

Israeli Domestic Policy Issues amid Sharp Economic Downturn

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Brief Analysis

This week, amid a deep economic recession, the national unity government of Israeli prime minister Ariel Sharon narrowly adopted a 2003 austerity budget. Given the likelihood of new elections within a year, the time and attention of Israeli policymakers will likely be devoted to political maneuvering on serious domestic problems, in addition to the main issue: ongoing Palestinian-Israeli violence.

Background: A Recession

Israel's gross national product (GNP) has been contracting for the second straight year. According to Israel's Finance Ministry research report, released two weeks ago, the accumulated decline over the last two years is approximately 6 percent of gross domestic product (GDP) per capita, which is unprecedented in Israel's history. Moreover, the country's unemployment rate stands at 9.3 percent, its fiscal deficit is growing, and even inflation—brought under control during the 1990s—is creeping upward.

The recession is partially a product of the Israeli-Palestinian conflict. Israel's exports to the West Bank and Gaza have dropped, while tourism has nose-dived. Yet, the current recession cannot be attributed solely to the violence between Israelis and Palestinians. It has been exacerbated by an international meltdown in the high-tech sector and by the broader recession in the United States and elsewhere. Israel felt the high-tech crunch more than most other countries because that sector accounts for 15 percent of Israel's GDP. The sharp drop in that industry has also halted the influx of venture capital into Israel, despite gains of approximately \$3 billion just two years ago.

Fiscal Austerity and Election Maneuvering

The economic crisis is forcing Israel to trim its budget by nearly \$2 billion. In the most recent budget forwarded by the cabinet for Knesset approval, the reductions are made in a variety of areas:

Cuts in defense spending, particularly on benefits for noncombatants. Despite these cuts, defense spending remains higher than its historic low in 2000, when it was 8.5 percent of GNP, the lowest in thirty-five years.

An estimated 10,000 of the 156,000 Israelis who currently receive welfare will be dropped from the rolls, and benefits will be cut for nearly 100,000 more, including single parents, new immigrants, and women on alimony.

Israelis cite the tightening of welfare criteria in the United States as a paradigm that their government should emulate. Moreover, Sharon recently stated, "it is not tenable that there are 270,000 people out of work in Israel while there are 300,000 foreign workers here."

Cuts in education, housing, and tax breaks and subsidies for companies operating far from the country's center.

The austerity budget is an important development given that elections must be held no later than a year from November; in fact Sharon's chief rival—Defense Minister Binyamin Ben-Eliezer, head of the Labor Party—predicted yesterday that elections would be held next June. Traditionally, Israeli politicians avoid controversial budget cutting during the year leading up to an election. Given Israel's emergency situation, however, Sharon's assessment appears to be that he would undergo more criticism for not cutting the budget. Sharon is politically vulnerable on economic issues, a fact illustrated by his consistently dismal approval ratings on such issues (e.g., in today's Ma'ariv poll, his rating was 19 percent). Amid talk that Labor may bolt Israel's national unity government in order to position itself in advance of the coming elections, it is telling that the party voted against the budget, which barely passed the cabinet by a 14-12 vote. Labor critics complained that Sharon did not cut from projects that are important to some of his core constituents (e.g., settlements and religious schools).

Military Service and the Ultraorthodox

One byproduct of the economic crisis is that the Knesset has passed some legislation that it had avoided for years due to insufficient political will. Resistance to reform has dissipated as the Israeli public acknowledges that there is little other choice. Recently passed tax-reform legislation can be put in this category, as can the capital-gains tax.

Another controversial reform is the Tal Bill (passed last week by a 51-41 margin), which would enable more young ultraorthodox Jews to join the work force. As it stands now, ultraorthodox Jews can be exempted from military service if they study in a post-high school yeshiva (rabbinical schools), but the exemption requires that they either remain in the yeshiva until the age of thirty or have many children. This keeps ultraorthodox youths out of the work force, with the result that Israel has the lowest participation of males in the work force in the West. This nonparticipation increases welfare costs. In addition, widely publicized anecdotal press coverage has insinuated that at least some yeshiva students are not truly immersed in study. These issues exacerbate religious-secular tensions in Israeli society, particularly since ultraorthodox Jews represent the fastest-growing subgroup among Israeli Jews, despite constituting only 8 percent of the general population.

The Tal Bill is named after retired Supreme Court justice Zvi Tal, who headed a commission that produced a 130-page report on this issue two years ago. The commission originated with a 1998 Israeli Supreme Court decision that draft deferment—which previously had been regulated without a clear legal basis—henceforth be regulated by legislation. The commission suggested that students be permitted to opt out of a yeshiva at the age of twenty-four and receive abbreviated military training and vocational instruction instead. Last week, the Knesset approved this program for a five-year period, after which it will be reviewed.

Support for the Tal Bill came from the ultraorthodox themselves, but only after some of their heterogeneous leadership came to a gradual and grudging realization of two key factors. First, not every student is intellectually or religiously driven to stay in a yeshiva. Second, lacking basic work skills, the ultraorthodox community has become disproportionately poverty stricken, even with substantial government subsidies. Moreover, given the current state of the economy, some ultraorthodox leaders acknowledge that yeshivas may not be spared from future budget cuts.

Secular opposition to the Tal Bill was fierce. Secularist parties, along with much of the Israeli public, complained about the lack of equity in military service, since non-ultraorthodox Israeli eighteen-year-olds face three years of army service and, given the current violence, enhanced annual military reserve duty. The shifting sands of the governing coalition have also played a major role in the bill's fate. When the ultraorthodox were part of former prime

minister Ehud Barak's coalition two years ago, Labor voted for a preliminary reading of the Tal Bill in the Knesset, while Sharon, then in the political opposition, voted against. Now that he holds power, however, Sharon has supported the bill in the hope that it will forge closer ties between the Likud Party and its religious allies.

Economics and Politics

Sharon's sparing of his own base from key economic cuts opened the door to potential political strategies for both Likud and Labor. Sharon's political assessment is that Labor is in utter disarray, and that his biggest challenge for re-election will therefore come from within—namely, from Binyamin Netanyahu. Therefore, his approach to domestic policy reflects his interest in consolidating his political base. Sharon believes that former Likud prime ministers Yitzhak Shamir and Netanyahu lost the 1992 and 1999 elections, respectively, because they did not adhere to this strategy. (Shamir was brought down by ideologues after the 1991 Madrid conference, and Netanyahu was brought down by ideologues after the 1998 Wye conference.)

Similarly, by positioning Labor against the budget and Tal votes, Ben-Eliezer seems to be signaling that the party must focus on socioeconomic change if it is to have any chance at political resurrection. Labor's past election strategies have too often been linked to Oslo and peace prospects, and the current Palestinian violence has virtually discredited Labor on this score. Labor must shift its attention to economic issues, as recent polls show that three out of five Israelis are deeply dissatisfied with the economy. Labor feels that it has an opening now that Sharon's approval ratings have dropped seventeen percentage points over the last three months (down to 52 percent as of today), particularly since he can no longer count on security being an all-consuming issue. As elections approach, Sharon needs to focus more attention on economic issues as well.

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