms or sectors, in favor of more market-based arrangements. The state's role in 'governing the economy' was believed to have withered away, replaced by the workings of a 'liberal' (Levy, 2006) or, at best, a 'regulatory' mode of governance (Levi-Faur, 2005; Vogel, 1996). Recent scholarship, however, has challenged this entrenched consensus. Leading

scholars such as Mariana Mazzucato and Fred Block, among others, have identified the ongoing persistence of strategic state policies geared toward creating new markets, upgrading existing technologies and facilitating innovation (Block, 2008; Block and Keller, 2009; Keller and Block, 2013; Mazzucato, 2015).

Although these studies identify several key differences between the catch-up developmental state of the post-war period and today's rapid-innovation-based (RIB) development strategies (Breznitz, 2007; Wong, 2011), one element remains crucial to the state's effectiveness: its capacity to *discipline* private actors (Block, 2008, p. 172, Schrank and Whitford, 2009, p. 526, Weiss, 2014, p. 200). Robert Wade (2010, p. 35, 38) has recently singled out this 'extra-market source of discipline', necessary for ensuring that 'resources are transferred to growth sectors and that those who receive them use them to good effect', to be 'the most difficult of the growth-enhancing government capacities'. The significance of the state's disciplinary capacity has long been acknowledged (Amsden, 1989; Chibber, 1999; Davis, 2004; Rodrik, 2004; Woo, 1991). The sources of this capacity, however, have remained relatively understudied. Whereas existing knowledge draws almost exclusively on the experience of the East Asian tigers, this paper leverages an underutilized case in order to identify an alternative mechanism for generating state capacity for discipline.

Following Wade (2010, p. 36), I define state discipline as the ability to withdraw public assistance from private firms—whether in the form of trade protection, credit subsidies, fiscal incentives or other—either when their performance is poor or when they no longer need assistance to be internationally competitive. Building on debates surrounding the concept of 'embedded autonomy' (Evans, 1995; Heller, 1996), I propose that discipline is produced when state managers leverage their 'embeddedness' with *non-market actors* in the form of collective enterprises to counteract the structural power of business. Two preconditions prove essential in translating this relationship into effective discipline. The first is for these collective enterprises to maintain a relative level of autonomy from the central state, particularly as it pertains to the realm of investment. The second is that these actors remain socially embedded in a manner which guarantees their commitment to broader social goals alongside the pursuit of economic gains.

To illustrate these points, I analyze the developmental success of Israel in the years 1948–1973. Underutilized in the comparative literature (but see Barnett, 1996; Levi-Faur, 1998), Israel is a highly relevant case. Despite its eventual developmental success, the state's initial starting conditions were far from advantageous. In fact, early assessments made soon after Israeli independence in 1948 by a team of World Bank experts concluded the state had 'little prospect of economic progress, escaping its poverty, or becoming anything more than an economic charge of the West' (Barnett, 1996, p. 107). Nevertheless, within two decades, Israel's economic performance was being praised by leading international organizations and showcased for other Third World countries. Future analyses would attribute much of this unanticipated success to the state's relatively autonomous state and its capacity to override the interests of powerful societal forces (Levi-Faur, 1998; Migdal, 1988; Shalev, 1992). Juxtaposing the pessimistic forecast with Israel's eventual success suggests this capacity did not inhere in its state institutions prior to independence, but rather had to be produced and maintained. Therefore, if the mechanisms responsible for producing Israel's disciplinary capacity were operative, they should be present and

observable by examining its developmental experience.¹ In this regard, Israel serves as a 'crucial case' (Eckstein, 2000, p. 147) fitting for an investigation of the sources of the state's disciplinary capacity.

In the following sections, I first outline why state discipline is a vital component in any attempt to spur national economic transformation and introduce competing accounts of the origins of this capacity. Next, I introduce the case study and demonstrate that, much like paradigmatic disciplinary states like Korea or Japan, public subsidies in Israel were also conditioned upon firm performance, including but not limited to meeting predetermined export targets. I then proceed to present the main theoretical contributions of the paper. I demonstrate, first, that Israeli state managers generated disciplinary capacity by leveraging their embedded relations with collective enterprises owned and managed by Israel's trade union federation—the *Histadrut*—to foster dynamic competition within the domestic market. Next, I show that once realized, this capacity empowered state managers to execute a novel industrialization strategy I call *pursuing overcapacity*. Implemented in the face of clear opposition on the part of private industry, this strategy supplied an additional layer of market discipline which allowed the state to combat the predatory and rent-seeking behavior of private firms. Thus, whereas the East Asian developmental states allowed a full monopolization of their domestic markets and focused on export competition, Israel prioritized the creation of a competitive domestic market and viewed exports as only a secondary concern. In the conclusion, I engage with the recent literature on RIB industrialization and discuss the relevance of this arrangement to more contemporary developmental strategies in both developing and developed economies.

The analysis is based primarily on original archival data compiled from Israel's State Archive (ISA) and the National Library of Israel (NLI). The historical materials include unpublished reports and committee meeting minutes; correspondence between senior officials, politicians, and leading industrialists; annual reports, 5-year plans, and speeches. Additionally, I rely on a systematic reading of publications issued by Israel's Ministry of Trade and Industry (MOTI), as well as the periodicals of the representative bodies of both private industry and the trade union federation for the entire period under investigation. These data are supplemented by secondary sources found in previous literature on the period and biographies of central figures.

2. Theoretical framework

2.1 The significance of the state's disciplinary capacity

It was the literature on the 'developmental state' that, starting in the 1980s, established the causal links between state capacity and economic upgrading. Through their investigations into the 'miraculous' growth patterns exhibited in a number of East Asian countries—first Japan, followed by Korea, Taiwan and Singapore—these studies demonstrated that the

1 It should be stressed at the outset that this paper does not argue Israel's disciplinary capacity *fully* accounted for the state's positive developmental outcome. The actual rate and structure of development was the product of the joint operation of many factors—a highly educated immigrant population, foreign capital flows, geopolitical imperatives, and so on. Discipline was but one in this cluster of causes. The analytical task at hand is not identifying which factor best explains this developmental outcome, but rather to uncover the source of one of these important causes.

success of these ‘Asian Tigers’ rested not in their devotion to free market principles and a minimalist state but rather on their reliance on a comprehensive industrial program (Amsden, 1989; Haggard, 1990; Johnson, 1982, 1995; Rodrik, 1997; Wade, 1990; Weiss, 1998).² Such industrial policies aimed to target investment in select industries—first traditional, labor-intensive sectors like textiles and steel but later also in more sophisticated industries such as semiconductors, automobiles and computers—through a variety of publicly financed subsidies (Amsden, 1989; Wade, 2010; Woo, 1991). Subsidies included generous tax breaks, cheap loans, export incentives, and public investment in research and development. These incentives worked to reduce the risk associated with the necessary investment, thereby lowering barriers to entry. With the help of these subsidies, state planners were able to ‘nudge’ economic elites away from final stage production and into the more sophisticated yet risky realm of high value manufacturing.

Subsequent research focused on understanding why public subsidies were effective in East Asia, whereas in places like South America, the Middle East and Africa they were often associated with government failure or even a ‘predatory state’ (Evans, 1989). What these studies found is that although public subsidies are necessary, they are not in themselves sufficient. Crucial to their effectiveness is the ability of state managers to ensure incentives are used in desirable ways. They must not, as was often the case, be channeled to operations in less productive lines due to political demands, nor can they be captured by firms who have limited potential to be globally competitive. Rather, it is essential the state be able to allot subsidies to productive firms located in strategic sectors and to guarantee that such funds are invested in ways that go towards upgrading productivity, lowering costs and, eventually, catching-up with international competitors. This task, however, is easier said than done. Ultimately, it requires states *condition* subsidies upon predetermined performance standards and *discipline* firms who do not perform on par with these terms (Amsden, 1989; Chibber, 1999; Davis, 2004; Wade, 1990; World-Bank, 1993). Several studies have illustrated the fundamental importance of this factor. The outstanding success of Korea’s industrial policies in the 1970s and 1980s, to name a classic example, is often attributed to its capacity to condition state subsidies on meeting performance standards and export targets (Amsden, 1989, pp. 21–23; Woo, 1991, p. 165, 74). More recent examples include the ascent of Ireland’s software industry during the 1990s (O’Riain, 2000, p. 30, pp. 159–161), and the recent wave of technological innovation in the United States (Schrank and Whitford, 2009, p. 526; Weiss, 2014, p. 200).

Whereas the importance of state discipline has been well established, few studies have attempted to unpack the process of policy formation responsible for generating this capacity. Studies that have, focus almost exclusively on the East Asian experience (Amsden, 1989; Chibber, 2003; Woo, 1991). As a result, our knowledge regarding alternative sources of disciplinary capacity is limited. In the next section, I outline the literature focused on explaining the origins of state discipline. I begin by highlighting the shortcomings of existing accounts, and then build on established knowledge to propose an alternative mechanism.

2 For critiques of the developmental state framework, focused particularly on Japan, see: Okimoto, 1989 and Calder, 1995.

2.2. Routes to state capacity

Many scholars have argued that the capacity to impose strict performance standards was due to authoritarianism (Haggard and Mo, 2000; Kohli, 2004; Schrank, 2017). Yet not all high-capacity states have been dictatorships. Democratic Japan and France both exercised discipline in the post-war period (Johnson, 1982; Zysman, 1984). Furthermore, more recent examples of discipline have occurred in liberal democracies such as Ireland or the USA (O'Riain, 2000; Schrank and Whitford, 2009; Weiss 2014). This does not necessarily mean that authoritarianism is irrelevant—a question still very much debated (Chibber, 2014; Schrank 2017)—but it does imply that it cannot represent the only source of this capacity. A more accurate approach would therefore be one that accepts the possibility of alternative or complementary sources of state capacity (Pedriana and Stryker, 2004).

Another route to discipline often discussed in the literature is the state's monopoly over financial resources. A classic example is John Zysman's (1984) canonical study of how the French state used its control over credit-based finance as an instrument to influence investment patterns and guide industrial upgrading. A similar claim is advanced in Woo's (1991) study of the 'Korean miracle' which argues the state's unilateral control over foreign aid and domestic savings provided a lever over industrial elites.

There is no doubt that the state's control over investment capital increases its power over business. However, there is little evidence to support the claim that such control could make the state *sufficiently autonomous* in a manner that would permit it to simply disregard the interests of business. In a capitalist economy, business will always maintain a certain level of *structural power* due to its unilateral control over final investment decisions (Chibber, 1999, pp. 321–322; Lim, 1998). This dependence upon private firms then acts as a constraining force—exerted through the potential of an investment strike or a decline in business confidence—on the state's ability to govern by decree. A deterioration of business confidence would most likely trigger an economic slowdown and, inevitably, a decline in the overall demand for finance. If the demand for finance is itself in decline, it is difficult to see how the state's control over finance can serve as a lever over business.

Subsequent research has advanced beyond the 'investment capital' hypothesis, emphasizing that effective developmental policies are the outcome of the structured relationship between the state and societal actors. Whether its Evan's concept of 'embedded autonomy' (1995), Wade's 'governed market theory' (1990, pp. 26–27) or Weiss's 'governed interdependence' (1998, pp. 38–39), this approach argues that an effective developmental state must enjoy not only a certain level of autonomy (i.e. insulation from the influence of firms and other state agencies) but also a sufficient level of '*embeddedness*', i.e. 'a concrete set of social ties that binds the state to society and provides institutionalized channels for the continual negotiation and renegotiation of goals and policies' (Evans, 1995, p. 12). Only through such dense networks are state managers able to get a sense of firms' investment priorities, negotiate developmental goals and gauge whether these targets are being attained.

While the state's embeddedness is widely recognized to serve as an 'underlying structural basis for successful state involvement in industrial transformation' (Evans, 1995, p. 12), a puzzle remains: it is not clear how embeddedness yields effective discipline. How do state managers guarantee their close relations with private actors produce positive outcomes rather than manipulated for predatory behavior. As others have already noted, Evans' account is limited in its ability to reveal the 'specific practices that state officials use to engage effectively with [...] firms' (Block and Negoita, 2016, p. 57). A more compelling mechanism

must therefore also account for *how* the state is able to leverage or make use of its embedded relations in ways that overcome the fundamental constraint of business' structural power highlighted above.

One potential avenue for overcoming this weakness can be found in the scholarship of Sean O'Riain (2000, 2004). Whereas Evans analyzed state-society relations almost exclusively in terms of the links between the state and an indigenous industrial class, O'Riain's work on the Developmental Network State (DNS) showed that states are able to maintain multiple 'embedded autonomies' (2000, p. 166). For example, in the period of Ireland's high-tech-led growth Irish developmental agencies maintained simultaneously close links to national employers, foreign capital, and indigenous innovation networks (2000, p. 166). It was precisely this 'multiple embeddedness', argues O'Riain, which sustained the state's ability to promote development (2000, p. 158).

While the concept of the DNS highlights the state's links with domestic and international capital, the possibility that state agencies can become embedded with altogether different kinds of social actors should not be ruled out. In fact, it was Evans (1995, p. 240) himself who proposed that embeddedness is not necessarily restricted to connections with industrial capital but can also include other societal actors, including non-elites. Using the Indian state of Kerala as an illustrative example, Evans (1995, pp. 35–40) suggests that developmental states can prove effective through their links with organized labor and peasant groups (also see: Heller, 1996). A more recent example of such positive synergies is highlighted in Ornston's (2013) analysis of how neo-corporatist institutions, which incorporated both employers and organized labor, were used to advance technological upgrading in places like Finland, Denmark and Sweden.

But exactly how do the state's embedded relations with additional social actors translate into effective discipline? Existing scholarship has not adequately addressed this question. My analysis builds on the work of Evans and O'Riain, yet my conclusions differ from these authors' in several important respects. I posit that embeddedness with non-market actors can be exploited to lower the state's structural dependency on private industry by providing it with an alternative investment outlet. This weakened dependency can in turn allow state managers to generate the disciplinary capacity necessary for implementing industrial strategy.

I illustrate this point with an analysis of Israel's successful state-led industrialization in 1948–1973. Israel represents a relevant case for this examination. It was not only a successful developmental state, but its ability to produce discipline is particularly impressive when considering it did so in the context of an Import-Substitution Industrialization (ISI) developmental regime. Understanding why requires a brief elaboration of the unique incentive structure of ISI development.

2.3 The incentive structure of ISI

The core principles of ISI development are twofold. Like any industrial policy it entails providing domestic firms with public subsidies aimed to incentivize investment in risky, yet highly productive sectors. Additionally, in order to provide local manufactures with time to upgrade their capabilities and 'catch-up' to international standards, firms are also protected from foreign competition through a variety of import barriers.

Herein rests the weakness of ISI development. By neutralizing external competition, an ISI-based development regime often leads to monopolization which, in turn, further weakens

market pressures that induce productive investment (Barkey, 1989; pp. 292–293; Chibber, 2003, pp. 38–39). This occurs as first movers into targeted sectors use state subsidies in order to monopolize them. Once such control is realized firms are able to determine prices and avoid productivity enhancing investment. With state discipline being the only substitute for market competition, the incentives of local industrialists to resist the creation of such capacity are significantly increased.

This prediction is borne out by the empirical record of ISI in places like Argentina (Sikkink, 1991, chapter 3), Mexico (Hamilton, 2014, chapter 6), India (Chibber, 2003, chapter 6), Syria (Waldner, 1999, chapter 5) and Turkey (Barkey, 1989). In all these cases industrial elites mobilized against the state's attempt to construct the institutions through which discipline could be exerted.

This elaboration is in no way meant to imply that generating disciplinary capacity in the context of ISI is impossible, but rather that doing so should be viewed as a considerable challenge. Having produced disciplinary capacity despite these structural constraints, Israel represents a high bar for testing the proposed mechanism.

3. Israel's developmental state

3.1 Israel's economic 'miracle'

From 1950 to 1970, Israel's gross domestic product (GDP) and per capita income grew at extraordinary average annual rates of 9.7% and 5.2%, respectively (Syrquin, 1986, pp. 45–48). The main source of this remarkable achievement was Israel's dynamic, albeit newly formed industrial sector which enjoyed an unusually high annual productivity growth of 4.7% and accounted for 43% of total output growth (Halevi and Baruh, 1991, pp. 24–25). While production throughout this period was largely geared towards the domestic market, Israel also produced an incredible growth in industrial exports which climbed from only 3% of all commodity exports in 1949 to 46% in 1965 (Pomfret, 1976, p. 56). The economic indicators presented in Table 1 demonstrate that Israel's economic performance in this period was virtually on par with the export-led development of Korea and Taiwan and fared much better than the growth patterns exhibited in Turkey or Mexico, considered to be two of the most successful cases of ISI-led development.³

What accounted for this developmental success? Many economists attributed it to Israel's increasing factors of production: the dramatic growth in population and the large and continuous flow of foreign capital.⁴ While the first was a result of mass Jewish migration, which provided an expanding supply of labor and a growing source of domestic demand, investment capital arrived in the form of unilateral transfers from three main sources:

3 Whereas Israel's industrial exports increased rapidly in this period, rather than 'export-led', its developmental model more resembled what Albert Fishlow (1990, p. 66) described as an 'export-adequate strategy' where diversifying exports regularly keeps up with product growth and earns needed foreign exchange. Even after Israel increased its encouragement of exports in the 1960s, its economy remained primarily inward-oriented. A closer look at Table 1 below demonstrates that as late as 1973, Israel's manufactured exports accounted for only 15% of GDP, whereas in countries that implemented a clear export-led strategy like Korea and Taiwan, exports ranged from 24% to 38% of GDP.

4 A similar argument has been advanced regarding the East Asian 'miracle', see: Krugman, 1994 and Young, 1995.

Table 1 Cross national indicators of structure and growth

		Average annual growth of GDP (%)	Average per capita growth (%)	Manufactured ExportsShare of GDP (%)	Value-Added in Industry [†]
Korea	1955		–	0.2	13.1
	1963		1.6	1.2	16.9
	1973		8.0	24.3	29.7
	1950–1970	6.8	4.5		
Taiwan	1955		–	1.4	23.6
	1963		3.0	6.2	28.6
	1973		7.4	38.3	43.8
	1950–1970	8.4	5.4		
Turkey	1955		–	0.2	16.9
	1963		3.7	0.3	19.0
	1973		3.8	3.8	26.8
	1950–1970	6.1	3.5		
Mexico	1955		–	3.8	26.8
	1963		2.4	1.7	27.2
	1973		3.4	3.0	31.1
Israel	1955		–	4.9	31.6
	1963		5.2	11.2	35.5
	1973		5.2	15.1	36.7
	1950–1970	9.7	5.2		

[†]Industry includes manufacturing and construction.
Source: (Chenery 1980: 282, Syrquin 1986: 45, 48).

US Export/Import bank loans, proceeds of Israel Government bonds floated in the USA, and from 1952 onwards, the German war reparations fund.

Although these other two factors undoubtedly contributed, they cannot on their own explain Israel’s developmental success. For one, mass migration to Israel occurred mainly in the years 1948–1950, but dropped sharply after 1951 (Halevi and Baruh, 1991, pp. 14–15). In fact, studies show the migrant population was almost completely absorbed in the labor market by 1955 (Chenery, 1979, p. 311). Thus, even if population growth did provide a boost, it is difficult to see how it alone can account for over two decades of sustained economic development. As for the inflow of capital, the experience of many developing economies has shown that large sums of foreign capital do not automatically translate into economic growth, and can in fact have a negative effect on development (Moss *et al.*, 2006). This is particularly true if the institutions required to oversee state-led investment are absent (Dollar and Levin, 2005). It is only when publicly controlled capital is coupled with the institutional capacity to ensure investment is utilized effectively that you get sustainable economic growth. Understanding Israel’s developmental success, therefore, requires a closer analysis of the state’s industrial strategy and the institutions in charge of overseeing it.

3.2 The origins of Israel's developmental state

The central state agency responsible for orchestrating Israel's industrialization campaign in this period was the MOTI. Under the decade-long direction of Pinchas Sapir—one of the most powerful economic state managers in Israel's history—a small, Weberian state structure crystallized within the Ministry. Similar to other nodal agencies such as Japan's Ministry of International Trade and Industry (MITI) or Korea's Economic Planning Board (EPB), Israel's MOTI enjoyed an autonomous position within the state (Levi-Faur, 1998, pp. 69–70). Largely responsible for its dominance in the realm of industrial policy was the strong political support and cooperation it received from Israel's Ministry of Finance (MOF) and the Prime Minister's office (Greenberg, 2011, pp. 83–84, Levi-Faur, 1998, p. 70).

MOTI was by no means isolated from private industry, as members of its upper echelons maintained close relationships with leaders from both private industry and the Histadrut. Whereas the agency's 'embeddedness' with labor predated the state, ties to leaders in the private industrial sector, many of which were organized under the Manufactures Association of Israel (MAI), were first established in this key period. Throughout his tenure as Minister of Trade and Industry, Sapir went to great lengths to cultivate these relationships. He famously took weekly trips across the state in order to tour manufacturing facilities and meet with managers or potential investors. He maintained an especially close relationship with the acting President of the MAI, Arie Shenkar, whom he met with on a weekly basis (Greenberg, 2011, p. 90, 113).

Like many other developing nations in this period, Israel's development policies were guided by industrial planning. In 1957, MOTI intensified its efforts in this direction by setting up an Industrial Planning Bureau with the object of centralizing planning and drawing up a blueprint for the development of industry.⁵ Shortly after, the Bureau drew up a 4-year 'pilot plan' for the development of industry and in 1959 published the first comprehensive 5-year plan, followed by another 5-year plan published in 1965. State planning in the period closely followed the tenets of ISI development—generating new manufacturing capacity by providing manufactures with generous subsidies and protection from international competition via a host of administrative trade barriers.

A detailed examination of Israel's 5-year plan for 1960–1965 demonstrates that the majority of its targets were met and in some cases surpassed (see Table A1 in Appendix). For example, industrial output exceeded its set target for 1965, 2 years earlier than originally planned (Ministry of Trade and Industry, 1964, p. 6). Similar success was attained with regards to industrial employment and total investment in industry. Efficiency and productivity also increased in excess of the forecast (Ministry of Trade and Industry, 1964, p. 10). Finally, industrial exports surpassed their projected amount in 4 out of the 6 years for which data are available (see Table A2 in Appendix).

As these data clearly show, MOTI was effective in achieving its long term goals. As a result, local industry was vastly transformed from one that mostly carried out the final stages of production, assembling semi-processed products, to one involved in all stages of the production cycle, from the production of raw materials through intermediate goods to final products, creating significant vertical linkages (Ministry of Trade and Industry, 1965, p. 22). Between 1958 and 1972 Israel enjoyed a rate of 'industrial deepening'—measured by the ratio of intermediate demand to total manufacturing output—that was only slightly

5 *Israel Economic Bulletin* (IEB) Vol. X, 5, July 1959, p. 2.

lower than Korea's and considerably higher than that of Mexico or Turkey (Wade, 1990, p. 45, Table 2.9). In subsequent years, Israel continued this dynamic of industrial upgrading producing more skill and capital-intensive goods. In the late 1960s, clothing goods replaced textiles as the largest contributor to export earnings. Also rising in importance were electrical equipment, metal products, fertilizers and pharmaceuticals (Pomfret, 1976, p. 69; Teubal *et al.*, 1986, p. 1397). By many accounts, the 1960s was also when Israel's high-technology industry began to take shape. It was in 1961 that ECI Telecom was founded and in 1962 Tadiran and Elron Electronics. All three would later become the 'founding parents' of Israel's most successful technological enterprises (Drori *et al.*, 2013, pp. 35–36). In short, industrial planning in this period proved remarkably effective in 'nudging' local industry up the value chain, and in many ways sowed the seeds for Israel's indigenous technological sector, which in later decades became the central engine of economic growth.

Can this impressive achievement be attributed to the state's capacity to act as an effective disciplinarian? In order to demonstrate that this was indeed the case, the following analysis will focus on two of the central investment vehicles mobilized in this period by MOTI to target investment in desired industrial sectors: the *Law for the Encouragement of Capital Investment* (EOCI law) and loans from the *State's Development Budget*. Although the importance of both instruments has been previously acknowledged, their disciplinary function has yet to be examined. Drawing upon a variety of original sources I demonstrate that, these policy instruments enabled state planners to oversee the utilization of public subsidies and punish enterprises that did not uphold the terms and conditions that accompanied government assistance. The goal of this section is not to illuminate or identify *new* forms of discipline. Rather, it aims to empirically demonstrate that Israel's developmental agencies were, in fact, disciplinarian and that this capacity manifested itself in a manner that resembled other developmental states. Once this is established, I will proceed to outlining the *sources* underlying this capacity, which represents the core theoretical innovation of the paper.

3.3 The law for the encouragement of capital investment

Originally legislated in 1950 and later enhanced, first in 1955 and then again in 1959, the EOCI law aimed at 'developing the productive power of the state' and closing the gap in the trade balance 'through the reduction of imports and increase of exports'.⁶ The law authorized the MOTI to provide new manufacturing facilities with a myriad of subsidies which included relief from payment of property taxes for 5 years, a ceiling on income and corporate taxes, an accelerated depreciation rate and an exclusion of imported capital goods and raw materials from custom duty.⁷ In addition, the law provided investors with cheap land upon which to erect their plants, allocated building materials for their construction and expedited the installation of vital infrastructure such as electricity, telephone lines and water.⁸ Starting in 1959, manufacturing plants not originally recognized under the law could also apply to receive approved status, allowing them to enjoy similar benefits on any new investment.⁹ Although the establishment of a new plant did not require government approval, in practice most manufacturers in this period found it difficult if not impossible to compete with rival

6 IEB, special Issue: The law for the encouragement of Capital Investment, January 1951, pp. 6–12.

7 Ibid.,

8 IEB Vol. 9/10, September 1953, p. 33.

9 Israel's Annual Government Report, 1959, p. 240.

firms which were awarded the economic benefits of an approved enterprise (Aharoni, 1991, p. 220).

Serving as a one-stop-shop for investors and entrusted with approving investment proposals was the MOTT's Investment Center. This agency's control over the approval process played a key factor in its ability to channel public subsidies to local industry. Its disciplinary capacity, however, was rooted in its authority to ascribe specific terms and conditions to each approval and, if necessary, sanction firms who did not meet these conditions by retracting their approved status.¹⁰

Ascribed conditions in this period directly reflected the State's developmental priorities. Between 1950 and 1962, approved status was often conditioned upon proof of replacing imports with local production. Unlike East Asian states, whose focus on export-led growth provided planners with a clear indication of how to judge firms' behavior, Israel's state managers could not use export performance as a sole benchmark for discipline. The alternative method they devised was to evaluate firm efficiency by the amount of added value, measured in net foreign currency savings.¹¹ 'It is not our aim to make every product locally, at any cost,' explained state managers, 'we are interested in local production only if the cost of the dollar saved is reasonable in relation to the official rate of exchange, once initial production difficulties have been overcome'.¹² In essence, this system made sure government would only support industries that proved they were efficient enough so as to not drain the state's already limited supply of foreign exchange.

In 1963, the state's developmental priorities shifted, and the expansion of exports became MOTT's chief concern. As a result approved investment in sectors specifically targeted for export like textiles and clothing began incorporating predetermined export targets that were based on the state's 5-year developmental plans. Approved initiatives in these sectors were required to export at least half of their output while existing manufactures had to commit to expand their production by 50% and export at least half of this additional output (Greenwald, 1973, p. 101).¹³ Data collected from the Investment Center demonstrates that in the years 1963–1972, an average of 44% of total approvals incorporated such export conditions.¹⁴

10 Although this authority was not clearly outlined in the law's original formulation, this issue was addressed in a series of amendments made to the law in 1955 see: Law for the Encouragement of Capital Investments (Amendment), 5715/1955 Articles 35(a) and 35(b). These amendments were outlined in *IEB* Vol. VIII no. 1, September 1955.

11 Letter from Deputy Director General of the MOTT, M. Gilboa, to Industrial Planning Committee, 8 April 1956, ISA/G/3442/17; Industrial Planning and Development, n.d., ISA/G/4557/1. Also see: *Industry Past and Future*. Jerusalem: Ministry of Trade and Industry, Division of Economic Publications, 1965, p. 17.

12 *IEB*, Vol. X, no. 2–4, December 1958, p. 11.

13 For evidence that such production and export conditions were indeed attached to granted approvals see minutes of Investment Center meeting number 210 (16 June 1957); 212 (10 July 1957) and 220 (18 December 1957), ISA/G/4553/8, as well as meeting number 249 (31 December 1958); 253 (25 February 1959) and 255 (18 March 1959), ISA/GL/6054/12.

14 Israel's Investment Center report for 1972, p. 23, Table 15: 'Export conditions for approved enterprises'.

Because approved status was conditioned upon attainment of predetermined performance targets, the Investment Center maintained continuous follow-up which helped determine whether firms were complying with the conditions stipulated by the Center ([Ministry of Trade and Industry, 1960](#), p. 114). Starting in 1953, the Center also began to carry out annual surveys of approved enterprises which included data on number of employees, annual output and sales, total investment and exports.¹⁵

While certainly not every case that warranted loss of approved status resulted in one, there is evidence that the Investment Center did retract a significant number of approvals. Between 1950 and 1965, 1093 out of a total of 3724 approvals (nearly 30%) were revoked by the Investment Center for initiatives that either failed to execute the proposed plan or did not uphold the required conditions (see [Table A3](#) in Appendix).¹⁶

3.4 The development budget

A second, equally important investment vehicle employed by state planners in this period was the Development Budget. Similarly to Korea's famous 'policy loans' ([Woo, 1991](#), pp. 162–163), assistance through the Development Budget was provided largely in the form of subsidized loans with exceedingly low interest rates and long maturity. When first adopted in 1949, Development Budget funds were channeled mainly to large scale infrastructure projects and to the state's agriculture sector. Starting in 1955, under the guidance of Sapir and the MOTI, the state began turning its attention to industry. In just a few years the share of total expenditure on industry more than doubled, rising from just 12% of total development budget allocations in 1955 to as high as 26% in 1960 ([Pack, 1971](#), p. 143). Long term loans to industry also grew in absolute terms, increasing from a mere IL 3.7 million in 1954 to IL 30 million in 1958.¹⁷

To become eligible for Development Budget loans, firms were required to submit investment plans which were initially assessed by the MOTI and then passed on to a public advisory committee composed of representatives of the MOTI, the MOF, members of industry, and the Bank of Israel.¹⁸ In line with the state's developmental agenda, top amongst the committee's goals was narrowing the trade deficit by replacing imports with local production, creating more job opportunities in the country's periphery, promoting exports, and generating vertical links by encouraging production in earlier stages of the production cycle.¹⁹ Like in the case of the EOCI law discussed above, proposals for developmental budget loans were also evaluated on the basis of net foreign currency savings.²⁰

15 Manufacturing Survey for Approved Industries: 1955–1956, May 1958, ISA/GL/6054/12.

16 Report on Investment Center Activities, 1965, Table 4. Approvals were revoked on a higher rate in the 1950s (43%) than in the first half of the 1960s (15%)

17 *IEB* Vol. X no. 6, 1959, p. 5.

18 *IEB* Vol. IX no. 5/6, 1957, p. 43.

19 Memorandum on industrial planning, meeting in the Director General of the Prime Minister's office, 12 December 1954, ISA G/4557/13; 'Memorandum on problems in industrial development', undated, ISA/G/4557/1; MOTI's Industrial Division management meeting summary, 8 July 1957, ISA/G/4545/5, Planning Guidelines sent to members of the Industrial Development Central Committee, 8 April 1956, ISA/G/3442/17.

20 Industrial Planning and Development, n.d., ISA/G/4557/1.

The authority to approve or reject applications for Development Budget loans was a central factor in the state's ability to target strategic sectors. Between 1956 and 1964 over 70% of government loans provided to industry were distributed among four sectors explicitly targeted in the state's development plans: textiles, basic metals, chemicals and foodstuff.²¹ However, like in the case of the EOCI law, the effectiveness of this instrument depended on the state's capacity to discipline underperforming firms. In 1956, Minister Sapir stressed the importance of following up on the utilization of state loans. He reported the MOTI had followed up on loans as far back as 1949 and filed lawsuits against seven enterprises that failed to uphold stipulated terms (Sapir, 1956, p. 7). In 1959, in order to further enhance the Ministry's disciplinary capacity the state created a new government entity endowed with the authority to audit and sanction firms who deviated from their approved plans.²² In its first year of operation this unit audited 896 investment plans and sanctioned 67 enterprises, 19 of which were forced to repay back their loan (see Table A4 in Appendix).²³

To summarize, I have shown that through the use of such policy instruments as the EOCI law and the Development Budget state planners located in the MOTI were able not only to provide 'carrots', but also to use 'sticks'. Discipline was practiced by either retracting 'approved status' from enterprises that enjoyed the benefits of the EOCI law or by sanctioning producers that did not adhere to the stipulated guidelines attached to loans provided through the Development Budget. But what was the source of this capacity? What explains the Israeli state's ability to sanction underperformers, and reward others? In the next section, I explain that the state's disciplinary capacity lay in its ability to leverage its relations with a key social actor: the Israeli labor movement.

4. Elucidating the mechanism: leveraging strategic relations with publicly-owned enterprises

To appreciate the sources of Israel's disciplinary capacity, one first needs to understand the distinctive characteristics of Israel's trade union federation, as well as its relationship with state. After illustrating this, I proceed to outline the ways in which state managers leveraged this relationship to foster competition for public subsidies between the Histadrut and the private sector. It was this competition, I argue, that made it possible to overcome the structural power of private industry.

4.1 Israel's third sector: the labor-owned industry

Israeli workers were historically organized within the Histadrut. In this period, the organization represented somewhere between 75% and 85% of Israel's wage laborers. Far from an ordinary peak labor union, the Histadrut also operated a conglomerate of public enterprises that encompassed numerous social and economic domains (Kleiman, 1964; Shalev, 1992). It served as the holding company of the state's largest bank, health provider and pension funds. But most important for our debate, the Histadrut also owned large industrial

21 *IEB* Vol. 10, December 1958, p. 61.

22 *Israel's Annual Government Report* 1960, p. 222.

23 *Trade and Industry: internal newsletter of the Ministry of Trade and Industry*, Issue 12–13, March 1960, p. 23, table 5.

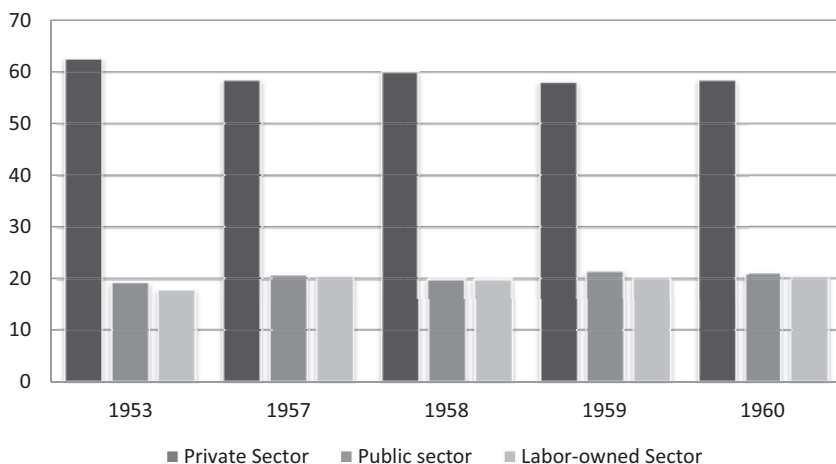


Figure 1: Net Domestic Product by sector 1953, 1957–1960.

Source: Barkai, 1968, p. 26, table 1.

conglomerates such as *Solel-Boneh* and *Koor-Industries* (Aharoni, 1991, p. 173, 81; Halevi, 1957, p. 177). The latter was Israel's largest industrial complex, overseeing more than a hundred manufacturing enterprises producing steel and heavy equipment, radios and telephones, glassware and ceramics, rubber and tires, electric motors and batteries. Overall, throughout this period the labor-owned sector accounted for around 20% of net domestic product (see Figure 1) and was responsible for somewhere between 19 and 22% of manufacturing's contribution to net domestic product (see Figure 2). Taken together, these elements are what led scholars of Israel's political economy to view the Histadrut as 'the most encompassing and powerful peak organization of labor in the developed non-Communist world' (Koreh and Shalev, 2009, p. 563).

Because Israel's political elites and the leadership of the Histadrut originated from the same political party (i.e. the labor party, MAPAI), and because of the historical role of the Histadrut in the state building project, early scholarship on Israel traditionally viewed the organization simply as an economic appendage of the state. To support this claim, such studies often pointed to what they viewed as the Histadrut's privileged access to sources of subsidized investment capital such as the German reparations fund or the organization's pension fund (Aharoni, 1991, pp. 64–66).

This view, however, has been largely overturned. Subsequent studies have shown that, in fact, relations between the two actors were far from harmonious (Grinberg, 1993; Levi-Faur, 2001). There is no doubt that the Histadrut served as the central economic and political agent in the era prior to Israel's establishment when it was committed to developing the economic, demographic and political infrastructure for a future Jewish state. However, in the years following independence the state was successful in weakening the Histadrut's de-facto control over many important investment outlets. Two examples were Sapir's replacement of the Histadrut's Hillel Dan as chairman of the German reparations fund in 1955 (Greenberg, 2011, pp. 125–126), and an agreement imposed by the state and signed in 1957 which required investments made through the Histadrut's pension fund receive the authorization of the

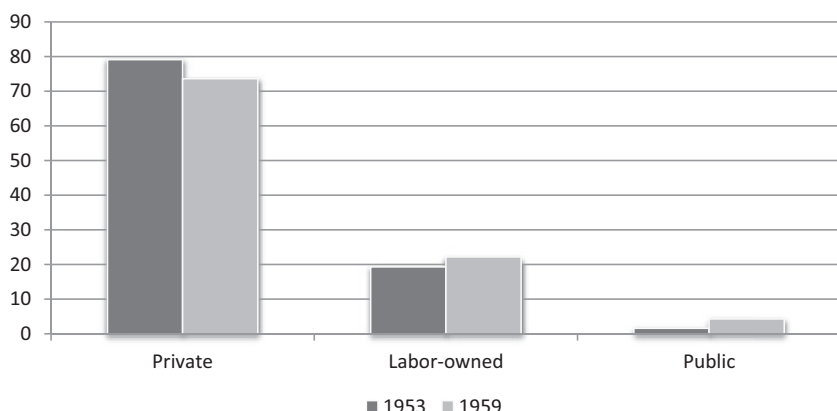


Figure 2: Manufacturing Contribution to Net Domestic Product by Sector.

Source: Halevi and Klinov-Malul, 1968, p. 114, table 41.

Minister of Finance (Greenberg, 2005, p. 336; Levi-Faur, 2001, p. 164). While these maneuvers weakened the Histadrut, the organization still maintained relative autonomy by exploiting the potency of its economic enterprises to generate funds internally (Shalev, 1992, p. 102).

Although the Histadrut should not be viewed as an organ of the state, there was also much to distinguish it from a traditional market actor. Far from profit seeking in the narrowest of senses, the organization pursued a broad range of social objectives and served various stakeholders in ways which greatly relaxed the short term behavior of its enterprises. On the one hand, managers of individual plants aspired to have a *modus operandi* not at all different than that of the private sector (Frenkel, 2005), and were reluctant to sustain losing, inefficient plants or to pay higher wages (Aharoni, 1991, p. 184). On the other hand, the organization's enterprises clearly considered the profit goal secondary to its unwavering commitment to industrial development and full employment (Bridger, 1961, p. 135; Greenberg, 2005). Their role as investment vehicles notwithstanding, the organization's enterprises embraced the government's development program and committed themselves to modernize and streamline production by increasing labor productivity and efficiency (Bridger, 1961, p. 46). For example, in a policy statement sent to the Board of Management in 1957 the General Secretary of Histadrut, Pinchas Lavon, stressed the organization had more than a business point of view:

Labor enterprises cannot be governed solely by the aim of accumulating capital for investment. Our economy is sustained not only by machines, techniques and managerial edicts. Its strength lies in the willing support of the community and especially of the workers. [...] The character of the labor economy as a servant of the community must be reflected in better service and lower prices.²⁴

One clear demonstration of this principle was the way the organization's profits were used. Rather than distributed to shareholders as dividends, all surpluses earned by its enterprises,

24 *Labor in Israel Newsletter (LIN)*, Vol. V. no. 10, October 1957, p. 2.

in accordance with the Histadrut's Constitution, were ploughed back as new investment (Aharoni, 1991, p. 184; Bridger, 1961, pp. 18–19, p. 143; Kleiman, 1964, p. 20). As Solel-Boneh's notorious Director General, Hillel Dan, noted: 'The differences between us and the private businessmen were in the matter of profits [...] we regarded each penny as a mean for further expansion' (quoted in Kleiman, 1964, p. 21). As a consequence, labor-owned enterprises were more capital intensive than private ones (Aharoni, 1991, p. 182) and enjoyed a higher rate of investment.²⁵ This method of operation was largely responsible for the ongoing advancement of the organization's activities. It not only retained its primacy in the traditional branches of industry but also expanded into more sophisticated, higher value-added industrial branches such as chemicals, pharmaceuticals, electronics, rubber and plastics, machinery and equipment (Daniel, 1976, p. 171).

4.2 Fostering domestic competition as a means of generating state discipline

How, then, did the state take advantage of its ties to labor to generate disciplinary capacity? To effectively implement its industrial policies, senior officials within the MOTI generated sectoral competition between labor-owned industry and the private sector. Evidence for this can be found, first, in the rhetoric mobilized in this period by the top officials of the MOTI. They repeatedly gestured to the fact that both labor and private industry would have to compete with each other for state subsidies and that neither sector would be favored by the government. In a special issue of *Israel's Economic Bulletin* dedicated to introducing the EOCI Law, Dr. Gruenbaum, the first Managing Director of the Investment Center stressed that the principle of sectoral competition would guide the center:

We work with the conviction that the enterprises of cooperative and trade unions, as well as private enterprises can operate in full equality and in *healthy competition* for the upbuilding of this country. We would consider the elimination of either of these factors by the other to be disastrous. [...] We are further of the opinion that monopolies and claims for exclusive rights can have no place in a pioneering country such as ours (emphasis added).²⁶

This logic was later reaffirmed by Gruenbaum's replacement, David Stern, who in 1955 stressed the Investment Center 'does not discriminate between [...] economic sectors, whether private, collective-cooperative, or a combination of the two'.²⁷ The principle of sectoral competition remained central as late as 1965, and was referenced on a number of occasions and in front of various audiences. Speaking at the MAPAI party convention in 1963, Sapir underlined that the dual existence of the private and labor sectors should be regarded as an advantage because it 'forces the local economy to be in a state of constant alertness and *healthy competition*' (emphasis added).²⁸ This principle was stressed repeatedly in speeches given by Sapir in this period, including at the annual meeting of the MIA in April 1965.²⁹

25 *LIN*, Vol. VI 1, January 1958, p. 3.

26 'Investment Policy', *IEB* special Issue: The Law for the Encouragement of Capital Investment, January 1951, p. 5.

27 *IEB* Vol. VII, 4, May 1955 p. 9.

28 Speech by Minister Sapir at the 9th convention, MAPAI, 16 October 1963.

29 Speech by Minister Sapir at the Annual Meeting of the MAI, 7 April 1965, p. 5. Also see speech by Minister Sapir, 1966, ISA/G/6969/6.

Far from just empty rhetoric, effective competition between the two rival sectors was realized in a number of key sectors. One example was in the field of tire manufacturing in which two large plants, the privately owned *Samson* and the labor owned *Alliance Tire and Rubber Co.*, competed over the domestic market and beyond.³⁰ Both plants were awarded the benefits of the EOCI law in the early 1950s,³¹ and by 1962 were producing on par with international standards, supplying all local demand and exporting 70% of their total output to nearly 50 countries.³²

Another indication of the ongoing competition between the private and the labor-owned industry is that both their respected leaderships repeatedly voiced concerns over what they viewed as unfair discrimination and preferential treatment of the rival sector (Kalman, 2013, pp. 25–38, 59–69). For example, a speech made at the 1957 annual meeting of the MAI emphasized the widespread belief among members of the organization according to which: ‘the labor sector is being prioritized in the allotment of long term state loans for development while the private industry is being discriminated against’.³³ In reality, however, both sectors enjoyed a share of state subsidies more or less equal to their relative size in the economy. Between 1954 and 1956, private industry received over 70% of development budget loans while the labor industry received about 20%.³⁴ A similar distribution applied to the EOCI law. As an internal document of the Investment Center shows, between 1950 and 1956, 91% of approved enterprises originated from the private sector, with the remaining 9% going to the labor-owned industry.³⁵ Responding to the complaints coming from the leaderships of both sectors, Minster Sapir remarked that:

It is not the task of the Government to protect vested interests. When a third cement works and a second tire factory were established [by the Histadrut], the Government was much criticized for encouraging overproduction, favoring one economic sector to the detriment of the other, etc. Today, all these enterprises work at full capacity, exporting a large part of their output; and although belonging to different economic sectors, they function side by side without serious friction.³⁶

As these facts demonstrate, the existence of the labor-owned industrial sector provided the state with an alternative investment outlet which it leveraged in order to counteract the structural power normally enjoyed by business. This was carried out by fostering domestic competition among Israel’s rival industrial sectors which, in turn, produced the disciplinary capacity necessary in order to implement the state’s developmental agenda.

30 *IEB* Vol. V, no. 1–2, October–November 1952, p. 13.

31 *Approved enterprises in accordance to the Law of encouragement of investment as of December 31st, 1958*. Jerusalem, February 1959, p. 11 (see items 2 and 11).

32 *Israel’s Annual Government Report*, 1959, p. 246; ‘The March of Industry’, *the Israel Export and Trade Journal*, Vol. XV, no. 3, March 1963, p. 40.

33 ‘Credit Policy for Industry’, a speech made at the 1957 annual meeting of the MAI, *Hataassiya Monthly Review* (HMR) January 1957.

34 *Ibid.*

35 Investment Center, the Ministry of Trade and Industry, Meeting minutes, 30 July 1957, p. 2; ISA/G/4553/8. Similar statistics were published in *IEB* Vol. VII no. 4, May 1955, p. 9.

36 *Israel’s Annual Government Report*, 1960, p. 222.

5. Disciplinary capacity in action

We have seen how the MOTI's multiple embeddedness with both private and the labor-owned industries was the source of its disciplinary capacity. However, it remains to be shown how this capacity facilitated the development of Israel's industry. In this section, I will demonstrate that with its disciplinary capacity secure, the MOTI devised and implemented an ambitious and novel industrial strategy: they aimed to *intentionally create industrial overcapacity*. This strategy, advanced despite clear opposition on the part of private industry, was intended to overcome the trends towards monopolization and lack of productive investment often associated with ISI development.

5.1 Pursuing overcapacity: overcoming the pitfalls of the ISI development

Recall that under ISI private actors have few incentives to risk entering new sectors. They are also able to take advantage of protection from international competition to bolster their own monopoly position in ways that diminish long-term productivity growth. Israel's state managers were well aware of these undesirable tendencies. For example, in an article published in *Israel's Economic Bulletin*, Michael Tzur—the Director General of the MOTI—explained:

One deterrent to improving efficiency has been the policy of protecting our young industry by banning many competitive imports. This has provided little incentive to rationalize production and has resulted in the formation of cartels and in other monopolization trends.³⁷

In other developing economies that pursued an ISI strategy, this lack of competitive pressures was often exacerbated as state planners intentionally limited the number of producers in each sector for fear that over-investment would create idle capacity. In states that implemented export-led strategies, development agencies were also weary of excessive capital investment, albeit for different reasons. Since they were concerned mainly with performance in international markets, these states' main preference was to foster economies of scale so as to improve the competitiveness of their 'national champions'. This was the case in Japan, where MITI legalized cartelization and used other policy instruments to actively encourage mergers between leading firms in key industries (Okimoto, 1989, p. 25, pp. 38–39; World-Bank, 1993, p. 96, 101).

Israel's state planners were able to avoid the negative outcomes of ISI by following the opposite logic: rather than limit the number of producers in each sector, they actively pursued excess capacity. Through their control over investment capital and their capacity to discipline unproductive firms, state managers created dynamic competition within the domestic economy which replicated the function typically served by the 'natural' forces of international competition. As a result, domestic enterprises were compelled to enhance production and efficiency, as well as work to expand their export capabilities in the goal of offloading excess production which the local market could not absorb. This logic was clearly outlined by Tzur in an address made at the Textile Technician Association's annual meeting:

37 IEB Vol. X, no. 5, July 1959, p. 8.

As long as the domestic market – which is protected from external competition – has not reached full saturation, it will exist with lack of competition and the necessary pressure to increase efficiency, to improve production, and to lower prices. We will only be able to achieve exports once we are able to create over capacity.³⁸

The policy's declared goal, to 'weed out the inefficient producer and the incompetitive [*sic*] exporter', was shared with both business and labor on numerous occasions.³⁹ It remained atop the agency's agenda as late as 1965 when it was highlighted in the state's 5-year plan for 1965–1970 (Ministry of Trade and Industry, 1964, p. 41).

This strategy, however, was far from embraced by private employers. They quickly realized that, if implemented, such a policy was likely to produce competitive pressures that would coerce them to make undesired investments and potentially drive the least competitive firms out of business. As early as 1956, Arie Shenkar petitioned the MOTI to have a decisive say in the approval of new industrial plants. Shenkar was alarmed not only by what he viewed to be an unacceptable overreach on the part of the state but, more importantly, with its ability to use instruments like the EOCI Law or the development budget to install new industrial capacity that would compete with existing firms: '[I ask you] not to ignore the facts and give up on the pipe dream to establish new industries without limits,' he wrote, 'otherwise this reality will suffocate us'.⁴⁰ Similar concerns were raised 3 years later when Shenkar once again protested the Government's active encouragement of overcapacity:

For some reason the Government encourages the foundation of new plants in any way possible while completely ignoring the alternative of increasing production in already existing firms which would require a much smaller investment. The MOTI hastily approves the installation of new plants that [...] create enormous difficulties for existing manufactures [...] *the industrialists reject this policy of encouraging new factories in cases where similar plants already exists* [...] as a result of excess enthusiasm and blind faith (Raviv, 1991, pp. 104–105, emphasis added).

Such harsh critique, however, did not cause state planners to veer from their original plans. Whereas similar threats in other contexts would normally constrain government action, in Israel, the existence of an alternative investment outlet in the form of the development-oriented Histadrut allowed the state to override business opposition and pursue unfavorable policies.

As a result, by the early 1960s overcapacity became a fact in numerous industries. One example of where this strategy proved effective was in textiles, the leading industrial sector in Israel's economy at the time. By 1958 cotton spinners were able, for the first time, to supply the needs of the domestic market, and by 1961 the output of the industry doubled that of local consumption. Between 1958 and 1968 production of textiles and clothing grew six-folds becoming Israel's most important manufactured export commodity (Levi-Faur, 1998, p. 77). In 1964, many producers of cotton threads were exporting as much as 60–70% of their annual production to places such as the USA, Iran, Germany and the Scandinavian

38 'The role of textile sector in production and export', *Yalkut*, December 1958–January 1959, p. 31.

39 'Editorial Notes', *The Israel Export and Trade Journal*, Vol. X, no. 10, Oct. 1958, p. 3; 'On our export development policy', M. Tzur, *HMR*, January 1959, p. 6.

40 Letter from Shenkar to Minister Sapir, quoted in Greenberg, p. 113.

countries.⁴¹ Similar results were achieved in tire manufacturing (discussed above) and the plywood industry where five manufacturing plants produced for the domestic market while also exporting to 24 countries, including the USA and Canada, Scandinavia and various South American countries.⁴² Remarks made by Mordecai Vecht, a member of the MAI's Executive Committee and the Managing Director of *Kitan*—one of Israel's largest cotton manufacturing plants—demonstrate that leaders in the private industry were well aware that overproduction was driving internal competition and preventing producers from raising prices:

I think the largest burden on most industrial sectors (if not all) is the existing excess of production capacity [...] the overstocked warehouses force manufacturers to compete with one another in the domestic market. It is this competition which caused the local price of textile products to remain constant in 1959.⁴³

This analysis of Israel's successful attempt to produce overcapacity in industry is important for two reasons. First, it illuminates how the state's disciplinary capacity enabled state managers to overcome the resistance of business to the state's pursuit of overcapacity. Second, it rules out an alternative reading of the evidence in which state discipline is not imposed, but rather accepted by the private sector due to a convergence of interests. One version of this argument previously advanced in the literature on Israel was that such convergence existed on the basis of a shared 'nationalist ideology' (Levi-Faur, 1996, 2001). However, as demonstrated above, private manufacturers in Israel not only recognized the costs that overcapacity would inflict upon them but openly opposed this strategy—albeit unsuccessfully. Overriding business's objections, therefore, can only be understood as a result of the state's disciplinary capacity, which permitted state managers to advance their development strategies in the face of clear opposition on the part of private industry.

5.2 The limits of Israel's over-capacity competition model

As we have seen, the disciplinary capacities of Israel's state managers, coupled with the state's over-capacity competitive model, proved effective in attaining the primary goal of the developmental state: producing sustained economic growth. Like every other developmental state, however, Israel also faced constraints that limited how far it could assert its will vis-à-vis organized economic interests. One noteworthy example was the failed attempt to liberalize trade in the context of the New Economic Policy (NEP) of 1962. Intended to stem the chronic problems of inflation and trade deficit this initiative called for the systematic removal of trade protections which hitherto shielded local manufactures from the harsh realities of international competition (Halevi and Baruh, 1991, pp. 79–83). However, the plan's implementation was largely prevented by a coalition of representatives from both private and labor-owned industries. Both sectors understood the implications that such a decree

41 'Our cotton threads enjoy a good reputation and an expanding market', D. Vidman, chairman of the Sharon Textile factory, *HMR*, January 1964, p. 6; 'The Top Exporting Industries', *The Israel Export and Trade Journal*, Vol. XVI, no. 3, March 1964, p. 38.

42 'The Top Exporting Industries', *The Israel Export and Trade Journal*, Vol. XVI, no. 3, March 1964, p. 38.

43 'What is Burdening Industry?' M. Vecht, *HMR*, October–November 1964, p. 3.

would entail and mobilized effectively to limit its implementation (Mandelkern, 2016, pp. 52–54; Raviv, 1991, pp. 123–124).

In many respects, this episode was a sign of things to come. Somewhat paradoxically, it was the *success* of Israel's industrial strategy in the 1950s and 1960s which worked to empower local manufacturers—from both the private and collectivist sectors—vis-à-vis the state. As a result, in following decades the state's developmental agencies found it more and more difficult to prevent established manufactures from appropriating capital subsidies without fulfilling their economic obligations (Shalev, 1992, p. 294; Silver, 1990, p. 172). This phenomenon, however, was not unique to Israel. Other successful developmental states, including the East Asian tigers, exhibited a similar pattern. In Korea, for example, the growing power of business—the result of three decades of highly successful developmental state policies—considerably hampered the government's ability to continue acting as an effective counterweight to private industry. In the absence of such capacities, business began exhibiting a growing tendency toward rent-seeking behavior, culminating most famously in the Asian crisis of 1997 (Chang, 1998; Haggard and Mo, 2000).

Another limitation of Israel's developmental model, one which pertains more generally to the nature of its particular ISI strategy, is its relative weakness in fostering large business conglomerates that can become global leaders in competitive export markets. Whereas East Asian enterprises the likes of Samsung, LG, Toyota and Kawasaki Heavy Industries (to name only a few examples) were able to first reach and then surpass foreign leaders in terms of productivity, quality, price, and market share, few of the Israeli enterprises nurtured during the state's first decades enjoyed similar success.⁴⁴ This outcome can be explained by considering the main difference between the East Asian model and Israel's over-capacity strategy. In Japan or Korea, state planners focused on export competition. As a result, state managers in these countries oriented their efforts to rationalizing production and creating economies of scale. Israel's overcapacity model, on the other hand, prioritized domestic competition and therefore encouraged multiple domestic firms to compete in similar sectors. Although Israel's rate of export expansion in this period was far from negligible (see Table 1), its development strategy placed its domestic firms at an obvious disadvantage when it came to competing in international markets.⁴⁵

As the trade deficit became a growing concern, state planners began to become more aware of this limitation. As a result, Israel started to slowly shift away from its ISI overcapacity model. As early as 1969, the MOTI began implementing a series of policies and legislation aimed at increasing domestic firms' export competitiveness by encouraging economies of scale. This reversal jump-started a decade-long process of economic consolidation via a wave of mergers and acquisitions that was responsible for creating Israel's own chaebol-like business groups: the labor-owned Koor and Hapoalim (later privatized), the state-owned Leumi, and the privately owned Clal, Israel Corporation and I.D.B. (Maman, 2002, p. 129; Maman, 2008, pp. 34–43). Israel's hardships in export markets, however, persisted well into the mid-1980s and were resolved only after a hyperinflationary crisis paved the way for a dramatic reshuffling of Israel's political economy (Maron and Shalev, 2017; Shalev, 1998). It was only at this point that Israel was finally able to pursue a full-fledged export-

44 The main exceptions were firms from Israel's security industries like the state-owned Rafael and Israel Aerospace Industries, the privately owned Elbit systems and the Histadrut's Tadiran.

45 I would like to thank one of the paper's anonymous reviewers for pointing out this key distinction.

led development strategy which reoriented the economy around the production and export of knowledge-based, high-tech products in emerging fields like software, cyber-security, and information communication technologies (Breznitz, 2007; Justman, 2002; Maman and Rosenhek, 2012). While this later developmental push is beyond the scope of this paper, it should be stressed that some of the key institutions and policy instruments established in the decades analyzed in this article, particularly the MOTI and the EOCI law, played a central role in the emergence of Israel's globally competitive technological sector (Breznitz, 2007, p. 55; Dishon, 2014, pp. 71–72).

6. Conclusions

The state features prominently in the literature on economic development, and its institutional capacity to discipline powerful societal actors has shown to be a crucial component of developmental success. Nevertheless, the sources of this capacity have remained understudied and draw almost exclusively on the East Asian experience. In this paper I specified a novel mechanism through which multiple embeddedness with both market and non-market actors can be leveraged to generate disciplinary capacity. I further point out that embeddedness with a collective enterprise sector is important because it provides state managers with an alternative investment outlet, thereby lowering the state's structural dependence on private industry. I illustrated this arrangement through an analysis of Israel's developmental experience.

What relevance, if any, does this mechanism hold today and could it function similarly in the context of contemporary developmental strategies? In the early 2000s, the intensification of globalization and the spread of economic liberalism led a number of scholars to wonder whether we had seen 'the end of the developmental state' (O'hearn, 2000; Williams, 2014). While some studies answered this question in the affirmative, others showed that such processes have not rendered the developmental state irrelevant. Rather than dismantle their developmental institutions, many states have responded to the dramatic changes in the global environment by adopting new modes and strategies, focusing their efforts mainly in the realm of science and technology (S&T) and innovation policies (Breznitz, 2007; Mazzucato, 2015; O'Riain, 2004; Wong, 2011).

Despite the various differences between the catch-up development state and today's RIB developmental policies, the provision of public subsidies still looms large, and state discipline continues to play a crucial role in ensuring their effectiveness. For example, in the USA, developmental agencies such as the Advanced Research Projects Agency (ARPA), the National Institute of Standards and Technology (NIST), and the Small Business Innovation Research (SBIR) Program have all demonstrated a capacity to impose strict performance standards, and withdraw or withhold funding from underperforming firms (Schrank and Whitford, 2009, p. 526; Weiss, 2014, p. 104). The same has been shown to be true in late-developing economies. For example, Taiwan's Science and Technology Advisory Group (STAG) imposes performance benchmarks for all publicly funded research centers, whereas Singapore's Economic Development Board (EDB) provides public subsidies on the condition that operations are brought back to Singapore (Wong, 2011, pp. 64–65, 72–73). In China, government-enterprise bargaining over provision of subsidies no longer focuses on supplies, prices, budgets for investment projects, but rather on predetermined sale forecasts, financial performance, and capacities to repay loans (Walder, 1995, p. 287).

Can the unique mix of collective-owned enterprises and private industry functioning within a state-induced competition model account for these more recent examples of state discipline? Answering this question more confidently requires more empirical research. However, there already is some evidence that suggests that it can. For example, in their investigation of US industrial policymaking, [Schrank and Whitford \(2009, p. 534\)](#) identify that national laboratories contracted to produce innovative technologies operate within an ecosystem which incorporates both private and public contractors with whom the state's development agencies are closely embedded (e.g., the University of California, Lockheed Martin, the Battelle Institute, etc.). Although their analysis does not focus on discipline, Schrank and Whitford recognizes that this kind of structured competition for public resources, contracts, and prestige greatly contributes to the 'robustness and diversity' of the American 'innovation ecosystem' (2009, p. 535). In late-developing economies such as China and Vietnam, a similar dynamic functions through the enduring presence of state-owned enterprises (SOEs) operating in key sectors of the economy. In Vietnam, for example, the state's Ten Year Developmental Plan of 2001 called for SOEs to continue to 'hold key sectors in the economy' and serve as 'leading actors in developing high-tech industries' ([Painter, 2003, p. 24](#)). In China, despite the rapid move towards a market economy, the central state still views SOEs as 'the leading force in the national economy' ([Breznitz and Murphree, 2011, pp. 48–49](#)). Although China's growth model is export-led, its domestic economy features a similar competitive environment to that of Israel's overcapacity model, where in the context of state-enterprise bargaining, SOEs are pitted against one another as competitors for state investment loans ([Walder, 1995, p. 287](#)).

In many ways, the government agencies working within the RIB development model seem even better suited to generate discipline via the mechanism outlined in this paper than the nodal agencies identified with the 'catch-up' developmental strategies. For one, various studies have noted that a central feature of today's RIB development model is its high degree of decentralization in which the development process is administered through a loose network of agencies embedded in multiple domestic or international networks ([Breznitz, 2007, p. 17](#); [Wong, 2011, p. 41](#)). This configuration has numerous advantages. For one, it strongly increases policy makers' leverage over specific actors and sectors, while simultaneously reducing their dependence on special interests. Secondly, this type of decentralization is likely to foster greater embeddedness, as state officials in charge of overseeing investment are often deeply rooted in the particular technological community which they are funding ([Block, 2008, p. 173](#); [Breznitz, 2007, p. 17](#)).

Furthermore, whereas the catch-up developmental state was geared to foster a handful of 'national champions', today's RIB developmental strategy is oriented towards creating a more competitive environment in which a large community of small and medium firms—both public and private—can function ([Block, 2008, p. 173](#); [Wong, 2011, pp. 40–41](#)). Leveraging multiple alliances and links with both private and public actors that participate within this competitive environment could go a long way in enhancing the disciplinary capacity of these various developmental agencies. A good illustration is Linda Weiss's (2014, pp. 125–128) discussion of the US National Nanotechnology Initiative (NNI). Conceived and initiated by the federal government, the NNI entailed multiple partnerships and competition for resources among private firms including DuPont and Raytheon, academic institutions like MIT, and arms of government such as S&T units from the US army and the Department of Defense.

In sum, these examples provide initial support for the enduring relevance of the mechanism discussed in the paper. Nevertheless, the contemporary literature on RIB development

has not yet offered a systematic account of the state's capacity to discipline. My hope is that this paper will inspire others to take up the question and assess the general relevance of the proposed mechanism to more recent cases of state-led development.

Acknowledgements

I would like to thank Colin Jerolmack, Ronen Mandelkern, Jeff Manza, Erez Marantz, Zeev Rosenhek, and three anonymous reviewers for critical readings of earlier drafts of this paper. I am also indebted to Vivek Chibber, Noam Maggor and Adaner Usmani for their invaluable guidance and support. Audiences at the annual meetings of the Society for the Advancement of Socio-Economics (SASE), the American Sociological Association (ASA), as well as participants of the Economic and Political Sociology (EPS) Workshop held in New York University's Department of Sociology provided important feedback and suggestions.

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Appendix

Table A1 Annual rates of growth: planned compared with achieved, 1958–1962

Branch	Rate of growth (%)		B/A (%)
	A Plan1958–1964	B Achievement1958–1962	
All	10.0	14.3	143
Mines & Quarries	18.6	20.0	108
Foodstuff	7.0	12.0	171
Textiles	9.9	18.0	182
Clothing	9.5	8.7	92
Wood	7.6	16.0	211
Paper & Printing	6.9	11.8	171
Leather	7.0	6.0	86
Rubber & Plastics	7.0	6.0	86
Chemicals & Petroleum	13.9	13.2	95
Non-metallic Minerals	8.9	13.7	154
Diamonds	9.2	28.8	313
Metals & Metal Products	9.6	14.4	150
Machinery and Electrical equipment	16.0	17.7	111
Transport Equipment	14.3	13.8	97
Miscellaneous	19.2	9.7	51

Source: Ministry of Trade and Industry, 1964, p. 7.

Table A2 Growth of industrial exports, plan compared to achievement (\$ million)

Year	1959	1960	1961	1962	1963	1964	1965
Plan	103	130	164	205	258	323	–
Achievement	118	149	177	202	262	301	345

Source: Ministry of Trade and Industry, 1964, 8; Ministry of Trade and Industry, 1965, pp. 23, 100.

Table A3 Investment center: approved and revoked investment plans (1950–1965).

Year	Total plans approved	Number of plans revoked	Percentage of plans revoked
1950	328	154	47
1951	330	241	69
1952	176	129	73
1953	88	55	62
1954	102	48	45
1955	136	61	45
1956	147	41	28
1957	163	32	20
1958	165	41	25
1959	200	33	17
1960	440	87	20
1961	453	108	24
1962	315	41	13
1963	231	17	17
1964	237	7	3

Source: Report on Investment Center Activities, 1965, table 4.

Table A4 Audit of development budget loans, 1959.

% Audit finding	Number of plans	%
Total approved investment plans	896	100
Investment plan implemented	626	69
Investment plan in the process of being implemented	203	24
Plan has not been accurately implemented, and loans have been returned or demanded	19	2
Plan canceled because unrealized or unreasonably delayed	48	5

Source: Trade and Industry: Internal newsletter of the Ministry of Trade and Industry, Issue 12–13, March 1960, p. 23.