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To my beloved parents, Maya and Ran

**THE ASCENT OF OLIGARCHY:**

**THE CASE OF ISRAEL**

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A dissertation submitted for the degree of Doctor of Philosophy

City University London  
Department of International Politics

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## ABSTRACT

The aim of this thesis is to explore the development of an oligarchy in the Israeli political economy. In that, it both sheds light on the state-business relationship in the Israeli political economy, and refines the understanding of oligarchy in general. In order to achieve this two-folded objective, I re-conceptualise oligarchy, identify its sources, characterise its structure, and analyse the main mechanisms through which it establishes its power in a national political economy, specifically — in Israel.

The literature so far scarcely addresses the ways in which such cluster of wealth and power emerges and develops in liberal and developed market economies. This thesis aims to fill this gap, by examining the origins of the oligarchy rise, the key actors involved in the process of 'oligarchisation', and the modalities through which oligarchs are distinguished from other wealthy actors. In particular, this work illuminates the critical role of the state in the formation and modus operandi of the oligarchy, which, in return, has substantial influence on the decision-making process and the political economy as a whole. The term 'oligarchy' in this thesis refers to a set of institutional, political, and social linkages and dynamics, whose interests are to some extent converged and are increasingly counterpoised to the interests of the 'traditional' economy. My analysis develops on the basis of a critical engagement with theories examining concentration of wealth and power in national political economies, together with data collected from various governmental and non-governmental sources and fieldwork, examining the facets of this concentration in Israel. My study reveals that the corpus of ideas and assessments of oligarchy points to a cohesive power structure, which, in the Israeli case, can be identified as an informal political economic institution.

## INTRODUCTION

This thesis started out as a dissertation that aimed to understand why the European Union (EU) appears to be a weak political player in Israel, despite its extensive attempts to generate political, social and economic change, and its position in the global arena. The literature reviewed initially did provide me with some answers. On the EU side, they include, for example, the lack of a single voice within the EU and different interests between member states. On the Israeli side, conversely, the conventional wisdom holds that a lack of coordination between different ministries, reluctance of cooperation with the EU (perceived often as 'dishonest broker'), and internal political struggles have stymied the internalisation of EU power in Israel. However, the findings in the literature and the official reports, greatly supported by fieldwork I conducted both in the EU offices and in Israel, have led me in a new direction that had not yet been examined. I came to realise that one of the key reasons underlying the EU weakness in Israel is a set of Israeli business groups and their affiliated professionals, such as accountants, lobbyists and lawyers, who have no interest in advancing the EU objectives. This discovery led me to the hypothesis that the Israeli political economy is built around an important power structure: an oligarchy, not analysed in the conventional literature on the region and the country's political economy, and, at the time, scarcely present in public discourse. This revelation (as well as my supervisors' input) compelled a dramatic shift in my research, which turned its focus to analysing the ascent of the Israeli oligarchy, its sources, its characterisation, and the implications of its power.

I argue in this thesis that an oligarchy had developed in Israel since mid-1990s, consolidating in the first decade of the 21<sup>st</sup> century. The Israeli state played an important and pro-active role in the development of the oligarchy. The main contribution of this thesis is twofold. First, this thesis provides the first account of the rise of oligarchy in Israel. In that, it sheds light on the Israeli political economy and in particular, on the evolution of the state-business relationship. Second, the thesis refines academic approaches to oligarchy. Specifically, using the example of Israel, this thesis develops a conceptual framework to understand the contemporary face of this important and increasingly common phenomenon of clusterisation of wealth and power in democratic and liberal political economies.

### **Research Questions and the Argument of the Thesis**

The main purpose of the present study is to disclose the mechanisms through which oligarchy, specifically the Israeli oligarchy, arises and accumulates power in a democratic national political economy. Four interrelated questions guide the inquiry of the thesis:

- How can oligarchy be most adequately understood as a political-economic phenomenon, and in the context of Israel's political economy specifically?
- What can explain the increased concentration of Israel's economy among a small group of wealthy individuals and families over the past few decades?
- What are the organisational mechanisms that have enabled the emergence of oligarchy and the expansion of its power over the past two decades?
- In the context of ongoing shifts in the global political economy, how specific is the case of the Israeli oligarchy?

The political economy of Israel shares some characteristics with other, older and more stable market economies. This particularly concerns the transformation of the 1980s and the 1990s, which included the hasty opening of the economy to the global market; the liberalisation and deregulation of the domestic economy; the privatisation of key public assets; the financialisation of the economy; and the commitment to strong and allegedly stable pool of shareholders that would cooperate with the state (Rosenhek and Shalev, 2014). A central point of the thesis is the extent to which the transformation of the Israeli political economy has, indeed, reduced constraints to advance the free market. However, following these processes, the Israeli economy has become increasingly oligarchic. Biased credit allocation, privileged provision of state resources, concentrated sectorial control and regulatory failures have eroded some of the most important mechanisms of a free and competitive market.

The Israeli oligarchy, which had developed since the mid-1990s, consists of ten pyramidal business groups, controlled by individuals or families, and their affiliated professionals, i.e. accountants, lobbyists, lawyers, managers, consultants, and other businessmen and business groups. It controls substantial shares of the market economy and the public financial assets, managing tight relationships with state agents. Its power has been one of the root causes to the market entrenchment, lack of competition, and rising inequality. The distinct role of the state in this process has also shaped the nature of the oligarchy. The oligarchy and the state, as I shall argue, are cooperative yet distinct entities.

This thesis analyses the political economy of Israel, tracing its development from the foundation of the state in 1948 to 2012. This time framework considers the background to the rise of the Israeli oligarchy and allows me to delineate the key processes in its development. This thesis demonstrates that the active role of the government in the oligarchisation of the political economy is consistent with previous policies enacted throughout the history of the Israeli state. At the same time, my research focuses on privatisation and financialisation, in order to better understand why the development of the oligarchy was accelerated during the mid-1990s and the 2000s. This work concludes with the aftermath of the social protests in 2011.

## Jeffrey Winters and Academic Approaches to Oligarchy

The study of oligarchy can be traced to as far back as Aristotle, who defined it as 'the rule of the few' (Politics, III). Historically, the concept of 'oligarchy' has been employed to describe a political-economic system where 'the few' rule (Michels, 1915 [1911]; Schmidt, 1973; Samons, 1998; Leach, 2005), and is increasingly used by various commentators today. Nevertheless, oligarchy has been "underspecified" in the literature (Leach, 2005), and remains "among the most widely used yet poorly theorized concepts in the social sciences" (Winters, 2011:1). Winters further argued (2011: 2) that the definition of an oligarchy is so incoherent that almost every political system or community that fails to achieve full and constant participation by its members displays oligarchic tendencies.

Until the 20<sup>th</sup> century oligarchy tended to be conceived as a corrupted type of regime in which the few rule for their own good at the expense of the common good. The notion of regime implies the form or structure of the society and its way of life as embodied in that structure.<sup>1</sup> According to this concept, the rulers are not separable from society, but rather rule society by developing its character through institutions and norms (Mansfield, 1983; McCormick, 1993). The fact that the few sacrifice the common good is what distinguishes oligarchy from aristocracy, and of course from democracy. In the traditional sense, therefore, oligarchy describes a political system.

With a degree of consistency, many scholars tend to define oligarchy from a normative viewpoint. The definition of oligarchy offered by Leach (2005), for example, centres on the degree of illegitimacy and the entrenchment of the leadership of an organisation or a community. She defined oligarchy as "the concentration of entrenched illegitimate authority and/or influence in the hands of a minority", which normally goes against the interests of the majority (2005: 329). Likewise, Fogel (2006) and Gilens and Page (2014) maintained that the structure of society is designed in a way that serves the interests of the governing elite, i.e. oligarchy. Clark (1977) described (in the context of the academic system in Italy) 'oligarchic particularism' as triumphing bureaucracy.

Of an exception is the key work of Jeffrey Winters on oligarchy (2011), who distinguished the interpretation of oligarchy from the Aristotelian view, defining it as "the rule of the *wealthy* few." Winters' concept of oligarchy refers to the political processes and arrangements associated with few wealthy individuals in their efforts to defend their wealth. It can thus be contrasted with the traditional notion of regime or governance. Following Winters and other analyses (e.g. Krugman, 2011; Johnson, 2009), today, the concept of oligarchy in democracies refers to influence, and to the methods of accumulating and preserving wealth and power, even without being a part of the

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<sup>1</sup> The origin of the notion of regime, as well as that of oligarchy, is Greek. Plato was the first to describe several types of regimes (such as aristocracy, oligarchy, democracy and tyranny, see *The Republic*, Book VIII), followed by other philosophers and writers (Aristotle, Polybius and Machiavelli are the most famous).

governance structures of the state. This concept thus captures the possibility that political processes and the political economy in general may serve the interests of the very wealthy few in a systemic fashion (because of inherent weakness of capitalism, problems of democracy, etc.), even if the very wealthy few do not formally rule.

Winters (2011) derives his vision of oligarchy through the notion of individual oligarchs, as a disparate collection of oligarchs cooperating to defend their wealth. In this thesis, in contrast, I emphasise the importance and cohesion of the oligarchic power structure, specifically as an informal political economic institution in a national political economy. This institution first and foremost sets the 'rules of the game' that influence economic behaviour (North, 1990), rather than specific agents and their total sum of actions. The term 'oligarchy' in this thesis refers, therefore, to a set of institutional, political, and social linkages and dynamics, whose interests are to some extent converged and are increasingly counterpoised to the interests of the 'traditional' economy. This conceptualisation enables a differentiation between oligarchs and oligarchy.

The conception of 'oligarchs' is not synonymous with big businessmen or tycoons, but only with controlling-owners that acquired their wealth in a specific way. As this thesis contends, it is possible to identify several intertwined characteristics of oligarchs around the world that make them qualitatively different from other very wealthy people, including 'fat cats', capital owners and tycoons. This difference is largely set out by the structure of their holdings, their sectorial spread across substantial market shares and the concentrated ownership, their relationships with the state and state agents, and the non-competitive or rent-seeking nature of their accumulation of wealth and of their activities. Furthermore, as seen in the Israeli case, the 'clubness', or the cohesion and coordination between the oligarchs, sustains the rise of the oligarchy, substantiates its power and sets it apart from other wealthy actors. Oligarchies around the world, therefore, develop around the nexus of state-business, and in most cases, are a result of regulatory weakness of the state or its retreat from the private market, which in turn, often implies implicit consent or explicit support to rising wealthy elite. The interactions of this informal institution with formal decision-makers are critical in enabling and shaping the rise of oligarchy.

Another key notion that will play a meaningful part in this thesis is institution. Institution can be understood as a collection of formal and informal rules that motivate, direct, constrain and, at times, enable behaviour. Institutions, according to North (1990: 3), are 'humanly devised constraints' that actors generally follow, for normative, cognitive, or material reasons. Institutions are not considered to be simple agreements or power structures created by individuals; instead, they direct codes of conduct and legitimise specific beliefs or ideas among society. The concept of institution is in contrast to understanding the oligarchy as a governance system or a type of regime. This conception enables us to analyse the reason institutions – in this case oligarchy – come into

being, why the Israeli oligarchy developed in the way it did, and what are the implications of its power. In order to answer these questions, it is necessary to introduce the state as the final key concept of this research.

The definition of the state used in this thesis draws on the Weberian vision of the state: "a compulsory political organization with continuous operations...its administrative staff successfully upholds the claim to the monopoly of the legitimate use of physical force in the enforcement of its order" (Weber 1978: 54). The state is a set of legal institutions, organised in a bureaucratic fashion, with a centralised government. That is, the main difference between the state and other organisations or institutions is the fact that the state is a compulsory territorial association as opposed to other groups (Poggi, 1990; Weber 1978; Perry and Wise, 1990; Sager and Rosser, 2009). Secondly, the state alone is able to represent people in the common interests that they have as citizens, and not as members of any one group. Social action, especially organised action, is considered political if it aims at exerting influence on the government, such as appropriation, expropriation, redistribution or allocation of the government power (Weber, 1978). Indeed, and this is another unique characteristic, the state often acts to advance the public good, and, at least in democracies, seeks public trust – that is – the consent of the people to its rule. Therefore, an oligarchy that is dependent on the state, as in the Israeli case, is limited in its scope, and is more fragile than oligarchy whose power is based on crude force, money, or corruption.

Winters' theory of oligarchy focuses more closely on the power and influence of the wealthy, and is a specific realm of minority power and politics (Winters 2011: xii). Defining oligarchy as 'the rule of the *wealthy few*', he suggests, as indicated before, focusing on individual oligarchs in order to understand oligarchy, not the other way round. Oligarchs are always individuals, not organisations or corporations; the latter, instead, are instruments to amplify the oligarchs' power. According to Winters, oligarchs are defined neither by their official position in the government, nor by a position of rule (ibid: 39). Instead, they are distinguished by their high degree of wealth and its concentration; extreme concentration of wealth is the central source of power of the oligarch, which not only creates advantages in the political realm, but also conveys special power and interests. Oligarchs are, therefore, actors with immense personal wealth who are uniquely empowered by it (ibid: 211), and are primarily characterised by a common goal of wealth defence (ibid: xii). This goal provides specific challenges, as well as capabilities.

Oligarchy, for Winters, is the set of institutional dynamics linking the individual oligarchs in their common goal of wealth defence. While the definition of oligarchs remains constant and fixed across time and societies, oligarchies assume different forms, depending on the degree of coercion and the organisational impetus (Winters 2011: 5). The regime of wealth and property rights varies across states, as do the characteristics of the oligarchy. Wealth and property can be protected

individually or collectively, but the process of wealth defence still exhibits certain modalities and a degree of organisation. Winters, accordingly, outlined four types of oligarchies, as a specific category of economic elite: Warring Oligarchies; Ruling Oligarchies; Sultanistic Oligarchies, and Civil Oligarchies. His typology reflects the changing nature of threats to the oligarchs' wealth, and how they act to overcome these challenges.

In Warring Oligarchies, like Medieval Europe, the relations between coercion, property and wealth are often blurred (ibid: 41); nevertheless, property rights exist, and wealth defence is central to political-economic dynamics (ibid: 49). In this kind of oligarchy, warrior-oligarchs use violence to defend their property. They fight the people they rule, as well as the competing oligarchs. In the more modern constellation of ruling oligarchies, conversely, oligarchs started to cooperate with each other, making "claims to massive private property, within increasingly institutionalized systems" (ibid: 43). Therefore, warring oligarchs defend their wealth "in a manner that is highly fragmented as opposed to collective-institutionalized" (ibid: 65).

In Ruling Oligarchies, such as the Mafia Commissions or the Greco-Roman oligarchies, wealth defence is achieved through a combination of several means, which cannot be used alone - coercion instruments, official positions and collective action or cooperation. The integration of these means, in turn, determines the rule of the oligarchy. Wealth defence is primarily achieved through coercion, as armed oligarchs separately rule their domains. Absolute property rights exist; however, the coercive capacity is the most important factor in shaping the character and the longevity of the oligarch and the rule of the oligarchy. Oligarchs in ruling oligarchies often hold official positions in state institutions, although an office alone is not sufficient for their wealth defence. Ruling oligarchies show higher degrees of cooperation between oligarchs than warring oligarchies; nonetheless, the greatest risks they face are not from the mass movements below, but from their fellow oligarchs. The rule and wealth defence of the oligarchs are enabled by collective arrangements of cooperation, overcoming the risks they pose to each other. The oligarchs thus mostly aim to avoid open conflicts through internal agreements that embody their oligarchic collective power (ibid: 104), rendering the ruling oligarchy more stable. Its power, therefore, is tightly sustained by its collective basis.

In Sultanistic Oligarchies (such as Suharto in Indonesia or Marcos in the Philippines) oligarchs are usually disarmed and tend not to rule directly, but are protected by a leading oligarch, "capo di tutti capi". Three elements characterise sultanistic oligarchies (ibid: 135-6): the rulers govern in a personal fashion, with extreme power over political-economic matters; they control the access to wealth, which, in turn, is their key power; and they have discretionary control over coercive power within a state or a regime. There are no absolute property rights as in the preceding oligarchies, only property claims, making the protection of the leading oligarch critical to wealth defence. The

leading oligarch regulates and constrains oligarchic power within state borders, through coercion or, alternatively, through corrupted measures, such as bribes and fees paid to the police, the judiciary, the legislators and the media (ibid:207). However, he is not necessarily subject to the rule of the state; instead, he shapes the institutional realm over which he rules. Accordingly, institutional devastation and re-institutionalisation can also take place. The stability of the political-economic system, therefore, ultimately depends on how the leading oligarch manages wealth defence (ibid: 135).

Civil Oligarchies are the most relevant type to this thesis. The civil nature of the oligarchy points to the separation between the oligarchy and the public offices, and indicates the state authority to which oligarchs are subjected. Oligarchs in civil oligarchies are fully disarmed, and coercion is provided by the state. Oligarchs do not engage in direct rule, and hold no public offices. The state is officially responsible for wealth defence, and is governed by legal rules and public institutions which dictate the wealth defence laws with which oligarchs conform. Importantly, the system of laws is stronger than the oligarchs (Jayasuriya, 2000). Oligarchs must negotiate with the state in their attempt to defend their wealth. Still, their core political demands regarding wealth defence are accommodated. The state provides them with property defence, and the oligarchs, in return, provide the state with shares in their economic surplus. In such settings, oligarchs do not seek to change their existing environment, but to influence it in order to serve their interests.

The strength of the civil oligarchs is linked to their ability to influence the statist system for their own needs. Their power is exerted by means of influence over political processes and outcomes in their favour (Winters 2011: 210). However, the specific goals of the oligarchs may differ. In the US, for instance, oligarchs are interested in driving down tax rates (ibid: 213-4). They can, for example, influence senators and congressmen about laws and rules and ask for policy assistance, employing professionals such as accountants, lobbyists, lawyers and advisors, in order to defend their income and protect their wealth (ibid: 214). The power of the oligarchs is conveyed through the mechanism that Winters termed Income Defence Industry (IDI), expressing the direct engagement of the oligarchs with wealth defence (ibid: 221). It is the most important tool used by the civil oligarchy in general. Other authors mention the campaign finance system as a major tool to reduce taxes and other aims of wealth defence (e.g. Lessig 2011).

In Winters' theory the parameter to distinguish oligarchs from other wealthy actors, and what, in effect, turns wealthy individuals into oligarchs, is the engagement with wealth defence. The particular mechanism of wealth defence defines the specific character of the oligarchs, and requires access to political power or influence over the machineries of the state. In fact, the conception of an 'oligarch' itself entails the use of political power in order to defend wealth and increase profits (Winters, 2011). The measures taken to defend wealth are not available to all citizens, as only above

certain wealth thresholds can actors afford such a costly political mechanism; therefore not every rich person is an oligarch (ibid: 217).

My theoretical approach draws on three key points of Winters' framework. First is his notion that oligarchy is 'the rule of the *wealthy* few', as opposed to the traditional interpretation of 'the rule of the few' (e.g. Michels, 1915; Leach, 2005; Clark, 1977). Second, Winters suggests that oligarchy does not refer to a system of rule by a particular set of actors. Instead, he describes the mechanism of wealth defence. Third and related, Winters emphasises that democracy and oligarchy are not mutually exclusive, but can co-exist. The rule of law, he argues, is stronger than oligarchs.

This thesis extends Winters analysis, in several critical ways. First, it distinguishes oligarchs from oligarchy. Winters refers to oligarchy as a mere compendium of oligarchs cooperating to defend their wealth. While he does assess the specific political processes and arrangements conducted between oligarchs in their efforts to defend their wealth, he does not engage with the formation of a cohesive oligarchic power structure in his analysis of civil oligarchies. This is largely because the starting point of his analysis is oligarchs and what they aim to achieve, while my starting point is *oligarchy*, and more generally - the national political economic context.

The second point is the factors underlying the emergence of the oligarchy. Winters' primary assumption is that these individuals are already significantly wealthy prior to their becoming oligarchs. While he does refer, more generally, to oligarchy as the nexus between wealth and power (Winters 2011: 27), wealth defence is the core objective of the oligarchy and what ultimately turns wealthy actors into oligarchs. In this thesis, conversely, I examine the process of wealth and power accumulation, both with respect to the formation of an oligarchy as a group enjoying access to wide market shares, and the cooperation between the members of the oligarchy. This process includes, more prominently than wealth defence, the efforts of the oligarchs to acquire, sustain, and expand their wealth.

Third, as part of the focus on wealth accumulation, the thesis examines the statist conditions under which oligarchy emerges and operates, and the role of the state in the formation of oligarchy. It aims to illustrate that the state, and not wealth, may be the crucial factor in the formation of an oligarchy.

Finally, the thesis delineates the modalities through which oligarchs can be distinguished from other wealthy actors, such as tycoons, 'fat cats', owners of corporations and even monopolies.<sup>2</sup> It argues that individual wealth is not a necessary or sufficient condition for an individual to be part of the oligarchy, and that oligarchs are not necessarily wealthier than other actors, who, rather, may be equally wealthy or even wealthier, highlighting what distinguishes the oligarchs. Furthermore, it

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<sup>2</sup>La Porta et al. (1999), for example, posited five types of controlling owners: a family or an individual; the state; a widely held financial institution such as a bank or an insurance company; a widely held corporation; and "miscellaneous", an entity such as a cooperative, a voting trust or a group with no single controlling investor.

illustrates how in the case of Israel we witness, in fact, an *oligarchy* without *oligarchs*.

In order to investigate these four issues, this thesis draws its major insights from two sets of scholarship – the first is the historical scholarship, built around the Marxist tradition (Marx, 1977 [1867], 1981[1894]; Hilferding, 1980[1910]; Lenin, 1999 [1916]) and the corporate power approach (Mintz and Schwartz, 1985; La Porta et al., 2000; Palmer et al., 1993; Mangel and Singh, 1993). The second is the contemporary scholarship, which includes oligarchic family control literature and pyramidal ownership structures (e.g. Morck et al., 2005; Fogel, 2006; Kapferer, 2005; Khanna and Rivkin, 2001), and the new wave of corporate power literature focusing on inequality in the US (Hacker and Pierson, 2010; Piketty and Saez, 2003, 2006; Gilens and Page, 2014; Johnson, 2009). The analytical framework adopts the idea that clusters of wealth and power and the concentration associated with them are important in political economies. Therefore, they deserve special attention when analysing allocation of resources and economic mobility.

The centrality of clusters of wealth and power to capitalism is hardly novel to the discipline of political economy. For centuries these clusters have been examined in the older traditions of economic analysis, such as the political economy of the Marxist school of thought and the study of crony capitalism in developing and transition economies. Recently, researches have advanced our understanding of role of market players in reconfiguring the clusters of wealth and power of the global economy (Reich, 2007; Johnson, 2009), the relationship between the very wealthy few and inequality (Piketty and Saez, 2003, 2006; Alvaredo et al., 2013; Atkinson et al., 2009, Piketty, 2014), and the challenges that such clusters of wealth and power present to economic stability, national policy-making, the role of the state, and the civil society (Hacker and Pierson 2010; Freeland, 2012; Gilens and Page, 2014; Krugman, 2007). This literature has raised crucial concerns about the functioning of state institutions, regulatory flaws and the absence of a more just and inclusive solution to the problems of inequality and wealth concentration.

These analyses of clusters of wealth and power allow us to see more clearly the economic aspects of oligarchy. At the same time, the treatment of oligarchy of the two above-mentioned scholarships tends to confuse oligarchy with the nature of the political, economic, and social system as a whole. In addition, despite the abundance of contemporary writing on concentration of wealth and power, studies have been mainly concerned with either the (somewhat derivative) problems of inequality and inadequate regulation, or with the implications of the power of the oligarchy to democracy, competition, and national political autonomy. While these issues are pivotal for a comprehensive analysis of an oligarchy, they are largely of a secondary nature to the underlying mechanisms of the oligarchy's power basis, the causality of its evolution, and its relationship with other institutions and processes in capitalism.

Notwithstanding the variety of different and varying institutional characteristics of today's states,

states continue to play a crucial role in the economy (Engvall, 2015). The oligarchisation of economies involves complex, intricate, and highly contentious processes in all major areas of life. This research framework, accordingly, exposes the role of the state in transforming the foundations of the political economy, particularly the composition of the economic elite. Specifically, it underlines the crucial role of the state in the rise of an oligarchy. It thus shows how the sources of the rise of the oligarchy in Israel reflect the historical relations between the state and a specific group it chose to develop (e.g. Aharoni, 1979; Shalev, 2004). The historical supremacy of the state is important for understanding the development of the oligarchy, and why it has developed in a particular form.

My analysis re-visits the assumptions of the literature, which considers the state to be a facilitator of the rise of an oligarchy or, alternatively, stresses the state weakness when it is captured by oligarchs (Hellman et al., 2000; Morck et al., 2005; Fogel, 2006; Mintz and Schwartz, 1986; Morck et al.; 2005). While in some cases concentration of wealth and power and inequality indeed reflect the incapacity or unwillingness of the state to challenge the rule of an oligarchy, these are only partial and contingent explanations for its emergence, which do not pertain to all states. I argue that the separation between the statist regime and the oligarchy can be preserved, and that the state is an important agent in the process of oligarchisation. That is, in a similar vein to the coexistence of oligarchy and democracy, oligarchy can coexist with a strong state. The process I identify as the “oligarchisation” of the political economy is carried out from within the state itself, rather than initiated by big corporations or individual oligarchs. Politicians, public servants and other state agents create an oligarchy under the jurisdiction of the state. The inner dynamics of state institutions, the workings of the market, and the manifestation of these processes at the level of national political economy sustain the rise of the oligarchy.

Specifically, the thesis takes the phenomenon of clusters of wealth and power as its initial subject of study, and analyses the available evidences of related epiphenomena around the world. It thereby acknowledges the tendency of modern states to adopt a model of liberal market economy, in line with writings about the development of capitalism in the world and its varieties (Hall and Soskice, 2001; Albert, 1993; Crouch, 2005; Hall and Gingerich, 2009; Schmidt, 2002; Coates, 2000; Howell, 2003). The illustrations from other cases around the world reveal the importance of the political context to the formation of an oligarchy, suggesting that oligarchies are a universal phenomenon of capitalism.

The thesis uses theories of Institutional Economics in order to explain the role of the oligarchy in a national political economy. This perspective helps recognise oligarchy as an informal political economic institution; yet, this does not mean that the influence of formal and informal rules is deterministic. Institutions matter, but politics are not reducible to institutions, and are no less

important (Sangmpam, 2007). The conceptualisation of oligarchy as an institution enables me to show how, like other institutions, oligarchy affects, motivates, commands, and encourages the behaviour of state ministries, regulators, political parties, market players and entrepreneurs, civil society, and the press. Indeed, the rise of the oligarchy has numerous implications for and impacts on many agents and actors in the Israeli political economy; nonetheless, some actors, first and foremost the state but also others, like the media, can fight against it, and refuse to cooperate with it.

## **Data and Methodology**

The first part of the thesis includes the theoretical and the historical settings for the analysis of the rise of oligarchy in Israel. Expanding on the work of Winters, it draws on historical and contemporary theorisation of clusters of wealth and power. It then critically reviews the available academic literature on the Israeli political economy and its specific economic, political, and social features (e.g. Shalev, 1992, 2004, 2006; Nitzan and Bichler, 2001; Maman, 1997, 2004, 2008; Aharoni, 1991). Defining the phenomenon of oligarchy as an institution, the thesis incorporates both the old school of institutionalism (Commons, 1934; Veblen, 2005[1899]; Hodgson, 1996, 2000) and the New Institutional Economics (NIE) School (North, 1990; Moe, 1991; Shepsle, 1989; Williamson, 2000; Richter, 2005).

The second part of the thesis, analysing the rise of an oligarchy in Israel and the way it substantiates its power, employs both primary and secondary sources, as well as empirical data from numerous sources. These sources include various official publications by international bodies, like the IMF and the OECD,<sup>3</sup> and by state agencies such as the Bank of Israel (BoI), The State Comptroller and Ombudsman, the Governmental Companies Authority (GCA) and the Central Bureau of Statistics (CBS). They further include reports produced by various government ministries, particularly the Ministry of Treasury and the Ministry of Industry, Trade and Labour (MOITAL), by the Knesset (Israeli Parliament), and by different committees appointed by the state. The importance of the formation and findings of these committees is two-fold. First, they point to a substantial problem, such as the lack of competition in the financial sector, or, later, the excessive power of the institutional investors. Second, they indicate that the state is still a central actor in the market economy, vested with the power to determine trajectory-altering reforms. These committees are thus both a technique that the state relies on as a means of exerting its influence, and a signal of substantial problems in the market economy. The thesis also uses data from the Tel-Aviv Stock Exchange (TASE) and from ratings providers and business analysis agencies, such as Dun&

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<sup>3</sup>These sources provide vital statistical data, economic reviews and analyses of the corporate governance in Israel, following Israel's accession to the organisation in 2010.

Bradstreet and BDI, as well as researches conducted by think-tanks and research centres such as Taub Centre, Milken Institute, Adva and The Israel Democracy Institute. Publications in the media are another important methodological tool.

This data is complemented by fieldwork conducted in Israel during 2013 and 2014, for which I had interviews and conversations with more than thirty scholars, politicians, journalists, regulators and ex-regulators, economists, entrepreneurs, activists, businessmen and professionals, some of whom are part of the club, and some who have observed its consolidation and power from the outside.<sup>4</sup> This fieldwork was designed to fill the gaps of data which are not covered by the existing literature, to interpret the data, and to arrive at a more comprehensive picture of the details of clusters of wealth and power and the role of the state in cultivating them.

### **The Structure of the Thesis**

Methodologically, my argument unfolds in three steps: (a) setting the theoretical foundations of oligarchy; (b) setting the historical foundations of the Israeli political economy; and (c) analysing the rise of oligarchy in Israel. The fourth and ultimate step examines what the analysis of the Israeli oligarchy can add to the study of the politics of the very wealthy few in general, and to the understanding of oligarchy in particular. With this research agenda, the thesis is organised into two parts. The first part, consisting of chapters one and two, frames the conceptual foundations for the analysis of oligarchy and reviews the evolution of the Israeli political economy. The second, empirical part, consisting of chapters three, four and five, presents a more detailed study of the rise of the oligarchy in Israel. Specifically, it describes and analyses the processes that have led to the emergence of the Israeli oligarchy and the key actors therein, using illustrations from similar cases around the world.

Chapter one reviews existing approaches to economic theory on clusters of wealth and power in capitalism. It analyses the two streams of scholarship indicated before, the historical scholarship and the contemporary scholarship, thus expanding the analysis of Winters with respect to four critical points: distinguishing oligarchs from oligarchy; assessing the origins of oligarchy and the mechanisms through which it establishes its power in a national political economy; the statist condition under which oligarchy emerges and operates; and the modalities through which oligarchs are distinguished from other wealthy actors.

Chapter two traces the development of Israel's political economy from the foundation of the state in 1948 up to the mid-1990s. The chapter examines the changing role and presence of the state,

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<sup>4</sup> As many of the interviewees were reluctant to be named, I did not want to indicate further identifying details regarding their role, position or views, and decided to keep the list of interviewees almost entirely anonymous.

the evolution of the 'big businesses' — several large and concentrated business groups at the hub of the Israeli economy since the end of the 1960s, and the development of the state-big business relationship.

In the second part of my thesis, chapters three and four examine the main stages of the formation of oligarchy, contextualising the oligarchic activities within the framework of the key reforms the political economy has gone through. The topic of chapter three is the first stage of oligarchisation, which lasted from 1985 until the end of the 1990s, entailing privatisation and the ensuing transition from the old 'big business' to the new business groups. In this process, a few individuals became very powerful and wealthy, largely due to the way the state conducted the privatisation process and not due to their economic activity. The 'coming of age' of the oligarchy and the resulting market concentration were accelerated by the financialisation of the 2000s.

Financialisation, the topic of the chapter four, broadly refers to the increasing presence and political role of financial markets and financial actors in national economic systems. Like elsewhere in the global economy, the financialisation of the Israeli economy originated in the 2000s liberalisation of the capital market, aimed at increasing competition in the financial sector. This reform process has led to the emergence of new players in Israel, but also empowered other players, especially institutional investors. In Israel, once liberalisation and privatisation processes were launched, financialisation has served to transform the big business groups, whose power was already concentrated, into oligarchic structures, utilising the pyramidal structure of ownership and control and the merger between financial and real holdings.

Chapter five analyses the organisational and institutional mechanisms and strategies through which the Israeli oligarchy substantiates its power. It maps and characterises the structure of the Israeli oligarchy as of 2011, demonstrating the familial and networked nature of the political economy. The chapter argues that the core of the Israeli oligarchy consists of ten business groups of pyramidal structure that have control over substantial shares in numerous market sectors. What makes them an oligarchy is 'the club'. The club includes the controlling-owners of the oligarchic business groups and other professionals, such as bankers, accountants, lobbyists, lawyers, managers, various 'consigliere', former politicians and regulators, and other businessmen and business groups. The club fulfils various functions, first and foremost coordination, both between the business groups and between them and statist decision-making circles.

Finally, chapter six, tying together both parts of the thesis, examines what the analysis of the Israeli oligarchy can add to the broader understanding of oligarchy, specifically – the two approaches identified in the thesis: the historical and the contemporary, as well as to Winters' theory. Four central points emerge from this analysis of the Israeli oligarchy: (1) the pro-active role of the state in the formation of the oligarchy; (2) the 'clubness'; (3) the particularities of the

pyramidal ownership structure; and (4) the predominantly domestic basis of power of the Israeli oligarchy. These four key issues help to distinguish 'oligarchs' from other wealthy actors, and to distinguish oligarchy from oligarchs, suggesting thus that in Israel the oligarchy is an informal political economic institution.

With this, the key insights of the thesis can be summarised in the following manner:

1. Oligarchy - 'the rule of the wealthy few' - refers to political-economic processes and arrangements associated with a small number of wealthy individuals in their efforts to acquire, sustain, defend, and increase their wealth.
2. In Israel, the rise of the new business groups that would later form the oligarchy was largely a continuation of the historically tight relationships between the 'old' big business groups and the state.
3. Two main processes have enabled the rise of an oligarchy in the Israeli economy, a consequence of the 1985 economic reforms: the 1990s privatisation of state assets and the 2000s financialisation. Specifically, state assets were privatised in a concentrated fashion, to a small group of controlling owners, forming the new business groups. Financialisation during the 2000s has further facilitated the expansion of oligarchic control over the economy of, and through, pyramidal ownership structures, rendering these groups very powerful.
4. In Israel today, oligarchy forms and is sustained by an informal 'club'. This oligarchic club, in addition to ten pyramidal business groups at its core, consists of professionals (accountants, lobbyists, lawyers, managers, and advisors), former politicians and regulators, as well as other businessmen and business groups. The 'clubness' is sustained by personal and professional networks, interlocking directorates, joint ownership, and by the access of the club members to and their influence on political decision-making processes. This set of networks perpetuates the rule of the Israeli oligarchy and functions as an informal institution in the political economy, rather than collection of oligarchs.
5. Overall, I argue that oligarchic capitalism in Israel is a result of the country's transformation to finance-led economic growth during the 2000s. In this, it falls within other countries where market economies are controlled by oligarchies. However, the case of the Israeli oligarchy is distinguished from other countries by the peculiar relationship of the oligarchy with the state — namely, the substantial dependence on the support of the state, which, in turn, holds the authority to break the oligarchy; by the 'clubness'; by the particular pyramidal core structures; and by the predominantly domestic basis of wealth of most oligarchic groups.

# **PART I**

## **CHAPTER 1**

### **OLIGARCHY IN HISTORICAL AND CONTEMPORARY THOUGHT**

The purpose of this chapter is to identify and critically engage with the literature on wealth and power clusters in political economies. My objective is to survey analytical approaches that have emerged over time when the questions about the concentration of resources, namely, money and power in the hands of a few, arose. To these ends, the chapter employs the concept of ‘oligarchy’ (distinct from large business or political elites), and analyses the political economy of a system where ‘the few’ rule (Michels, 1915; Schmidt, 1973; Samons, 1998; Leach, 2005).

The chapter expands Jeffery Winters' conceptual analysis of oligarchy (2011). First, it examines oligarchs versus oligarchy to understand the role of oligarchy in a national political economy. Second, it outlines the sources of the rise and accumulation of wealth and power of the oligarchy, delineating the mechanisms used by the oligarchy to substantiate its power. Third, it illuminates the statist conditions under which oligarchy evolves and operates and the state-oligarchy relations. Fourth, it delineates the modalities through which oligarchs are distinguished from other wealthy actors.

For this purpose, the chapter analyses two streams of scholarship: first, the historical scholarship, focusing primarily on the Marxist tradition (Marx, 1977 [1867], 1981[1894]; Hilferding, 1980[1910]; Lenin, 1999 [1916]), and on corporate power, mainly systems characterised by the vast control of large Trans-National Corporations (TNCs), mostly pertaining to the US since the 1970s (Mintz and Schwartz, 1985; Palmer et al., 1993; Mangel and Singh, 1993). The second body of scholarship is the literature on oligarchy from a contemporary perspective, which includes oligarchic family control literature (Morck et al., 2005; Fogel, 2006; Kapferer, 2005; Khanna and Rivkin, 2001), and the new wave of corporate power literature, focusing on inequality as central to the definition of an oligarchy (Piketty, 2014; Gilens and Page, 2014; Hacker and Pierson, 2010).

The first two sections analyse these scholarships. Each section brings forward a definition of oligarchy, describes the processes of its formation, and delineates its organisational form. Along these lines, this chapter emphasises the social facets of the rule of the wealthy few, analysing its key implications on the economy and polity. The third and final section aims at reformulating a conception of oligarchy, incorporating the analysis of the two approaches and their insights into Winters' conceptualisation, before summing up the chapter.

## 1. Oligarchy: Insights from Early Historical Scholarship

### *The Marxist Approach*

It was Marx (in *Capital*, Vol. I) who first anticipated the change in the structure of capitalism from competition to a process of centralisation and concentration of capital, leading to the dominance of big corporations. Although Marxists mostly focused on the position of the bourgeoisie, their work is pertinent for understanding the modalities through which an oligarchy is formed. The Marxist tradition, as surveyed here, consists of two strands of scholarship. One strand concerns the early Marxist scholarship on the world system prior to World War I and its central dynamics (mainly Hilferding, 1980[1910]; Lenin, 1999 [1916], Bukharin, 1968 [1927]). The other strand involves the secondary literature critically interpreting Marxism or building on Marxist understanding of capitalism and its structures. This literature, as analysed here, concerns the rule of joint-stock companies or corporations, and capitalism in general (e.g. Cohen, 1970; Harris, 1982; Sawyer, 1988; Harvey, 2010). A significant part of the analysis of this school of thought of oligarchy and its consolidation focuses on economic monopolies and on the process of monopolisation.

In 'finance capital,' Hilferding (1910 [1980]) explained how and why the process of concentration and centralisation had rapidly evolved in the Austro-Hungarian empire prior to the First World War. Like other authors within the Marxist tradition at the time (e.g. Kautsky, 1910; Luxemburg, 2009 [1909]; Bukharin, 1968 [1927]; Lenin, 1999 [1919]), Hilferding challenged the prevailing paradigms of 'laissez faire' and the 'invisible hand' of the market, according to which an individual frequently promotes the interests of the society by pursuing his own interest (Smith, 2000 [1776]). Hilferding described the rapid proliferation of ownership and control, in the form of cartels and trusts, which were replacing smaller forms of businesses (today's Small-Medium Enterprises - SMEs). This new stage in the development of capitalism was termed 'monopoly capitalism' (Hilferding, 1910: 5).<sup>5</sup> Analysing the monopolisation process, Hilferding (*ibid*) stated that the most characteristic feature of 'modern' capitalism are those processes of concentration which, on the one hand, eliminate free competition, through the formation of cartels and trusts; on the other, they bring bank and industrial capital into "an ever more intimate relationship". Through this relationship capital assumes the form of 'finance capital', "its supreme and most abstract expression".

Therefore, a central feature of this new stage of 'monopoly capitalism' was the growth of the

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<sup>5</sup> The Marxist theory has tended to identify joint-stock companies (corporations) with monopolies, using the terms interchangeably. Monopoly is defined as a large corporation ruling a remarkable share of industries in relation to its size. As Malcolm C. Sawyer (1988) explained in his theory of 'monopoly capitalism', monopolies imply the domination of firms that operate in oligopolistic industries, few in number which nevertheless possess wide control over the economy as a whole. It is noteworthy that this definition stands against the later, economic-oriented definition of monopoly as an exclusive provider of a certain commodity or service (Sweezy, 1937; Horowitz, 1981). This identification between corporation and monopoly was in view of the substantial and exclusive control that a corporation could obtain in the 19<sup>th</sup> century and in the 20<sup>th</sup> century. Accordingly, it largely drew from the Marxist focus on class struggle (Marx and Engels, 1846 [1970, 2004]), inferring that the bourgeoisie can rule over the working class through control of monopolies. The 'degree of monopoly' (Kalecki, 1968) depends chiefly on the degree of its centralisation vis-à-vis the economy, which conventionally rises over time.

financial sector, which in the course of its development had come to dominate the industrial sector. By this means, according to Hilferding, it was forming 'finance capital', in which the bank owns a large part of the capital employed by the industry. The dominant role of banks in the monopolisation process was the result of their ability to provide credit and finance. As the banks were interested in constructing cartels to protect their self-interests and investments, they gradually became central actors in the market.<sup>6</sup> The dependence of industrial firms on financial institutions has led to a strategic control of the latter over the former. The process of 'finance capital' thus enabled a few wealthy 'finance men' to control the greater part of a state corporate sector. In his analysis of the increasing dominance of joint-stock companies, Hilferding (1910 [1980]) identified three processes in their consolidation: separation between ownership and management; leverage of capital (when the amount needed to obtain ownership is significantly smaller than the actual value of the share); and the expansion of activities, both to other sectors or industries and within them.

For Hilferding, the monopoly (or corporation) is governed by a small group of people or a single body (like a bank) that aims to fulfil its self-interests, independently of the mass of small shareholders. Hilferding deliberation on monopolies as oligarchic entities assessed monopolistic inclinations as depressing competition and strengthening the interests of the (financial) oligarchy. He stressed that "Finance capital in its maturity is the highest stage of the concentration of economic and political power in the hands of the capitalist oligarchy. It is the climax of the dictatorship of the magnates of capital" (1980: 370). According to Cohen (1970), the key insight of Hilferding was identifying and conceptualising this transformation from 'laissez faire' and 'invisible hand' doctrines into monopoly capitalism, which displaced free competition as the financial sector's importance increased.

Adding to Hilferding, Lenin (1999 [1916]) sketched five inter-linked features of monopolies, specifying the ways by which they establish control over society: (i) their decisive role in economic life; (ii) the merger between bank capital and industrial capital (creating a 'financial oligarchy', *ibid*:58); (iii) the growing significance of capital export (to other states); (iv) the formation of international monopolies and their expansion around the world; and (v) territorial division of the world by the leading 'capitalist' states.

Most Marxist authors, such as Hilferding, Lenin and Bukharin, were concerned with the global aspects of wealth and power concentration. They associated the far-reaching structural changes within national capitalist systems with imperialism; they analysed the way in which processes of

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<sup>6</sup>Although not in the Marxist context, in the same period (1911) Woodrow Wilson (the President of the United States from 1913 to 1921) made a speech stating how the 'money monopoly' has always been the prevailing monopoly, while industrial nations were controlled by a credit system (Brandeis, 1914).

economic change and industrialisation evolved into a concentration and centralisation of money and power in the hands of big corporations, thus creating a world-wide economic monopoly by the ruling class of capitalist states over weaker states. The Marxist approach thus associates 'finance capital' with power exercised by certain states over poorer markets (Brewer, 1984, 1990; Willoughby, 1995).

According to Hilferding, Imperialism was not an integral product of the new organisation of capitalism, but a dynamic policy that was the final stage of the 'finance capital' process. Like Hilferding, Bukharin (1968 [1927]) also defined imperialism as an organic manifestation of monopoly capitalism; however, he attempted to radicalise the idea of Hilferding of imperialism (Cohen, 1970: 439), by identifying it with the nature of the capitalist system (ibid). For him, imperialism was not only associated with modern capitalism, it was its most essential characteristic. Lenin (1977 [1916], 1999[1919]) effectively integrated both approaches. He defined imperialism as the highest stage of capitalism, marking the new form of world capitalism; at the same time, his analysis still sees imperialism as a policy of 'finance capital', designed to enable the expansion of control. Lenin, in his struggle against capitalism, highlighted the transition of the capitalist system into monopoly capitalism as a state tool in the international sphere (Willoughby, 1995). In his analysis, inequality of exchange dictates the international division of labour in a way that is detrimental to the interests of poor countries.

As for the role of the state, Marx himself never developed a theory of the state or its unique and crucial role in the development of modern forms of capitalism. While the state was central to the definition of imperialism, its role in the evolution of 'finance capital' is secondary. According to Marxist theory, states are instruments in the hands of big corporations or the capital owners (Marx and Engels, 1846 [1970, 2004]; Brewer, 1990). The bourgeoisie - the owners of the means of production - dominate policy making, causing the state to serve their material interests. This view of the role of the state was also feasible in the case of 'finance capital'. Hilferding also did not give much credence to the role of the state, seeing it as another actor in this process rather than its main coordinator or leader; he understood the state as an instrument in the hands of the ruling class(es). Nevertheless, he termed the monopolisation process – the take-over of the industrial sector by financial institutions, backed by state support – a 'state capitalist trust', and the system 'state capitalism'. The latter was increasingly becoming a regulated economic system, or, as Hilferding termed it, 'organised capitalism' (1910 [1980]).

Nigel Harris (1982) criticised the understanding of Hilferding of the role of the state. According to Harris, Hilferding's analysis does not account for the tight affinities of the state with monopolies and cartels. He argued that “the ideology of liberal state, founded upon an open competitive market, gives way to the aggressive nationalism of monopoly capitalism, denying the right of national self-

determination to all except the imperialist power” (1982: 351). By these means, he points to the passive role of the liberal state in the market as a function of its ideology. It was because of the state that the monopolisation process was, in fact, so pertinent. The monopolisation process was so prevalent, in other words, because of the state. Winters (2011: 9) also challenged the Marxist causal vision of actors who economically deploy material resources for socio-political effects. Instead, he argued, these actors obtain their material resources politically, with economic impacts.

Also in contrast to Hilferding, Bukharin (1968 [1927]) emphasised the role of the state in the emergence of monopolistic or oligarchic power. The conceptualisation of 'state capitalism' was at the heart of his theory of imperialism, which he referred to as the 'imperialist state' (1929). For him, the most striking feature of modern capitalism was the new prevailing role of the state. The state was no longer a non-interventionist actor that mediated economic competition between groups of the bourgeoisie, as previously assessed in the Marxist approach. Through the process of 'finance capital' the state had become a direct organiser and owner in the economy, a "very large shareholder in the state capitalist trust" and its "highest and all-embracing organisational culmination" (1929: 120). The long-arm of the state was spread across all areas of social life (ibid).

The view of Agghiri Emanuel (1972) was different from that of most Marxist writers; Emanuel engaged with 'mercantile imperialism', wherein he focused on governments rather than on corporations. As governments were a logical and historical precedent to 'finance capital', he focused on the interplay between them. Thus, he associated Lenin's evolutionary view of imperialism with the domestic origins of 'finance capital', i.e. governments or state institutions.

Despite the differences between Marxists regarding the role of the state in the monopolisation process, they all emphasised that the state serves the monopolies' interests (Bottomore, 1985). Their analysis concerns a world system; the reference to monopoly was in the wider context of the international system, linking it to imperialism. On the other hand, these thinkers argued that the way to confront this rising monopolistic power is by forming a domestic opposition of the working class (Marx, *Capital*, vol. I). The interplay between the domestic and the international still remains somewhat ambiguous. It is possible to suggest, then, that while the process of 'finance capital' primarily illuminates the take-over of industrial concerns by the financial sector, these monopolies cannot increase their economic power, as well as their social and political role, without the support of the state. The Marxist instrumental understanding of the role of the state still positions it as an active actor in the monopolisation process. The presence of the state is highlighted by means of its support for big corporations, thereby increasing its own power in the international arena.

The Marxist analysis of monopolisation intrinsically integrates critical or normative judgment. Here, the power of the financial oligarchy is different from the power traditionally affiliated with other capital owners; the latter, even if not socially just, stands in direct relation to control over

means of production. The financial oligarchy, instead, is based on rents from its holdings in or take-over of the industrial sector, thereby creating a structural phenomenon: the so-called 'competitiveness deficit'. For their part, Lenin (1999 [1916]) and Bukharin (1968 [1927]), emphasised the rule of the rentier and the financial oligarchy as leading to imperialism, inequality, and corruption, detrimental to weaker states, to the proletariat (the working class), and to society in general. Lenin further argued (1999 [1916]) that monopoly capitalism resulted in stagnation and negatively affected investments. Sawyer (1988) also rejected two assumptions of the liberal thought regarding monopolies: that the spread of their operations raises economic efficiency and welfare, and that it promotes competition. Instead, he argued, these monopolies constrain competition and damage general welfare. The conception of monopolies was thus entangled with the critical scrutiny of the rising capitalism and the escalating class struggle.

The evolution of early structuralist approaches to oligarchy was further informed by more institutional focus on social structures and classes. Against the same chronological and historical background of Marxism, the German social democratic strand pre-World War I and the Italian School of Elitists made a case for how a small, privileged elite actually serves the interests of the state. Represented by Max Weber (1946, 1964, 1999), and by elitists like Pareto (1971 [1927], 1991 [1920]) and Mosca (1939), this strand of literature suggests that a strong business elite actually advances state and society interests. Weber indeed focused on the state interests—in his case, Germany—and was concerned with the strengthening of its power position in world politics (Giddens, 1970, 1971). In contrast to the Marxist instrumental view of the role of the state, for Weber the objectives of the state were those which dictated its choices. While the state wanted to advance capitalism – as Marxists claimed – the reason was organisational and not reducible to the interests of the bourgeois.

Weber also associated the role of business elite with the international arena; however, he suggested a different perspective to the Marxist notion of imperialism. Presuming that success in the global markets is a crucial factor of state invigoration, Weber encouraged coordination between the business elite and the government, advancing shared interests (Bottomore, 1985). In his view, the advancement of the state of a narrow business elite could bring nations to harmonious relations by centralising the interests of the state in the hands of a specified influential group. Cohen (1970, commentating on Bukharin's writings) further associated these advantages with imperialism. He asserted that one of the basic features of imperialism is its acceleration of development in the most 'backward countries', which can thereby intensify their struggle against national oppression.

It is important to recognise that while Weber did explore the role of the few in the organisational-political field, he did not envisage the evolution of a business elite into an oligarchy. Moreover, the particular form of such a business elite was less consistent with his analysis – for he

wanted to stress the importance of non-economic elements in social life. Therefore, he chose to present the social implications of the ascent of the business elite, associating them with advantages at the state level, with concentration of economic power as a natural and even desirable evolution. Conversely, Weber was mostly concerned about the increasing power of bureaucrats and bureaucracy (Wright, 1974; Niskanen, 1971; Rudolph and Rudolph, 1979), depicting it as the actual problem of liberal democracies and modern economies. He argued that instead of fulfilling their role as agents facilitating the activities of the state, bureaucrats were becoming too dominant as actors.

Along similar lines, Schumpeter (1934, 1950), examining monopolistic practices, argued that they do not necessarily damage economic welfare, because they encourage accelerated innovation. He also suggested that the profits of a small, privileged group with immense control may actually increase welfare and more easily generate an economic boost.

As for distinguishing oligarchs from other wealthy actors, the Marxist school of thought helps to identify financiers in the general group of capitalists. The Marxists delineated, in effect, a social and financial class that controls monopolies (Harvey, 1974, 2010; Scott, 1997; Giddens 1971, 1981; Giddens and Held, 1982), most prominently consisting of financiers. Hilferding (1980:370) termed it a '*capitalist oligarchy*', denoting the excessive power of financial sector firms and their control over industry. Such control enables further accumulation of wealth and power (Bellamy and McChesney, 2009; Shaikh, 1989). Both Lenin and Bukharin assessed the supremacy of financial capital over other forms of capital. The financial oligarchy (Lenin, 1999 [1916]:58) principally obtained its wealth and power through acquiring vast parts of the industrial sector, centralising its control over the economy.<sup>7</sup> While there is no reference to particular individuals or oligarchs, but rather to members of the financial oligarchy, the differentiation between financiers and top managers of these corporations to other wealthy actors is the most adequate method to single-out oligarchy within the 'bourgeoisie'. This type of cluster of wealth and power, understood as oligarchic, is largely determined by political context, especially as it relates to the specific nature of the liberal state. The oligarchy, as developed in the Marxist approach, is thus the result of the specific state-business relations.

### ***The Corporate Power Approach***

The historical approach to oligarchy identified here also includes more recent analyses of the institutional underpinnings of corporate power, mainly with regard to systems characterised by the vast control of large corporations. These analyses examine clusters of wealth and power with

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<sup>7</sup>Contemporary oligarchy, as Harvey (2010B) argues, is the dynamic of numerous sectors, especially finance, which act to restore their fortunes after they were threatened by social democratic endeavours.

reference to the globalisation of markets. The key focus of scholars who developed this strand of literature is the evolution of big corporations since the 1970s and the ascent of the financial sector to dominance, mostly pertaining to the US and the UK (Useem, 1984; Wallerstein, 1974; Barnet and Muller, 1974; Channon, 1973; Egelhoff, 1984; Cosh and Hughes, 1987). This set of literature largely focused on Trans-National Corporations (TNCs), pointing to their rule in the international markets. These clusters of wealth and power, characterised by the control of large corporations, did not point, however, to a specific ruling group or individuals, but rather to the institutional linkages between these actors, that afforded them increasing power and influence. It was mainly in the aftermath of the 2008 global financial crisis that debate on an American Oligarchy was heightened, as the next section will show.

Developed during the 1970s and 1980s, with the financial revolution, the corporate power approach has evolved against the background of globalising market capitalism. Drawing primarily on the work of Berle and Means (1991 [1932]), this literature makes a number of interesting points. Specifically, because a corporation is widely held, its ownership is dispersed between large numbers of public shareholders, and public companies generally do not control other public companies. In the absence of a dominant owner, the management team effectively controls the corporation. In such corporations, governance is about decreasing the divergence of interests between professional managers and small public shareholders with respect to profit maximisation (Jensen and Meckling, 1976). While large block-holders and inter-corporate equity are at play, they are smaller and much less common in big US corporations, compared to other countries (Shleifer and Vishny, 1986; Anderson and Reeb, 2003; Holderness and Sheehan, 1988); furthermore, block holders in the US seldom control more than one corporation (Morck et al., 1988).

The corporate power approach specifically addresses corporations in the financial sector and the gradual proliferation of their economic power in national political economies, particularly in the US (Singh and Zammit, 2006; Mizruchi, 1983; Akard, 1992; Graham and Dodd, 1934). Mintz and Schwartz's (1985) 'Bank Control theory' describes an asymmetrical dependence of non-financial firms on financial firms or banks, and the strategic control of financial institutions over industrial ones. The mechanism of their control is similar to the Marxist assessment, highlighting the ability of banks to provide credit and control money. This approach is reasonably consistent with the 'inevitable internationalisation' of firms (Whitley, 2005:216-17) and their spread across global markets. More specifically, it illustrates how the impact of transnational economic activities has broken the monopoly of the nation-state in international politics (Gilpin 1971: 67-8). As a result of the conditions under which this school of thought evolved, a period of intense globalisation and free market capitalism, it describes TNCs, cross-border investments and technologies as social institutions with a larger role than ever (Radice 1998:1-2; Nye 2002).

While the power of big corporations is related to their rule over the international arena (Madeley, 1999; Sklair, 2001), TNCs have not replaced the nation-state as the primary actor in international politics. This set of literature tends to draw on the vision of the neoclassical economics of the role of the state. It shows that while big corporations were empowered by accelerated processes of globalisation, the political gap between the state and the corporations has enabled the concentration of wealth and power in the hands of big business group. This approach vastly heightened the debate on the ‘retreat of the state’ (Strange, 1996; Enrich, 1996; Walsh and Seward, 1990; Sklair, 2001), as an active policy designed to enhance the autonomy of the state. This political act includes de-regulation and empowerment of dominant market actors, which itself is a series of important political decisions and regulatory moves (Cerny 1996), pointing to the state exercise of power in a globalised era. The state is responsible for bonding society, preventing its segregation into smaller units as a result of the corroding actions of market relations. Mintz and Schwartz’ analysis (1981, 1985), for example, examines how state-imposed constraints and inter-corporate unity shaped the structure of business activity. The role of the government is defined as both a chief actor in inter-corporate coordination (Coen et al., 2010: 25), and as facilitator in paving the way for TNCs to accumulate wealth and power.

A more prominent approach to the study of power, though, concerns the influence of big corporations on the state, where “the existence of economic planning, however imperfect, implies the collateral existence of political planning and suggests that business intervention in government is as inevitable as it is prevalent” (Mintz and Schwartz 1985: 43). The policy regime is reflected in the structure of these corporations, as well as in other interest groups (Coen et al, 2010: 22). Nye and Keohane thesis of interdependence (1971), for example, attributes a key role to non-state actors, such as autonomous individuals or organisations that control substantial resources. The way TNCs exert their influence on the state is not specified or highlighted; this is probably because of the focus on the shared interests in the global arena, committing such cooperation. Still, there is no ‘triumph’ of markets over states. Instead, states use interest groups to advance their own purposes (Schwartz, 1994), typically to generate growth, promote stability, or strengthen their position in the international arena. While the state plays an important role in determining the structure of markets and business, in legal and policy terms (ibid: 12), this approach emphasises the role of TNCs in establishing and preserving the position of the state in the global arena, and shaping the balance of power in the political economy.

This discussion highlights the increasing interdependence between the state and big corporations. The model of inter-relations between them corresponds with analyses suggesting that governments cannot run the economy (Drucker, 1989). This approach is more decisive, therefore, than approaches suggesting that governments are doing a poor job managing the economy, or are

losing control over it (Schwartz, 1994). The limits of governments' power results in further space for businesses, particularly business elites and big corporations.

The balance of power between state and big corporations, consequently, can be understood as 'institutional complementarities' (Hall and Gingerich, 2009; Hancke, 2007; Hall and Thelen, 2009; Morgan, 2005; Howell, 2003). Not excluding conflict of interests and controversies which indeed take place (Biersteker, 1980; Grossman and Adams, 1996), their trajectories are largely attuned. The government and big corporations are seen as actors on the same side, and state-business relations are characterised by continuity and stability (Coen et al. 2010: 4).

At the same time, focused on the mechanisms of interactions between the state and the TNCs, the corporate power approach scarcely deals with the negative implications of the rise of big corporations and TNCs. Their significant power, a function of their economic role, has often been seen as consistent with the national interest (Gilpin, 1971), providing a response to the needs of technological and economic development (ibid: 54), or augmenting political supremacy. This approach comes close to the Weberian rationale behind the establishment of the state of a strong business elite. It highlights some advantages offered by these power structures, such as greater public participation in global affairs from citizens of rich countries as a result of investments that stimulate the democratisation of technology, finance, and innovation (Nye 2002:88). In this reading, the investments of TNCs, in effect, empower society, strengthening the state and its institutions. Nevertheless, corporate power is often considered a threat to usurp national sovereignty and the role of the state in foreign policy (Wells, 1971; Kaiser 1971).

Considering the settings under which this school of thought has evolved, it is hard to extract clear criteria to determine what makes oligarchs distinct among a set of wealthy actors, tycoons, and executives; as such, this literature does not address individual oligarchs. Yet, the power of big corporations is largely embedded in their proximity or access to political circles. Interdependence with the state and access to or power over it differentiate top executives and owners of these corporations, distinguishing them from other actors within the upper wealthy class or the business elite. This literature helps in understanding the emergence of these clusters of wealth and power as an outcome of particular state-business relations, and more specifically, as a product of the globalised era, but it does not analyse oligarchy as such.

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There are some parallels between the 'corporate power' and Marxist literature. First, both approaches focus on structural aspects of wealth concentration or on institutions and structures of economic power - monopolies in the Marxist tradition and corporations in the corporate power

approach. At the same time, both approaches do not refer to oligarchs on an individual level. Second, both elucidate a process of transition from industrial to financial economic predominance, emphasising the control of the financial sector over the real economy or the industry which results in the concentration of wealth and power in the hands of these corporations. This merger illustrates the leverage of capital in spurring the expansion of the activities of the financial sector. Third, both approaches are similar in how they contextualise the power of big corporations with their substantial influence over the international arena. Fourth, both approaches link the expansion of the corporation activities to power exercised over society as a whole. Finally, in both approaches the big corporations tightly cooperate with the state, which facilitates their rise.

At the same time, the corporate power literature has substantial differences with the Marxist tradition. First, its focus on the US, in the particular time settings, points to a more specific resolution of economic power and control. While it does analyse power in an international context, it does not cover debates about imperialism and is not directly concerned with the implications of states' rule over other states. TNCs are seen as power structures emerging as a result of global processes, with considerable support by the state. Yet, this approach thoroughly surveys the inequality that results from the diverging internalisation of globalisation in different states (e.g. Krugman and Venables, 1995; Dollar, 2005).

Second, the corporate power approach specifically highlights that the power of financial firms is an expression of the financial sector's increasing importance in the US market economy (Lamoreaux, 1996; Helleiner, 1995), rather than an attempt to monopolise the system.

Third, while the corporate power approach does distinguish share-holders and owners of big corporations from their managers (Holmstrom and Kaplan, 2001; Mizruchi, 1983, 2004; James and Soref, 1981; Jensen and Meckling, 1976; Larner, 1971; Useem and Karabel, 1986), it focuses more closely on the managers. The privileged positioning of managers shifts the focus to profit-maximising objectives, instead of the accumulation of power. The expansion of the activities of the corporation, accordingly, becomes a logical means to augment profits rather than a deliberate attempt by owners to obtain more power. The focus on "mismanagement" and profits over monopolisation is no accident; it allows the corporate power approach not to be too critical about the American political economy, let alone capitalism, despite portraying a gloomy picture of its evolution and operation.

In conclusion, the historical scholarship on oligarchy has tended to focus on the sources of structural power in capitalism. This angle points to the prominent place of the corporation in capitalism, mainly in the financial sector. This literature does not inquire, however, into specific corporations, nor does it discuss individual oligarchs, businessmen or financiers. Instead, it attributes power to a section of a business class (or elite), and more specifically, the owners,

managers and financiers of the big corporations.

The notion of a 'financial oligarchy' developed in the historical literature is a vehicle to engage closer with the concept of oligarchy, as opposed to 'oligarchs'. The financial sector dominates and often takes over the industrial structures of capitalism. The role of the state in this process is that of an enabling actor: the neoliberal form of the state facilitates the activities of the corporations and allows for their rule over the market economy. These processes result in the expansion of the activities of the corporations and the accumulation and concentration of wealth and power over market economies and political economies.

In terms of distinguishing oligarchs from other wealthy actors, while there is no reference to specific oligarchs, this scholarship nonetheless illuminates the power of financiers, owners, and managers, primarily in the financial sector, in managing tight relations with the state.

## 2. Oligarchy: The Contemporary Scholarship

### *Oligarchic Family Control and Pyramidal Business Groups*

The first strand of the more recent literature highlights the rise of clusters of wealth and power in a particular context of economic reform, specifically the transition from command state to neo-liberal state. It thus principally addresses developing countries, which are often characterised by a poor institutional structure (Morck et al., 2005; Payne, 1968; Fogel, 2006; Kapferer, 2005; Leach, 2005). The concept of oligarchy, as developed here, comes closest to the traditional understanding of oligarchy, a system of rule by a few over the political economy as a whole. For example, focusing on Latin American states, Leach (2005) and Fogel (2006) introduced a more extreme case: oligarchic rule, rather than state rule, over political choices, allocation of market resources and interaction with the global arena. While the oligarchy includes few wealthy individuals, both Leach and Fogel did not stress this fact, but rather that they are few and not democratic.

This set of literature focuses on a specific oligarchic power structure: business groups (e.g. Granovetter, 1995, 2005; Khanna and Rivkin, 2001; Powell and Smith-Doer, 1994; Leff, 1978). Khanna and Rivkin (2001: 47-8) defined business groups as: "a set of firms which, though legally independent, are bound together by a constellation of formal and informal ties and are accustomed to taking coordinated actions." Morck, Wolfenzon and Yeung (2005) demonstrated how big firms around the world, or more specifically, business groups, have dominant shareholders; more often than not, these groups are controlled by wealthy families (Almeida and Wolfenzon, 2006; Morck and Yeung, 2004; La Porta et al., 1999), especially in states with poor competition and regulation policies, (Khanna and Rivkin, 2001). In many cases, then, the rule of a small number of business groups relates to oligarchic family control. Like Winters theory (2011), then, this approach also focuses on the power of wealthy families (e.g. Payne, 1968; Fogel, 2006; La Porta et al., 1999; Goldman, 2004; Freeland, 2000).

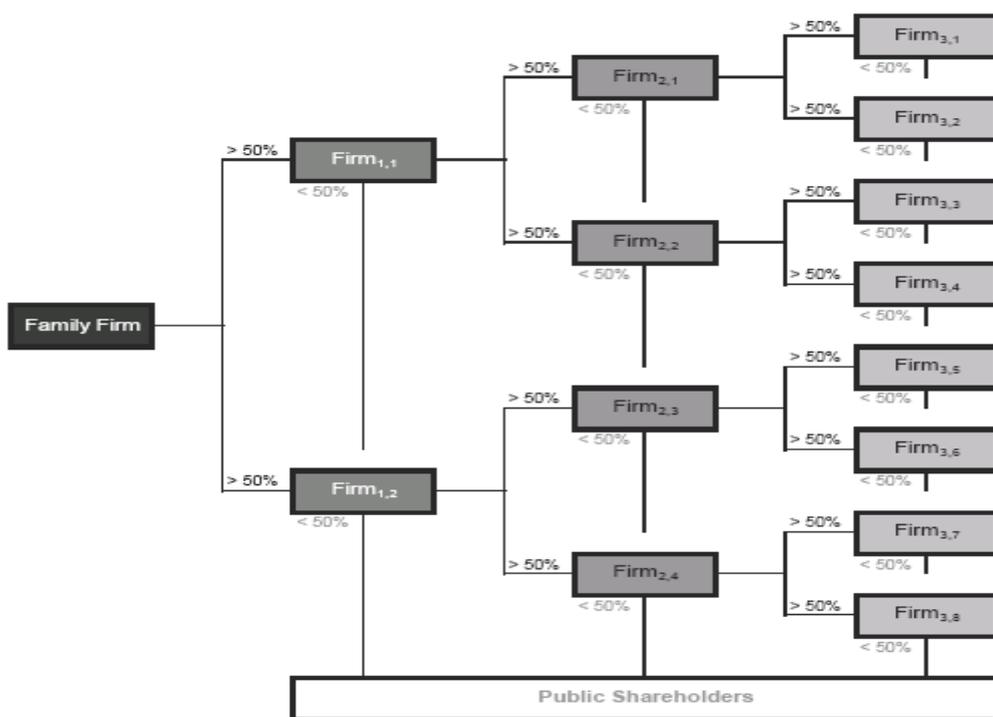
There are several explanations for the emergence of powerful business groups around the world, most of them drawn from a developmental perspective. In European and East Asian countries, the emergence of business groups was designed to promote industrialisation (Hamilton et al, 1990; Khanna and Yafeh, 2007; Ghemawat and Khanna, 1998). In Russia, conversely, as a result of the collapse of the USSR in December 1991, a huge void of political and economic power opened up. In the chaos of transition, power shifted from formal political institutions to informal networks of influence among individuals who had political connections or economic resources at their disposal (Shleifer and Treisman, 2000; Aslund, 2002, 2004; Shleifer, 2005). While power structures similar to business groups existed in the 19th century, their contemporary configuration started to flourish during the 1970s and, more substantially, during the 1990s, in countries like India, South Korea and Mexico

(Khanna and Rivkin, 2001; Kedia et al., 2006; Hamilton and Kim, 1993; Khanna and Yafeh, 2005).

These business groups usually expand across several sectors, using a pyramidal ownership structure, while separation between ownership and control is slight. The wealthy families (or individuals) can thus exercise extensive leverage of their capital, obtaining control over considerable parts of states' economies, in turn leading to an accentuated role in the political-economic arena. In pyramidal structures (as shown in figure 1.1), the control of a firm implies a significant ownership stake (Aminadav et al., 2011). Control is obtained through a chain of ownership relations - an individual or family controls several listed companies, which in turn control more listed companies, or a large group of corporations. Expanding the pyramidal ownership structure thus implies acquiring new companies through existing business units (Bebchuk et al., 2000; Almiada and Wolfenzon, 2006; Claessens et al. 2000; Claessens, 2006; Khanna and Yafeh 2007). The controlling owner at the top of the pyramid controls the firms indirectly through layers of intermediate companies. Pyramidal business groups by nature have extensive reciprocal holdings as well as simple pyramidal inter-corporate ownership links.<sup>8</sup>

Figure 1.1. A control pyramid

**A family firm controls a first tier of firms with dominant voting stakes, in this case greater than fifty percent. Each first tier firm controls several second tier firms, each of which controls yet more firms. The overall effect is to extend the family's control to encompass assets worth substantially more than its actual wealth.**



Source: Morck et al., 2005: 16

<sup>8</sup>Different from the wide-spread privately owned pyramidal business groups, in which political interference is limited, Fan et al., (2012) examined the role of state-owned pyramids, popular in a number of countries, such as China, Hungary, Russia, and the Czech and Slovak Republics, as well as in developed economies like Austria and France.

Pyramidal business groups are created over time, typically following the strong performance of existing firms (Almeida and Wolfenzon, 2006: 2651), and their structure is fairly complex, composed of cross-holding and dual-listed shares (capital rights and voting rights). The families or individuals controlling large business groups around the world (Morck et al., 2005; Morck and Yeung, 2004; Almeida and Wolfenzon, 2006; La Porta et al., 1999) can thus amass control over several firms, secure control rights and retain absolute control of the firms in the lower layers of the pyramid with minimal investment relative to the value of the controlled holdings. Superior voting rights and crossholdings between financial and real assets are devices of this control, entangled with better access to funds in order to acquire more industrial assets.

Such 'Oligarchic Capitalism' stands in contrast to 'Diffuse Capitalism' (ibid), which is most common in the US and the UK, where large and professionally managed corporations are owned by investors, whose property rights are legally protected (Berle and Means, 1932). However, Oligarchic Capitalism is not specific to developing countries, but is present everywhere, with the exception of the US and to a great extent the UK (Morck et al., 2005).<sup>9</sup> Centralisation or clusters of wealth and power around the world has been, therefore, hastened through powerful business groups (Morck et al., 2005; LaPorta et al., 1999; Chandler et al., 1997).

By means of the pyramidal ownership structure, business groups can expand their activities (Claessens et al., 2000; Faccio and Lang, 2002; Colpan et al., 2010; Masulis et al., 2011), accumulating greater wealth and power, and controlling dominant market shares, often by means of the central industries (Chandler et al., 1997). Morck et al. (2005) described how this 'oligarchic capitalism' (ibid: 693), exercised by most East Asian and Latin American economies, is characterised by public investors holding minority voting stakes in large corporations controlled by a family or a few families through pyramidal structures. As a consequence, these families are highly influential in the economic and institutional development of the states in which they operate. They come to dominate the capital investment decisions (ibid), policy-making, and the general direction of the market economy; "control pyramids effectively entrust the corporate governance of the greater parts of the corporate sectors of many countries to handfuls of elite, established families, who can quite reasonably be described as oligarchs" (ibid).

This approach, therefore, defines oligarchs implicitly as a group of wealthy people or families taking-over the essential political-economic machineries of a state and society. This is done by means of control over various market sectors and national resources, as well as over the decision-making processes. The consolidation of these business groups and the rule of powerful businessmen over the political economy, furthermore, are largely strengthened by means of state retreat from the

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<sup>9</sup>Indeed, the term "family firm" in the US is often a synonym for small firm, while around the world it describes the typical controlling owner of a large firm (Morck et al., 2005, La Porta et al., 1999).

market (Muller and Wright, 1994; Strange, 1996).

Business groups around the world are not homogenous, and their particular characteristics are shaped by the contextual statist conditions in which they emerge and operate, including institutional environment and the systems of corporate governance. The same is true for oligarchies. In this strand of scholarship, the most prominent factor enabling the rise of an oligarchy is poor institutional structure—the fragmentation, permeability, and, consequently, the deficit or failure of the state. However, it is true that families in developed states can also use their economic power to obtain political benefits and shape institutional development to their advantage. Similarly, the extent to which family-controlled firms belong to business groups is not necessarily associated with weak governance (Masulis et al., 2011). Correlation between weak institutional structure and lack of regulation is not an automatic determinant, as observed in the corporate power literature. Nonetheless, the rise of wealthy families is most common in developing states (La Porta et al., 1999; Morck et al., 2005; Colpan et al., 2010).

Although the oligarchic family control approach does not overlook the corporate form of the underlying economic activities, it does not assume oligarchy as a cohesive power structure. The manner in which the wealthy families that constitute an oligarchy contest or cooperate with each other is not thoroughly assessed. However, familial linkages, along with the role played by personal ties and networks in forming ‘related enterprises’ (Scott, 1991; Numazaki, 1991; Orru et al., 1997) elucidate the mechanisms sustaining the evolution and empowerment of oligarchic families. The familial network, then, is critical to the cohesion of the oligarchic power structure, and is further associated with the relations between wealthy families.

The key channel of power used by future oligarchs to accumulate wealth is their rule over the corporate governance system and their influence on policy-making (Khanna, 2000; Morck et al., 2005). Considering the context of economic transition under which oligarchies often emerge, these oligarchs or families can thus influence both policy-making and the institutional framework of the state as a whole. Such influence, which often outweighs that of the state, is primarily translated into the holding of privatised, formerly state-owned assets, and a greater control of economic resources (e.g. Aslund, 2004; Kapferer, 2005a; Robison and Hadiz, 2004; Silva, 1998). The oligarchs’ degree of influence depends on the wide-ranging configuration of holdings allocated to all shareholders (Aminadav et al., 2011). By means of such alliances, the oligarchs gain control over the political decision-making process, thereby transforming the character of the state (Kapferer 2005a: 286). To maintain the status quo as ‘the only game in town’ and to augment their power, oligarchs are required to constrain the market in which they operate. Oligarchs, in effect, use their political connections to establish variegated entry barriers. They can, for example, lobby for policies that counteract competition (Morck et al., 2005:70), like tax loopholes, tariffs, licenses, subsidies, and

state-administrated wealth transfers, by entering into strategic sectors aligned with government interests (Kosenko 2013: 12).

State-oligarchy relationships are based not only on shared economic interests, but also on personal relations between oligarchs and state officials. Such relations are important to embody the consolidation of oligarchy (Leach, 2005), while state leaders have common interests with members of the oligarchy, and furthermore, take an active part in it themselves (Kapferer, 2005). Such political connections (De Jong, 1991; Hadiz, 2001; Hutchcroft, 1993) give business groups (or the wealthy families themselves) preferential access to government subsidies, finance from the government and banks, tax breaks, and exemption from some regulations (De Soto, 1989; Aslund, 2002; Shleifer, 2005; Khanna and Rivkin, 2001; Kedia et al., 2006; Hamilton and Kim, 1993).

Another common mechanism to preserve oligarchic interests is the creation of employment dependency of the public sector in the oligarchy, by means of 'revolving doors' between the government offices and pyramidal business groups. This is a variant of 'captured regulators' (Maggetti, 2009; Tsingou, 2009; Gely and Zardkoohi, 2001; Carpenter and Moss, 2013). In addition, these groups have aggressive lobbies, and oligarchs themselves are highly effective political lobbyists (Morck et al., 2005; Morck and Yeung, 2004). The oligarchic family control literature, therefore, places an emphasis on the personal and inter-subjective relationships to the evolution of an oligarchy. In view of this, the pyramidal ownership structure is primarily enabled by domestic settings, although these business groups can be globalised or opened to the international market. The power of the oligarchy is enhanced by domestic sources of control and backed by state policies — or, conversely the lack of thereof.

The oligarchic family control approach directly delineates the detrimental implications of such wealth and power concentration to the market economy and to society at large, a result of the pyramids' widespread control over the market economy and their influential role in the political economy (Kapferer, 2005a). The economic dominance of the pyramidal business groups and their resulting political power creates structural inefficiencies, both at the firm and at the macroeconomic level. State ownership is negatively correlated with efficiency in capital allocation (Wurgler, 2000), and the same is true for oligarchic rule. The participation of the oligarchy across numerous fields creates a market dependency on the power of the oligarchy. Furthermore, the efforts of the oligarchy to maintain its power impedes economic development and growth, hampering the institutional development and openness of capital markets (Masulis et al., 2011), resulting in reduced rates of innovation in addition to diminished competition.

The oligarchic power structure is often associated with agency problems, which include entrenchment problem, 'tunnelling', and weak investor protection. The agency problems result from the wedge that pyramidal business groups create between their ownership and control; in other

words, the divergence between control and cash-flow rights that opens up as the controlling families attempt to increase the value of their own shares (Gillan and Starks, 2003). A primary variant of agency problems is the entrenchment phenomenon, whereby a high concentration of holdings in the market leads to the increased entrenchment of the controlling owner and biased allocation of resources (Shleifer and Vishny, 1988; Stulz, 1988; Morck et al., 2005). A market is economically entrenched if it has a “highly oligarchic flavour of capitalism and exhibits signs of enduring economic inefficiency” (Morck et al., 2005: 37). The interests of the few are given precedence at the expense of the broader economy (ibid: 70), thus risking the state democratic character or democratisation. The concentrated distribution of corporate control, combined with institutional deficits, generates and preserves economic entrenchment; and this, in turn, creates a stable equilibrium that characterises many oligarchic capitalist economies.

'Tunnelling' is a mechanism of wealth expropriation from minority shareholders (Johnson et al., 2000, Bertrand et al., 2002; Gilson and Gordon, 2003; Djankov et al., 2008; Khana and Yafeh, 2007; Joh, 2003). Given that the cash flow rights of the controlling owner are minimal, so is his or her individual risk. Therefore, they are more likely to risk the interests of minority shareholders, mainly of firms in the lower floors of the pyramids (Morck et al., 2005). An example of tunnelling activity is the transfer of resources from companies at the base of the pyramid to companies at its apex (Morck, 2000; Morck et al., 2005; Khana and Yafeh, 2007; Kosenko, 2008; Masulis, 2011).

In the corporate governance system, the distinction between voting rights, which mainly entitle cash flows, and control rights is not only enabled by investor protection deficits—it may actually lead to weaker investor protection, exposing minority investors to unforeseen risks, while producing information asymmetries (Khanna and Rivkin, 2001; Khanna and Palepu, 2000; Bebchuk, 1999). This is a ‘self-sustaining feedback loop’ (Morck et al., 2005: 711), whereby institutions convey far-reaching corporate governance powers to several individuals, who then lobby for sustaining the weak institutions, in order to preserve their own power. This loop makes oligarchic capitalism quite stable with respect to its position in a national political economy.

Pyramidal business groups tend to acquire firms formerly associated or affiliated with the government (Kosenko 2013:13) as a means to pursuing monopolistic conduct while spreading across economic sectors. This process is most prevalent in states undergoing economic transition, often characterised by weak property rights (Sonin, 2003). The non-competitive nature of the groups' activities is concurrent with other efforts to counteract market competition. Corporate governance problems are effectively intrinsic to control pyramids, mainly by means of hampering competition, enabling oligarchs to obtain vast rent-seeking influence (Almeida and Wolfenzon, 2006; Morck and Yeung, 2003; Morck et al., 2005: 699; Murphy et al., 1993; Bourricaud, 1966; Sonin, 2003).

The literature regarding the advantages of business groups, particularly pyramidal- structured organisations, is fairly vast.<sup>10</sup> As previously stated, the rule of the oligarchy is often associated with developing economies exhibiting “market immaturity” (Khanna, 2000). In developing economies, the pyramidal business groups controlled by wealthy families arguably have an important role in spurring broader market economic growth (Khanna and Yafeh, 2007), especially in the early phase of market development, covering for ‘missing institutions’ or stabilising institutional voids (Amsden and Hikino, 1994; Khanna and Palepu, 2000). Alternatively, they may fulfil an intermediation function in creating “intra-group markets” (Khanna, 2000), resolving failures in product, labour, or financial markets, as well as providing exchange flows of technology (Leff, 1978; Khanna and Palepu, 1997, 1999; Morck et al., 2005).

In such market economies, the financing advantage provided by affiliation to a pyramidal business group is of increasing importance (Almeida and Wolfenzon, 2006), as a source of secure and cheap credit. Hence, the constituent groups of the oligarchy may actually supply resources for further development of the market. These resources include the ability to inject money into failing firms or internal equity funding (Morck and Nakamura, 1999; Friedman et al., 2003); the use of a group’s ‘deep pockets’ or investment capacity as a strategic tool in product market competition (Cestone and Fumagalli, 2005); as a value-enhancing factor (Ghatak and Kali, 2001; Kim and Yi, 2006); and to enhance firm performance (Masulis et al., 2011). The intra-group integration also reduces transaction costs and risks (Khanna and Yafeh, 2005), prevents takeovers (Morck et al., 2005), and better protects the affiliated companies from financial crises and bankruptcy (Almeida and Kim, 2012). These companies also enjoy information-sharing, through interlocking directors (Khanna and Thomas, 2009; Palmer, 1983), while financial constraints are more moderate (Almeida and Wolfenzon 2006; Almeida et al., 2011).

With regards to the family control, Morck et al. (2005:27) concluded that often “family firms perform as well as, if not better than, non-family firms”, suggesting that large block shareholdings by a family and family involvement in management may even add value for public shareholders, despite the fact that family members often retain top management positions, without any mechanism to assure their competence (Morck et al., 2005; Stulz, 2005). In a similar vein, Roe (2003) argued that family control pyramids serve to protect shareholders from powerful labour unions. Indeed, family ownership is strongly associated with faster growth and accelerated innovation, as illustrated, for example, by the case of the Wallenbergs in Sweden (Bebchuk et al., 2000; Collin, 1998; Hogfeldt, 2005). Family control is rooted in history, when families such as the Medicis, Rockefellers and Rothschilds owned large shares of economies; their wealth, inherited

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<sup>10</sup>It is important to note that most of the literature addresses business groups, not necessarily pyramidal ones. For the purpose of this research the advantages are applied to the pyramidal structure as well.

throughout generations, reduced their dependence on the state for wealth accumulation. However, the situation is different for single-generation oligarchs (Sidel 2004:55). In particular, the more developed a market is, the more marginal these advantages become, whereas the disadvantages grow more prominent.

In focusing on wealthy families or individuals controlling pyramidal business groups, the oligarchic family control scholarship is the most refined approach distinguishing oligarchs from other wealthy actors. The conception of oligarchs as developed in this scholarship points, first, to the organisational form; that is, traditionally, pyramidal business groups with wealthy families at their apex. Second, it points to the oligarchs' or families' particular relations with the state. Third, the oligarchs are distinguished by their ability to monopolise national resources and spread across various sectors of the market economy. Such a cluster of wealth and power has the ability to determine its relations with the state. The statist conditions in which oligarchy operates, i.e. poor institutional structure or fragmentation, allows for the development of oligarchy. Oligarchy, in this approach, is the reason for the particular state-business nexus, with great ability to shape and direct the economy.

### *The New Wave of (US) Corporate Power Approach (the 2000s)*

During the new millennium and especially in the aftermath of the 2007-8 global financial crisis, an increasing number of publications – called here the new wave of the corporate power literature – highlighted the income inequality between the top percentage of wealthy people and the rest of the population, in the US and across the world (e.g. Piketty and Saez, 2003, 2006; Alvaredo et al., 2013; Atkinson et al., 2009, Piketty, 2014; The Economist, 2012). The discourse on clusters of wealth and power in the US has shifted from the focus on the power of big corporations, mainly in the financial sector, to inequality. This discourse illuminates the fact that the lion's share of money and assets is being increasingly concentrated in the hands of a tiny fraction of the population. It demonstrates that most of the economic growth since the 1970s has gone to the top one percent of the population, in contrast to the broader income distribution which existed beforehand.<sup>11</sup> This has resulted in growing gaps in society, with the rich becoming richer and the poor and the middle class becoming poorer.

According to this literature, the power of big corporations during the 1970s and the 1980s was in fact a "warm-up" to "super capitalism" (Reich, 2007) - the aggressive capitalism of the 2000s (Hacker and Pierson 2010:194). The new wave of US corporate power literature is a continuation of

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<sup>11</sup>The top 0.1 percent (the richest one in a thousand households) collectively rake more than \$1 trillion a year, including capital gains – an average annual income of more than \$7.1 million (compared to just over \$1 million in 1974). As for the share of national income earned, it grew from 2.7 percent to 12.3 percent.

the earlier trend, which also focuses on systems characterised by diffuse control. It is included in the contemporary scholarship literature because it delineates more specific organisational mechanisms and sources of power. In particular, it points to inequality as the basis of the power of the oligarchy, combined with the way in which economic power seeks to influence the political system. Like the previous approach, it directly analyses the social facets of the oligarchic power structure, but applies these insights to the Western context.

Particularly in the aftermath of the 2007-8 global financial crisis, the literature started using the term 'oligarchy' explicitly when referring to the top one percent, most prominently from the financial sector. Krugman (2011), in an article titled "Oligarchy, American Style", directly highlighted the "small, wealthy minority", describing the American oligarchy in terms of the top percentage of the population by wealth. Johnson (2009) drew on similar characteristics, but used the term 'financial oligarchy' in assessing financiers and big banks. This income concentration was also addressed by Hacker and Pierson (2010), who analysed the rise of the 'winner-takes-all economy', where economic growth skews heavily to top earners. The real division in society, they argued, is between the top percentage of the rich people and all the others (ibid: 4). Freeland (2012), similarly, analysing US 'plutocrats' or the American plutocracy, also distinguished a class or an oligarchy by tremendous wealth inequality. Inequality of wealth, specifically the concentration of the top percent, became the most important feature defining the US oligarchy.

Socio-economic inequality, as revealed in this literature, is not only the outcome of wealth and power concentration; it is at the very core of the wealth and power accumulation process. Inequality is not only about numbers— but also what they say about the economy and the government (Gilens and Page, 2014). Sharpening the analyses executed in the first wave of US corporate power literature, this wave suggests that in today's highly globalised and competitive environment deep economic gaps based on skill and education are inevitable. While technological changes and globalisation matter, this approach argues that they are not critical in explaining such gaps (ibid: 290). Instead, these forces are channelled by the government and its policies to nurture America's economy in a manner that is far more crucial than is generally perceived (Krugman, 2007).

The analyses of inequality further triggered a debate on the interplay between American democracy and American capitalism (Hacker and Pierson, 2010: 6), or the gap between democracy and politics (ibid: 8). Its underlying message, it is not merely the 'invisible hand' of the market which leads to inequality of wealth and, subsequently, power; instead, it is the visible hand of the government. Although it was not expected that governments would promote inequality, the US government in effect did. As Hacker and Pierson note, "America's slow, steady slide towards economic oligarchy has been neither beyond human control nor bereft of resistance" (ibid: 6). The role of the oligarchy has expanded, in parallel to the legislative system becoming more open and

dynamic (Hacker and Pierson 2010:120), and exposing the latter to the pressures of the former. The changes in the market point to changes in the government's role, with policy-making increasingly becoming subject to the influence of the oligarchy (Baumgartner et al., 2009: 233), privileging those at the top (Hacker and Pierson 2010: 54; Gilens and Page, 2014). Along similar lines, Rajan and Zingales (2003) argued that the trend of established or "incumbent" industrialists and financiers becoming enemies of the free market is universal.

The new wave of corporate power literature states that economic inequality is rooted in politics. There are three ways in which the government enables the oligarchy to emerge and accumulate wealth and power, thereby increasing inequality: taxation, legislative initiatives, and government failures to respond to economic dynamics.

Taxation is crucial for the development and sustainability of oligarchy because it is the main threat to oligarchs in civil oligarchies, such as the US. Therefore, a key strategy for US oligarchs to exert power is their perpetual search to drive down tax rates. This is both a means of protecting their income and keeping the tax system porous, maintaining its complexity and uncertainty (Winters 2011: 213-4). Governments affect the distribution of 'market income' proportionately to their profits from taxes to citizens (Hacker and Pierson 2010: 44), but more significantly, determine what these taxes are to begin with. The government, then, enables tax cuts, using various 'tricks' and tax benefits for the wealthiest Americans (ibid: 212) so that the rich pay less. Johnston (2009) further argued that the tax system was recalibrated to take from the poor and the middle class, and to give to the big corporations and the richest citizens. The government, accordingly, not only does little to reduce inequality through taxation, but increases it. Economists name these government-created rewards as "rents" (Hacker and Pierson 2010: 70). This is "money that accrues to favoured groups not because of their competitive edge, but because public policy gives them specific advantages relative to their competitors" (ibid).

The second way in which the government supports the oligarchy is through legislative initiatives—or through their elimination, absence, or omission. For example, deregulation has led to a corporate governance system that drives up the pay of Chief Financial Officers (CFO), giving advantages to executives, limiting transparency, and facilitating the rise of stock options (ibid: 62, 66-7). The US government has conducted a policy of "financial markets rewards that have flowed into the pockets of the rich from America's widening range of exotic new financial institutions" (ibid: 67). This corresponds with the tradition of Economic Elite Domination, according to which U.S. policy-making is dominated by individuals with substantial economic resources (Gilens and Page 2014: 13).

The third way in which the government strengthens the oligarchy is in the failure of the former to respond to economic dynamics. Hacker and Pierson (2010:53) term a growing part of the policy-

making process as "drift". For example, regulations which are not updated to better serve the interests of big shareholders (ibid). Also, in cases of public protest, powerful groups can control the debate and preserve the status-quo, by passing a version of reform that still accommodates their interests without really addressing the underlying problem (ibid:279). These failures are linked to the retreat of the state from the market rather than its mere weakness. Absence of a government response to growing inequality, for example, is indeed a policy per se (ibid: 52), and a vivid illustration of government choice and failure—but not because it is not powerful enough to do so.

These processes give rise to ability of the oligarchy to shape the policy-making agenda and manipulate the public's preferences (Gilens and Page 2014: 22) in order to accumulate and defend its wealth. US oligarchs have, to an extent, control over the machineries of the state, although they usually hold no public office themselves (Winters, 2011). They thus tend to cooperate to defend their wealth. As a result, US public officials have "re-written the rules of American politics and economy in a way that benefited a few at the expense of many" (Hacker and Pierson 2010: 6). This has consequently led to an "unrepresentative democracy" (ibid: 110), in which the opinions of wealthier citizens are more likely to be heard. The drift of democratic governance is, consequently, pervasive and significant (Hacker and Pierson 2010: 297). The oligarchy, as developed in this approach, conveyed its priorities through its wealth (ibid: 114) by "driving the legislative train" (ibid: 133), a process reinforced by the US government and the US congress. This influence resulted in government gridlock, prevention of progressive legislation, and a distortion of representation whereby the government no longer represents the preferences of the public as a whole (Hacker and Pierson, 2011; Lessig, 2011; Johnston, 2005).

The means by which the oligarchy influences policy-making include, first, direct funding of politicians, candidates, political parties, or election campaigns, and more generally the use of "independent expenditures" and "Super-PACs" (Lessig, 2011; Reich, 2010). This is illustrated by the increasing reliance of the Democratic Party on financial industry donations (Hacker and Pierson 2010: 123). Democratic politicians feel pressured on economic matters, such as better pay for CEOs (Hacker and Pierson: 231), because over a third of their campaign funders are from the financial services industry (ibid: 227). The second tool used by the oligarchy is lobbying. Lobbying activities entail the provision of draft legislation, as well as the conveyance of insider information to officials (ibid). The third tool is the 'revolving doors' (Seabrooke and Tsingou, 2009; Abbott, 1988; McGuire, 2000), a variant of 'captured regulators' (Bratton and McCahery, 1994; Johnson, 1983; Levine and Forrence, 1990), a phenomenon where regulators, bureaucrats, politicians and public officials nearing the end of their public tenure are employed by big corporations. Another important mechanism for economic power over policy domains is 'friends in high places' (Hacker and Pierson 2010: 70); that is, the oligarchs' personal relationship with public officials or bureaucrats (Bernheim

and Winston, 1990; Faccio, 2006).

A key political instrument and channel of power is the concentrated ownership of media (McChesney and Schiller, 2003; Noam, 2009). The media has become a central instrument to exercise power, both through the oligarchs' direct ownership of media bodies (Baker, 2007; Cohen-Almagor and Seiterle, 2004; Doyle, 2002), and through their control over publications budgets, a result of their dominance in the market. The counter-actions to address these risks are fairly limited. For example, academic analyses focusing on the hazards posed by the escalation of an oligarchy are scarce, as the academy's activities rely on the oligarchy for funding or employment opportunities. The same is true for the media coverage itself (Lessig, 2011).

The oligarchy distorts resource allocation, mainly with respect to the allocation of public funds. This is due to the sophisticated financial system at the apex of the oligarchic structure, the complexity of its financial products and services, and the general instability of the financial system (Scharfstein and Stein, 2000; Rajan and Zingales, 2003), characterised by its intangible financial activities (Pinault, 2001; Jameson, 1997). Financial professionals have been gambling, to put it simply, with 'other people's money', turning profits out of unsophisticated consumers and benefiting from short-term market swings (Hacker and Pierson 2010: 46). The burden of these risks, however, is on the middle and lower classes (Orhangazi, 2008; Stolz and Wedow, 2010).

Consequently, the remarkable inequality of wealth reflects the changing nature of the American democracy (Hacker and Pierson, 2010; Gilens and Page, 2014; Reich, 2007, 2010; Lessig, 2011). The gains of the oligarchy come at the detriment of society as a whole (Krugman, 2011). Johnson (2009), for example, argued that the financial industry has actually captured the US government. He maintained that the situation in the US is much more similar to emerging markets than conventionally assumed. The government, in effect, has been supporting the excessive risks taken by the members of the financial oligarchy. This support resulted from the proximity of the government and senior financiers, "running the country rather like a profit-seeking company in which they are the controlling shareholders" (ibid: 2). This influence on policies can imply raising personal returns to rent-seeking activities (Rowly et al., 1988; Murphy et al., 1993; Tullock, 2005; Morck and Yeung, 2004).

Although the increasingly pertinent debate on inequality focused on the richest people in the US (e.g. list of "The World's Billionaires" or "Forbes 400"), it has not addressed specific oligarchs. All the same, this approach allows delineation, in concert with Winters' analysis, of a particular business class defined by its extreme wealth compared to the rest of society. The structure of this class, as developed here, like the traditional US corporate power approach before it, points to a financial oligarchy and its close relations with the state, consisting of company executives and managers, a growing share of them from the financial sector (Hacker and Pierson 2010: 16).

Financial professionals form a large proportion of tax payers in the top 0.1 percent in 2004 - nearly 2 out of 10 (ibid: 45-6). As opposed to tycoons that obtained their power as a result of industrial holdings or technology firms, the oligarchs' power in the US is substantially rooted in their control over the financial sector (Johnson, 2009; Freeland, 2012; Kapferer, 2005), further enabled by tight relations with the state and influence over policy-making.

To conclude, in the new corporate power approach inequality and influence on policy-making are key to distinguishing oligarchs from other wealthy actors and drawing a conception of oligarchy. There does not seem to be a particular emphasis to the oligarchs' cooperation or to the cohesion between them. However, the notion of IDI or the attempts to shape policy-making indicate a certain degree of cohesion which advances the development of the oligarchy, and is derived from the attribution of the oligarchy to a certain class, based on the inequality of wealth.

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In both approaches of the contemporary scholarship, the oligarchy consists of families or individuals, the number and nature of which vary from state to state. The Contemporary scholarship defines the mechanisms of the oligarchic organisation, pyramidal family control or the top wealthy percentage of the population. It also accounts for the sources of power and of the accumulation of wealth – the pyramidal structure and the increasing inequality of wealth. By means of the interaction with the state, the sources of power are further specified – fractured and weak institutional structure, or strong influence upon policy-making, enabling the rule of the oligarchy. While the statist condition under which oligarchy emerges and operates is critical, the nuances of the relationships between the oligarchs and the cohesion of the oligarchic power structure are not highlighted. As analysed next, these family connections lead to the conception of 'institutions' because the familial structure sets a built-in boundary to other actors in the political economy, with respect to ownership and control. This is because these family links make access to resources and leverage comparatively more affordable, thus enabling the concentration of wealth and power. Like the historical approach, the nature of the state and the political regime determine the type of oligarchy. The difference between the historical and the contemporary approaches is that the oligarchy in the latter has greater influence on the state-business nexus, shaping it and directing the relationship.

### 3. Redefining Oligarchy

In defining oligarchy, the historical scholarship focuses on big structures – monopolies in the Marxist tradition and big corporations in the US Corporate Power literature, and the collusion of interests, representing a structural approach. In contrast to the historical scholarship, the contemporary literature is more focused on domestic functions and mechanisms of organisation, and represents a more institutional approach. Accordingly, it develops a more granular approach, identifying wealthy families controlling pyramidal business groups or the top percentage of wealthy individuals as oligarchs. It thus assesses the personal attributes of the oligarchs, relating directly to the members of the oligarchy, and in particular the nuances of their relations with the state. This scholarship is therefore closer to Winters' analysis.

The change in the understanding of oligarchy since Marx mainly concerns the structural evolution of the organisation of the oligarchy, and particularly the mechanisms of its relations with the state. In the historical scholarship, the analysis of these clusters of wealth and power is entangled with international dynamics, whereas the contemporary scholarship focuses more closely on localised institutional dynamics or organisational principles and arrangements. In both scholarships, nevertheless, the nuances of the cohesion of the oligarchy do not seem to have a significant role. Both scholarships assume that collaboration among members of the oligarchy is required in order to obtain shared interests, but do not elaborate on the specific mechanisms and characteristics of this collaboration.

The next point deals with the sources of the emergence of the oligarchy. First, an oligarchy usually rises or matures due to the merger between financial and industrial holdings, typically by means of the former's takeover of the latter. Second, power in the international arena encourages the rise of an oligarchy. This power can be contextualised by imperialism, which is less relevant today, and the intensification of globalisation, such as the global expansion of markets and the organisation of big structures in a globalised era. This reveals that the emergence of the oligarchy is also an outcome of a free market mechanism (Coates, 2000). Processes of liberalisation, globalisation and privatisation effectively enable privileged actors to gain control over fundamental resources in the market, domestic and international.

Both the historical and contemporary approaches identify the organisational form as an embedded source of the rise of the oligarchy. The new wave of US corporate power scholarship adds another source of oligarchic power – inequality of wealth – which highlights the ways and the extent to which wealthy individuals can influence policy-making.

Most importantly, both scholarships trace the fusion of various capitals in relation to the state,

in historical settings of capitalism. In many countries, the state has changed its economic presence from economic actor controlling unions, an employer and a financier of last resort, to a regulator gradually retreating from the market, to enhance its own autonomy. Accordingly, the role of the state in the rise of the oligarchy varies. It can be a measure of its weakness, its poor institutional structures or institutional fragmentation; such an institutional void facilitates the rule of the oligarchy over the political economy as a whole. It can also be aided by tight cooperation of an oligarchy with a strong state. The role of the state can range from mediator of free market competition (Schumpeter, 1934; Mintz and Schwartz, 1985), to direct provider, of taxation benefits, funds, and access to resources, allowing the oligarchy to subsume the role of the state (Payne, 1968; Kapferer, 2005; Fogel, 2006). Specifically, in the historical scholarship the oligarchy is largely the result of a specific type of state-business nexus, while in the contemporary scholarship the oligarchy has greater power in shaping it.

It is hard to conceptualise oligarchy without acknowledging the statist condition under which it emerges and operates. The economic power of the oligarchy, the type of its ownership, and its social and political role cannot increase without state support; hence, the nature of the oligarchy is largely pre-determined by the state. The state, in effect, has become the safeguard of the oligarchy from competition. Although corporations or pyramidal business groups can be globalised or open to the market, their origins lie with the state. In turn, the oligarchy uses particular mechanisms of influence over policy-making, including through personal relations with state agents, to maintain and increase its power. Essentially, the internal logic governing economic decision-making and actions is designed by dominant institutions (Whitley, 1999: 5), including the oligarchy itself.

The sources and proliferation of the power of an oligarchy are embedded in the integration of all three dimensions: merger or take-over of industry by the financial sector, global processes of capitalism, such as privatisation and deregulation, and the organisational structure itself. The role of the state is central. The organisational and institutional mechanisms and strategies through which the oligarchy accumulates wealth and substantiates its power is a key point developed in this chapter. This chapter points to another characteristic at the origin of oligarchic power – the cohesion of the oligarchic power structure, in other words - 'clubness'.

As mentioned before, while the literature analyses the rise of individual oligarchs, the cohesion or what makes them an *oligarchy* is not widely assessed, mainly with respect to the process of wealth accumulation, but also with relation to wealth defence. However, shared interests and the affiliation to the same socio-economic milieu do define a power structure in itself, such as upper wealthy class or elite. Oligarchy, more specifically, is an institutionalised form of minority exercise of power. The way the oligarchy is consolidated, along social, political and economic lines, reflects its grand, more inclusive role in public lives. The oligarchy, rather than mere collection of oligarchs,

is largely embedded by the cohesiveness of the oligarchic informal network.

The networked alignment and the inter-relations within it that form the ruling class of the market (Van der Pijl, 1989, 2007), in this case the oligarchy, are termed here 'club' or 'clubness'. The notion of 'clubness' serves to point to the activities of this particular group or 'club', which is geared towards accumulation of wealth and power by selected few. Clubs matter because they enable members to interact with powerful agents within broader policy communities (Maclean et al., 2010). The club denotes the mechanism through which self-selected members of a certain group have influence and replicate their power (Tsingou, 2014), while at the same time imposing boundaries on the entry of new members.

This 'clubness' is similar to the concentrated net depicted by Hilferding. Also, Actor Network Theory (ANT) depicts the 'clubness' phenomenon in various states and societies (Porter, 2013; Bueger, 2013; Latour, 2005). Along similar lines as ANT, Engelberg et al. (2012) argued that when banks and firms are connected through interpersonal linkages – decision-making, with respect to credit allocation and interest rates, is biased. Another source depicting 'clubness' is the analysis of interplay between elites, preserved by interaction and inter-personal coalitions in several forums, such as joint ventures, interlocking directorates, social clubs, informal encounters, and family networks (Burton and Higley, 1987; Mills, 1959).

At the same time, the notion of 'club' or clubness is used here because it helps to point at several characteristics in particular. Among these are the specific features and ideas unifying this club, the cohesion in and by the club, and its silent commitment to restrict the influence of external forces, such as market forces and competition, and as a result - maintain the power in the same circle. This mission, in turn, is achieved by a peculiar nature of the club itself which sets it aside from other such networks,

Shared interests and cohesion sustain these relations, which are often based on informal and personal interactions (Useem 1984; Bearden and Mintz 1987). Social club memberships often overlap with board memberships, personal relations, and high social status (Useem, 1984; Bonacich and Domhoff, 1981). The interactions and special access allow for members of the same 'club' to come together and negotiate compromises (Higley et al., 1991). This club is a way to achieve inner trust (Granovetter 1985, 1993), which, in turn, is a critical factor in the increasing power of corporations, mainly financial (Mintz and Schwartz, 1985). These connections indicate 'crony capitalism' (Kang, 2002; Haber et al., 2002; Enderwick, 2002; Singh and Zammit, 2006; You, 2005; Krugman, 2002). Through these connections, businesses can obtain tremendous political power (Vogel, 1989; Lessig, 2011), such as access to resources and to credit, ability to influence governmental decisions and often control over the ideational sphere via ownership of media.

In terms of the social facets of the oligarchs' power, the latter, for the most part, comes at the

detriment of society. The oligarchy interacts with state agents in order to defend its wealth and aims for rent-seeking, in a way that thwarts both free market and democratic principles. Therefore, oligarchy is characterised by constraints to competition, entrenchment, growth impediment, political and economic inequality, use of public resources, and misrepresentation of ordinary citizens' preferences. The tight linkage to the state is the reason that oligarchy becomes independent of market considerations (Harris 1982:349). The oligarchy, thus, with the support of the state, "both protects itself and increases its share of the aggregate social profit" (ibid: 351). It becomes stronger at the expense of the society in which it emerges.

Finally, several salient features emerge in this analysis for distinguishing oligarchs from other wealthy actors, also part of the upper pecuniary class or economic elite, complementing thus the literature. Oligarchs are first and foremost identified with wealth (Winters, 2011), or, alternatively, ownership and control, from which they derive their power and influence. Nevertheless, as the analysis in this chapter substantially focuses on the process of accumulation and the sources of the power of the oligarchy, the degree of individual wealth is not as critical and not a necessary or sufficient condition for an oligarch to be part of the oligarchy. While oligarchs are wealthy actors, they are not necessarily wealthier than other actors, who, rather, may be equally wealthy or even wealthier. What distinguishes a large business tycoon, a 'fat cat' or owner of big companies from an oligarch, or what turns them into oligarchs and defines their power, is not wealth alone, but the way in which they accumulate wealth.

Specifically, it is the combination between the following features which enables such distinction, as each feature can be valid for other power structure (see table 1.1 below). These features include: (1) structure - pyramidal business groups, with a holding company at their apex. While not every corporation or business group is affiliated to an oligarchy, pyramidal ownership structure often indicates a way to obtain control over large shares of the market economy; (2) market concentration and the type of ownership, merging financial and industrial holdings across substantial market shares and fields. In developing states, furthermore, ownership also includes former state assets; (3) the 'clubness', or the internal ties and cohesion within the oligarchy, preserving and enhancing its power; (4) the relations with the state, demarcating the oligarchs as political actors. Indeed, the definition of 'oligarch' largely entails the use of political power to increase profits (Winters, 2011), manipulating thus political outcomes to reflect the objectives of the oligarchs. The power of the oligarchs entails formal delegation of decision-making authority from the state (Leach, 2005: 317-8), which allows them to shape political, economic and social development; and (5) the rent-seeking or non-competitive nature of oligarchs' activities in the accumulation and defence of their wealth. This 'competitive deficit' distinguishes oligarchs from tycoons who have obtained their wealth as a consequence of competitive skills or accomplishments in the market, such as success in the

technology or manufacturing sectors.<sup>12</sup> This relates also to public acknowledgement of the excessive and detrimental power of the oligarchy. Leach (2005), for example, stresses that the indicator of the existence of an oligarchy is commonly a community sensation of oppression, often stimulating resistance of some kind.<sup>13</sup> At the same time, public opinion is often influenced by the oligarchy itself, for example through ownership over the media. The combination between these distinguishing features lead to the understanding of an *oligarchy*, since the cohesion of and the affiliation to the oligarchic club serves to transform specific oligarchs that participate in it to members of the Israeli oligarchy.

Table 1.1. The features distinguishing oligarchs from other wealthy actors

Features	Winters Approach	Historical School of thought	Contemporary School of thought
Pyramidal ownership structure	X	X	Yes (e.g. Morck et al., 2005, LaPorta et al., 1999)
Market concentration and a merger between financial and industrial holdings	X	Yes (e.g. Hilferding, 1919; Lenin, 1916; Mintz and Schwartz, 1985)	Yes (e.g. Morck and Yeung, 2004; Almeida and Wolfenzon, 2006)
'Clubness' or affiliation to the oligarchic network	Yes	X	Yes (e.g. Shleifer and Treisman, 2000; Aslund, 2002, 2004; Shleifer, 2005; Khanna and Rivkin, 2001)
Tight relations with the state	Yes	Yes (e.g. Bukharin (1968 [1927]); Weber (2009, 1964, 1999)	Yes (e.g. Hacker and Pierson, 2010; Freeland, 2012; Gilens and Page, 2014)
Rent-seeking or non-competitive nature of oligarchs' activities	X	X	Yes (e.g. Morck et al., 2005; Murphy et al., 1993; Johnson, 2009; Sonin, 2003)

<sup>12</sup>Along similar lines, there is a difference between oligarchs perceived to 'have their hand deep in the public's pockets' (as seen, for example, in the Israeli case, analysed in the next chapters) and 'meritocratic' or 'fair' oligarchs (as in Hong Kong, see for example Davies and Ma, 2003). Essentially all oligarchic structures are shown to exercise a significant control over society. How inefficient and detrimental such control is to society has to do with the more specific nature and structure of the political economy and the oligarchy, respectively.

<sup>13</sup> This notion, however, encounters the problem of public ignorance. Hacker and Pierson (2010: 108-9), for example, argue that very few citizens pay attention to politics, although it is commonly thought that all information is free and available (ibid). Conversely, Gilens and Page (2014) negated the assumption that economic elites and special interest groups enjoy greater policy expertise than an ignorant and inattentive public, whose policy preferences are poorly informed. They argue (2014: 23) that ordinary citizens are generally aware of their interests and that their expressed policy preferences are worthy of respect.

## **Conclusion**

All three strands of scholarship - Winters' conceptual framework, the historical and the contemporary - illustrate that in systems of private property there will always be a concentration of wealth, embedded in close relationship with key state structures. The combination of the three suggests that oligarchy can be understood as a power structure defined by wealth, as well as by its relation to political decision makers. In this thesis 'oligarchy' denotes an informal institution of wealth and power, which has political characterisations and far reaching consequences on the structure and dynamics of a national political economy. The formation of an oligarchy is determined by the historical, political, and social context in which it emerges, including public choice, cultural norms, and formal rules (Kapferer, 2005).

Oligarchy, by means of the collective and institutionalised action, implies rule over politics. Oligarchs as political actors are a universal phenomenon of capitalism, not only a symptom of developing, peripheral capitalism, such as in emerging markets, where political and civil institutions are weakened or absent. The oligarchs' ability to expand and have wider control over market shares overlaps with the role of the state. The control of the oligarchy over large corporations and financial institutions can shape cohesion and consensus amongst political leaders (Dye, 1978). Governmental policies are thus exposed to manipulation (Drucker, 1989: 98), influenced by the oligarchs' interests. The political influence of the oligarchy is expressed, therefore, in a much wider context than its direct impact on state institutions, but is a factor in changing the balance of power between them. Corporate power arises from more than just market power; a wide sphere of control, restricted to free market competition, effectively enables the formation of an oligarchy because it allows it to accumulate power, first and foremost at the domestic level.

## CHAPTER 2

### ANALYSING THE EVOLUTION OF THE STATE-BUSINESS NEXUS IN THE ISRAELI POLITICAL ECONOMY

The purpose of this chapter is to explain the historical background for the rise of the Israeli oligarchy, by identifying the main stages in the evolution of the Israeli political economy from the foundation of the state in 1948 up to the mid-1990s. This time-frame provides background for the analysis of the rise of the oligarchy in Israel during the 1990s in the next chapters. In order to identify the main stages of the Israeli political economy's evolution, the chapter examines, first, the changing role and presence of the state within the political economy. The role of the state is understood here as the role of the government and the key state institutions and bureaucracy. Second, the chapter examines the evolution of businesses, focusing mainly on the 'big businesses' - several large and concentrated business groups, at the hub of the Israeli economy since the end of the 1960s, and the development of a state-big business nexus.

The main argument of this chapter is that the links between the state and big businesses have been central to the Israeli political economy; Israeli governments have always attempted to establish big businesses and to expand their role in the political economy. The relations between the state and big businesses have been continuously characterised by proximity and the support of the state of big businesses. As follows, the chapter demonstrates that the active role of the government in the oligarchisation of the political economy is consistent with previous policies enacted throughout the history of the Israeli state. At the same time, the chapter also suggests that in order to understand why the oligarchy had developed most substantially during the 2000s, and not before, we must look to other causes (such as market liberalisation and financialisation). This chapter thus contributes to the understanding of the rise of the Israeli oligarchy by emphasising how the shift leading to its emergence was rooted in the particularities of the government's actions and its specific political economic context.

The argument of this chapter develops in three steps. First, the chapter argues that the role of the Israeli state in the economy has transformed from that of a central actor and owner till late 1960s, to regulator and facilitator in the rise of the 'big business' during the 1970s onwards, although state ownership was still prevalent. Despite its changing nature within the political economy, the role of the state has remained central. Second, in line with the conventional wisdom stating that the Israeli economy was designed to meet national goals during its first two decades, the chapter argues that the development of big businesses has also been part and parcel of this objective in the subsequent

decades. Finally, the chapter argues that the state-big business nexus has transformed from dependence of the 'big economy' on the state during the 1970s and 1980s, to inter-dependence with the state in the post-1985 period.

To demonstrate this argument, the chapter adopts the insights of New Institutional Economics (NIE) and some insights from historical institutionalism, presented in the first chapter, and draws on universal political-economic analyses of the state-business nexus (Coen et al., 2010; Schwartz, 1994; Schneider and Maxfield, 1997; Strange, 1994). In addition, it re-interprets the secondary literature on the Israeli political economy and its specific economic, political and social features (e.g. Shalev, 1992, 2004; Nitzan and Bichler, 2002; Maman, 1997, 2004, 2008; Aharoni, 1991). It focuses on key events and illustrations delineated therein, relating to the state fortification of big businesses and its coordination with them (e.g. the policy of Pinhas Sapir, the Isenberg Law, the rise of the Military-Industrial Complex). The chapter also uses data from other official sources, such as the Bank of Israel and the Central Bureau of Statistics (CBS).

As this chapter aims to highlight the continuity of and changes in the political economy's structure, and more specifically, in state-big businesses relations, some socio-political dynamics and processes are excluded. Among these are Israel's foreign policy, the wider impacts of the immigration waves, the cultural-religious facets of the political economy and the socio-economic implications of the Arab-Israeli conflict.

Traditionally, the Israeli political economy is divided into three phases: 1948-1967; 1967-1985; and 1985 onwards (Shalev; 2004; Beenstock et al., 1995). The 1985 Emergency Economic Stabilisation Plan (EESP) is identified as the key turning point in the nature of the political economy; from government intervention to macroeconomics (Ben Bassat, 2002), or from the 'managing hand' to the 'invisible hand' (Simhon, 2011). Although this periodisation was not based on the evolution of the state-big business relations, it does represent their critical stages. This chapter, therefore, adopts the accepted periodisation, and is divided into three sections to reflect these three periods. In each section, the analysis centres on three key components: (1) the part of the state in the economy; (2) the role of business (particularly big business); and (3) the changes and continuity of the state-business nexus.

## 1. The Developing Economy (1948-1967)

### *The Part of the State in the Economy: A Key Actor*

The first phase of the Israeli political economy began with the foundation of the state in 1948 and lasted until the 1967 Six Days War. The state fulfilled a crucial role in the political economy during this phase. The most important state instruments were Mapai and the Histadrut, which were tightly linked. Mapai – Land of Israel Worker's Party, came out of the merger between 'Achdut Ha'avoda' and 'HaPoel HaZair', and dominated the political and economic landscape until the late 1960s (Shapira, 1975; Shafir and Peled, 2005). It was an exceptional case in Israeli history, of a party which role was identified with that of the state. The most important institution of the Labour movement and of Mapai was the Histadrut, The Workers Federation, which was established in 1920. In fact, during its initial years there was a 'symbiosis' between Mapai and the state (Kimmerling, 1993: 407). The capacity of Mapai to win the majority of votes in comparison to other parties, in eight consecutive elections since the foundation of the state, was enhanced by its ability to influence beyond the political sphere. It built one-party dominance in the most important civilian spheres, and succeeded to identify itself with 'the State', both as an institutional entity and in terms of the public interest. Mapai's political hegemony made it difficult for its political rivals to air their criticisms without being portrayed as 'enemies of the state' (Shalev, 1992; Aharoni, 1991). Mapai populated the major offices in the Histadrut, even before the establishment of the state, as well as those offices in the government, after the establishment of the state. Moreover, Mapai ran and led a collectivist state-centred economy, with a powerful, all-embracing political-administrative-governmental sector. The structure of the state-centred model was characterised by high levels of government expenditures and employment, corporatist delegation of state functions to the Histadrut, and modest private ownership (Shalev 2000: 131).

The Histadrut was an important part of the political-economic mechanism of the developing phase. Its dominance in the political economy was unprecedented, even in European terms (Shalev 1992: 19). It did not evolve as a grassroots or hierarchical union struggling with capital owners, as in most socialist cases; instead, following the establishment of the state, it became a fundamental statist institution, with a robust bureaucratic mechanism, comprising two arms. The first was a corporate form of labour federation, isolating the Zionist labour from its Arab counterpart (Shalev, 1992; Grinberg, 1991) and organising Jewish Israeli workers. It was responsible for their employment conditions as well as their health services. The second arm was the owner of member enterprises and institutions (such as the health services and banks), which made the Histadrut a sizeable employer in the market managing industrial relations, and intermediating between state-

owned and Histadrut-owned enterprises.<sup>14</sup> All the institutions and enterprises were owned and organised through either Hevrat Ovdim (the Workers' Society, the Histadrut holding company) or cooperative entities (Aharoni, 1998; Grinberg, Y., 1993; Cohen et al., 2007).

The activities of the Histadrut, accordingly, were in line with the government's objectives; those objectives included arming and defending the country, settling the waves of new immigrants, settling frontier regions of the country, and developing an economic infrastructure that could cope with the absorption of immigrants and eventually eliminate Israel's dependence on exterior assistance, charity and loans (Shalev 2004: 87; Horowitz and Lissak, 1977). Industrialisation and economic collectivism, including government-directed resource allocation, were perceived as essential for the successful establishment of a Jewish State in Israel. The government's objectives were identified with those of the new state, as well as of Zionism, thereby justifying the interventionist role of the state. The activities of the government were portrayed to serve the public interest and all strands of Zionism in general (Gutwein, 2008). This state-centred model was advanced by the socio-economically dominant core of immigrants from Europe, driven by the rational of a Jewish state in Israel.

The main feature of Mapai was Jewish nationalism (Sternhell, 1996), and the prevailing ideology was identified with 'social-democratic corporatism' (Shalev, 1992).<sup>15</sup> This orientation was also the result of the geo-political conditions (Shalev 1992: 271-2), as well as the European origins of the leading political, economic and cultural elites (Maman, 1997; Aharoni, 1976; Shalev, 1992). However, the Israeli case is different from parliamentary, Western socialist states post-Second World War in two ways: private industries were not nationalised (as these hardly existed at the time), and the welfare state was segmented (Shalev, 2004). That is, Israel was a state with an interventionist government and limited beneficiaries of its welfare policies, namely citizens affiliated with Histadrut and Mapai (Gutwein, 2010; Gal, 2002). Also, the Histadrut, a powerful economic actor in itself, never followed the traditional, socialist-oriented role of a labour union; instead, it built an exceptional Israeli structure – as labour federation and owner in the economy. The Israeli welfare regime, therefore, was developed along lines of state-building, later entwined with state- business cooperation, rather than strictly socialist rationale.

The government shaped the trajectory of most economic development. The economy was constructed to serve the various objectives of the state, and as such was hardly competent with market economy considerations or rules (Patinkin, 1959; Shalev, 1992, 2004). Encompassing

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<sup>14</sup>By the late 1950s the Histadrut represented 85% of all wage and salary earners in national and industry-wide collective bargaining, and served about 70% of the entire population through its Sick Fund. Agricultural, industrial, and commercial enterprises and cooperatives owned by or affiliated with the Histadrut occupied 25% of the working population (Shalev 1984: 370). The number of people employed in the market reached 162,000 by 1957 (The website of the Labor Movement in Israel).

<sup>15</sup>The social democratic order of the time is further substantiated in recent accounts, both in governmental reports (Van-Leer, 2015), in the wider public discourse, such as various social forums (e.g. Shatil), or in the political discourse, as advanced for example by the Labour Party during the 2013 elections (led by Shelly Yacimovich, trying to proclaim the revival of the social-democratic nature of the political economy - 2013 Official Site).

governmental involvement, not private ownership, was the default position. The state was at the centre of financial activity; the financial institutions were all statist, and their role was, in effect, to mediate between the government and investors, while the only available investment instruments were governmental bonds, as others simply did not exist. The state also controlled imported capital, exercising protectionist policies in matters of consumption, public investment, trade, budgeting, the exchange rate, and tax composition. It also operated directly in the market, as the owner of different businesses, selling goods and services, while having a monopoly on post services, telecommunication, ports and airports, in addition to the assets owned by the Histadrut (Aharoni, 1991).

The key economic sources of the state-centred economy (as well as its growth) were capital inflows from the US and Europe (especially Holocaust reparations from West Germany), and massive immigration.<sup>16</sup> From mid-1950s to the early 1970s the government spurred rapid growth in the Israeli economy (Shafir and Peled, 2000: 6), among the highest in the world. The average annual real growth per capita between 1954 and 1967 was 6 per cent, backed by manageable inflation rate, of 7.2 per cent per annum averagely for the same period (Maman and Rosenhek, 2012: 349). The growth (see table 2.1 below) was first and foremost a product of money received through the reparations agreement with West Germany, which was the accomplishment of Prime Minister Ben-Gurion. The reparations were complemented by non-investment foreign funds, arriving from US Jewry and the US government. In parallel, the massive immigration of the 1950s broadened housing and consumer demand, ameliorating and increasing the (relatively cheap) labour force.

Table 2.1. Changes in GNP

GNP 1952-1972	Change (in percent)
annual growth rate of population	3.6
annual growth rate of GNP	9.1
annual growth rate GNP per capita	5.3

Source: Metzer, 1986

Concurrently, the government encouraged the development of the private sector. In fact, the ministers of finance came from "Hapoel Hazair", the more liberal and pro-competition faction in Mapai. In the 1950s, Levi Eshkol (the Minister of Finance in the 1950s and later the Prime Minister) and Pinhas Sapir (the Minister of Finance and the Minister of Trade and Industry in the 1950s and the 1960s), two powerful politicians from Mapai, with the help of Pinhas Lavon

<sup>16</sup>In the framework of the Reparations Agreement between Israel and West Germany, which was concluded in 1952 and went into effect the following year, Israel received Deutsche Mark 3.450 billion in the years 1953-1965 (Weitz, 2005; Carmel, 2009: 180).

(Minister of Agriculture, Minister without Portfolio and Minister of Defence during the 1950s), adopted policies that reduced the power of the Histadrut as an employer and owner of business. Pinhas Sapir also prominently advanced foreign investments in Israel, designed to develop factories and infrastructure (Levi-Faur, 2001).

### ***The Role of Business: State-Dependent Industrial Sector***

The business sector in the developing phase was almost entirely state-dependent. It was part of the socio-political arrangement, which was embedded by the remarkable coordination between the heads of the Histadrut and the government (most of whom were related to Mapai). It was basically an extension of the state, represented by a rising state-dependent industrial sector, along with relatively marginal, independent private businesses (Patinkin, 1959). Industrialisation in the developing phase, thus, became a logical infrastructure under the sponsorship of the state, linked to national goals (Maman, 1997: 66), and was carried out with favouritism and political considerations (Aharoni, 1991).

In this context, a number of big corporations, e.g. Koor industries<sup>17</sup>; Kitan, a textile company; and Strauss, food products manufacturer, started growing, accumulated capital and became the basis of Israel industrial sector (Bruno, 1989; Metzger, 1986). Owners and managers of private firms were a part of the dominant socialist-Zionist order. While they did not actively support the semi-socialist model of political, economic and social infrastructure, they cooperated within it (Frenkel et al., 2000: 65). Notwithstanding individual interests of businessmen and functionaries, there was hardly any clash between state involvement and private initiatives (Aharoni 1991:26). This was a result of the long arm of the state and the objective of state-building, with which the private entrepreneurship was largely consistent. More importantly, the private sector at the time was not strong enough to lead economic development and demanded a subsidised and protected market (Shalev, 2004). The overall aim to advance the Israeli economy was thus congruent with the individual interests of businessmen.

### ***State-Business Relationship***

The state-dependent business sector was a part of a triangle consisted of the government, the Histadrut and itself. Since the beginning of the 1950s, the balance between these three parts started to change (Maman, 1997: 30). This change most importantly concerned the internal power struggle between Mapai, which dominated the government, and the Histadrut, despite the synergies between them. Those struggles were about the government's objective to cultivate and strengthen the private

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<sup>17</sup>Established in 1944 as an industrial subsidiary of Solel Boneh, Koor was the largest industrial corporation in Israel, consisting of various factories and enterprises in fields like heavy metals, chemical products, electronics, glass, ceramics, and more

sector, at the expense of the Histadrut. Mapai's advancing of initiatives to develop the private sector was a product of the vision of people like Eshkol and Sapir. The following cases illustrate how the power struggles between Mapai and Histadrut, as well as the internal conflicts of the Histadrut, played out in economic policy initiatives throughout the era.

The Ministry of Finance (MoF) instructed the commercial banks, in 1958, to prioritise industrial and agricultural production by means of credit provision, at the expense of the Histadrut authority (specifically - "Hevrat Ha'ovdim"). The MoF assisted the banks for that purpose by exempting them from reserve requirements for credit extended to selected economic sectors. In parallel, the government hindered the industrial development plans of 'Solel Bone', a big construction corporation owned by the Histadrut, by refusing to transfer the required budgets and by splitting the company to parts (Levi-Faur, 2001). To stress this point, this act was designed to enhance the autonomy of the banks, specifically Hapoalim Bank (Nitzan and Bichler 2002: 118), at the expense of other Histadrut branches, namely industrial concerns. In effect, the MoF limited the capacity of the Histadrut to allocate credit to itself (Maman and Rosenhek, 2011, 2012).

Another expression of these internal political struggles was the 'full employment' policy, adopted from mid-1950s till the early 1960s. This policy increased the labour force in the market, and resulted in the weakening of the Histadrut and in a series of strikes. This time, the government supported the Histadrut and tried to help it against the workers, gradually withdrawing from the full employment policy. As a complementary tool, government investment in the public sector decreased; few government projects, which stood at the core of market activity during these years, were finalised, such as the construction of Ashdod port and the factories of the National Water Carrier of Israel ('Hamovil Ha'artzi') (BoI, 1966: 83, 85-88). The termination of government investments in these projects slowed market activities. The objective of this policy was to block employees' constant demands for salary increases effectuated by the full employment policy in previous years (Shalev, 1992). Nitzan and Bichler argued that this was, in fact, the initial liberalisation attempt of the state (2001: 187), increasing the power of the private sector (Shalev: 1992:6-10).

The tight connection between the government and business sector, specifically, its attempt to advance specific businessmen at the expense of the Histadrut power, is evident in the Law for the Encouragement of Capital Investment (1959 Law, MOITAL). The law is commonly referred to as the 'Eisenberg Law', after Shaul Eisenberg, the founder and owner of the Eisenberg Group, and the reason behind the law. The law was designed to encourage Eisenberg to shift his businesses to Israel to boost growth in the domestic economy. It provided Eisenberg with a credit line, tax exemption for 30 years, and discount as well as tariff reduction on raw materials. This well-targeted legislation, then, served the interests of a powerful businessman the state wanted to advance. In other words,

even during the developing phase of the state-centred economy, the very process of state- building in Israel contained the seeds of the oligarchic structure. In particular, it was the active role of the state, through provisions to specific businesses, and businessmen, which eventually enabled the accumulation of wealth.<sup>18</sup>

Moreover, this power struggle was also sustained by intra-party politics and the individual ambitions of Histadrut leaders. For instance, the very powerful banker Jacob Levinson, a key functionary of the Histadrut, was motivated by the objective to make the Histadrut banking branch more professional, which simultaneously served his personal interests (Levi-Faur, 2001). By enhancing the autonomy of the Histadrut main bank, Hapoalim Bank ("the Workers Bank") as an independent unit, he thus built his personal, political and economic power (ibid).<sup>19</sup> To achieve this, he was willing to sacrifice other Histadrut branches.

During that period, economically, private consumption rose faster than GDP growth, which was detrimental to savings and investments (The Central Bureau of Statistics, 2008: 11-12). However, the government lost control of the economy at this stage, and a deep economic recession, which lasted till 1967, followed (Grinberg, 1991). As the reparations agreement expired, on the state level, capital inflows sharply decreased, further contributing to the recession (CET, 1995)<sup>20</sup>. Immigration also declined significantly (CBS 2012: 28). The excessive responsibilities of the state in the economic arena, along with its dependency on foreign money, marked the Israeli market's failure to reach economic autonomy (Patinkin, 1959).

These crises –the so called 'full employment' crisis and the recession - were transformative, both economically, with respect to the gradual decrease in the economic domination of the state, and cognitively, i.e. the public acknowledgement of the limited capacities of the state. In addition, the emergence of new political parties—Gahal, a right-wing block, and RAFI, a splinter party from Mapai—introduced, for the first time, real political threats to Mapai and the political-economic order it represented (Waiz, 2010). These crises pointed to the increasing inadequacy of the state-centred model, given the new conditions. They stimulated an expansion of private business while highlighting the need for the gradual opening of the market towards the global arena. Thus the initial developing phase of Israel's political economy ended and a new phase, marking the rise of big businesses, started.

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<sup>18</sup>The government used other tools to strengthen the private industry, such as the transfer of loans to individual entrepreneurs and businessmen. The decision to provide the loans was usually made at either ministerial or governmental level. A famous case concerns Avraham Shapira, a businessman and later a member of the Israeli parliament (the Knesset), who received loans from the government in order to buy failed industries and recover them, generating employment opportunities in the market (Avneri, 1988).

<sup>19</sup>Hapoalim Bank was established in 1921 in order to finance cooperative activity in agriculture, construction, and industry.

<sup>20</sup> Reparations did continue on an individual basis.

## 2. The Rise of the Big Business (1967-1985)

The second phase of Israeli political economy started after the 1967 Six Days War and lasted till the mid-1980s. In this phase, like the first, the state was facing security challenges, including the ongoing Arab-Israeli conflict, the 1969-70 War of Attrition, the 1973 Yom Kippur War, the 1973 oil crisis and embargo, and the 1982 Lebanon War. Additionally, it was packed with economic crises, such as the domestic hyper-inflation crises of the 1970s and the 1980s, continuous supply shocks, declining foreign investment, and flagging internal wages (Grinberg, 1991).

### *The Part of the State in the Economy: Developing the Big Businesses*

At the beginning of the second phase, the role of the state in the economy was influenced by the dramatic developments in the Israeli-Arab conflict. First and foremost, the victory in the 1967 war "reinforced the image of the state as an effective actor" (Kimmerling, 1993: 410), at the expense of Mapai and the Histadrut. Second, the occupation of the West Bank and the Gaza Strip following the 1967 War increased the population by 36%, an addition of 1,000,000 Palestinians to the Israeli existing population of 2,776, 000 (Palestinian Central Bureau of Statistics, 2007; Israeli CBS, 2013). The increase of the population exacerbated the effects of post-1967 crises. In the years 1968-1972, government expenses, particularly defence expenditures, budget deficit, and external debt rose, while foreign capital decreased considerably (CBS 2006: 5-6, 11, 13). Conversely, the addition of the Palestinian population at this stage added cheap labour to the existing labour market, buttressing the economy (Miaari and Khattab, 2013). This was part of the reason Israel's pace of growth through the early 1970s, as shown in table 2.2 below, was commensurate with global growth, in spite of broader problems in the political economy, (Helpman, BoI 2003). The post-1967 growth, on the whole, was largely driven by state provision, but was not backed by capital inflows as before.

Table 2.2. Annual Average Growth Rate of GDP per capita - 1953–92

Years	Israel Growth rate (in percent)
1953–1969	5.7
1961–1970	5.6
1971–1980	2.8
13.981–1990	1.6

Source: Helpman, 1999

Following the 1967 war, the liabilities of the government were far above its income ability (Razin and Sadka, 1993), significantly increasing the government deficit and public debt (CBS

2006: 6). The state, as a result of the new economic conditions, started boosting more rigorously practices to develop a viable private sector, in order to establish a strong economic base (Shalev 2004: 122-4). As such, the role of the state in developing private businesses, and more specifically a business elite, was central in the decade following the 1967 war. Israel adopted the rationale concomitant with liberal capitalist states, according to which an economic boost is more easily generated by a capable and responsible economic elite. This economic elite, the logic went, would strengthen the state and its institutions; first, by decreasing their responsibilities in the market and, second, by generating growth and fostering better interaction with the global arena (e.g. Weber, 1964; Reese and Rosenfeld, 2001; Persson and Tabellini, 2002; Porter, 1998). The efforts of the state were largely channelled to the consolidation of big businesses—several large and concentrated business groups at the hub of the Israeli economy since the late 1960s.

The state used economic measures, legal means, and institutional instruments to develop a viable market economy and cultivate a business elite. In the economic sphere, the state encouraged private initiatives and capital accumulation, while extending trade relations with the global arena outside of the state framework. The means employed included direct incentives, subsidies, and a more flexible monetary policy on the basis of cost-plus purchase contracts (Aharoni, 1991; Maman, 2004; Shalev, 2004). More importantly, access to finance was granted through privileged loans and credit conditions for specific businesses. Special funds, jointly operated by the central bank, the Ministry of Finance, and the Ministry of Trade and Industry, were set up to allocate heavily subsidised credit in local and foreign currencies to firms in preferred economic sectors (Maman and Rosenhek, 2011).

The credit allocated through these funds amounted to 69 percent of total credit extended during the years 1971–1980 (Djibre and Tsiddon, 2002:87), and was a major tool for promoting industrial growth. Access to capital was provided exclusively by the state, whose agencies controlled the main channels for local capital formation (Levi-Faur, 1998). Moreover, the state transferred economic power to specific businessmen to lead the market economy alongside the state. This was largely based on personal connections and circles of influence established during the 1950s, most prominently illustrated in the case of Eisenberg. Through this process, the state sold part of its holdings in the national Oil Refineries and the national shipping company (ZIM Integrated Shipping Services) to Eisenberg, in 1968. He then founded The Israel Corporation, the largest holding company in Israel at the time.<sup>21</sup>

The legal means included, most prominently, the 1967 amendment in the Law for the Encouragement of Capital Investment, which provided specific enterprises with cash grants, rather

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<sup>21</sup>The discourse regarding the Eisenberg law was heightened in recent years, mostly by the media. For example, in 2013 Globes Magazine appealed to the Tax Authority, requesting to expose the tax benefits enabled by the power of the law (see Masfax, 2013, Calcalist, 2009).

than long-term loans, and reduced their taxes (1959 Law, MOITAL). The Treasury further assumed full responsibility for any discrepancy between state-linked rates paid to savers and unlinked rates charged from investors. As for institutional instruments, the powerful business elite consolidated during these years was institutionalised along the state lines, with official representation - the Manufacturers Association of Israel and the Central Chamber of Commerce (Ben-Porat, G., 2004). The role of the state in the market remained central, throughout the gradual transition to private business.<sup>22</sup>

During this phase, the political economy became more pluralist and the differentiation of various elites – cultural, religious, intellectual, political and business – more significant (Aharoni 1991, 2007; Maman, 1997, 2006). With the increasing importance of the private sector and the rise of new political powers, the dominant socialist-Zionist ideology of Mapai began to diminish already prior to the 1973 Yom Kippur War. This ideological shift opened up more opportunities for individuals, contrary to the previous stagnation of the collective. New agendas emerged concerning the direction of the political economy; more and more mainstream scholars started to criticise the government calling for increased liberalisation (Shapira, 1975, 1977; Horowitz and Lissak, 1977). It was no longer mainly Mapai or its successor, the Labour Party, which ruled the political, economic, and social sphere. These events revealed that as the role of the state in the economy declined, the role of business was becoming more important, as will be demonstrated next.

### ***The Role of Business: Developing The Market Economy***

The formation of big business groups after 1967 was a key moment in the formation of a market economy. The new business groups' model was based on the German (from where the majority of owners and executives hailed) 'Konzern'—a collection of corporations operating in various sectors. The Konzern controls a substantial portion of member companies' shares, and maintains tight relations with commercial banks, which in many cases own shares of these Konzerns (like Elite and Osem in the food sector). The first generation of Israeli business groups (also called Konzerns) were structured in a moderate pyramidal-vertical form, composed of holding companies and sub-companies, with the Konzern retaining substantial control over affiliated companies (Maman 2008: 144-5). The structure of Israeli banks is also reminiscent of the German model of universal banking, in which banks act as multi-product firms within the financial sector (Maman, 2008).

The new business groups had access to finance, primarily from the banks, which were themselves at the centre of some business groups. A second source of finance was the capital market; the activity of the Tel-Aviv Stock Exchange (TASE) was settled in 1968 (although founded

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<sup>22</sup>Hodgson (1988) generalised it, arguing that economies of scale imply divergent patterns of corporate growth, leading to the domination of small number of large firms.

in 1953), the same year the Israel Securities Authorities was established, both under the 1968 Securities Law (NEVO, 1968).<sup>23</sup> The government and the Bank of Israel allocated subsidies to the business sector through targeted credit programs in local currency. Owners and executives built their business groups to spread risk and secure political-economic stability, as well as to compete with Trans-National Corporations (TNCs) (Maman, 2002), and could thus counter-balance the comprehensive involvement of the state in the political economy.

During the 1970s, the organisational model of big US corporations—i.e. a multi-industry operating company (MIOC) under the same office—was gradually adopted in various sectors and industries. However, in contrast to the American model, every firm in an Israeli business group was an autonomous legal entity, rather than the corporation itself operating as one legal entity (Maman, 2008). This was most prominently illustrated in the structure of Koor, in which the companies were autonomous, to a certain degree, while Koor still operated as a business group. This period saw the emergence of the basic model used by Israeli business groups—a synthesis of the American and the German models.

The market structure became increasingly dualistic. It consisted of a growing 'big economy' segment, several large and concentrated firms, fifty in all, and a multitude of small-medium sized enterprises (SMEs) and self-employed proprietors (MOITAL, 2007; Shalev, 2004). At the centre of the 'big economy' were a few Konzerns, initially developed and controlled by the state, which included the big banks and other industrial corporations.<sup>24</sup> Namely, the big business groups included: (1) Koor, owned by the Histadrut; (2) Hapoalim, owned by the Histadrut; (3) Leumi, owned by the Zionist Histadrut; (4) Israel Discount Bank Holding (IDB), which began as a private bank in 1936, owned by the Recannati family; (5) Eisenberg group, owned by Shaul Eisenberg; (6) Chemicals for Israel, owned by the state; and (7) Clal, set up by Minister of Finance Sapir in 1962 as a means of luring foreign investments through tax incentives and subsidies (Nitzan and Bichler 2002: 118), co-owned by IDB, Leumi and Hapoalim. In addition, the 'big economy' included the Military Industrial Complex (MIC).

As trans-national corporations were not present in the domestic economy, and very few foreign investors operated in Israel, the activity of the local business groups grew, with the aim of gradually establishing 'economic empires'. The business groups' central position in the economy facilitated their access to resources. In addition, their managers and owners were close to the decision-making circles (Maman, 2002: 739). In effect, they took advantage of structural conditions created by the

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<sup>23</sup>The Tel-Aviv Stock Exchange (TASE) is the only stock exchange in Israel (in parallel to TASE, a number of alternative trading platforms operate in Israel). TASE is a private company owned by its members (domestic and international banking and non-banking corporations), overseen by the ISA. TASE is vertically integrated, providing listings for an array of financial instruments, an automated central book order trading system, a mechanism for clearing and settlement activities, and real-time trading data and announcements. It is responsible for supervising the investment houses of the banks, which are members of TASE and the Clearing House.

<sup>24</sup>Since the 1960s, the historical structure of the banking sector included Hapoalim Bank, Leumi Bank and Discount Bank as the three central banks, Hamizrahi Bank as the fourth, and First International Bank ('Habeinleumi Harishon') as fifth in size.

state, such as preferential access to finance, subsidies, and exclusive provision of services to the state itself, to accumulate wealth (ibid). In a process directed by the state, the money earned was used, in turn, to further expand these business groups, which eventually came to dominate considerable parts of business activity, such as finance, raw materials, retail, services and communication (Nitzan and Bichler 2002: 118). For their part, despite relying on state support, the groups were motivated by the objective of accumulating wealth rather than leading Israel's economic development (Nitzan and Bichler, 2001).

The aforementioned business groups gradually took over smaller firms. This 'internalisation' (Nitzan and Bichler, 2001: 55-6) led to massive wave of Mergers and Acquisition (M&A), mainly the purchase of distressed businesses by big business groups. Each business group (or conglomerate) consisted of a large number of enterprises, normally directed through holding companies, commonly used to merge real and financial assets. For example, IDB, owned by Discount Bank, founded a holding company in 1969 as a means of obtaining the bank's shares, as well as to purchase and control other industrial enterprises (Aharoni, 1976; Maman, 2004). Another example is Clal, which had several divisions: industry, insurance, construction, trade, and finance.

The business groups ruling the Israeli economy until the end of the 1980s employed a major labour force and controlled most of the capital in the system (Aharoni, 1991; Shalev, 1992; Maman, 2008).<sup>25</sup> This process resulted, initially, in these groups' growing respective market shares, and their ability to generate the required economic boost (Nitzan and Bichler, 2002). However, their strengthening led to their control over the corporate sector. In the banking sector, for example, Leumi, Hapoalim and IDB accounted for 80% of all assets, employment and branches, and 70% of net profits (ibid: 118). In the industrial sector, the big business groups, together with the government, controlled 14 of the 20 largest industrial firms, and 28 out of the top 50. The excessive power of these groups over the political economy came at the expense of unaffiliated businesses and businessmen. Nitzan and Bichler (2002: 59) defined this excessive power, the domination of the political economy by a small group, as "socially traumatic". They further argued (ibid: 119) that there was a 'conspiracy of silence' around this power structure, as academia and media at the time did not analyse it, but rather "went out of their way to obscure its existence", discouraging the examination of it (ibid). For example, during the 1970s the banks started collaborating to manipulate shares prices, predetermining their real rates of return (ibid; Bejsky, 1986). These actions led to the 1983-4 economic crisis (as analysed next); however, neither the media nor the academy investigated the malfeasance of the banks, so as to expose it to the public in real time.

The rise of the 'big economy' was mainly sustained by two factors: the concentration of the

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<sup>25</sup> The exact data of the big business groups cannot be gathered, as they were consisted of governmental, Histadrut and privately-owned firms. D&B in 1986 and the State Revenue Administration point at the significant share in the GNP of 100 big industrial companies.

banking sector (Aharoni, 1991) and the thriving security industry (Mintz, 1985). The structure of the financial system was characterised by the dominance of the banks in all areas of activity, particularly in the control of provident and mutual funds. The banking system was highly concentrated, central in credit provision, management of provident funds, and underwriting activities (Yosha and Yafeh, 1996: 598). Most public savings, i.e. pension funds, provident funds and mutual funds, were restricted to investment in non-tradable government bonds or in the form of special deposits with the Ministry of Finance (Ben-Bassat, 2002; Shalev, 1992). The investment in these bonds, intermediated by banks and insurance companies, was to assure safe, real returns. The same was true for credit; a substantial portion of credit provided by the banks was targeted government credit (Yosha and Yafeh: 601). The activity of TASE was small; until the mid-1980s only 1-2% of industry investments were financed by TASE issuances (ibid: 597). Finally, the state had complete control over foreign currency market through rigorous restrictions on foreign currency transactions and the international movement of capital, both by firms and individuals (Maman and Rosenhek, 2011). Private foreign capital, which the state would have had difficulties controlling, was almost totally absent in Israel until the 1990s (ibid).

The Military Industrial Complex, which included the arms industry and the military-related firms, accounted for the other key segment of Israel's economy (Halperin et al., 1973; Rosen, 1973; Phillips, 1973). The MIC was defined as a coalition of "powerful interest groups comprising bodies responsible for Israel's security, pressing for vast-scale defence production" (Mintz, 1985: 627). The MIC was comprised of the Israeli Defence Force (IDF), the defence industries, the Ministry of Defence, and political representatives (For example "Rafael", The Armament Development Authority, a sub-division of the Defence Ministry, whose largest share of income was from exports). The rise of a powerful MIC was the result of the tangible security threats, reflecting the common conviction that Israel must provide for its own military needs; it was triggered by the French embargo on arms sales to Israel after the 1967 war (Maman 2008). This power structure has been a clear manifestation of how the state is the engine behind business empowerment, which served the state interests and relied, primarily, on its funding.

The MIC has continuously been prioritised by the government (Mintz, 1985; Sheffer and Barak, 2013; Aharoni, 1991: 175-7).<sup>26</sup> Specifically, it nurtured the MIC by funding research and development (R&D), enlarging purchase commitments, and offering tax exemptions and other subsidies (Maman 2008). While defence spending ranged between 10%- 16% of GNP until the 1967 War, it grew to over 25% of GNP in 1970-1982 (Metzer 1986). Government expenditures on

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<sup>26</sup>The centrality of the security sphere in Israel vastly exceeds the norm of other Western countries (Mintz, 1985), not only in terms of national concern and active involvement (by means of compulsory military service, in addition to the tangible threats on citizens); there has been a spill-over from the military sector into civilian spheres, such as education, settlement, and social welfare (Lissak, 1984), breaking the balance between the military and the civilian (Mintz, 1985). Retired senior officers, for example, occupy key positions in the political economy (ibid: 631).

security reached 47% of the overall budget in 1973 because of the Yom Kippur War, and remained in the range of 30 to 45 percent until the 1980s (Ben-David, 2009:55). The MIC became a dominant industry in the market, in terms of employment (employing Jewish Israelis only), exports, and R&D investments; it has been the country's fastest-growing sector in the post-1967 period (Mintz, 1985), significantly boosting the Israeli economy. The MIC was distinguished from the big business groups but at the same time was tightly linked to them. Koor, for example, started shifting a substantial portion of its activities in the late 1960s to concentrate on MIC-related enterprises. During the 1970s, more than half of Koor's 34,500 employees were employed in MIC-related activities, accounting for 17% of domestic sales, and 20% of total exports (Mintz, 1985:35).

The central place of the MIC in the Israeli political economy further pointed to the correlation between economic decisions and geo-political circumstances. The growth of the Israeli MIC was underpinned by increasing demand for weapons; the global annual arms trade post-1973 rose by 136% (Nitzan and Bichler, 2002: 25).<sup>27</sup> In these years the Israeli MIC took an active role in exporting arms, investing in R&D and developing the industry as a primary national objective. Nitzan and Bichler described the situation as 'accumulation through crisis' (ibid). This sort of "Military Keynesianism" (Nitzan and Bichler, 2001: 210-11), in terms of the linkage between military expenditures and business changes has had its Israeli characteristics. It was part of the framework defining national goals, namely security. Furthermore, the ownership structure of the Israeli MIC was mostly statist—only a marginal part was privately owned, generally in partnership with the government. The state ownership was conveyed through the control of Ministry of Defence ancillary units (The Military Industry and Rafael) and indirect control of government corporations (such as Israel Aircraft Industries and its subsidiaries, e.g., Elta). This ownership structure further marked the inter-dependence between the military industry and the state. Military expenditure as a percentage of GDP, accordingly, demonstrated the role of the state in stabilising the powerful position of big businesses, rising from 15% in the years 1968-1972 to 28% in 1973-77 (CBS 2006: 5). The role of the MIC, therefore, helps to further extrapolate the interdependent links between big businesses and the Israeli state at the time.

### ***State-Business Relationship***

State-business relations in this phase were primarily characterised by the transition from the private sector's dependence on the state to mutual inter-dependence. The state continued to support the private sector to stimulate growth and to better accommodate its own position in the global arena. Trade relations were most effectively developed with the US and Europe (MOITAL Foreign Trade

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<sup>27</sup>The decade following the 1973 Yom Kippur War was abundant in security crises and challenges, such as the 1970s commodities supply shocks and the 1979 Iranian revolution (Nitzan and Bichler, 2002: 217-246). However, during these years there were also peaceful trends, most notably the 1978 Camp David peace accords with Egypt, signed in 1979, in parallel to the Détente between the US and the Soviet Union.

Administration), turning Israel into a trade partner rather than a rentier state relying on capital inflows. The state, using its legal and policy powers, still played a decisive role in determining the structure of the market and the business environment. Governmental initiatives like protectionism, subsidies, financial assistance, R&D support, policy and program restructuring, and stimulative tax and procurement policies were used to support the private sector, and more specifically big businesses (Razin and Sadka, 1993; Ben-Bassat, 2002). The investments of the state in the MIC, as indicated before, is an example. As a result, owners and managers of businesses influenced the formation of public policy.

In parallel to that, the political elite lost its power (Aharoni 1991: 232). To illustrate, with comparison to his predecessors, the Finance Minister, Yehoshua Rabinovitz (1974-1977), was a weak and less assertive politician. Thus, when he initiated a fundamental reform in the Israeli tax system in 1974 (known as the Ben-Shachar Committee), it was, for the first time, formulated by experts from outside the government - three members from the academy (one of them the head of the committee, Haim Ben-Shachar) and two members from the private sector (Klein, 1977: 283). While the state could no longer make a real change in the market economy's structure (Aharoni, 1991:239), the private sector was still dependent on government-allocated capital, significantly undermining its autonomy. These relations played a crucial role in the strengthening of the big business groups, eventually changing the balance of power between the political economy's main actors.

State-business relations were significantly developed through personal interaction and organisational settings – termed 'policy forums' (Maman, 1997: 40), specifically between Labour Party politicians, managers and ex-managers of the Histadrut, and private businessmen. For example, 'the water council' and 'the insurance advisory committee' brought together during the 1970s public officials and representatives from the private sector. Senior management of the big business groups lobbied for their economic interests and cooperated with governmental bodies, such as Governor of the Bank of Israel, in various forums. Thus, policy forums had power over a wide range of domestic and foreign policies, sharing similar interests and vision, which were also shared by the cultural elite (Maman, 1997; Ben Rafael and Sternberg, 2007; Aharoni, 1998, 2009). Besides inter-dependence with the government, the groups themselves managed tight business connections; for example, through joint ventures, such as Clal, owned by Hapoalim and IDB, or the cement monopoly, Neshet, owned by Koor and Clal. Another example is directorate ties among the 104 largest firms in Israel in the years 1974-1988 (Maman, 1997). This tight partnership among the big business groups strengthened their position in their relationship with the state, and resulted in the concentration of the market economy.

Parallel to the cultivation of the big business groups, the state commenced a gradual transition

into 'internationalisation', a process common to most economies of free-market scale. This gradual 'internationalisation', the increasing economic activity outside state borders (Giddens, 2000; McGrew, 2005), encouraged the integration of military power, technological supremacy, and corporatist management practices in re-defining the national interest (Swirsky 2004:70-3). Technological progress and competitive pressures in the global arena spurred institutional changes in Western states, such as the US (Hall and Soskice, 2001: 1), and started to play a bigger role in shaping the trajectory of the Israeli political economy.

The developing and highly capitalised arms industry played a leading role in Israel's interaction with global markets, transitioning 'from aid to sales' (see Figure 2.1) (Nitzan and Bichler, 2001: 216). The state used subsidies to encourage the increase of exports (Figure 2.2), rising from 2.5% to 5.5% of GDP between 1972 and 1977 (Shalev, 1998). Interaction with the global arena was further supported by several other factors, including a thriving agriculture industry and American support of Israeli R&D.

Using its highly developed arms and agriculture industries, Israel further enhanced its competitive advantage in innovation and R&D, favouring gradual integration in the global markets, to serve the interests of the state (Bar-Efrat, 2006). Such branding of a national competitive advantage is not unique to Israel; permanent innovation is a well-known strategy for attaining competitive advantage in global markets, particularly technological innovation (Audretsch 1991; Tyson and Zysman 1983; Kapferer, 2005),<sup>28</sup> subsequently empowering participation in world politics (Nye, 2002).<sup>29</sup> The state had a crucial role in improving national competitive advantage, encouraging the development of firms and markets while still depending on market forces beyond the direct control of the state in a globalised era (Nye 2002:6-8). The capitalist system at the time (Mestrovic, 2003) denoted governmental intervention in business, designed to restore, maintain or capture competitive advantage (Porter, 2011).

This internationalisation, however, did not amount to a complete endorsement of globalisation and its various offshoots, such as liberalisation and business sector autonomy.<sup>30</sup> Despite the market's gradual opening to foreign capital flows and reduced regulative constraints with regards to access to foreign capital, subsidies, trade and the labour market, the state was still at the centre, responsible for credit provision and capital allocation. Its support, furthermore, was aimed at specific exporting industries, most significantly the MIC.

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<sup>28</sup>Both Veblen (2005[1899]) and North (1990) adopted an evolutionary perspective in this regard, emphasising the role of technological -industrial progress (linking it to the importance of financial ability), as the basis of social-economic evolution, coherent with economic growth, thereby forming the nature of the interaction with the global arena.

<sup>29</sup>Schumpeter's (1934) hypothesis suggests that innovation ought to depend on the existence of functional capital markets and institutions, with technology promoting scientific, managerial, and other vital practices.

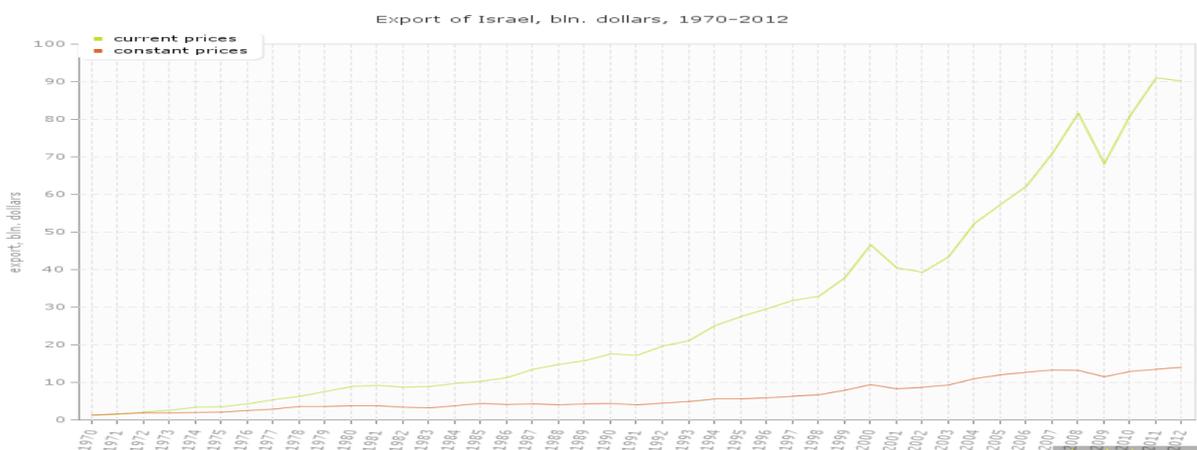
<sup>30</sup> McGrew (2013: 23-4) defined four fundamental processes of globalisation: great power competition, technological innovation and diffusion, internationalisation of production and exchange, and modernisation.

Figure 2.1. Arms exports (constant 1990 US dollar) in Israel



Source: The World Bank

Figure 2.2. Israel exports (in \$ billion): 1970-2012



Source: Kushnirs.org

The market, therefore, became more concentrated because a very limited number of units participated in the big parts of its activity, both within various sectors, and with respect to the market as a whole; these units, in turn, had a vast influence upon the market. This control has been described as a form of corporatism (Shalev, 1992; Ram, 2004; Maman, 2004). However, due to the dominant role of the state, Israel's market economy could not be characterised as completely corporatist (Grinberg, 1991). In addition to its provision, the state authorities failed to build a proper tax structure to charge the appropriate returns or apply adequate regulatory oversight (Shalev, 2004: 89-90). The irresponsible economic policy (ibid) comprised fiscal imbalance, festering instability, inadequate regulation, systematic demand posed by the big business and the Histadrut, and a continuing flow of subsidies, which were not tangibly returned, even as dividends (ibid). It was not only the failure of the state to adjust its state-centred mechanism to the new conditions—it was a reckless economic regime. The stability that the state tried to preserve in its relations with the big

businesses and its formation of an economic elite resulted in damages to the political economy as a whole. These unilateral government transactions and liabilities were a dominant cause of the crises in the 1970s and 1980s (Shalev, 1992).

The state failed to cope with the impacts of the global economic hurdles in the 1970s mentioned above (Nitzan and Bichler, 2011). This, along with the discrepancy between the continuing provisions of the state and the lack of an economic basis to do so, eventually led to a series of severe domestic economic crises. Those crises were entangled with Israel's on-going geo-political challenges, namely wars, growing security expenditures, and the occupied territories (where, in addition to the increased population, trade was unilateral, flowing from Israel to the territories only). Only two branches of the economy kept growing: The MIC (see Figure 2.1) and the banking sector. From 1975 to 1978, the total volume of capital in the banking system grew from IL1.2 billion to IL 4.492 billion (BoI 1974-8, chapter VI: 151). State allocation of resources to specific businesses was not made according to macro-economic considerations or on the basis of a security policy, but out of political reasons resulting from coalition agreements, as a payment to maintain political control (Aharoni 1991: 138). The resources allocation thus made specific businesses more successful, but at the expense of the private sector as a whole, thereby worsening stagflation (Shalev, 2004).

The state was no longer able to guarantee economic stability and growth. It was, in fact, on the verge of economic collapse. The period between 1975 and 1985 became known as the "lost decade" in later literature and analyses.<sup>31</sup> It was characterised by low levels of growth, with annual average real growth of 0.3%, narrowing reserves, and high inflation rates, running an annual average rate of 35% in the years 1974-1977 (Fischer and Orsmond, 2002). During this period, Israel experienced chronic current account deficits and increased government expenditures (Metzer, 1986). The trade deficit grew from an average of 20% of annual GNP in 1960-1964 to 35% in 1973. GDP fell to a 3.4% annual growth rate in 1973-1988 (ibid). Furthermore, the fiscal deficit grew from annual average of 1.3% of GNP in 1960-66 to an annual average of 12.6% in 1967-72, and then 17.3% in 1973-84 (Maman and Rosenhek, 2012). The GNP structure exposed some of the difficulties facing a small economy burdened with massive defence expenditures (ibid).

A corporatist class did not emerge at this stage, due to institutional disabilities, particularly on the part of the Histadrut and the national institutions. The dominant Labour party did not fully implement the Keynesian welfare state; labour was organised by the Histadrut, however, as analysed next, its authority and power were decreasing (Shalev, 1992:172). Once again, the combination of the outdated state-centred mechanism and new market conditions proved unsuccessful in generating a strong economy. The tension between market reality and socialist

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<sup>31</sup> Previous governor of the Bank of Israel, Michael Bruno (quoted by Nitzan and Bichler, 2001: 84).

rhetoric was, for the first time, very tangible (Aharoni, 1991: 243), illustrating the paradox of the Israeli capitalism, which was based, in effect, on state intervention.<sup>32</sup>

Consequently, an ideological conflict between the traditional social-democratic doctrine and neo-liberalism surfaced, spurred by the economic crises (Almog, 2004) and the rise of new actors from various fields –economic, academic, cultural, and, naturally, political. The role of non-state actors, such as scholars and economists, who started to question the excessive presence of the state in the economy, became much more substantial (ibid). The state tried to respond to these changing needs, such as the 1975 Government Companies Law (see Knesset, 1975), which institutionalised a privatisation policy (Katz, 1997: 166). This, however, was not executed, and privatisation was still informal and exclusive. Under these circumstances, Labour politicians could no longer present a façade of powerful actors handling the most important economic challenges by a mixture of goodwill, based on faith in collective Jewish action, and direct intervention. The cooperation between Zionist and Labour organizations, clustered in a corporatist-socialist class, started to collapse (Shalev, 2007; Cohen et al., 2007; Aharoni, 1998).

The decline of the Labour Party's hegemony started during this period, and was formally marked by the first victory of the Likud, the right-wing party, in the 1977 elections. The Likud, led by Menachem Begin, had an integrated objective: to end the old rule of Israeli neo-corporatism—the Mapai and then Labour Party, the Histadrut, and the Kibbutz—and to liberalise the market (Gutwein, 2007). The rise of the right-wing party, advancing neo-liberal market perceptions, was a major turning point in the economy's changing trajectory towards liberalisation (ibid). The period between 1977 and 1984, indeed, saw the seeds of liberalisation (Eckstein et al., 1998). By the end of the 1970s, currency exchange was liberalised, and by 1984 twenty one companies were privatised. However, none of them was a big governmental company, and new government enterprises were still being established (e.g. Paz). Privatisation, therefore, was a narrow phenomenon (ibid).<sup>33</sup> The rise of the Likud exacerbated the condition of the Histadrut, which was no longer connected to the ruling party, and had problems of adjusting to the multi-faceted labour structure and to liberalisation in general.

The economic crisis reached its peak in September 1983 with the stock market crash, probably the most severe economic crisis in Israel to date. The largest Israeli banks had been manipulating the price of their shares, as well as those of the big business groups since the 1970s, leading the public to believe in their constant rise and, accordingly, their stability and safety (Bejsky, 1986),

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<sup>32</sup>It illustrated the persistent tension in the political economy between liberal market economy paradigms and a state-coordinated market economy. Albert (1993) and Hall and Soskice (2001) thoroughly analysed and outlined the differences between the various models of capitalism: Liberal Market Economy (LME) or the Neo-American model, and Coordinated Market Economy (CME) or the Rhine model. This is further analysed later in this research.

<sup>33</sup>Governmental enterprises had been sold to private entities before, but only under specific circumstances and needs, and in parallel to the establishment of others. For example, between 1968 to 1974 the state sold its share in 46 companies, but in the years 1961 to 1968 the number of government enterprises increased from 75 to 137 (Aharoni, 1979: 248).

creating an economic bubble. The government, for its part, was a silent accessory to these actions (Nitzan and Bichler 2002:119). In 1983, due to rumours that the government planned to drastically reduce the value of the Israeli Shekel, the public sold bank shares and bought dollars. The massive selloff and subsequent over-supply led to a severe crisis. Inflation reached an astounding 446%, the currency fell by 493%, public debt reached 171% and the stock market became very volatile, on top of continuous stagflation (Bejsky, 1986; Bruno, 1993).

The crisis was a turning point in the Israeli political economy. It demonstrated the failed coordination between the state, the private sector and the Histadrut, which threatened the economic existence of the state and its legitimacy (Shalev 2004:90). The crisis illustrated that the state-big business reciprocal reliance, exacerbated by the absence of adequate supervision and regulation, had led to conflicts of interest between the business elite's interests and the responsibility of the state towards the political economy as a whole.

Following the 1983 crisis, Michael Bruno, the Governor of the Bank of Israel, together with Immanuel Sharon, the General Director of the Ministry of Finance, and Stanley Fischer, then a professor of economics in the US (and later the Governor of the Bank of Israel, 2005-2013) designed a secret program (Mandelkern and Shalev, 2010: 475). On June 1<sup>st</sup> 1985, the Israeli government adopted the "Emergency Economic Stabilisation Plan" (EESP) to stop the hyperinflation and restore the trust in the state. A new political-economic era in the history of Israel began.

### 3. The Transformation of the Israeli Economy (1985 – mid-1990s)

Accounts of the Israeli political economy's evolution and its central actors vary in focus, angle of examination, and emphasis. Nonetheless, there has been a conventional narrative used in the literature to explain how and why the political economy has changed. It tends to focus on the extensive transformation of 1985, following the Emergency Economic Stabilisation Plan (EESP), as the key turning point in the nature of the market economy and the broader political economy. This understanding is widely shared by politicians, bureaucrats, economists and ordinary citizens. The transformation – from neo-corporatist to neo-liberal economy – was the result of the privatisation of government and Histadrut enterprises, the liberalisation of the economy, and accelerated pace of exposure to the international arena, beginning the process of Israeli globalisation. Following the implementation of the EESP, the third phase of the Israeli political economy consisted of crisis and rehabilitation, including the vast impact of liberalisation, privatisation and globalisation. These processes provide the context for the analysis of the contraction of the role of the state and the changing business environment.

The main driving forces behind the structural transformation have highlighted the changing role and presence of the state. These driving forces were primarily attributable to the severe economic crises—the full employment crisis of the late 1960s, the stagflation of the 1970s, the hyper-inflation of the 1980s, and, more generally, the malfunctioning of the state-driven economic mechanism, which led the market economy to the verge of collapse. The crises pointed to the incompatibility of the state-led model in view of changing economic needs and conditions, stressing the limits of the capacities of the state in managing large enterprises, balancing the budget, and producing growth. These crises, therefore, indicated a need for far-reaching change, including the increasing integration of the state in the global arena. This was entangled with a gradual ideological change: the Zionist ideology of Jewish nationalism was increasingly overshadowed by 'market culture' and neo-liberalism oriented towards free and competitive markets and capital accumulation (Shalev, 2004).

The pressure for change was primarily exercised internally, mainly by the old business elite drawn from 'big business' and big industrial companies, including leading owners and managers (Maman 2006:42). The pressure was largely due to the problems of the economy and the Israeli business elite's growing confidence that it could compete in the open market, domestically and internationally, and that it no longer needed the protection of the state. The long-standing business elite thus urged liberalisation and globalisation in the Israeli economic sphere, seeking to open new business opportunities. Its involvement changed public priorities and accelerated political

adaptations and compromises (Aharoni, 1991; Ben-Porat, 2004; Shalev, 2004). The transformation process, furthermore, was advanced by the media. Although there was essentially no organised social-political resistance (Filc, 2004), the Histadrut did try to oppose privatisation (Katz 1997: 175-7). However, given its own poor functioning, and its continuing inter-linkage with the Labour party, once more heading the government (in the years 1984-1986), the objection was not very significant.<sup>34</sup> In addition, there was an external boost for change, exemplified in programs advanced by the IMF, as well as the discourse of the Washington Consensus.

In contrast to other cases of economic liberalisation, such as Russia or Chile, the transformation of the market economy was not grounded on the business elite's aim to weaken the state, nor was it driven by the aspiration to build an alternative political regime.<sup>35</sup> It was, instead, a result of both state and business elite's aim to reconstruct the economy and integrate in the global economy of the 1980s. The transformation in Israel was coordinated, conversely, by the state itself, while the restructuring after the EESP was facilitated by the massive economic support of the US, Germany, and western Jewish communities (Swirsky 2004:72). It was not, thus, a grassroots revolution from below, but a process designed to generate something like a 'capitalist revolution' from above, largely advanced and supported by the business elite and the political and professional leadership at the time. This phase cannot be understood, therefore, without examining the EESP and the ensuing transformation of the market economy.

### ***The 1985 Emergency Economic Stabilisation Plan***

The critical notions brought up in the literature on the Israeli economy's transformation focus on changes originating in the reform's efforts; for example, the social outcomes of the transformation, such as wage differentials and reduced welfare benefits (e.g. Ram, 2004; Filc, 2004), the market's opening to external exchange (Ben-Basat, 1993; Yosha and Blass, 2000), and political changes, including the decline of the Histadrut and the big business groups, and the emergence of new ones (Shalev, 2000; Shafir and Peled, 2000). There is no evident controversy about the EESP's features among scholars. However, two narratives can be distinguished in the literature. The first depicts a sharp transition from a state-coordinated model with strong socialist features to a free market capitalism mechanism (Filc, 2004; Ram, 2004; Gutwein, 2008). The second highlights continuity alongside change, stressing the evolutionary nature of the political economy more than a revolutionary trajectory (Shalev, 1999, 2004; Aharoni, 1991; Kosenko, 2008; Maman and Rosenhek, 2012). This thesis, which focuses on continuity in state-business relationship, despite substantial changes, is attuned with the second approach.

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<sup>34</sup>The coalition of 1984-88 was headed by the Labour party in the first two years, with rotation between the Labour party and the Likud. It was renewed in 1988 for another two years, this time headed by the Likud with no intention or agreement of rotation.

<sup>35</sup>In the cases of Russia or Chile, fear of the return of communism or dictatorship stimulated liberalisation efforts, see, for example, Boycko et al., 1995; Silva, 1996.

The EESP was carried out by a national unity government of the Labour Party and the right-wing Likud Party. It prompted the market transformation into a privatised, globally-opened and liberalised era, a marked departure from the previous economic structure. The EESP was primarily designed to transform and stabilise the malfunctioning mechanism which led to the collapse of the Israeli economy. Its key aims, accordingly, were to stop hyperinflation and reduce public deficit. The EESP also sought to reconfigure state–business relations so that the state could reclaim its autonomy and its institutional capabilities to regulate economic processes (Shalev 1992; Maman and Rosenhek, 2012). Another EESP objective was to enhance economic competition, thereby augmenting efficiency and encouraging private investment, which was therefore entwined with openness to foreign markets and actors (Spivak, 2008). As follows, the EESP advocated a more limited role for the state, prompting a gradual shift in the government’s economic function, from an owner to a regulatory role. While the power of the state decreased in terms of ownership, its presence nonetheless remained prominent.

The EESP was consistent with the 'Washington Consensus', which advocated fiscal discipline, elimination of government subsidies, tax reform, public announcements of interest rates, maintenance of low inflation, uniform exchange rates, and guarantee of property rights, de-regulation, trade liberalisation, financial liberalisation, privatisation, and elimination of barriers for Foreign Direct Investments (FDI). If measured by fast and inclusive enforcement and implementation of the main guide lines, the Israeli adoption of the Washington Consensus guidelines was a remarkable success (Shalev, 2004; Maman and Rosenhek, 2011). The most substantial steps were the liberalisation of the financial system, including the changing role of the banks, the privatisation of state and Histadrut assets, and the globalisation of various aspects of the market economy.

The implementation of EESP reforms mainly pertained to the financial system and capital markets during the initial years (Ben-Bassat, 2002:48). Macroeconomic reforms were most efficiently implemented by state ministries and relevant institutions, primarily the Bank of Israel (ibid: 3). The new monetary policy dictated rigid inflation targets and a restrained fiscal policy, signalling a significant cut in government expenditures, including in the number of employees, a general wage freeze, and various tax reforms (implemented in 1987), such as tax reduction for enterprises and employers, and the replacement of old subsidies with new ones (Filc, 2004: 47-8).<sup>36</sup> The private sector could now issue bonds without the approval of the Minister of Finance, tax discrimination that favoured government bonds was eliminated, banks could invest in the stock market and corporate bonds, and state designated bonds were eliminated (Committee, 1996; Ben-Bassat, 1993; Committee 1996:19). Trade was also liberalised.

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<sup>36</sup>Three types of taxation– enterprises taxes, social security and employers' tax - were significantly reduced.

The Israeli financial system, which until the mid-1980s was a credit-based system dominated by the state in close alliance with its partners—the commercial banks and the Histadrut —changed. Since 1986, a determined alliance of state agencies, headed by the Ministry of Finance and the Bank of Israel, in partnership with the Israeli Securities Authority, the Israel Antitrust Authority and the Ministry of Justice, advanced a series of important institutional changes that significantly contracted the role of the state in the financial system, especially with respect to capital mobilisation and allocation (Blass and Yosha, 2002). A central component of the financial liberalisation that the EESP brought was the termination of the government and Bank of Israel's direct involvement in allocating subsidised finance to the business sector, through targeted credit programs in local currency, and the reduction of credit in foreign currency provided by various state-run funds. A deregulated and liberalised capital market, its activities intensified, enabled, for the first time, access to capital without state mediation. From 1990, firms could raise capital from abroad.

By 1991, the old system of state-directed credit was abolished in favour of direct credit provision through the banks. Beginning in 1992, banks could provide credit and receive index-linked certificates of deposits and, in the following year, were barred from underwriting activities. In 1992, foreign currency exchange was also liberalised; foreigners could invest in government bonds, trust funds, and options, convert them to foreign currency, and manage Israeli deposits (Bufman and Leiderman, 1995; Committee, 1996). The business sector thus acquired relative autonomy from the state, no longer dependent on the government to raise capital or expand. The government, in turn, was no longer at the core of financial activity. In these years, accordingly, the number of listed companies in the capital market rose, from 100 in 1990 to 250 in 1995. The annual turnover, which rose to over \$30 billion in 1993, was ten times higher than in 1988 (Blass and Yosha, 2000: 6). While in 1988 governmental bonds were more than half of the trade volume of stocks, by 1994, it was 16 percent (ibid: 7).

Significantly, the power of the banks, which was at the centre of the 1983-4 crisis, was addressed in the Bejsky Committee. The committee, which published its report in 1986, stated that banks would always favour their own interests rather than those of their customers, resulting in a fundamental conflict of interest in the market (Bejsky, 1986: 226). As a part of the efforts to further stabilise the market's liberalisation, the committee attempted to abolish the old structure of banks rules by limiting their ability to control public savings and real assets. Accounting for the hazardous concentration in the banking sector, it stated that banks should divest their real holdings and withdraw from managing provident and trust funds to reduce structural conflicts of interest (Bejsky, 1986). The state tried to take measures implementing the Bejsky Committee's defined objectives, but it mostly failed (Brodet, 1995; Bachar, 2004). It was only after a pair of subsequent committees, the 1995 Brodet Committee and the 2004 Bachar Committee, that its conclusions were

implemented.<sup>37</sup>

Privatisation was another fundamental process in the political economy's transformation, centring on state assets and those of the old 'big businesses'. Prior to the EESP, 160 companies were under government ownership, about 90 percent of their employees concentrated in the 10 largest firms (Ben-Bassat, 2002). The government-owned enterprises accounted for approximately 20 percent of the GDP, with Histadrut companies accounting for another 20 percent. The remaining 60 percent of GDP not directly controlled by the government and Histadrut ownership engaged in government-related economic activities (OECD 2011a:14). The few active units in the market, therefore, had wide influence over it (Brodet, 1995). The Israeli Government commissioned the First Boston Corporation Bank to design the strategic privatisation process of the market, delivered in a 1988 comprehensive strategic master plan. The report recommended the privatisation of 25 government companies and a like number of government company subsidiaries, together representing about 85 percent of government-owned company activity (Katz, 1997: 171). These included, among others, some of the largest companies in the market: Bezeq (Telecommunication Company), the Israel Electricity Corporation, Zim Integrated Shipping Services (the national shipping company), El-Al (the national airline), the national Oil Refineries, and Chemicals for Israel (Katz, 1997).

The globalisation of the market economy was most prominently manifested in the Hi-technology industry (analysed later in the chapter), and was sustained through tighter collaboration with the global arena. Following the gradual removal of restrictions on foreign exchange and overseas investments by Israeli citizens and companies, the Israeli economy has increasingly integrated in the global financial markets—and, in turn, became more attractive to them. In addition, the market transformation was entangled with cultural-social change and a clear ideological imprint of neo-liberalism, indicating, arguably, the end of the Israeli political economy's 'exceptionalism' (Shalev 2004: 84).

The EESP is largely perceived to have brought positive results, stabilising the market and leading to an increase in most tangible measures. Public debt was reduced from \$1.5 billion in 1984 to a surplus of \$1.4 billion in 1986, representing 6 percent of GNP (Bank of Israel, 1987: 2-3). The inflation rate dropped to 20 percent (ibid: 49, 53) and the currency was strengthened (ibid: 231-3). In contrast, reforms to increase competition in state-owned monopolistic industries, such as in the electricity market, the national railway or the ports, are still incomplete as of 2015. Nonetheless, public expenditures were reduced and fiscal discipline tightened (Strawczynski and Zeira, 2007:53), changing the balance of power from public to private.

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<sup>37</sup>The 1995 Brodet committee forced the banks to sell a large percentage of their real assets in industry and services; the 2004 Bachar Committee forbade banks from managing mutual funds and provident funds. The actions of these committees are detailed in subsequent chapters.

### ***The Part of the State in the Economy: The Contraction of the State Role - From Owner to Regulator***

As a result of the EESP, the role of the state in the economy contracted, enhancing its autonomy vis-à-vis the capital market, the labour market, the trade relations and other agencies. It was still responsible for macroeconomic stability and developing the market, along with its continuous responsibilities of Jewish immigration and security (Shalev, 2004:84). Nonetheless, it aimed to stimulate free competition. The contraction of the role of the state mainly pertained to the financial system and financial activity, its ownership over key assets and companies, and its control of the labour market, through the Histadrut. These changes, prompted by the EESP, also resulted in enhancing the autonomy of the business sector. It was not, therefore, a complete retreat. Rather, the state decreased its ownership but has become more dominant in terms of regulation and control of the privatisation process. Consequently, the transformation changed the institutional balance of power between the key actors of the state. The power of some actors that represented the old order was reduced, most prominently the Labour Party and the Histadrut. Conversely, the transformation allowed for other actors, both state and private, to become more dominant, as a result of the new market economy. A prominent example is the Bank of Israel.

After 1985, the Bank of Israel (BoI) became the key actor in determining macro-economic policy, controlling the interest rate and exchange rate (Shalev, 2006: 209). Both facilitating and facilitated by the transformation of the political economy (Maman and Rosenhek, 2009: 51-3), the BoI shifted from a governmental instrument of industrial development, economic growth, and full employment into an independent and powerful actor. In addition, the role of the BoI in the global arena increased, managing close relations with the IMF and later with the European Central Bank (ECB). The macroeconomic analysis and outlook that the BoI shared with these international actors have not always been shared with the government and the Ministry of Finance. The role of the other regulatory agencies of the state, namely the Commissioner of Capital Markets, Insurance and Savings in the Ministry of Finance (founded in the early 1990s) and the Israel Securities Authority (ISA), also increased.

As the revised role of the BoI asserted a new neo-liberal order, an internal struggle within the government, in particular the Ministry of Finance, began (Maman and Rosenhek, 2009). This was part of the wider power conflicts that broke out regarding the appropriate instruments for monetary management (ibid: 91). These internal conflicts were deepened further as the BoI progressively became a powerful actor in the international arena (mainly throughout 1995-2005). Even though the conflicts concerned the efforts to re-define the role of the state, they revolved around the fact that the state did not entirely retreat from the market, but facilitated the change in the balance of power between its agents. Furthermore, the state and its various institutions were no longer regarded as a

monolithic body, but as an institutional complex with different objectives. It was, therefore, not a struggle for the optimal political-economic route of liberalisation, accepted by all actors, but for dominance in the Israeli political-economic sphere (ibid: 137).

The EESP considerably marked the decline of the ideology of the labour party, which began with its political defeat in the 1977 elections and the rise of the Likud party as a viable political alternative.<sup>38</sup> Furthermore, the characteristics identified with the labour ideology, such as collectivism, social solidarity, pioneering and the central role of the party in the political economy, as owner and coordinator, were seriously evaded by the EESP. Indeed, the Labour party's outlook on the market economy grew closer to the neo-liberal view of Likud.<sup>39</sup>

Another effect of the EESP was the exclusion of the Histadrut from the control over the big business groups. The decline of the Histadrut corresponded with the end of the Labour party's hegemony, particularly after 1985. In the hyperinflation environment, many Histadrut enterprises concealed their problems with financial obscurantism; however, in the aftermath of hyperinflation the Histadrut could no longer hide its poor performance. As a large employer and owner it failed to adapt to the changing management, productivity, and efficiency practices in the economy. In addition, following the weakening of the big business groups after the 1980s crisis and the shift in the role of the state, labour was no longer perceived as an objective in itself, but as a means to other ends in the market. This considerably diminished the position of the Histadrut in the political economy. Finally, the EESP reduced the economic support that the government provided to the organisations of the Histadrut (Mandelkern and Shalev, 2010: 486).

Shalev (2004) noted three developments in the labour market that symbolised the changing role of the Histadrut in the political economy following the EESP: (1) the entrance of a foreign labour force, decisively breaking the 'Hebrew labour' taboo;<sup>40</sup> (2) the transformation of the Histadrut from a powerful owner into a labour union; and (3) the narrowing of the bureaucratic sector, due to the dismissal of 10,000 public sector employees and the privatisation. The crisis and decline of the institutional network and power of the Histadrut in the years 1980 to 1994 represented the end of the Zionist-socialist era of state building, and more broadly — the decline of labour ideology.

By May 1994, the Histadrut had sold most of its economic assets, a required privatisation in that stage, because of failed economic performance (Grinberg and Shafir, 2000: 103-4; Shalev, 2004: 108-9).<sup>41</sup> The nationalisation of the Histadrut health services in 1994 was its most significant

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<sup>38</sup>Herut party was active in the Israeli political system since the state foundation (and merged into the Likud party in 1988). Alternatives to Mapai, therefore, have actually always existed; it was only in 1977, nevertheless, that they could takeover the political rule.

<sup>39</sup> Notwithstanding foreign policy differences towards the Middle East, see for example Aran, 2009.

<sup>40</sup>This taboo started collapsing with the inclusion of Arab-Israelis in the labour market and accelerated with the occupation of the West Bank and the Gaza Strip, leading to the incorporation of Palestinians into the labour market.

<sup>41</sup>The Histadrut kept holding pension funds, which were privatised in 2003, a chain of homes for the aged, and some real-estate assets. It is still quite difficult to obtain transparent and updated report on the actual economic holdings of the Histadrut from before 1994 (Horesh, 2011). It was only during the 2000s that it recovered from the economic loses of the 1980s-90s.

loss. The increasing autonomy of the private sector overpowered the old order that the Histadrut represented. Its economic decline and de-legitimisation were accompanied by internal political struggles and a lack of cooperation with the government. The Histadrut has lost its historical role in favour of the government and the private sector.

All the same, the state still remained a powerful actor and its role in the economy remained central. The continuous centrality of the state was to a great extent justified, at least publicly, by the nationalist ideology of the Jewish state, the on-going security challenges, the corresponding liabilities and expenditures, and the small size of the market, which required state support to develop. More tangibly, it was a result of the role that the state and its related institutions still held in the market, as well as the processes of liberalisation and privatisation themselves. The contraction of the role of the state, therefore, did not imply a loss of control or of responsibility; it was, in effect, a process that increased the power of state institutions at the expense of the Histadrut, while simultaneously strengthening the market economy. These processes enhanced the autonomy of the state and fortified, rather than neutralised, its position in the domestic and in the global arena.

### ***The Role of Business: A Changed Business Environment***

Following the implementation of the EESP, the 1990s saw substantial changes in the Israeli business environment, engendering new business opportunities. These changes included, first, a new political climate, shaped by the end of the Cold War and the 1993-4 Oslo Peace Process with the Palestine liberation Organization (PLO). More emerging markets were opened following the collapse of the Soviet Union and later with the peace process. Most importantly, the immigration of Jews from former Soviet Union, beginning at the end of 1989 and continuing through the early 1990s, brought a high-skilled labour force into the market, with professional expertise, academic training, and managerial experience (Lerner and Hendeles, 1996; Eckstein and Weiss 2002; Friedberg, 2001). The absorption of the immigrants in the years 1990 to 1997 added 711,000 citizens to a population of 4.56 million Israeli citizens (Eckstein and Weiss 2002:349). The comfortable political climate was also a result of the Israeli aspiration to reach 'normalisation' (Shalev 2004; Ben-Porat, 2004).

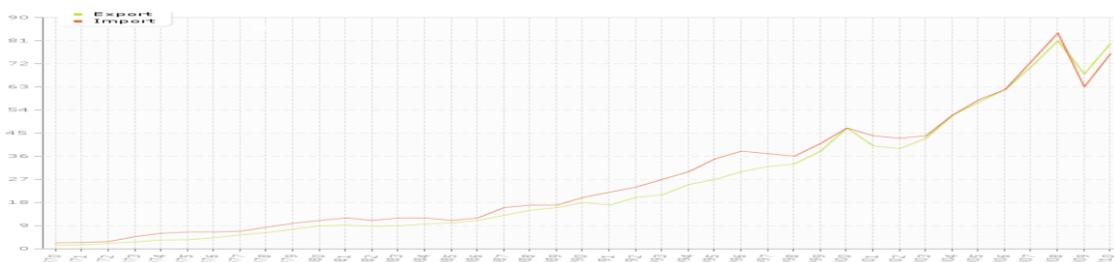
Second, the entrance of the Israeli capitalism to the globalised stage was rapid (Ram 2004:31) and characterised by numerous structural changes (Ben Bassat, 1993), such as new sources of capital, extended trade relations, and the rise of new, globally integrated industries. This process was characterised by increasing competition, new opportunities and an environment of actual integration in the global arena rather than submission to the closed Israeli market. The shift of Israeli enterprises to cheaper zones of production and manufacturing (Filc 2004:40-1) further contributed to Israel's integration in the global economy, weaning its dependency on West-European

markets for production, and creating investment opportunities in developing East-European countries (Shalev 2004:92).

The changes in the business environment were critically supported by alternative sources of capital created by the EESP. As capital accumulation and movement were required to integrate and compete in international markets, private capital began dictating, for the first time, the conditions of employment, offshoring, outsourcing, subcontracting, and foreign investments (Ram, 2004: 31-2). The new sources of capital included liberalised capital markets, the banks as more autonomous actors, and institutional investors, referring here to a small number of insurance companies, investment houses and other private institutions in the financial market, which could, since 1992, invest in the capital market. So could other foreign investors. Firms had free access to these economic sources of finance (Blass and Yosha 2002: 193). In addition, the new economic strategy encouraged TNCs and external investors' access to the domestic market. Flows of FDI into Israel contributed to the recovery of the domestic political economy and generated growth. The annual average of total foreign investments (direct and portfolio) rose from US \$597 million in 1980–91 to US \$4.9 billion in 1992–2005, reaching US \$17.6 billion in 2006–07 (Central Bureau of Statistics 2008: 642). FDI grew from US\$4.5 billion in 1990 to US\$22.4 billion in 2000, and US\$77.8 billion in 2010 (UNCTAD 2011).

Israel's transformation into a neo-liberal economic partner delivered strategic and economic benefits to foreign actors, broadening first and foremost Israel's trade relations with the US and with Europe. Trade agreements were conducted with the US, the EU, and Canada (MOITAL Foreign Trade Administration).<sup>42</sup> Capital import and export increased significantly, as did the activities of domestic corporations investing in foreign markets. The economic growth of the 1990s (MUNDI, 2011) was thus paired with accelerated and further developed trade relations (see Figure 2.3), stabilisation of the dollar exchange rate, and continued success of the arms and diamond industries, among others.

Figure 2.3. Israel foreign trade - 1970-2010 (in USD billion)



Source: Kushnirs.org

<sup>42</sup> Trade agreements with the EU and the US existed before the EESP, but Israel did not quite comply with them until after the EESP was launched.

The changed business environment engendered the rise of new financial and the hi-technologies industries. As opposed to the dual phase, when the share of large industrial firms was responsible for the majority of GNP (Shalev 1992:297), the structure of the economy increasingly centred on the financial and hi-technology industries. The expanding financial sector partly took the place of traditional industries, such as agriculture and construction.<sup>43</sup> The hi-technology industry captured a rising share of total market production (Ben-Bassat, 2002: 36-7), growing from 4 to 25 percent of total production and from 5 to 35 percent of total product; conversely, output of classic industries decreased from 55 to 25 percent of total production, and from 46 to 24 percent of total product (CBS 2008:16). The hi-technology industry's rise during the 1990s illustrated Israel's competitive advantage, in terms of its interaction with the global arena and as a source of domestic growth. In addition, it illuminated the central role of the state in cultivating the market economy.

Although still prospering, demand in the defence industry dropped significantly, what consequently weakened the MIC. Former employees in the industry, as well as scientists and programmers, now joined the market. The MIC subsequently became the main technological and institutional basis of the emerging technology sector, providing the foundation for new companies (Maman and Rosenhek, 2012; Barak and Sheffer, 2006). The technology industry replaced, to a great extent, the role of the MIC in interacting with the global arena (Lissak, 1986; Maman and Lissak, 1996; Breznitz, 2005; Senor and Singer, 2009).

The rising hi-technology industry in Israel created a new generation of influential business elite. It was mostly characterised by singular companies rather than business groups (Kosenko, 2008). While hi-technology enterprises have also been characterised by concentrated ownership structure, unlike the big business groups the owners were more focused on innovation and the underlying technology, rather than on forming sector-spreading business groups (OECD 2011a:14-15). Their competitive advantage was knowledge, technology and innovation. In the changing structure of the previously state-centred economy, the technology sector's emergence as a focal industry was a manifestation of Israel's competitive advantage in innovation and R&D.

The centrality of innovation and research and development (R&D) was cultivated by the state to obtain economic and industrial progress, technological innovation, and greater integration in the international markets. Continuing previous trends, the promotion of Israel's competitive advantage in technology was initially fostered by state sources (Shalev 2006:210). The hi-technology rise of the 1990s was aided by state funds and government investments in the technology sector. Between 1991 and 2003, direct government funding contributed 27.5% of all civilian R&D expenditures, representing around 1% of GDP, higher than all other OECD countries (Central Bureau of Statistics

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<sup>43</sup>While some of the long-standing old industries, such as agriculture and raw materials, were not as central in the market economy as before, they did benefit from the openness to the global arena.

2007:25, 40). Since the mid-1990s, the state has set up several programs of financial and organisational assistance targeting hi-technology research and development, becoming an important instrument of Israeli hi-technology's growth (Avnimelech and Teubal 2004; Breznitz 2007). Beginning in 1993, the state developed the growth of the Venture Capital (VC) industry through the 'Yozma' Program of the Chief Scientist, funding ten VCs and several technological incubators (Avnimelech and Teubal 2004), giving significant impetus to Israel's growing integration in global markets. In addition, the government has provided grants to big technology TNCs since 1996—such as to Intel, with special tax benefits worth hundreds of millions USD—to support the establishment of manufacturing plants, totalling more than \$1.5 billion (Maman and Rosenhek, 2012). The state also provided direct financial assistance, supportive environment, and government grants of \$300-400 million a year since the end of the 1990s (Moital, 2007; OCS, 2008, 2010).

The state support of the hi-technology sector provided it with the tools to compete in the open market, generate growth, innovate, and remain competitive, illuminating the crucial role of the state in cultivating the private sector. It also contrasts it with other private sector segments which drew their power from the state, namely the big business groups that later formed the oligarchy, and, specifically, the financial sector.

### ***State-Business Relationship***

The state, in addition to investing in the hi-technology sector, reduced taxes, incentivising increased capital flows and stronger, investment-based interaction with the global arena (as opposed to aid-based interaction). The state-business nexus was no longer characterised by the dependence that prevailed in the transitional phase, but rather exhibited features of 'institutional complementarities'. The state conceded some responsibilities, but still shaped the direction of economic activities and exerted extensive influence on the market, while letting globalisation and privatisation run their course; for example, the state moderated rules concerning the borrowing of foreign capital (Shafir and Peled, 2000: 8). New opportunities emerged in finance, marketing and production, enabled by global processes applied in Israel, offering grounds for a new structure of mutual-profit coalitions between the state and the private sector (Shalev, 2004: 112-3).

The rise of the hi-technology industry paralleled the re-structuring of new business groups, primarily throughout privatisation of state assets, from the Histadrut and the former big business groups, including the banks. The privatisations have thus resulted in the consolidation of new business groups, often on the basis of old business groups or 'big business' (a process analysed in detail in the next chapter). The big banks—Hapoalim, Leumi, Discount Bank, and Mizrahi-Tefahot bank—retained immense power over the local market (Blass and Yosha, 2000). They were central credit providers to the private sector, and therefore a key factor in shaping the political economy

and in determining the power positions of the new and restructured business groups. At the same time, they continued their coordination with the state, gradually turning into an instrument of capital accumulation (Nitzan and Bichler, 2002), serving largely the same groups. The state broadened the capital market, attracting foreign investors and local institutional investors (Ben Bassat, 1993). Still, the institutional investors were not entirely autonomous; they were obliged to deposit their money at the Ministry of Finance, which issued designated bonds in return, to prevent market volatility (Bachar, 2004; Ben-Bassat, 2002; Maman and Rosenhek, 2011). The state had fewer public savings requirements and allowed inflows of FDI and transactions through the capital market and the various trade agreements.

The steady rise of the capital market caused the monetary authorities and the government to lose some power in allocating funds, as new avenues for raising funds in foreign stock exchange markets reduced dependency on the government and local banks (Yafeh and Yosha, 1998). Nonetheless, the state led the process, accommodating global trends. The state was central in opening the market and generating economic growth, eliminating trade barriers and conducting far-reaching agreements on trade liberalisation, capital liberalisation and financial reforms. It tried to stimulate competition, using, for example investments in technology (Shalev, 2006, 1992). It subsequently began a trust-busting policy, including various tax reliefs to businesses, and transitioned qualified managers from the public sector to private business (Shalev 2004:102-3).

Domestically, therefore, the most significant outcomes of the transformation of the Israeli economic regime were the tightening of the state-business power nexus and their increasing mutual dependence (Aharoni, 1991). The balance of power inside the state-business nexus changed (Shalev (1992, 2004). For example, while the state narrowed its control in the financial markets (Blass and Yosha, 2000), its role—attracting international corporations to Israel, such as Intel (Shalev, 2004), investing in Israeli enterprises, marketing weapons technology, and subsidising start-ups (BoI, 2006; CBS, 2009) —became bigger. In other words, the autonomy of the state increased by means of strengthened market discipline. In effect, the new state-big business nexus, composed of the new business groups and a reformed state presence, maintained the harmony between them and determined the structure and direction of the political economy as a whole. Despite significant changes in the Israeli political economy, state-big business relations have exhibited a significant degree of continuity, evolution rather than revolution.

The continuing corporatist concentrated structure characterised the political economy both before and after the transformation. Rather than being social-democratic, Israel, in effect, exhibited an inconsistent model of neo-corporatism, as embodied by the old and failed corporate mechanism of the Histadrut, which was gradually replaced by the private sector, mainly the business groups, as a "paradigm of political-economic stability" (Shalev, 1992: 272). The shift in state-business

relations did not alter the extent of the involvement of the state in the economy, but rather its mode of involvement. The state continued, in effect, to play a key role in the economic arena by using regulation and control to create a viable private sector (Maman and Rosenhek, 2012). The private sector, especially the big businesses, was no longer under state control, but still enjoyed state support and massive subsidies.

Beginning in the late 1990s, growth slowed, government debt grew (see Figures 2.4 and 2.5), and the market entered a period of relative stagnation (Ben Bassat, 2002, CBS, 2004, BoI, 2005). The stagnation was a result of the Dot.Com Crisis in the hi-technology field (see for example Kraay and Ventura, 2007; Buenstorf and Fornahl, 2009), the deterioration in the security situation, specifically the second intifada (for more see Ghanem, 2010), and the global slowdown (see for example Schwab et al., 2002; Begg et al., 2002; Bayoumi and Helbling, 2003). Inflation rose from 0 percent in 2000 to 6.5 percent in 2002. Government debt rose from 0.7 percent in 2000 to 3.6 percent in 2002 (BoI 2008:3). The total product declined by 2.7 percent in 2001 and by 2.6 percent in 2002. The business product declined in 1.7% and in 2.5% in the same years (ibid: 30). FDI dropped from \$8,047,500,000 in 2000 to \$1,771,300,000 and \$1,582,500,000 in 2001 and 2002 respectively (Mundi Index). The revenues of the defence industry, subsidies provided to businesses and interest payments all declined. Welfare transfers to households, on the other hand, increased (Strawczynski and Zeira, 2007). In 2002, the state was again on the verge of deep economic crisis; after a seven-year rise, there was a decline of 9% in the non-linked bond index. In the course of the year, yields on government non-linked, long-term bonds reached 12% (TASE 2002:6), indicating a high risk to investors.

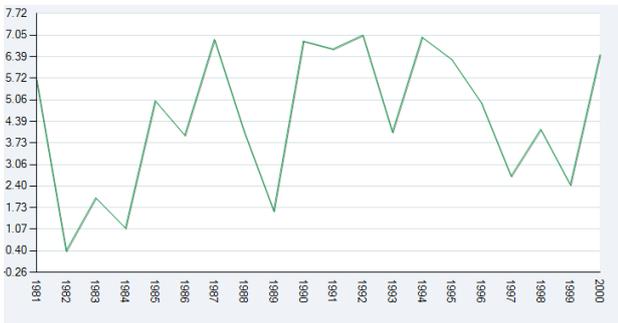
This crisis trend only changed in the wake of a renewed wave of privatisation during the 2000s and the reforms in the financial system. Yet, these transformations have augmented the power of a small group of businessmen, narrowing thereby the state-business cooperation to a smaller scale. The process of 'oligarchisation' of the market economy, in which the state had a central role, began to crystallise at this point. These processes will be analysed in the next chapters.

Figure 2.4. Government deficit (ILS millions)



Source: Bank of Israel – statistics series

Figure 2.5. Change in GNP (in percent)



Source: Bank of Israel – statistics series

## Conclusion

The evolution of the Israeli political economy has been traditionally understood as a shift from a state-building phase, drawing heavily on the social-democratic model, into adoption of the neo-liberal order and free market capitalism. Most authors describe this transformation, taking the 1985 EESP as its turning point (“from dominant party to dominant capital”, Nitzan and Bichler, 2001: 133). However, Israel’s political economy was never social-democratic before the transformation, nor has the market economy been utterly free after it. As a matter of fact, the understanding of the continuity of the state-big business nexus helps to shed light on the political economy’s evolution; the transformation of the political economy, accordingly, can be conceived as an accentuation of the core relations between both parties – the state and the big business groups.

The role of the state in the post-EESP period has gone from a central economic actor in the developing phase, with encompassing government involvement and ownership in the market, to being a key actor in the economy during the second phase. This role was most importantly conveyed through the formation of the ‘big businesses’. By well-intended policies the state enabled the big business groups to expand at the expense of other businesses, mostly SMEs, through mutual-profit coalitions. During the third phase, of the market economy’s transformation, the EESP prompted a gradual shift in the government’s role, from owner to regulator. However, the government remained a chief agency in inter-corporate coordination (Coen et.al, 2010: 25).

The economy in the first phase was constructed to serve the various objectives of the state. The business sector in the second phase has shifted from dependence on the state to inter-dependence and, to a great extent, symbiosis. The big businesses included the banks, the industrial sector, and the MIC. Following the EESP, new business groups emerged on the basis of their predecessors, composed of the privatised state assets and those of the old groups. The state, all the same, remained a powerful actor in the liberalised market economy.

The nature of the state-business nexus in the first phase was of symbiosis between the political elite of Mapai and the consolidating economic elite. In the second and the third phases, this nexus displayed features of ‘institutional complementarities’, while letting globalisation and privatisation leave significant impacts. Despite substantial changes in the Israeli political economy, state-big business relations have exhibited a significant degree of continuity, evolution rather than revolution, continuously characterised by proximity and the support of the state of big businesses.

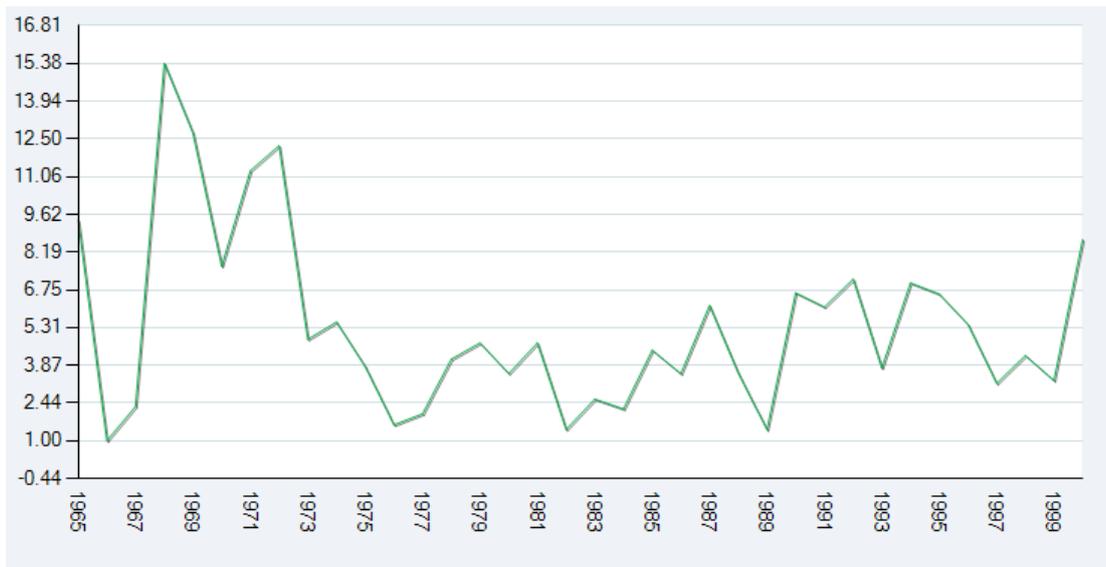
The state’s central role is a result of religious-national and historical heritage, the security-political situation, and the centralised, rather small market structure. It started with the Jewish settlements in Israel prior to the establishment of the state, and continued with its development, standing at the core of all economic and social activity, even throughout processes of market liberalisation, which compelled the contraction of its role in the market. Shalev (2004) argued that

the evolution of the political economy has been a transition from one state-economic regime to another. Accordingly, the function, mode or identity of the key actors has changed, both within the state and its institutions, and with respect to the prominent actors in the private sector.

Despite the EESP's positive results, which are broadly agreed to have saved the market economy and advanced Israel's trade relations, some of the changes can be associated with the emergence of the oligarchy. The business community in Israel currently operates under different conditions than those of the pre-1985 dual phase, such as its access to non-government capital, free trade, a liberalised labour market, etc. However, the continuity of the state-business nexus is no less significant than the changes across the previous periods, particularly with respect to state- big business relationship. The symbiosis between the state and the big businesses, which continued throughout the transformation, eventually resulted in the formation of an oligarchy. Nonetheless, the shift that enabled the rise of the oligarchy was rooted in the particularities of the government's actions and the specific political-economic context, as analysed in the next chapters.

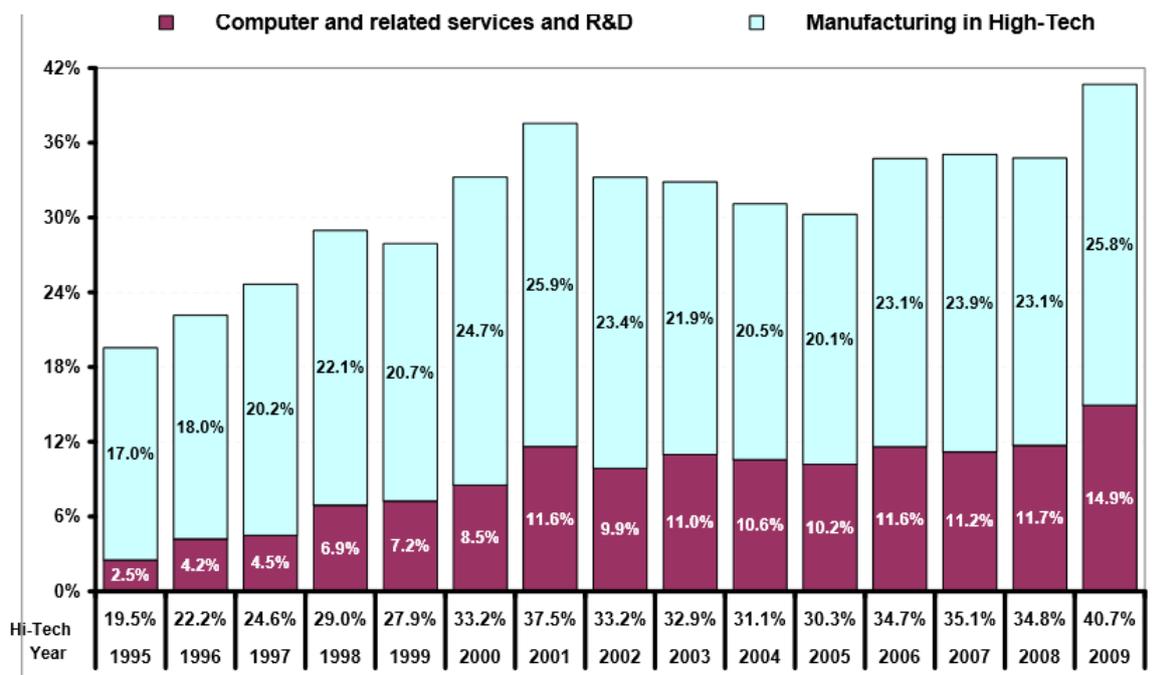
**Appendix:**

Figure 2.6. Change in GDP (in percent)



Source: Bank of Israel – statistics series

Figure 2.7. Share of Hi-Tech in Exports of Goods and Services, 1995 – 2009



Source: Centre of Excellence, Israel, 2012

## **PART II**

### **CHAPTER 3**

#### **PRIVATISATION AND THE EMERGENCE OF NEW BUSINESS GROUPS**

The following two chapters examine the main stages of the formation and evolution of oligarchy in Israel. As the previous chapter analysed the transformation of the market economy—and the main processes and reforms related to its evolution—these chapters examine more closely the way the oligarchy consolidated and commandeered the economy following the implementation of these reforms. I argue that the Israeli oligarchy formed in two stages. The first stage, which is the topic of this chapter, lasted from 1985 until the end of the 1990s. It was defined by privatisation and the subsequent emergence of new big business groups. In this stage a transition from the old business groups (the 'big business') to the new ones took place. Throughout this process, a few individuals became very wealthy and powerful, by means of their control over the market, largely due to state sanctions, specifically privatisations. The second stage of the rise of the oligarchy, which took place in the early 2000s, evolved as a process of financialisation and is the topic of the next chapter.

The assets of the state and the Histadrut, e.g. the banks and the old business groups, were privatised with the logic of transferring control to a stable pool of shareholders. This development or mechanism of wealth accumulation was a political rather than purely economic process, with its beneficiaries tightly linked to the political circles. A quality that defines the oligarchy in Israel specifically is termed here 'clubness': it points to the networked alignment of the oligarchy, sustained by shared interests and cohesion, and its close relationship with the state.

The following analysis is grounded in the two approaches presented in chapter one, the historical and the contemporary, and draws on some of the main parameters to distinguish oligarchs from other wealthy actors: tight relationship with the state, rent-seeking activities, market concentration and merger between financial and industrial holdings. These approaches help elucidate how a particular state-business nexus evolved into an oligarchy. In order to examine how the processes of the emergence of the Israeli oligarchy reflect global trends, and the extent to which the Israeli case is distinct, the chapter refers to other cases and similar phenomena around the world.

This chapter is divided into three parts. The first part analyses privatisation as a key process in the accumulation of wealth and power by a specific group of businessmen and families. The second part analyses the changing role of the banks in the political economy, including the privatisation of their assets. Finally, the third part analyses the new ownership structure, namely the transition from the old business groups to the new ones, which resulted in the concentration of the economy.

## 1. The Privatisation Process

### *Privatisation as a Key Process in Economies in Transition*

The historical approach to the concept of oligarchy discussed in chapter one helps to illuminate the process whereby power is transferred from the state to a business elite, enabling its accumulation of wealth. In return, prominent businessmen have influence on the state. The contemporary approach further illuminates the context of transformation as key to the formation of a specific type of an oligarchy. It focuses on the prevalence of business groups and their influence over the corporate governance system and policy-making, showing how government support of a rising oligarchy is exerted through tax cuts and subsidies, legislation, and policies responding to the dynamics of a concentrating market. The transformation conditions further accentuate the institutional structure enabling the consolidation of an oligarchy. The two approaches point to how the sources of the rise of an oligarchy are rooted in global processes of capitalism, most importantly privatisation and state policies favouring certain businesses and individuals. The role of the state, either by means of retreat and cooperation or, alternatively, weakness and subordination to the interests of the oligarchy, is central.

The root causes of transformation or transition of economies are often the spontaneous collapse of an old regime. In economic terms, the aims of the transition are generally believed to be attainable through privatisation of state assets with the aim of transition of ownership, interests and decision making to more efficient constituents. Privatisation is generally designed to boost economic efficiency, strengthen the private sector, narrow governmental involvement in the economy, and generate a developed capital market. Privatisation revenues can be used for other purposes, e.g. infrastructure or social purposes (Fershtman 2007:13). There are usually three active actors in a transformation process, and in the privatisation of state assets in particular: 1) the state (the representative government and top managers of the bureaucracy); 2) the bankers managing the transactions; and 3) the businessmen enjoying the benefits of the privatisations. Other interest groups that take part in the process include unions, such as banks union, industrial union, or the MIC union; the importance of these, nonetheless, is secondary.

Transitology literature generally views the rise of an oligarchy as largely rooted in poor institutional structure or 'missing institutions' (Shumilov and Volchkova, 2005; Boerner and Hainz, 2004; Lizal and Svejnar, 2002; Khanna, 2000; Solnick, 1998; Freeland, 2000). Rising oligarchs and business groups, empowered and invigorated during the transition and its aftermath, often supersede the role of state institutions in advancing economic growth, stability, trade in the international arena, and employment. The individuals who become oligarchs as a result of privatisation often emerge as

key actors in the process.<sup>44</sup> In such cases, the state is not the sole agent of privatisation and is dragged into the process by more powerful actors or external pressures; moreover, during the early stages of privatisation, the state loses control of the process. In most cases, therefore, privatisation is not the result of a power struggle between future oligarchs and the state. Instead, it is rooted in the close relationship between these parties, enabling businessmen to benefit from state support (and often vice versa, by enabling state officials to benefit from access to private business and capital networks), a closeness that ultimately mutates into a power reign defined as an oligarchy.

For example, in the privatisation programme that took place in Russia following the fall of the USSR, the state was weak, with "rotten leadership" (Hoffman 2002:67). In 1990s Russia, as well as in many other former Soviet states, in the absence of institutions to embed reforms in the market and the political economy as a whole, oligarchs (forming Financial-Industrial Groups - FIGs) took over this role (Boycko et al., 1995; Aslund, 2002, 2007; Perotti and Gelfer, 2001). Russia's privatisations were largely advanced and controlled by private actors, who in many cases were in official positions of power themselves (Freeland, 2000). The reformers leading the transformation, some of whom later became oligarchs, argued for the necessity of privatisation as a means of dividing shares to various groups of stakeholders (Boycko et al., 1995). While the massive privatisation was a well-intended reform conducted by the state officials, the state supervision and regulation was largely absent, thereby enabling the rise of the oligarchs.<sup>45</sup>

Schemes like 'Loans for Shares' and 'Voucher Privatisation' were the main instruments that facilitated the rise of the Russian oligarchs in the mid-1990s. These schemes were designed in 1995-6 to consolidate the financial support for Yeltsin's re-election bid in 1996 (Freeland, 2000).<sup>46</sup> A group of new Russian businessmen, including traders, bankers and business owners, were given a mandate to manage (temporarily) and control the country's companies in the natural resource sector, namely in oil, natural gas, timber, coal, metals and precious metals. Under the condition of 'loans for shares' schemes, while the management schemes were deemed only temporary, the companies in question were later auctioned off to private bidders. In these auctions, Russia's assets, heavily under-valued by global market standards, were sold for a fraction of their potential market value to the very same 'temporary' managers who had lent Yeltsin the money for the presidential campaign ("Sale of the Century", *The Economist*, May 1994, as described in Hoffman 2002:207). Bankers played a key role in the process. The bank auctioneers, supposedly acting on behalf of the

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<sup>44</sup>In Russia, for example, the chaos of transformation was largely led by six people, protégés of then President Yeltsin, who took over key industries: Mikhail Khodorkovsky - Yukos; Anatoly Chubais - electricity monopoly; Yuri Luzhkov - Khozyain of Moscow; Alexander Smolensky - banks; Vladimir Gusinsky - oil and Media; Boris Berezovsky - media and metals.

<sup>45</sup> Similarly, the poor institutional structure of many Latin American countries enabled the rise of oligarchies, who largely replaced the role of the state (Leach, 2005; Fogel, 2006).

<sup>46</sup>In this scheme, the government appointed a commercial banker to run an auction that would allocate a controlling stake of a large state resource or enterprise in exchange for a loan to the federal government, which they never intended to repay. The auctioneer could thus award the stake to himself for a nominal bid (usually, slightly above a low reserve price) by excluding all other bidders, even if the price they offered was more competitive. The advocates of the scheme argued that differently from other privatisations, money was actually paid, and most of the enterprises involved in loans-for-shares did extremely well, notably Yukos and Sibneft, which led the revival of the Russian oil industry (Aslund, 2004; Li-chen, 2008).

state, rigged the process and almost always ended up as the winning bidders (Goldman 2004: 35).

As it evolved since 1995-96, the Russian privatisation was not a straightforward give-away; instead, the Kremlin awarded the then-developing oligarchy a federal mandate to try and wrest control of some assets (Freeland, 2000; Goldman, 2004). The rising oligarchs were faster than other businessmen in taking advantages of the opportunities offered by market privatisation and liberalisation. Most importantly, they were connected to the political circles, receiving protection from the political leadership (Hoffman, 2002), often holding office,<sup>47</sup> or ending up being members of parliament.<sup>48</sup> While the oligarchs and the bankers themselves were key actors in the architecture of Russian privatisation, it was a process nonetheless directed by the state, requiring its support, the distribution of its assets, and its poor institutional structure to enable the take-over.<sup>49</sup>

In general, privatisation is a means to reform the economy, aiming for a more free and competitive model. No less important, it is a means to overcome economic and political crises. Privatisation in Russia was implemented because the state, in general, and the reformers, in particular, were interested in advancing a market capitalist revolution (Brady, 1999), but also because the Russian economy suffered a structural economic crisis in the aftermath of the Soviet Union's collapse (Shleifer, 2005). Specifically, President Yeltsin, together with the reformers, embraced a 'shock therapy' for the economy (Hoffman, 2002:184).

In Chile, to take another example, a massive privatisation was conducted under the dictatorship of General Augusto Pinochet. The neo-liberal reform, which was the basis of transition from military rule to stable democracy in the 1990s, utilising free market economic reforms, was largely led by capitalists and landowning elites (Silva, 1996, 1998). In other Latin-American states, privatisation was a means of implementing free-market paradigms (McKenzie and Mookherjee., 2003; Campello, 2002; Morley et al., 1999). These privatisations were backed by external pressures from the US, the World Bank and the IMF (Boycko et al., 1995; Woods, 2006; Williamson, 2000; Gomulka, 1995).

Poor institutional structure in transition economies is often associated with 'lawlessness' or corruption among politicians, bureaucrats (Shleifer and Treisman, 2000), and the judiciary (Kaufman and Siegelbaum, 1997). In Russia, corruption in the system largely concerned bureaucrats, or '*apparatchiks*' (Freeland, 2000; Hoffman, 2002; Goldman, 2004; Hellman, 1998). Corrupt institutions and dubious deals of questionable legality, often done in the shadows, facilitated the emergence of the oligarchy (Freeland, 2000; Hoffman, 2002). Corruption, furthermore, was often imperative to enforce contracts and secure property rights (Hellman,

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<sup>47</sup> Like Boris Berezovsky.

<sup>48</sup> Roman Abramovich is perhaps the most notorious but not the only example of a wealthy businessman rising to a position of political office.

<sup>49</sup> Often the oligarchs and the bankers were part of the same group structure, like in Yukos – the oil company of Mikhail Khodorkovsky and the bank MENATEP which belonged to the same group.

1998).<sup>50</sup> Rising oligarchs commanded private armies, manipulated elections, and essentially ruled the country. Some of them became politicians themselves (e.g. Luzhkov who was the Mayor of Moscow on two occasions). As a result, the reforms and privatisation of the 1990s were flawed to the extent that they actually created an unstable business environment (Byanova and Litvinov, 2003; Goldman, 2004).<sup>51</sup>

In Ukraine, the new oligarchs ‘bought’ politicians, judges and other officials as a result of weak property rights, a process termed ‘state capture’ (Hellman, 1998) that describes that ascendant influence of big businessman over the state. In Indonesia, the transition from Sultanistic oligarchy to electoral ruling oligarchies was undermined by weak legal institutions which could not replace Suharto's control, making the system more volatile, both politically and economically (Winters 2011: 192). Bribes were commonly paid to the police, legal system members, legislators, and media (ibid: 207). In effect, the rise of democracy without strong institutions prevented Indonesia from becoming a civil oligarchy (ibid). In the Philippines, control by the sultanistic oligarch (Marcos) over the police and the armed forces was crucial (Winters 2011: 199), and the armed forces were Marcos' personal instrument of coercion (ibid: 202).

In most cases around the world, then, sweeping privatisations have been key to the rise of oligarchs and the engine of their wealth accumulation (Hoff and Stiglitz, 2004; Goldman, 2004). Traditionally, a fundamental source of accumulation and concentration of wealth is the sudden achievement of great economies of scale in certain industries, especially metals, oil and railways (Goldman, 2004; Aslund, 2002, 2007). This was seen in the US during the industrialisation that followed the Civil War, where the take-over of state resources, such as rubber and railroads, was an important cause of the immense wealth accumulation by a small group of tycoons at the turn of the 19th century (Winters, 2011). The same phenomenon was also seen in Russia and Ukraine in the post-USSR period, with the take-over of oil and metals in Russia, and the steel industry in Ukraine (Aslund, 2004). Accumulation, in general, has been facilitated in resource-rich countries with large markets and rapid structural change.

Nonetheless, while the consequences of liberalisation and privatisation enable the ascent of oligarchy to power, such process may involve higher levels of state control. In fact, the rise of oligarchs is typical to middle-income countries in transition (Shleifer, 2005), parallel to the increasing economic presence and power of the state. Russia is an illustrative case of increasing state power following market liberalisation. Parallel to the rise of the oligarchs during the 1990s,

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<sup>50</sup>Key institutional structures such as the Communist Party and the central planning system were dismantled, and the new entities that emerged, such as the presidential administration, the State Committee for the Administration of State Property, and regional governors, were pushed to expand their effective zone of control (Rutland, 2009).

<sup>51</sup>Western observers were initially uncomfortable with the rise of the oligarchs, whose ascendancy coincided with a wave of lawlessness, assassination contracts, and displays of wealth. However, Western economists soon started arguing that the oligarchs were playing a key role in creating the Russian market economy (Guriev and Megginson, 2007).

Russia became much more integrated in the global economy. In the first period of liberalisation, in 1992, a multitude of independent economic actors emerged. The centralised, command economy was dismantled; 70% of economic activity occurred in legally independent private corporations, and price controls on most goods were abolished (Rutland, 2009). The consolidation and internationalisation of the oligarchs in 1994-96 was sustained by increasing macroeconomic stabilisation. However, while large sections of economic activity gradually opened, the Russian economy was only partially liberal, parallel to a thriving barter economy (ibid). Russia entered into a period of severe economic crisis in 1998-1999. Vladimir Putin's rise to power in 2000 was characterised by his reassertion of statism.<sup>52</sup> His regime has shown a higher level of state control, sustained by memories of earlier economic crises (Sawka, 2010; Shevtsova, 2007; Hanson, 2007; Putin, 2006). Still, growing state authoritarianism was not detached from the process of 'oligarchisation', but rather, defined its transformation: in the 2000s Russia, the oligarchs have been made 'equa-distant' from the more powerful state apparatus, while some new groups, namely the *siloviki*,<sup>53</sup> acquired both political posts and assets (Bowder 2014; Dawisha 2014; Ledeneva 2010).

To take another example, the transition of the richest Eastern European countries — Slovenia, Czech Republic, Poland, Hungary, Slovakia, and Estonia — from state socialism to capitalism has exhibited high levels of privatisation and ascending participation in the global economy (Lane, 2007). The leaders of these countries have embraced the capitalist system, and the maximisation of economic performance was not viewed as mutually exclusive to the promoting of their political objectives and the furthering of their political dominance (Bremmer, 2010). This practice gave rise to the phenomenon of 'state capitalism' (ibid). In contrast, the poorer group of states had an unsuccessful period of transition (ibid). The entrenched power of oligarchs aligned with increasing state control, witnessed in Latin America (Dornbusch and Edwards, 1989) and in other countries in the former Soviet Union, notably in Kazakhstan, Turkmenistan, Belarus, Uzbekistan and Georgia, was not common in very poor countries like Kyrgyzstan and Tajikistan (Aslund, 2002), where the state remained weak.

### ***The Big Privatisations in Israel***

As demonstrated in the previous chapter, in Israel the 'old' big business groups (or the 'big businesses') consolidated, beginning in the late 1960s and intensifying during the 1970s. Directed by the state, this process was designed to stabilise the market economy, serve the market's changing needs, generate growth within the Israeli economy, and, to a certain extent, improve interactions with the global arena. During this period, the privately and publicly owned business groups were strongly

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<sup>52</sup> Putin announced plans for a radical overhaul of his country's political system, with the goal of enhancing the Kremlin's power (Buckley and Ostrovsky, 2006).

<sup>53</sup> Most commonly referred to as the FSB (former KGB).

linked to the state. The Histadrut was a powerful actor with vast holdings. The structure of the old business groups, as well as that of the Histadrut, merged financial and industrial holdings. They diversified their financial portfolios, while substituting personal guarantees with artificial government insurance. The state, in turn, still controlled capital allocation from both internal and external sources. Following the 1983-4 economic crisis, however, the old business groups were destabilised.

In the aftermath of the 1985 EESP, the government implemented deep reforms in the market. No official announcement was made about the precise policy measures or the general timetable for the process (Bufman and Leiderman, 1995). The two main aspects of the reforms liberalising the economy included lifting finance and trade restrictions, and massive privatisation of state-owned and Histadrut-owned companies. The process of market liberalisation started de-jure in 1985 and de-facto in 1987, proceeding in a slow and gradual mode until present day. The process of privatisation, carried out with the aim of increased economic efficiency (Fershtman, 2007: 13), began in 1986. However, by the mid-1990s less than a dozen of the government enterprises indicated in the 1988 First Boston Corporation Bank report were privatised. This was the result of political pressures, the resistance of the Histadrut, and bureaucratic inefficiency (Doron and Adiri, 1994; Katz, 1997). In total, between 1986 and 2007, 94 companies were privatised, although the government still held partial control in some of these companies.

The privatisation, as a part of the broader liberalisation of the economy, was initially advocated by some members of the business elite, which at the time was composed of the business groups and other powerful, politically-connected industrialists. Interestingly, the people who convinced the government to privatise its assets did not become oligarchs afterwards (although they too benefited from the market liberalisation). One of the most prominent examples is Dov Lautman, a businessman and entrepreneur in the textile industry. He was one of the businessmen advocating the market transformation, and later the peace process with the Palestinians (Ben-Porat, 2004), acting on the objectives of economic growth and increased profits.<sup>54</sup> After moving his factory's production to Jordan following the 1993 Oslo peace process and the 1994 agreement with Jordan (Ben-Porat, 2004), Lautman was one of the great winners of market liberalisation and could obtain 'peace dividends' (Nitzan and Bichler, 2001). He profited from the market liberalisation because he could expand his existing businesses (e.g. Delta), based on competence in the global market economy. Similarly, the hi-technology industry that thrived during the 1990s, as elaborated in the previous chapter, is an example of market liberalisation enabling actors to compete and succeed in the global arena. All the same, Lautman, an actor in the free market and an agent for advancing it, was not one of the businessmen that benefited from the privatised assets, in contrast to actors that profited from

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<sup>54</sup> Ideological-political motives are less relevant to this analysis.

privatisations conducted in a biased and non-competitive fashion. These actors turned into rent-seekers whose primary interest was to circumvent competition, as explained next.

The way the privatisation was conducted, transferring state assets to a narrow number of actors, helped preserve previous patterns of state-big business relationship (Kosenko and Yafeh, 2010; Maman, 1997, 2006; Aharoni, 2006). The state preferred to establish centralised cores in the market rather than broadly decentralising its holdings, for example by issuing shares in the Tel-Aviv Stock Exchange (TASE). Furthermore, since there were only a few potential buyers for the assets of the state, privatisations were bound to be conducted on a narrow scale. Several wealthy families and businessmen, drawing on good connections with political decision-making circles, and their understanding of the opportunities offered by the reformed market, obtained assets previously owned by the state, as well as national resources, at the expense of an evenly balanced distribution to the public (The 2012 Committee to Examine Crony Capitalism in Israel, henceforth Committee, 2012).<sup>55</sup> The controlling owners of the new business groups consolidated during the 1990s had a clear preference to purchase old, stable, and monopolistic state and Histadrut businesses. The function, mode, and identity of the key actors in the business sector, and more particularly the business groups, started to change. Therefore, while the market was indeed opening to competition in some sectors, the EESP did not generate a significant change in terms of market concentration.

The first substantial wave of privatisation took place during the 1990s and centred on the assets of the state and of the old business groups, including the banks and the Histadrut. The biggest privatisations were Israel Chemicals (ICL), Koor, IDB, and Clal. The more intense wave of privatisations took place at the end of the 1990s and during the first years of the new millennium. Arutzei Zahav Cable Company was sold to the Fishman Group, controlled by Eliezer Fishman, in 1999, a transaction completed in 2001 (Gabison, Haaretz, 2003).<sup>56</sup> The privatisation of Shekem (Military Chain Store) was completed in 2001, to the Elco Group owned by Gershon Zelkind, who also purchased Electra (electronics manufacturer) and then merged the two. Bronfman Alon Group purchased the Blue Square supermarket chain in 2003 (Levi, news1, 2003). Zim, the shipping company, was sold to the Ofer family in 2003. El Al, the national air carrier, was sold to the Mozes family between 2003 and 2007. The Haifa Oil Refineries, privatised between 2003 and 2007, were sold to the Ofer family, while the Ashdod refineries were sold to Zadick Bino in 2006. Sonol Fuel Company and Tambour paint factory were sold to the Azrieli Group (through his company Granit Hacarmel) in 2006. Other state-owned or Histadrut-owned assets were sold to private hands, mostly to business groups controlled by wealthy families.

In contrast to other cases, privatisation in Israel did not feature an atmosphere of 'lawlessness',

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<sup>55</sup> The particular mechanisms, informal but important connections and social ties, are analysed in detail in chapter 5.

<sup>56</sup> This transaction followed Fishman's purchase of Mivnei Taasia, a governmental real-estate company, in 1993.

institutional corruption, or flagrant abuses of power. Bribes were never prominent, and as far as is known, illicit payments did not play a significant role in the emergence of the oligarchy (Navot, 2012). While the rise of the new business groups and their accumulation of power betrayed the common good, it was a fairly 'grey' activity, not automatically indicating the violation of any laws (Committee, 2012:19). Moreover, clashes between the regulatory system and the political circles (such as the privatisation of Zim, as detailed next) were not concealed (ibid), indicating transparency and the prevailing rule of law.

The process of privatisation in Israel did, however, feature institutional deficits and bureaucratic failures, eventually enabling the rise of the oligarchy. Therefore, while we cannot talk about corruption, the exploitation of the new economic conditions and the sacrifice of the public interest are relevant (Johnston, 2014). What enabled the rise of the Israeli oligarchy, and what distinguishes it from other wealthy actors within the market, was the intermediated and state-directed accumulation of wealth and power. The following section analyses five indications of institutional and bureaucratic failures embedded in the way privatisation was conducted: failure to generate competition in the market by transferring assets to only few parties, discriminatory taxation policies and state withdrawal from royalties, whole-scale transfer of monopolies, bureaucratic hurdles, and influence of the consolidating oligarchy on the process of resource allocation. These led to the concentration of the market and its control by a narrow number of individuals and families enjoying privatised state assets, resulting in the rise of the Israeli oligarchy.

First, privatisation in Israel was not characterised by decentralisation of control and did not account for competition in specific sectors or in the broader market (Katz, 1997; IDI, 2010a). Instead, only a few new business groups had the opportunity to take-over state and Histadrut assets, usually under extremely beneficial conditions for the purchasers (Maman 2008). The privatisation of Koor, for example, which was particularly significant because of the company's size, illustrates how the big privatisations eventually resulted in control by a small group of individuals and families. In 1985, Koor, under the control of the Histadrut, generated 12.6% of Israel's GDP. It employed 11% of the industrial labour force and accounted for 13.8% of the industrial exports of the state (Maman, 2002; Grinberg, 2004). During the years following the EESP, however, Koor sustained major losses (a loss of \$250 million in 1987, debt of \$1.2 billion to banks, including \$300 million to foreign banks; Gaon 1997: 22). The losses substantially increased following the EESP as the stagnation in the exchange rate eroded exports, and sales to the MIC declined (ibid: 26). It was then sold to Shamrock Holdings, owned by the Disney family. Under new management, it issued shares on the *NASDAQ* Stock Market during 1995 (Gaon, 1997). Koor changed owners several times after that. Beni Gaon, the CEO of Koor from 1988 to 1998, described how the process of the Koor's privatisation illustrated who were the central actors in the business elite at the time; top

lawyers, bankers and accountants were all involved in the sale (such as accountant Gad Somech and the lawyer Igal Arnon - Gaon, 1997). Eventually, in 2006, the Claridge Group, owned by the Bronfman family, sold its shares in Koor (31% for \$394 million) to Nochi Dankner, who controlled IDB Holdings (Pauzner, Bizportal 2006).

As for IDB, in 1991 the state sold the controlling stake of IDB (37%) to an investors group led by the Recannati family, for \$230 million. A more marginal share was sold to the Karaso family. The state held the remaining shares of IDB (42.5%), which were then sold to the public in 1992 for \$344 million. Clal merged with IDB in 2000 (Shalev, Globes, 1999). Other collections of firms experienced a similar consolidation into business groups during this period (Maman, 2006b: 119). IDB was sold to Nochi Dankner in 2003 (Zelekha and Zur-Neiberg 2007: 5); this will be discussed further in the next chapter, when I discuss the stage at which the oligarchy became an informal economic institution.

Second, important state policies underlining the rise of an oligarchy were discriminatory taxation policies and state withdrawal from royalties. Reduced taxes for big corporations are designed to stimulate their activities, and are a crucial element of the neo-liberal order. The way it is used by the state, however, can be discriminating. In Northern Europe, for example, despite the increasing intervention of democratic politics in the economic sphere, the oligarchs' wealth defence strategies ensured that they remained intact and unburdened by the high cost of welfare states (Winters 2011:278-9; Karhunen and Keloharju, 2001; Kenworthy, 2009). Similarly, in Israel, taxes imposed on the new business groups were significantly lower because of privileged taxation policies and the failure of the state to charge the equivalent tax or dividends. The stimulating corporation tax was accompanied by expanding inequalities in society (Knesset, 2012); consequently, the new business groups paid less taxes (Arlosoroff, 2013b), which were simultaneously raised on lower stratas. The relatively equitable distribution of income during the 1970s was replaced by growing income inequality—the Gini index of inequality of economic income rose by 7 points between 1979 and 1997 (Dahan, 2002).<sup>57</sup>

The privatisation of ICL is a clear demonstration of discriminatory taxation and state withdrawal from royalties. During the 1990s, ICL was a loss-making company, with no investors interested in purchasing it.<sup>58</sup> In order to sweeten the bargain, the state guaranteed not to raise extraction royalties, and standardised them at 5% of potash revenues. There was, however, an exception: if ICL managed to extract over 1 million tons of potash a year, the state was entitled to royalties of 10%. The privatisation of ICL was initially conducted in 1992 on the Tel-Aviv Stock Exchange, where the state sold 20% of ICL's shares. The estimated value of ICL was \$650-700 million according to First

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<sup>57</sup>The Gini coefficient index is a measure of distribution inequality. It is defined as a ratio with values between 0 (equal distribution) to 1 (unequal distribution).

<sup>58</sup>Established in 1968, ICL was one of the only companies extracting Israel's limited national resources, mainly minerals from the Dead Sea.

Boston, whereas 'Economic Models' company estimated it was worth \$1.25 billion (Fershtman, 1992:70). In 1995, Shaul Eisenberg, through the Israel Corporation Ltd. which he controlled, purchased a controlling stake in ICL (24.9%) for \$231 million. Although he held less than 25% of ICL shares, the state awarded Eisenberg full management authorities (Adva 2006: 11). The state subsequently gave up its rights to collect the excessive royalties of 10%, until the end of the concession in 2030 (Hovel, Calcalist 2010). The reason for doing so was to prevent ICL from making more demands from the state concerning infrastructure; however, the section in the law allowing ICL to make such demands was eliminated in 1995 (NEVO 1995: 128-130).

In 1997, the state sold another fraction of its shares, 17% for \$ 200 million to Eisenberg and the Israel Corporation Ltd.; ICL was still a losing company at the time. In 1998, 30.74% of the shares were sold to employees and former employees of ICL (GCA, 2005, privatisation appendix). In the same year the Eisenberg family sold their shares in The Israel Corporation Ltd. (53%) for \$330 million to the Ofer family (Adva 2006: 11), a transaction completed in April 1999 (Raviv, Globes 1999).

During the 2000s, ICL had strong revenues (TASE - ICL, 2002-2010) stemming from the global bonanza in the price of Potash. This meant that the Ofer group made an immense profit on a national resource, while the royalties to the state stayed the same as in the 1990s. The state, as a result of its withdrawal from the original royalties' agreement, lost \$180 billion (Hovel, Calcalist 2010). In addition, similar to other big companies during the second wave of privatisation in the new millennium, ICL enjoyed a reduced corporate tax, with the aim of boosting growth.<sup>59</sup> As of 2014, the Israel Corporation Ltd., under the Ofer group, holds 52.29% of ICL, the public holds 33.67% and the rest is held by shareholders (ICL in TASE). The state has reduced its holdings to zero, but still holds a golden share (providing the state the ability to outvote all other shareholders in specific circumstances).

Third, as seen in these transactions, the government policy was to transfer state monopolies to private interests intact, without reducing their hold on their respective markets. Monopolistic markets were not opened to competition during the privatisation process, enabling the state to preserve the monopolistic stance. In the aftermath of the 1985 reforms, the government determined the degree of competition and the number of actors which could access markets, and chose to privatise the monopolies as such. The reason for this policy was that the Ministry of Finance wanted to maximise the revenues from the privatisations—a sale of a monopolistic firm, rather than a competitive firm, is more profitable. Furthermore, when markets were eventually opened to

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<sup>59</sup>In May 2013, the Calcalist economic journal (see Amsterdamsky and Avital, 2013) revealed a section in the state Revenue Division showing that in the years 2003-2010 there was a growth of 140% in tax incentives awarded to big companies under the framework of the 1959 Investments Promotion Act (from 2.3. to 5.5 NIS billion a year), whereas the big companies benefiting most from this policy are Teva, Check-Point, Intel and ICL, already controlled by the Ofer Group.

competition, the big actors in the market were allowed to merge. In short, the state monopoly became a private monopoly, while the state failed to predict the problems in transferring its assets as monopolies or cartels, and to specific businessmen. Such controversial transfers of assets maintained power within the same circle of people, narrowing the state-big business cooperation at the expense of the wider public interest. Competition was thus limited.<sup>60</sup> Only since the mid-1990s, with the intensification of market liberalisation and privatisation, has the paradigm shifted from regulating monopolies to preventing their formation.

The privatisation of the National Oil Refineries helps elucidate the preference of the state for transferring control of a monopoly to specific individuals, rather than to dismantle it and distribute it among many, for example, through the stock market (Zelekha, 2008; GCA, 2006). The privatisation was carried out in phases. In May 1971, the state transferred 26% of its shares in the National Oil Refineries to the Israel Corporation (which had received a 70 years mandate, issued in 1933, to operate the oil refineries in Haifa and in Ashdod), under the ownership of the Eisenberg Group. The Eisenberg Group had a primary right of refusal if the state wanted to sell the rest of the shares to other actors (The State Comptroller and Ombudsman, 2000:354-5; The State Comptroller and Ombudsman, 2001: 337-8, 375). In 1988, the government agreed for the first time to privatise the oil refineries. In August 1999, it decided to privatise the Ashdod and the Haifa refineries separately, in order to create competition. The right of refusal was cancelled (*ibid*). In 2003, at the end of the mandate, rather than transferring the assets back to the state, the Israel Corporation demanded payment from the state, receiving ILS 667 million (The State Comptroller and Ombudsman, 2003 :329-333).<sup>61</sup> It was not till 2004 that the oil refineries in Ashdod were separated from those in Haifa. The latter was to be issued on the stock market, whereas the former was to be sold to a private investor. In 2006, Zadik Bino, through the Paz Company, gained control of the Ashdod Oil Refineries for \$3.5 billion (Adva, 2006: 15). This privatisation has enabled a duopoly in the market economy. Bino himself has criticised the privatisation, arguing that state' assets and resources should be issued in the stock market, for the wider public (*ibid*).

In a similar way, the privatisation of Zim illustrates how state monopolies were privatised at the expense of the broader public interest. It has since been described as 'a historical mistake'. In 1970, the state sold half of Zim shares to the Israel Corporation Ltd., with a primary right of refusal to the sale of the rest of the shares of the state (The State Comptroller and Ombudsman, 2002: 339).The state decided to privatise Zim in 1992 and again in 1997, but those privatisations were not carried

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<sup>60</sup>In interviews for this research, several bureaucrats indicated that there has been tight cooperation between government ministries and the new controlling interests of the monopolies; this cooperation was often a hurdle to the activity of the antitrust authority.

<sup>61</sup>Furthermore, additional block-holdings acquisitions by family groups have been made, including in companies where they already have a controlling stake. For example, the Ofer Group acquired an additional ILS 100 million holding in Israel Chemicals, in which it already held a greater than 50% interest (Globes, April 2, 2008).

out due to increasing losses during these years (ibid: 350, 353). By the end of the 1990s, 48.9% of the shares were controlled by The Israel Corporation Ltd., and 48.6% was under state control; the rest of the shares were owned by private investors (ibid: 343). In 1999, the Ofer Group bought shares of the Israel Corporation Ltd., thus obtaining control over Zim (ibid: 355). The state rights over Zim were damaged as a co-owner (ibid: 349). In 2000, the state decided to sell its shares. The Israel Corporation Ltd., controlled by the Ofer Group, was the sole buyer of the 48.6% owned by state, instead of privatising to different shareholders, or, moreover, to the wider public (ibid; Adva 2006: 13). In addition, the price that the Israel Corporation paid for the shares of the state was ILS 504 million, at the bottom of the estimated value range provided to the Governmental Companies Authority by experts (The State Comptroller and Ombudsman, 2005: 1081).

Fourth, privatisation and the opening of the market to greater competition featured bureaucratic hurdles and burdensome regulation on companies, including monopolies, which, instead of increasing the level of competition in the market, ultimately hindered it. An example of these bureaucratic hurdles is evident in the reform of the communications market, whose telecommunications and communications infrastructure was dominated by the Bezeq monopoly (the national telecommunication operator, which was established in 1984 and was controlled by the government until its privatisation). Since 1991, before the privatisation of Bezeq, the Ministry of Communications (MoC) has tried to open the communications market to competition. A MoC Committee in 1991, the Boaz Committee, recommended changing the market's monopolistic structure and easing the strict regulatory regime.<sup>62</sup> In 1996, as the communications market was still not open to competition, another MoC Committee was appointed and recommended opening the market to competition by providing operating licenses for telecommunication and infrastructure to external actors in a defined timeline of 1-3 years. It initially recommended access of only a few actors to the market, which would expand to full competition later (MoC Committee, 1996: 4).

In 1998, Bezeq was no longer a monopoly in the international calls market, with the entry of Kavey Zahav and Barak to the market. In 2001, MedNautilus, a submarine telecommunications cable system, linked Israel to the internet, allowing for an internet-based telecommunications system. In 2002, another MoC Committee, the Karol Committee, recommended removing barriers to entry in the landline telecommunication market, opening the infrastructure to competition, rather than allowing only standing users to operate (MoC Committee, 2002: 5-7). The committee specified August 2004 as the deadline to apply the reforms. There were three more operators in the international calls market in 2004. However, in the cable market, the Minister of Communication at the time, Reuven Rivlin, decided that these steps would not be applied before 2005. This was meant to allow operating cable companies enough time to merge and prepare for the competition (Horesh,

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<sup>62</sup>David Boaz, who headed the committee, termed the Israeli regulation as a dictatorial regulation system in a 2001 interview (Landau, Globes, 2001).

Haaretz, 2003); however, this merger was not implemented until 2007.

Fifth, the influence of the consolidating oligarchy on resource allocation led to an institutional deficit in the privatisations process. The transfer of monopolistic power led these specific families and individuals to activate strong lobbies (Navot, 2012; Zelekha, 2009). In a flexible climate of regulatory change, they could obtain a certain degree of influence on resource allocation, as well as access to capital. While Israel's rising oligarchs never pursued any political trend or movement, their political presence was strongly felt in the allocation of the state assets. Israel, although not as rich in natural resources as other states going through transformation, nonetheless exhibited similar patterns of narrow asset dispersion.

The privatisation of Bezeq is very intriguing in itself, pointing to how specific businessmen had privileged access to finance, exploiting the new conditions of the debt market to obtain control, without equivalent personal guarantees. In 1999, Gad Zeevi purchased 19.6% of Bezeq shares (from Cable & Wireless Communications, a British telecommunications company, which entered the market as a partner of Bezeq the year before), for \$643 million (Raz, 2009; Schon, 2011). The sum was raised using loans from a consortium of seven banks (Hapoalim, Leumi, Fibi, Discount, Igud, Mizrahi-Tefahot and Mercantile-Discount). In 2000, Zeevi was given another loan of \$90 million. The guarantees of \$143 million were provided by Michael Cherney, a Russian oligarch. The privatisation of Bezeq was supposed to take place at the beginning of the new millennium, but was delayed. Zeevi, therefore, could not return the debt, and in 2002 the banks filed an appeal for receivership of 17.75% of the total shares. Between 2002 and 2005 the state remained the controlling stakeholder. In 2005 the company was privatised, sold to the Apex-Saban-Arkin group of Haim Saban, Mori Arkin, and the Apex Partners investment fund. They purchased 30% of Bezeq's shares for \$972 million (Horesh, Haaretz, 2005). The public was left with 35.87% of the shares (ibid). Zeevi and the banks engaged in a legal process regarding the interest rate charges on the unpaid debt (Raz, 2009; Schon, 2011). The banks claimed the returns, while Zeevi argued that it was only due to the delayed initiation of the privatisation that he could not repay the debts on time. In 2008, despite the global financial crisis, the shares' price came close to the debt. The receivership process ended seven years after it started, in 2009, when Bezeq shares were sold. Zeevi, despite his heavy debts to the banks and the long legal process, received ILS 500 million as his takeaway (ibid).

The sale of the Israel Salt Industry Companies (Navot, 2012; The State Comptroller and Ombudsman, 2001; Globes, 2010; Calcalist, 2013) further illustrates the influence of these businessmen and wealthy families on the process of resource allocation. In 1957, the Dankner family purchased Israel Salt Industries Ltd. In the framework of this transaction, it leased land, 1300 dunam in Atlit, originally given to the company for the purpose of establishing a salt production

factory. It also had leasing rights for land in the Eilat area, 1805 dunam in total. During the mid-1990s, Shmuel Dankner, the owner of the company, asked to change the land designation to real-estate and tourism. This aligned with the interest of Israel Land Authority to develop these grounds in order to increase real-estate supply. Two issues stood between the Dankner family and The Israel Land Authority: whether the former was to return the land to the latter, and whether the land designation would be agricultural or urban (Navot, 2012: 331-2). In June 1996, after long legal correspondence, both parties signed an agreement. According to the agreement, the ground designation would be changed to real-estate and the Dankner family would receive 50% of the construction rights in Atlit and 30% in Eilat. The whole process was based on specific bureaucrats' promises to the Dankner family, while their authority to do so was not clear, and was not backed by equivalent scrutiny. The decision was obtained only one day after an agreement between the Head of The Israel Land Authority, Uzi Wexler, and the Dankner family (ibid). An inspection of the ground designation was never completed for the public's interest. The state assets were transferred to an individual under favourable conditions, without public bids, but with substantial rents on state assets, enjoyed by one family.<sup>63</sup>

In summary, the privatisation process in Israel was carried out in a manner that led to the rise of oligarchy not because of poor institutional structure; rather, the rise of oligarchy resulted from the active management of the state of the market transformation. This points to the dominant role of the state in the accumulation of wealth and power by specific business groups and wealthy families. Unlike in some other countries, the privatisation of state assets was done with the purpose of preserving the basic structure of few big economic actors – but this time they were private ones. It was most often conducted through individual deals, not open to the wider public or even the business sector. It featured, besides preferences for specific businessmen or business groups, clear patterns of state withdrawal from royalties, provision of concessions for decades, and sometimes lack of fair concessions or public bids at all (Committee, 2012). Discriminatory provision of loans was also a factor (ibid). The privatised assets became the basis of the new, consolidated business groups, which gradually took over the market economy and formed the Israeli oligarchy.

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<sup>63</sup>This analysis does not include the corruption aspect, as it is less relevant than the structural mechanism of transferring control to strong parties. For more about corruption and the procedural steps taken against individuals involved in these transactions see Navot, 2012.

## 2. The New Finance Capital in Israel: the Role of the Banks

The dominance of banks in political economies, in general, and in economies in transition, in particular, is manifested on three levels – ownership over real assets, credit provision, and intermediation in key transactions, including the necessary regulatory functions. The tight linkage between the power of the financial sector over the industrial economy, access to credit, and market centralisation were most prominently featured in analyses carried out in the aftermath of the 2007-8 global financial crisis, that mainly focused on the power of the banks in the political economy (Ivashina and Scharfstein, 2010; Taylor, 2009; Bernanke, 2007; Dewatripont et al., 2010; Beltratti and Stulz, 2009). These analyses highlighted the extent to which banks have come to dominate contemporary economies. However, the powerful position of the banking sector in the economic systems is hardly a new phenomenon. Hilferding used the notion of 'finance capital' to describe a powerful fusion of financial and industrial capital as a nucleus of oligarchic power (as examined in Chapter one); for the most part of the 20<sup>th</sup> century, banks and their support have traditionally played a key intermediary role in the relations of the state with the private sector, particularly with respect to big corporations or business groups. In the 1980s and 1990s the banks were key actors in market reforms in the so-called emerging markets.

In transitional economies, banks were both a source of wealth for the rising oligarchs and a means to conduct the transformation of ownership of the assets. In post-1991 Russia, rising oligarchs took over national banks. Most of the Russian oligarchs headed private corporations, which were formed on the basis of former state enterprises, including the banks. Indeed, a large part of the first wave of oligarchs was concentrated in the banking sector, building financial-industrial groups - FIGs (Freeland, 2000; Goldman, 2003). The banks could then engage with emerging oligarchs in high-stakes, quick turnover deals that yielded enormous profits (Hoffman, 2002:48). The rationale behind it was similar to that behind privatisation in general – creating a strong control core (Jacobson 2002:36). In contrast, some states, like South Korea, have not allowed business groups to control financial corporations. There, the domestic business groups, *Chaebols*, can control retail and industrial assets, but cannot have a hold over the banking system (Maman, 2002).

The lending policies of the banks were central to the transformation, in particular to privatisations. In transitional economies, such as Central and Eastern Europe and, later, in the Balkans, commercial banks became a central vehicle behind the privatisation of state assets during a period of privatisation and restructuring. They rapidly expanded their lending to the private sector (Cottarelli et al., 2005) and served as intermediaries in natural resource exports, exploiting currency arbitrages. The identity of the shareholders of the banks and the nature of the holdings of the banks are therefore of great importance. If these holdings were shared with other businessmen, the credit

provision policies might have been biased in favour of specific owners, independent of economic rationale. Aoki and Kim (1995), examining transitional economies, argued that banks can play an important regulatory function, providing corporate governance and enabling stockholders to exercise corporate control. Conversely, the banking sector itself is much more regulated (Jacobson 2002:32), suggesting that the state has a critical role in the allocation of power to the banks.

### ***The Dominant Role and the Privatisation of the Israeli Banking Sector***

In Israel, parallel to the privatisation of state and Histadrut assets, changes in the banking sector were a key turning point in the evolution of national political economy. The EESP ended the practice of directed credit in local currency and significantly reduced the foreign currency credit provided by various state-run funds. By 1991, the entire system of state-directed credit was abolished and the methods for raising capital changed. Following these changes, external financing through equity underwritings in stock markets increased significantly, both in Israel and abroad. Raising capital abroad has become a more widely used financial instrument and has been more significant in Israel in comparison to other states (Yafeh and Yosha, 1996: 605-6). In addition, the early 1990s witnessed a large wave of Initial Public Offerings (IPOs) on the Tel Aviv Stock Exchange, as about 130 manufacturing firms went public during the period 1991-1994 (Ber et al., 2001: 195). Government funds remained central to financing domestic industrial firms in the years after these reforms, but the government's role in the financial market contracted (Yafeh and Yosha, 1996).

Despite the increase in external finance during the 1990s, banks continued to play an unusually dominant role in the Israeli financial sector as a whole (Blass et al., 1998). Banks remained key actors in credit allocation to business, replacing state provision of corporate funding, and were the exclusive credit providers to households (Yafeh and Yosha, 1998). The banks had no significant competitors in credit provision, through the stock market, and increasingly dominated all segments of the capital market (Yafeh and Yosha, 1996). They were engaged in underwriting securities, managing mutual and provident funds, and in brokerage activities (Ber et al., 2001: 191). They owned equity in firms, directly as well as through their funds. They thus controlled large segments of manufacturing, construction, insurance, and services (Blass et al., 1998). The banks were also heavily involved in the IPO wave, both as underwriters, including the banks' affiliated underwriters, and as buyers of large blocks of the issued equities, mainly through bank-managed investment funds (ibid). In about 75% of IPOs, out of a total of 128 sampled, a bank-affiliated underwriter was one of the leading members of the underwriting consortium. For approximately one-third of the firms, a bank-managed fund purchased at least 5% of the equity of the newly-issued firm (Ber et al., 2001: 195). The dominance of the banks in the market economy meant that several important

mechanisms of corporate governance were missing, such as an effective market for corporate control and a sufficient incentive for institutional investors to monitor managers, designed to improve firms' performance and increase shareholders' value (Blass et al., 1998).

While the liberalisation of the financial sector reduced distortion in the resource allocation process (ibid: 605, 607), it did not abolish it. As a result of the central role of the banks in the financial sector and the market economy in general, as well as their tight linkage to companies, credit bias was almost intrinsic to the issuing process. Similar to other states, the continuous dominance of the banks reflected their deliberate attempt to restrict competition in arm's length capital markets, by strengthening bank-firm relationships (Yafeh and Yosha, 1998). This way, certain firms could enjoy the combination of both bank lending and stock underwriting. The advantages enjoyed by the affiliated firms, nevertheless, came with built-in potential for conflicts of interest, as the banks tend to favour client firms over fund investors (Ber et al., 2001).

Moreover, firms' affiliation to banks was associated with lower market performance. In three main investment categories, the average annual revenues of the forty one provident funds, most of which were owned by the five big banks, were substantially lower than the average revenue in the market between 1987 and 1994 (Blass, 1996). Unlike firms benefiting from the custody of the banks, companies listed in the US were young and innovative. High-quality, innovative firms were willing to incur the additional costs associated with listing in the US in order to reveal their actual value and distinguish themselves from firms that issued stocks in Israel and rely on their proximity to the banks (Blass and Yafeh, 2000).

In addition to the power of the banks over the economy, the banking system itself was highly concentrated. It was dominated by the five big banks (Hapoalim, Leumi, Discount, Mizrahi-Tefahot and FIBI), but during the 1990s the two biggest banks (Hapoalim and Leumi) held 64% of the banks' deposits, extended 66% of the bank credit, serviced 66% of the bank accounts, and managed 63% of trust funds assets and 65% of provident funds assets (The Brodet Committee, 1995: Appendix A; Bebchuk et al., 1996:645, 653). As will be analysed below and in the next chapter, this concentration in the banking sector has not changed significantly in the last couple of decades.

The main point of change in the banking system, key for understanding the rise of the oligarchy, was the adoption of the recommendations of the Brodet Committee, published on December 1<sup>st</sup>, 1995. The Brodet Committee acknowledged that the power concentration of the Israeli economy, especially in the financial sector (dominated by the two biggest banks – Hapoalim and Leumi), damaged the public interest as a whole, and that of consumers in particular (Brodet, 1995: 1; Bebchuk et al., 1996). As the non-financial sector was also concentrated, dominated by IDB and the Eisenberg Group, the merger between the financial and industrial sectors was more acute because of the concentration of wealth and power (Bebchuk et al., 1996).

In four out of the five banking groups the state was the main owner.<sup>64</sup> The government wanted to privatise the banks, and at the same time not make the market more concentrated. Embracing the conclusions of the 1986 Bejsky Committee, the Brodet Committee stipulated that banks would be prohibited from controlling real assets and forced them to sell their control in all real enterprises. The banks were required to reduce their holdings in any Israeli non-financial company to a maximum 15% of their capital and were required to report any investment in domestic non-financial companies that exceeded 5% of the outstanding equity to the Bank of Israel (Brodet, 1995:9). In addition, the committee recommended that Hapoalim Bank should sell its ownership of one of the two strong industrial corporations – Koor and Clal – but not to Leumi Bank, IDB or The Israel Corporation (ibid: 20).

The government adopted the committee's recommendations and from 1996 the banks started to sell their industrial holdings. Nevertheless, the way the state managed the recommendations of the Brodet reform, similar to its management of privatisation, effectively engineered the re-establishment and invigoration of the new business groups. The privatisation of the various components of the banks – the real holdings and the ownership shares of the banks themselves – was symptomatic of how privatisation was generally carried out in Israel, allowing only a small group of families to take over assets once owned by the state, largely preserving concentration in the market. The big business groups were significantly strengthened by the privatised banks and their assets, either by means of their control over the assets and ownership shares of the banks, or by means of well-directed credit provided to them. The internalisation of the reform demonstrated that, despite the transformation of the market economy post-1985, the patterns sustaining the narrow state-big businesses nexus were preserved.

The real assets of the banks were sold to a relatively small group of wealthy families and businessmen. Hapoalim sold Delek (a fuel company) to Yitzhak Tshuva; Ampel (a corporation focusing on development of basic industries, utilities and housing) was sold to Dani Shteinmatz (and then to Yosi Maiman); Poalim Investments – was sold to Dovrat Shram group; Clal to IDB, then later taken over by Nochi Dankner (The state Comptroller and Ombudsman, 2003). Leumi sold Africa-Israel to Lev Leviev. These sales were not executed on a broader scale to the wider public; instead, the holdings of the banks of real enterprises were sold to the new, consolidating business groups.

Parallel to the sale of their real assets, the ownership structure of the banks themselves changed. In the framework of liberalisation, the state agreed to provide loans to the private business groups so that they could purchase the shares of the banks. The state, again, had a clear policy of

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<sup>64</sup>This excludes FIBI – the First International Bank of Israel - the only bank which remained under private ownership, of the Safra family, in the aftermath of the 1983 crisis.

privatising in a concentrated fashion, to strong control cores, i.e. a strong shareholder or group of shareholders controlling a substantial part of the shares of the banks and having control rights, such as appointing the CEO and the board of directors. The privatisation of Leumi Bank to a control core was argued to be inevitable (Abeles, 2002:38). Such a control core is not necessarily an individual shareholder, but rather a corporation or a collection of corporations (ibid).

The state sold banks ownership shares in phases, to the public, to business groups, or to acquisition groups working in unison (Zelekha and Zur-Neiberg, 2007). In 1997, the state had 76.7% ownership stake in Hapoalim, and the public had 23.3%, through the stock market. In Leumi, the figures for the state and the public were 81.8% and 18.2%, respectively. In Discount bank, the state held 79% of shares, IDB 13.2%, and the public, through the stock market, held 7.8%. In Mizrahi-Tefahot Bank, the state had 71% of shares, Wertheim-Ofer had 26%, and Mizrahi Holdings capitalised 3%. In FIBI Bank, FIBI held 46.9%, Discount held 27.3%, and the public, through the stock market, 25.8%. In Igud Bank, Eliyahu group held 60%, the state 23%, and Leumi Bank 17% (Katz 1997: 246-7). The state remained a minority shareholder in two banks –Leumi and Discount. Table 3.1 below sketches the sale of large stakes in the big banks to individual businessmen or families.

Table 3.1. The sale of the control shares of the banks

<b>Bank</b>	<b>Sold to</b>	<b>Years</b>
Hapoalim Bank (43% for \$1.37 billion)	Arison family, leading an investors' group	1997
Hamizrahi Bank (26% for \$ 110 million with the option of 25% additional, sold in 1997 for \$129 million)	Ofer and Werthaim families (owning the control core)	1994 and 1997
Bank Igud (89.5% for ILS 280 million, in stages).	Shlomo Elyahu and Yehoshua Landau (two control cores)	1992-9
Discount Bank 26% for ILS 1.3 billion, with an option to buy additional 25% for ILS 1.25 billion	Bronfman family	2005
FIBI (First international Bank of Israel)	Liberman and Bino families	2003

Sources: Katz, 1997; Zelekha and Zur-Neiberg, 2007

Like the privatisation of the state and Histadrut assets, the privatisation of the ownership shares

of the banks suffered from problems of short sightedness and an eagerness to privatise to strong control cores, without taking into account the hazards of power concentration in the market economy. Hapoalim bank, for example, was sold to the Arison family in 1997 in a control core, without splitting the bank's shares (Globes, 1997; Adva, 2006). Before that, during the end of the 1990s, the Dankner family made a bid to purchase the privatised shares of Hapoalim Bank. The BoI approved a transaction of 11% of Hapoalim shares. The money for the transaction was borrowed from Leumi Bank. As collateral, the Dankner family deposited the salt land, discussed earlier in this chapter, which was still owned, de jure, by the state. In a 2003 report, the Attorney General of Israel sharply criticised this agreement. He stated that it could not be justified, questioned the ground's classification, to begin with, and stated that it provided large benefits without appropriate authority, exceeding the legal framework of providing such benefits (Navot, 2012: 334-5).<sup>65</sup> Ehud Olmert, the Minister of MOITAL at the time (later Prime Minister, in the years 2006-8), argued, on the contrary, that breaking the agreement would destabilise Leumi Bank (Maor, Haaretz, 2003). The state sold shares in a big national bank (Hapoalim) to an individual family (Dankner), which used, in turn, loans obtained from another state's big bank (Leumi), based on collateral also owned by the state. Furthermore, it is not clear whether these procedures were legally appropriate (Navot, 2012: 334-5; The State Comptroller and Ombudsman, 2001: 740-9). Such controversial transfers of assets maintained power within the same circle of people, enhancing state-big business cooperation at the expense of the wider public interest.

The same strategy of ownership concentration was evident in the privatisation of Leumi Bank, which was not split prior to the intended shares sale in 2005. In effect, this strategy of selling the control of the banks to strong hands was a structural matter. Moreover, it was in line with the 2002 Committee appointed by the Ministry of Finance to examine the privatisation of Leumi Bank, which recommended either the bank's sale to a foreign strategic investor, its sale in the capital market, or its sale to a control core consisting of 15-20 shareholders (MoF Committee, 2002:5). Prime Minister Olmert made efforts to advance two businessmen related to him, Frank Lowy and Daniel Abrams, as the main buyers (Zelekha, 2008; Zelekha and Zur-Nierberg, 2007; Globes, 2007). The BoI, accordingly, defended the sale. Eventually the privatisation of Leumi was not executed, and there was no evidence of conflict of interest in this case (Glickman, Ynet 2008).<sup>66</sup>

The process of the transition of the banks from nationalisation to privatisation resulted in heavy losses to the public (Zelekha and Zur-Neiberg, 2007). Altogether, Zelekha and Zur-Neiberg (2007:9) estimated that the state lost ILS 830 million from the Igud transaction (i.e. nationalization

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<sup>65</sup>The report is in the hands of the author and is not available to the wider public.

<sup>66</sup>In 2007, the attorney general opened an investigation against Olmert concerning an alleged breach of trust because of serious conflict of interests with respect to the sale of the Bank's control core. In December 2008, the state prosecutor closed the case. After several appeals, the High Court of Justice (Bagatz) decided to drop the charges, but concluded that Olmert's behaviour was concerning (Bagatz 4379/09).

following the 1983-4 crisis and, later, privatisation), ILS 5.8 billion from the Hamizrahi Bank transaction, ILS 16.7 billion on the Hapoalim transaction, approximately ILS 3 billion on Discount transaction, and approximately ILS 15 billion on Leumi transaction (although control remained with the state). As a result of these changes, the role of the banks in the economy was redefined, from owner and coordinator in the capital market to central credit provider.

The control of the banks over industrial companies abated, in addition to new restrictions on related party transactions embedded in the 1999 Companies Law (OECD, 2011a). Also, following the Brodet reform the capital market became independent from the banks. However, the banks dominated the credit market, and in the absence of a non-bank credit market, a strong dependence developed between the business sector and the banking system. The limited array of credit sources was sustained by personal ties and preferences for more familiar and connected businessmen and wealthy families. At the same time, the regulatory restrictions governing the provision of loans to a single borrower or to a group of borrowers sometimes blocked borrowers from mobilising funding. All these factors raised the price of credit in the economy, preventing it from realising its full growth potential (Hodak, 2009:5), and ultimately increased the domination of the banks.

The credit bias, previously rooted in the control of the banks over real firms, was substituted, then, for credit bias based on personal relationships or affiliation to business groups. The element of 'clubness' of the new group of owners was built in during this process: some of the new business groups (Arison, Eliyahu, Bino, Ofer and Wertheim) controlled the banks. The banks, therefore, became a key vehicle for the expansion of the new business groups, providing credit on preferential terms to their own groups and to the others. Leumi Bank, for example, has been a central source of loans to build the new business groups. Providing credit to IDB, Leumi Bank and Discount Bank have provided it tremendous leverage, with Nochi Dankner only risking a marginal amount of money in his dealings (Sokolinski, 2012; Committee, 2012). The banks' liberal provision of credit resulted in, among other things, non-recourse crisis of the banks in 2001, ending with enormous bad debt write-offs and a significant recession.<sup>67</sup> The main loser was Leumi bank, which held the debts of Tevel and Bezeq (Horesh, Haaretz, 2002).<sup>68</sup> The government was not actively involved in the managerial decisions of the banks (Ber et al., 2001: 194).

Despite various measures adopted by the government to increase the role of capital markets, and even more directly, to break-up the existing banking groups, the level of concentration in the banking system has been relatively constant over the years. The two biggest banks, Hapoalim and Leumi, together with Israel Discount Bank, the third in size, have dominated the financial sector for many years (Maman and Rosenhek, 2011; Barnea et al., 2001; BoI, 2004; Paroush and Ruthenberg,

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<sup>67</sup>A non-recourse debt is a loan secured by a pledge of collateral, with no personal liability. For more see Pavlov and Wachter, 2004; Weidner, 1978.

<sup>68</sup>Afterwards, there was a retreat from non-recourse, but the collapse of the pyramids in 2012 -13 exposed that it has not entirely vanished.

2003; Ber et al., 2001). Hapoalim and Leumi have played a major role in the financial sector and have managed most of public savings. They dominated not only banking services, but also securities-related activities. In addition, despite the level of concentration in the banking system, the BoI has encouraged acquisition of smaller banks by big ones. As a result, more than ten banks were either sold or liquidated since 2001.<sup>69</sup> Concentration in the banking system was high compared to global indices. As of 1999, the market shares, measured in total assets of the three and five largest Israeli banks, were among the highest in the world. Out of 42 states, only four (Finland, Jordan, New-Zealand and Zimbabwe) have shown higher measured market shares than Israel in one or more of concentration level categories (Cetorelli and Gambera, 2001).

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<sup>69</sup>It derived from a concern that smaller banks have neither sufficient size to support the higher regulatory costs arising from initiatives like Basel II, anti-money laundering rules, and accounting requirements, nor the ability to compete with larger banks.

### 3. From the Old 'Big Business' to the New Business Groups

#### *Market Concentration Following Transformation*

The concentration of the market economy following transition, and specifically – privatisation, has been a common outcome of market reforms in many economies around the world. Even if politicians declare that privatisation is designed to disperse shareholdings, property rights are eventually concentrated among a few large owners rather than a broad scale of small owners. In Russia, for example, privatisation was carried out on a narrow scale, despite the stated goal to create a broad class of owners (Boycko et al., 1995), exemplified by Yeltsin populist slogan, "we need millions of owners, not hundreds of millionaires" (7.4.1992 speech, Hoffman 2002: 189). More than a third of Russian industry was owned by twenty rising oligarchs, who built conglomerates that accumulated enormous power within a decade. The ownership structure quickly consolidated through expropriation of outside investors, including the government (Boone and Rodionov, 2002), largely a result of poor minority shareholders protections. This resulted in further concentration of control in most big companies (López de Silanes et al., 1998). Examining ownership around the world, Claessens et al. (2000) showed that the shares of the ten largest firms in a market economy were highest in Indonesia (58%), Philippines (52%), Thailand (43%) and Korea (37%). The numbers for Indonesia and Philippines include the holdings of one family in each country, controlling 17% total market capitalization, in both countries (the Suharto and Marcos families, respectively).

Two key factors maintain the concentration of the economy, often entangled with the rise of oligarchy. First, how the state chooses to internalise the core processes of liberalisation, mainly through privatisation. Second, there are significant relationship between the new owners and the political and bureaucratic decision-making circles. While larger corporations or business groups are more effective at influencing judicial and political decisions and protecting their property from bureaucratic predation (Grossman and Helpman, 1994; Sonin, 2010; Yakovlev and Zhuravskaya, 2005), the personal ties between oligarchs-to-be and politicians and bureaucrats are nonetheless significant. By means of this proximity, rising oligarchs can enjoy government support, enabling their takeover of the market economy. In addition, the relations among these businessmen and families, and the networks connecting ultra-wealthy businessmen, evident in numerous states in various capacities, are important to the oligarchisation process, as illustrated in the following examples.

The Russian oligarchs essentially started as pioneers, supported by President Yeltsin, who wanted to develop a small group of young reformers to overhaul the old system. Some relied on ties fostered during their tenure in government offices, including some who were ministers

(Kryshtanovskaya and White, 2005), and others with a common background in the Komsomol (Graham, 1999).<sup>70</sup> In addition, the emerging oligarchs were brilliant lobbyists. As the heads of powerful business corporations, they had close connections with the political leadership at national and regional levels (Kryshtanovskaya and White, 2005). In particular, the oligarchs managed tight relations with Yeltsin. These interactions with the state were pivotal to the initial consolidation of the oligarchy (Hoffman, 2002:6).

Conversely, although they created a network of social interactions, e.g. saunas, tennis clubs, and private restaurants (Rutland, 2009), they did not cooperate with each other in business, but operated as individuals. Moreover, the business relations between oligarchs developed into a violent competition over market shares, including assassination attempts (Freeland, 2000, Goldman, 2003). Only when facing the government have they overcome their conflicts and operated as a unified front (Freeland, 2000; Yavlinsky, 1998).<sup>71</sup> Likewise, power struggles between the oligarchs were wide-spread in Indonesia. Despite their immense wealth, especially compared with their millions of poor compatriots, the oligarchs have not faced grassroots threats from below. The only threats they have faced since the fall of Suharto in 1998 were from each other, or from characters in the state, but not from "the state" (Winters, 2011: 156).

In contrast, the established oligarchs of Latin America, the Philippines and Japan were raised and educated as a cohesive elite, which also included politicians. In Chile, for example, politicians interacted with business groups about policy formulation in the post-military rule. Capitalists and landowning elites affected economic policies, agenda priorities, and implementation. The business elite supported the Pinochet dictatorship not only because they feared of socialism, but also due to their cooperation in economic coalitions (Silva, 1996). In turn, state power structures and international factors influenced internal conflicts, shaping policy coalitions, also as a result of the oligarchs' relationships with bureaucrats and the inter-relations among the oligarchs themselves (ibid). In the US, to take another example, cosy relationships were built up over years between Wall Street and Washington: "Oversize institutions disproportionately influence public policy... Washington insiders already believed that large financial institutions and free-flowing capital markets were crucial to America's position in the world" (Johnson, 2009).

Also, such oligarchic networks are, in many cases, facilitated through familial structures. In the Philippines, for example, the family patriarch could be involved in various businesses, like finance, have a seat in the Senate, while other family members might own a sugar plantation and be governors of provinces (Winters, 2011: 197).

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<sup>70</sup> Young Communist League, a youth organisation controlled by the Communist Party of the Soviet Union.

<sup>71</sup> Mikhail Khodorkovsky, the head of Russia's largest oil company, Yukos, is the most prominent illustration of the threat posed by the oligarchs to the state leaders. Khodorkovsky was sentenced to eight years in jail for tax evasion, an accusation which is commonly believed to cover the real reason of his arrest - his political aspirations, as suspected by President Putin (Byanova and Litvinov, 2003). Conversely, the lack of firm legal basis for the rapidly-acquired wealth of oligarchs in some states, such as Russia, made the new business elite vulnerable to attack by the state (Rutland, 2009: 3-4).

As noted before, oligarchs themselves can be powerful political actors. In Indonesia, for example, key oligarchs, like Akbar Tajung, Habibie, Megawati, Wahid, and Rais, populated political offices (Robison and Hadiz, 2004). An “oligarchic ruling class” emerged during the years of Suharto’s New Order economic policy.<sup>72</sup> The reforms in the economy served to reinforce the economic position of the oligarchy, enabling them to seize private control of former state monopolies (Robison and Rosser, 2000). Global and domestic forces, therefore, shaped the rule of the oligarchy.<sup>73</sup> The oligarchy, in turn, was fortified by taking-over new governing institutions.

### ***The Formation of the New Business Groups in Israel***

The post-1985 conditions which ultimately provided the genesis of the Israeli oligarchy were an evolution of the dominant state-business nexus in the political economy. The management and execution of the privatisation process fundamentally reflected pre-1985 power relations. The implementation of the EESP’s outcomes enabled the new business groups’ accumulation of power, on the basis of old power structures. Nonetheless, the structuring of new business groups cannot be attributed to the EESP—the seeds of the big business structures were planted much earlier.

In the aftermath of market liberalisation, parallel to a more extensive state retreat, the new control core of the political economy was formed. The model of business groups remained more or less the same. In effect, the new groups adopted the business model of the old groups – founding new enterprises and acquiring existing corporations in different sectors and industries (Khanna and Yafeh, 2007; Maman, 2004). The most common preference was to acquire resource-rich, low leverage, less liquid assets (Kosenko, 2013). The ultimate aim of the new groups was to build domestic business empires, or political-economic projects, like Koor, Hapoalim, and later IDB (Maman, 2006a, 2008). In turn, once they had acquired power, the controlling-owners' interests were focused on protecting what they already had, often through expansion (Maman, 2008), most commonly conducted through a pyramidal structure (as analysed in the next chapter). Power thus shifted from previous structures to a few businessmen and wealthy families, and some foreign actors (Maman 2006:43). The centrality of the business groups in the economy intensified, while competition was undermined.

A substantial force behind the new business groups' formation and strengthening has been the robust connections across them, specifically among the families and individuals controlling them. While links among elites and multi-market contacts have always been common in the Israeli economy (Sokolinski, 2012; Maman, 2002, 2006; Aharoni, 1991, 2006), it was only in the post-

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<sup>72</sup>The New Order economic policy was prevalent from the mid-1960s till the end of the 1990s (Robison and Hadiz, 2004).

<sup>73</sup>For example, Indonesian oligarchs control most of the media, which is used as a medium for power. They thus defeat the rule of law, capturing democracy. Other media entities were controlled by oligarchs that resisted the sultanistic oligarch, and were used for opposition purposes (Thompson, 1995).

1985 period that the new economic elite organised in a mode of a 'club'. As analysed in chapter one, the club denotes the organisational though informal form through which oligarchy members interact. The 'clubness' refers to the networked alignment and the inter-relations that form an oligarchy. In Israel it was a process of state selection of specific individuals and families due to their strength and their connections to other powerful economic actors, in parallel to the strengthening of these connections in order to expand the control over the economy. The new business groups have increased their presence in the Israeli economy via a network of social and professional relationships, such as business partnerships and interlocking directorates in affiliated companies (Maman, 2001), in addition to traditional forums such as state institutions and councils, and military background and high offices (Maman, 2006a). They created partnerships with other groups to guarantee control over wider market shares (Maman, 2002) and expanded through investments and Merging and Acquisitions (M&A). These relations enabled the groups' access to state resources, their acquisition of state assets, and favourable credit and taxation conditions.

This 'clubness', a rather new phenomena (Kosenko, 2008), is not only a peculiar characteristic of the Israeli oligarchy, but effectively a source of its power. In the political economy context of the country, the 'clubness' acts as a self-enforcing mechanism for turning the Israeli business groups into an oligarchy (as analysed in chapter 5). In contrast to the former business elite, whose members mostly came from the same socio-economic circles (Aharoni, 2007; Maman, 1997), some of the new business groups emerged as a powerful group as a result of being a member of the 'club,' and the cohesion that such a position afforded. The cohesive dynamics of the club, in turn, further facilitated the accumulation of wealth and power.

By the end of the 1990s, the map of business ownership in Israel had completely changed. Hardly any of the old business groups was present, and no business group maintained its pre-crisis structure. Those companies which maintained a leading position in the market economy were no longer under the same ownership (Aharoni, 2006; Kosenko and Yafeh, 2010). Table 3.2 below sketches that transition. Three business groups were left out of the seven big business groups which dominated the Israeli market economy in the pre-crisis era—Hapoalim, IDB and Leumi—and these were subsequently reformed.<sup>74</sup> The remaining four—the Eisenberg group, Chemicals for Israel, Koor, and Clal—were dismantled and their holdings sold to other groups. In addition, some new business groups emerged, such as Tshuva Group, Bronfman Group, and Bino Group, all under private ownership. While some groups maintained parts of their previous holdings, the groups have generally deepened their holdings.

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<sup>74</sup> The colours are added in order to illuminate the continuity and change in the structure of the big business groups. Also, this table shows only selected business groups operating in Israel.

Table 3.2. From the old 'big business' to the new big business groups

Period	Groups	Sector	Affiliated Firms	Principal activities	Management	Major companies	Origins
Late 1960s- mid 1980s	Government	State	1000 ca.	All industries	Labour Party members	Jewish Agency for Israel Group Holdings	1948
	The Histadrut	State	2000 ca.	All industries	High rank members	Koor, Hapoalim Bank	1920
	IDB (former Discount)	Private	20	Diversified	Family, professional	P.A.C. Group Holdings, Discount Bank, Elbit	1970
	Eisenberg Group	Private	10 ca.	Investment, real-estate, shipping	Family	Israel Corporation, Zim, ICL	1968
	Hapoalim Group	Financial		Banking	The Histadrut	small banks (Zrubavel, Yefet)	1921
	Koor	Industrial	200 ca.	Raw materials, chemicals, electrics, communication	The Histadrut		1944
	Leumi	Financial		Banking	Leumi Le-Israel		1951 <sup>75</sup>
	Ofer	Industrial		Shipping	Sami Ofer, Yuli Ofer		1966
	Clal	industrial		textile, electronics, tractors, cement			1971
The 1990s	IDB (Dankner Group)	Private	20	Diversified	Family, professional	Clal, Discount Investments, Cellcom, Koor	2003
	Leumi	Financial		Banking	Leumi LeIsrael		1951
	Leviev Group	Private	7	Real-estate, investments	Family, professional	Africa-Israel	1996
	Ofer Group	Private	4	Banking, Manufacturing, Shipping, aviation	Family, professional	Israel Corporation, Zim, ICL	1999
	Delek Group (Tshuva)	Private	11	Real-estate, oil, Hi-technology	Family, professional	Delek Israel	1991-4
	Fishman Group	Private	3	Real-estate, telecommunications	Family, professional	Jerusalem Economy Ltd., Industrial Buildings	1989
	Arison Group	Private	3	Banking and finance, Real-Estate	Professional	Hapoalim Bank, Shikun Vebinui (Housing and Construction)	1991-9
	Bronfman-Alon Group	Private	3	Banking, food and retail chains	Family, professional	Discount Bank, Blue Square	1989
	Bino Group	Private	3	Oil and gas, real-estate, banking	Professional	Paz Oil, FIBI	1999
	Nimrodi Group	Private	7	Real-estate, media, hotels	Family, professional	ILDC, Maariv	1989-1992
	Akirov Group	Private	3	Real-estate, telecommunication	Family, professional	Alrov	1983
	Borowitz	Private	3	Air industry	Professional	Knafaim	1989
	Zelkind Group	Private	4	Electronics, real-estate	Family, professional	Elco, Electra	1992
	Harel Group	Private		Finance, insurance	Family, professional	Harel Insurance, Harel Finance, Dikla Insurance	1982

Source: Kosenko and Yafeh (2010: 471-3)

<sup>75</sup>Founded in 1902 as Anglo-Palestine Company.

The ownership of most of the pre-1985 business groups has changed within the last three decades (Kosenko, 2008), turning over approximately three times within the last 50 years (Kosenko and Yafeh, 2010). Ownership concentration in the market as a whole, before and after the EESP, has remained constant (Sokolinski, 2012). Despite the high exchange of ownership, the number of owners and their holdings has been persistent (ibid), with relatively high ownership concentration since 1995 (Kosenko, 2008<sup>76</sup>). The ownership structure of the new, consolidating groups reflected the state-led pattern of close cooperation with the business elite. This was similar to the pre-EESP period, when many of Israel's largest corporations were jointly controlled, at varying levels, by the state, the Histadrut, and private capital (Maman and Rosenhek, 2012: 349).

In summary, the concentrated structure of ownership and control by a small segment of the Israel private sector, initially developed in the 1960's and inherited from a long period of governmental patronage, strengthened in the post-EESP period (Shalev 2004; Nitzan and Bichler, 2001; Maman, 2004). The state directed most of the EESP outcomes to a small number of businessmen and enterprises, perpetuating the traditional, narrow nexus of state-big business. The market power of the new business groups, in turn, has further enabled their extensive influence. Israel's rising oligarchs managed social and professional relations with political decision-making circles, including politicians, regulators and bureaucrats, garnering considerable influence over the resources allocation processes. Consequently, along with vast liberalisation, on-going waves of privatisation, increasing exposure to the international arena, and various structural reforms, the economy has become more concentrated. The state-big business nexus characterising the Israeli economy was maintained and adapted to include the new business groups, who gradually constituted the Israeli oligarchy.

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<sup>76</sup>Examining 650 public companies traded on the Tel-Aviv stock exchange from 1995 – 2005.

## Conclusion

The extensive rise of capital in Israel was a product of economic, political, and legal changes. Specifically, it was a result of the way that the privatisation of state, Histadrut and banks assets was conducted. The process was also embedded in the particular nature of the Israeli market economy, featuring 'clubness'. The privatisation processes opened up new opportunities for the consolidation, expansion, and strengthening of new business groups, which were controlled by a small number of wealthy families and individuals (Sokolinski, 2012; Maman, 2002). Specifically, the relations between these actors and the state and their influence over policy-making allowed them to take-over former state assets in a non-competitive fashion.

Israel's transition from state-centred economy to liberalised economy has characteristics common to other states that have undergone the process. First, it was a result of state policies, in Israel's case altering the market model which brought it to the verge of economic collapse, while adopting the neo-liberal paradigm of a free and competitive market. Second, privatisation was a key feature of the transition. Third, the banks played a substantial role in the transformation process. Finally, the transformation resulted in the concentration of the market economy.

However, while the general trend in the transition from the old businesses to the new business groups was repeated, some characteristics are peculiar to the Israeli case. Most notably, the transformation of the market economy was actively and directly conceived and coordinated by the state and its machineries, although it was advanced by the business elite of the time, together with international actors. In addition, while the transformation was indeed a product of a failed economic regime, it was not, nevertheless, a result of poor institutional structure. The central and active role of the state, before, after, and during the transformation process is unique.<sup>77</sup> In addition, the Israeli banks were not only intermediaries in the privatisation process, providing credit under preferential conditions to the new consolidating groups; instead, they were a part of it, privatised in a process symptomatic of the narrow structure of Israel's privatisation.

The new business groups are similar to the preceding business groups in a few ways. The model of the old business groups, merging financial and industrial holdings and acquiring monopolistic and strong enterprises, was preserved. While the new groups' formation was based on the Israeli internalisation of global processes, it was the state-big business nexus that ultimately dictated the transfer of power to a small group of businessmen and wealthy families, maintaining the market's concentration. The next chapter analyses the second and more resilient stage of the formation of the oligarchy – the financialisation of the economy.

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<sup>77</sup>Furthermore, parallel to market liberalisation, the role of the state was conveyed in other critical channels, namely immigrant absorption (from both the USSR and Ethiopia in 1991), and peace negotiations (with the Palestinian Authority in 1993, which failed, and with Jordan, in 1994). The exclusive responsibility of the state for security and the particular nature of a Jewish state have constantly shaped its pivotal position in the political economy.

## CHAPTER 4

### THE CONSOLIDATION OF OLIGRACHY THROUGH FINANCIALISATION

This chapter focuses on the final but definitive stage in the formation of the Israeli oligarchy: the financialisation of the economy beginning in the early 2000s. Financialisation broadly refers to the increasing presence and political role played by financial markets and financial actors in economic systems and societies (e.g. Aglietta and Breton, 2001; French and Leyshon, 2004; Nesvetailova and Palan, 2008). Like elsewhere in the global economy, the financialisation of the Israeli economy originated in the liberalisation of the capital market. As such, this reform process has led to the emergence of new players in the financial system (such as investment houses, e.g. Psagot, and companies specialising in algorithmic trading, e.g. Final), but also empowered other actors, especially institutional investors (e.g. insurance companies like Harel and the Phoenix).

Much like the Israeli variant of privatisation reform analysed in the previous chapter, financialisation in Israel, while part of a global trend, was marked by the prominent presence of the state in the economy, and worked through the 'clubness' of the oligarchic business groups. As such, it evolved along the established lines of the historically close relationship between the state and big businesses. After the implementation of privatisation and liberalisation reforms in Israel, financialisation has served to transform the already-concentrated big business groups of the post-EESP period into oligarchic structures, merging real and financial holdings. Through finance, the new controlling owners were able to construct pyramidal structures of ownership and control. Financialisation contributed most significantly to the prevalent ratio of control of the new business groups over the financial sector, specifically over public savings.

The chapter uses data collected in the reports of the various committees appointed by the state, mainly the 2004 Bachar Committee, the 2009 Hodak Committee for Establishing Parameters for Institutional Bodies' Investments in Non-Government Bonds, the 2010 Committee to Increase Competitiveness in the Market, and the 2012 Committee to Examine Crony Capitalism. In addition, the chapter examines various reports produced by the Bank of Israel, the OECD and the IMF.

The chapter is structured in two parts. The first part examines the changes in the financial sector that took place during the 2000s and highlights the rise of institutional investors and of the non-bank credit market. The second part takes a closer look at the mechanism of 'oligarchisation' through financialisation. It analyses three inter-linked processes: the biased allocation of the bank and non-bank credit; the expansion of businesses through a pyramidal structure; and the fractured regulation in the financial sector. Accordingly, these mechanisms show how the state-business nexus was shaped into an oligarchy, cooperating to form the ruling class of the market.

## 1. Financialisation in Israel

### *Financialisation*

While many academic definitions of financialisation exist in the social sciences (e.g. Krippner, 2005; Canterbury, 2011; Toporowski, 2006), the phenomenon of financialisation broadly refers to the increasing presence and political role played by financial markets and financial actors in economic systems and societies (Aglietta and Breton, 2001; Talani, 2010; French and Leyshon, 2004; Froud et al., 2006; Cutler and Waine, 2001). The process of financialisation is typically paralleled by the emergence of new types of financial institutions and practices, such as activist institutional investors, hedge funds and private equity funds, as well as the introduction of new financial instruments in domestic and global economies (Nesvetailova and Palan, 2008), and new channels of financing (McKenzie, 2011; Boyer, 2000; Soederberg, 2005; Crotty, 2009). In the social science scholarship, financialisation tends to be conceptualised either as a macro-historical trend in the evolution of capitalism, or as a socio-cultural shift within the financial system driven by innovation and competition (Montgomerie, 2008). Scholarship in International Political Economy (IPE) has examined the power of finance as a relatively monolithic bloc of interest and capital, vis-à-vis the state and the so-called ‘real economy’ (Nesvetailova, 2014: 548).

Financialisation has been evolving as a global process of finance-led change, and over the past few decades has engulfed most advanced and emerging economies (Foster, 2007, 2010; Merhling, 2010; Froud et al., 2006). At the same time its role in national political-economic contexts is determined by the local institutional framework, historical settings, and mode of economic integration. Across the world economy, financialisation has been enabled by processes of deregulation of the financial sector and liberalisation of international capital flows (Stockhammer 2012: 121). These measures were themselves reactions to the increasing activities of private agents to circumvent financial regulation in the late 1960s–early 1970s, and were further accelerated by the IT revolution and its impact on banking and finance (ibid).

Through the liberalisation of the financial market, financialisation tends to bring down the cost of credit. It facilitates wider access to credit, through money market funds, banks or other entities, including private enterprises. The unique capacity of financial markets to codify, price, and liquefy economic and social assets fuelled the process of financialisation (Froud et al., 2006), along with increased Mergers and Acquisitions (M&A). Partly as a result of the financialisation process, the structural power of finance in contemporary economies is twofold: it manifests the influence of a wide range of financial agents’ endeavours, intentional and otherwise; and it rests on the financial system’s seemingly boundless ability to adapt, change, and evolve (Nesvetailova, 2014).

The processes of financialisation have facilitated a merger of interests in the financial sector,

involving banks, capital markets, insurance companies and investment houses. These agents have cooperated to circumvent economic reforms and prevent tighter regulation (Zingales, 2012). Market reforms often lead to a domination of the financial sector and its gradual concentration, which, in turn, creates barriers to entry in these markets (Acemoglu and Johnson, 2003), either through suppressing financial development (Rajan and Zingales, 2003; Perotti and Volpin, 2004) or through a superior access to political resources (Hacker and Pierson, 2010). Often (as in the US in the pre-2007-8 financial crisis) these constraints are designed to preserve the interests of the financial elite; for instance, credit in such cases is allocated to a small specified group, mainly comprised of shareholders (ibid). Financialisation, together with the development of a corporate control market, has shifted power to shareholders (Lazonick, 2010). As a result, management priorities changed, enhancing the power of a few shareholders (Stockhammer, 2004). Financialisation, therefore, while it has liberalised the capital market, has also led to a concentration of wealth and power.

The experience of advanced economies and the emerging market economies in particular illustrate how these processes work. The financial system is often the basis of growth in economies. The development and proper functioning of the financial sector, in general, and of the capital market, in particular, are associated with stronger growth (Hasan et al., 2009). This linkage has been shown in both developed and developing economies, such as Southeast Asia, Japan and the US (Miller, 1998; Alfaro et al., 2004; Levine, 2003; Rajan and Zingales, 1998; Levine and Zervos, 1998; Cetorelli and Gambera, 2001). Authorities in less developed countries (LDCs) often regard intervention in the financial sector as an efficient way to induce growth and structural change (Bencivenga and Smith, 1991; Levine and Zervos, 1996). This linkage is particularly pertinent during periods of political-economic transition. Elaborate regimes of interest ceilings, for example, are a common instrument to promote industrialisation, exporting, and other national priorities (Tybout, 1984). In turn, creditors are compelled to allocate their portfolios according to these criteria (ibid).

To illustrate, when the government of Korea started to implement various financial liberalisation reforms in the 1980s, the financial sector played a critical role in the structural adjustment of the state (Cho, 1988; Cho and Cole, 1986). In India, reforms in the financial sector also advanced liberalisation, financial soundness, and competition (Ahluwalia, 2002). Conversely, the Chinese financial system has remained state-dominated and entrenched during the 1980s and the 1990s; despite effective financial intermediation, bank finance flowed to state-owned enterprises (Cull and Xu, 2000; Allen et al., 2005). During the 1990s and the 2000s, the banks allocated credit to the private sector in the same biased fashion, with the assumption of the state-owned firms' strength and stability (Firth et al., 2009). As a result of the credit extended by the banking sector at the state level, in lieu of a viable capital market, the development of SMEs was hampered (Lin and Li,

2001), capital mobility was low (Boyreau-Debray and Wei, 2005) , and provincial economic growth lagged (Boyreau-Debray, 2003).

Due to its key role in developed and transitioning market economies during the 1990s, the financial sector, and banks in particular, became a key part of the oligarchic system, or oligarchic actors themselves (King and Levine, 1993; Singh and Zammit, 2006; Rajan and Zingales, 2003; Johnson, 2009). The increasing autonomy and power of the financial sector is not based on ownership of real assets or its regulatory function; rather, it is associated with its ability to provide credit and with the broader concentration of the financial sector. Indeed, most contemporary financial sectors or banking structures in the world are highly concentrated (Beck et al., 2000; Cetorelli and Gambera, 2001). In the US, the concentration of the banking system was most prominently displayed following the 2007-8 financial crisis, when big banks bought smaller ones, like the Bank of America acquisition of Merrill Lynch and J.P. Morgan Chase purchase of Washington Mutual (Duffie, 2010). Concentration in the American banking sector was further augmented, and the 'too big to fail' banks became even bigger, increasing their power (Johnson, 2009; Zingales, 2012; Sorkin, 2010; Cho, 2009).<sup>78</sup>

Since the 1980s, financial sector around the world has expanded to include institutional investors. Institutional investors worldwide nearly doubled their share of the stock market from 1980 to 1996 (Gompers and Metrick, 2001). Their role is greatly advanced through their significant funds, often representing a large share of public savings. Generally, institutional investors invest in stronger and more stable companies, whether foreign or domestic, often involving close personal connections (Griffin et al., 2003; Dahlquist and Robertsson, 2001). Institutional investors have a strong preference for large firms with good governance, while foreign financial institutions tend to follow global stock indexes (Ferreira and Matos 2008). Firms with higher ownership by foreign and independent institutions often exhibit higher valuations and stronger performance (ibid). Consequently, the role of institutional investors can shape a market's direction and its peculiarities. Their dominance in market economies reflects changes in the financial sector, namely the rise of new actors in liberalised capital markets, and more specifically, the transition from bank-based financial sectors to capital-market models of funding and the rise of non-bank actors.

In summary, financialisation has developed as a global phenomenon common to most advanced and emerging economies. However, its role in national political-economic contexts is determined by the local institutional framework, historical settings, and mode of international economic integration. The following section focuses on the Israeli case of financialisation and its role in consolidating the power of the oligarchy.

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<sup>78</sup>Termed a 'banking oligarchy', a loud contingent of economists, politicians and business leaders, sticking to neo-liberal perceptions, argued that nationalising the banks is "crime against the capitalist system" (Johnson, 2009).

### *The Reforms in the Israeli Financial Sector*

The previous chapters highlighted two factors that enabled the accumulation of wealth and power by a narrow group. One was the way the state implemented particular aspects of the EESP, such as privatisation of state, banks and Histadrut assets to a small group of interests, i.e. the new business groups such as IDB, Bino and Ofer. The other was the 'clubness', a particular feature of the circle of self-selected fraction of business leaders, which works both as a source of power and a characteristic of this group. The starting point of most of the businessmen controlling the new business groups, their proximity to decision-making circles, and their personal and professional relationships with each other all contributed to the emergence of a new type of oligarchic business elite, distinguished from the previous business elite by several parameters, mainly by the privileged access to bank credit and state resources.

As detailed in the previous chapter, until the early 2000s the financial market in Israel was highly concentrated (Blass and Yosha, 2000). Most of its activity was conducted by five large banking groups, controlling provident funds;<sup>79</sup> by the Histadrut, controlling pension funds until the pension reform (analysed next); and by a few insurance companies that were active in the market (BoI: Financial Stability Report 2003: chapter 4). The institutional investors, i.e. the insurance companies, for their part, were not entirely autonomous. Although they could invest in the capital market, they were obliged to deposit their money at the Ministry of Finance, which in return issued designated bonds in order to prevent market volatility (see chapter 2). Following the 2002 economic crisis in Israel, the Israel Ministry of Finance enacted reforms. The reforms were designed to rehabilitate and liberalise the capital market and increase competition, thereby increasing the number of active actors in the financial sector and strengthening their positions.

The efforts furthered previous reforms in the banking sector, initiated during the second part of the 1990s. These reforms were a result of the state policy of retreat in favour of the liberalisation of the capital market; for example, through the state's gradual elimination of limitations on foreign currency transactions (Benita and Lauterbach, 2007).<sup>80</sup> The state, on its part, continued to cultivate a specific group of businessmen and business groups, providing them with more power and enhancing their ability to accumulate wealth. The reforms focused on three inter-linked issues: reducing the role of the banks in the management of public savings; curing the structural problems of the pension funds; and enhancing competition in the capital market.

At the beginning of the 2000s, the banks still had a key role in the economy. They allocated credit to households and the business sector (see the previous chapter), controlled public deposits, managed provident and mutual funds (see figures 4.1 and 4.2 below), and dominated the

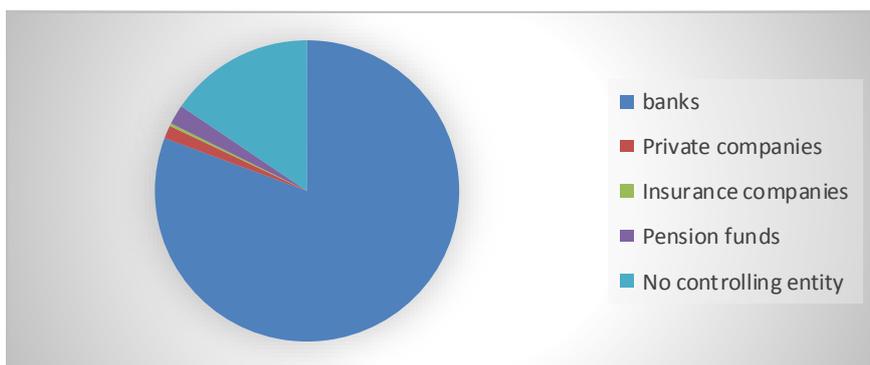
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<sup>79</sup> A provident fund is a long-term savings instrument which enjoys tax benefits. In Israel the savings deposited in provident funds are exempt from capital gains.

<sup>80</sup> The state began to eliminate limitations on foreign currency transactions in 1998.

underwriting of new equities, amounting to 99% of all new underwriting activities, including bonds and commercial shares.<sup>81</sup>

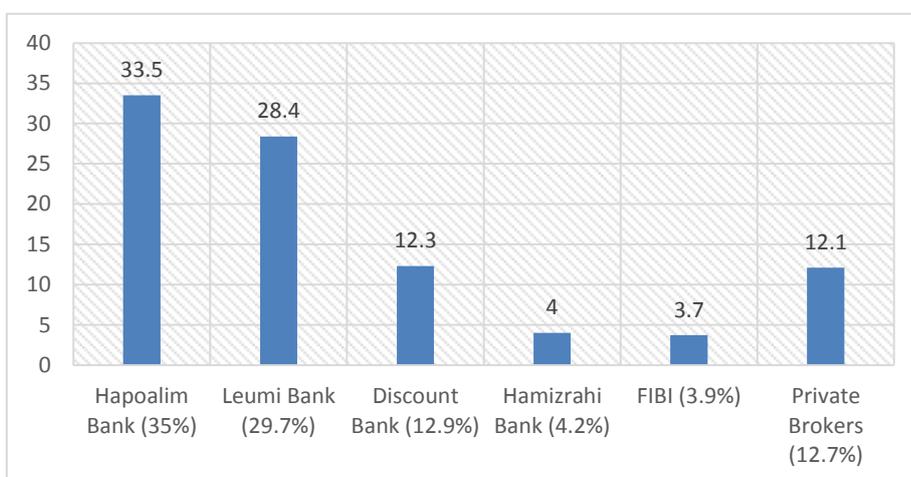
Figure 4.1. The control over provident fund (as of 2003)



	<i>Assets in provident funds (in ILS billion)</i>	<i>Market share</i>
Banks	94	80.7%
Private companies	1.6	1.4%
Insurance companies	0.4	0.3%
Pension funds	2.3	2.1%
No controlling entity	18.1	15.5%
Total	116.4	100%

Source: IDI 2004:12

Figure 4.2. Assets in mutual funds (as of July 2004)



Source: IDI 2004:12

<sup>81</sup>The provident funds were heavily weighted in the capital market. In 1996, they amounted for 44.1% of total bonds traded, 58% of corporate bonds, and 11% of free stocks (Committee 1996:48). As a result of this dominance, provident funds were compelled to sell securities, which, in turn, led to a continuous price decline. The provident funds thus showed negative returns, and therefore had to sell more securities, and so on (ibid).

By 2004, the three largest banks (Leumi, Hapoalim, and Discount) accounted for 78% of bank deposits, managing 80% of mutual funds assets and 73% of provident funds assets (Bachar, 2004). Most borrowers and savers, therefore, had to approach one of the three largest banks, which in return provided 95% of all financing to the private sector, in the form of credit, investments through mutual funds, or underwriting of corporate bonds (ibid). The dominance of the banks in the financial sector led to a conflict of interest. For example, banks provided credit to the private sector and managed public savings, which were also invested in the private sector, creating an inherent credit bias. In addition, the performance of companies' shares issued by the banks (which also provided them credit) was significantly lower (by 32.3%) than the market performance (Ber et al., 2001). This conflict of interest led to state intervention via the Bachar reform of April 2004 – one of the milestones in the financialisation of the Israeli economy.

The stated goal of the Bachar Committee was to enhance competition in the Israeli capital market, and to decrease concentration and conflicts of interests (Bachar 2004: 2). Specifically, the committee focused on the management of the public's financial assets and on enabling credit provision through non-bank credit instruments vis-à-vis the household sector (Bachar, 2004). Starting from the observation that banks were the central problem of the operation of the market economy, the main objective was to reduce the concentration in the Israeli banking system. The committee thus recommended that Hapoalim bank should sell its holdings in Bank Otzar Hachayal (ibid: 37).<sup>82</sup> The reform was also designed to weaken the power of the banks in the financial sector, thereby lessening the potential for conflicts of interest. The reform, in essence, sought to enforce the implementation of the 1986 Bejsky Committee conclusions, the guiding lines defined in the 1995 Brodet reform, and also in the 2000 Ben- Bassat committee.<sup>83</sup>

The Bachar reform primarily focused on expropriating the provident funds from the management of the banks. The banks were required to sell their holdings of mutual and provident funds within a defined timeframe of three years (Bachar, 2004). The reform also stated that companies controlled by banks should not manage assets for provident or mutual funds (excluding the Nostro accounts, i.e. the companies own assets). It did not forbid banks from underwriting activities, but imposed limitations, i.e. the bank (or any underwriting agent) could hold no more than 10% of the issuer's liabilities, and could not sell more than 5% of the offered securities to itself or to companies it controlled (ibid: 6). Eventually, the holdings of the banks of the issuer liabilities were limited to 15%, and they could sell up to 10% of the offered securities to themselves or to companies they controlled (Milken, 2011B: 10). The Bachar reform also directed the funds to invest in the capital market. Moreover, it enforced provident funds to reduce investments in designated

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<sup>82</sup> This sale took place on August 17<sup>th</sup>, 2006.

<sup>83</sup> The Ben-Bassat Committee was an inter-ministerial committee, founded to examine the control of the banks over provident funds.

bonds to a rate of 30% (Bachar, 2004). The reforms were thus aligned with a trend which dated back to the 1980s and 1990s, when the government significantly reduced the scope of designated bond issues for provident funds and insurance companies, to reduce instability (OECD, 2011).

The recommendations of the Committee were enacted and implemented through a series of legislation under the 2005 Law for Increasing Competition and Reducing Concentration and Conflicts of Interest in the Israeli capital market and in corrections to the legislation (The Capital Market Reform – full Legislation, MoF, 2005; Nevo, 2005). The legislation forcing the divestiture of the holdings of the banks in mutual and provident funds was thus anchored to structural reforms in the capital market. Most of the mutual and provident funds were sold within a few months period, despite the defined time-scale. Two-thirds of the provident funds were sold to big domestic insurance companies already operating in the market— Clal, Menora-Mivtachim, Harel, Migdal, and the Phoenix - most of which were public companies controlled by the new business groups: Clal, controlled by IDB; Migdal, controlled by Eliyahu since 2012 (previously owned by the Italian insurance group Assicurazioni Generali and by Leumi Bank); Phoenix, controlled by Tshuva; and Harel, controlled by Yair Hamburger. The rest of the provident funds were sold to foreign investors, such as York and Marxton funds, and later APEX (IMF, 2006). The price for both the foreign and the domestic sales was perceived to have been substantially higher (up to 50%) than might have been expected, based on the current fee income received by the bank (*ibid*). The dominance of the banks in managing public savings was thus curtailed.

The Bachar reform was a cornerstone in the transfer of power to institutional investors. It broadened the number of actors in the financial system, specifically, in managing public savings, from five banks to five banks and five big insurance groups. The reform was thus successful in generating a less centralised financial market. Through a state-orchestrated process, the reform enabled the creation of autonomous institutional investors, by means of providing the big insurance companies the authority of autonomous management of public savings, which was previously dominated by the banks and the Histadrut (and later by the state). The position of institutional investors, now managing public savings, was empowered in the financial sector and the broader economic sphere; not only in terms of wealth or profits, but also with respect to an enhanced role in the market economy by means of managing public savings and the erection of a non-bank credit market. While the provident funds were already declining at the time of the reforms, and although their long-term yields have not significantly changed since (Steinberg and Porath; BoI 2011), the power of their owners, conversely, increased substantially as a result of their holdings, as analysed next.

Parallel to the Bachar reform, and as a result of a crisis in pension funds managed by the Histadrut, the latter were also reformed in a process designed to encourage investment and

competition in the pension savings sector. The crisis was already acknowledged during the 1960s (Spivak, 1991). Prior to the EESP, the eight main pension funds invested heavily in non-tradable government bonds. As a result, they absorbed the heavy government deficit; the latter reached a severe actuary deficit (i.e. the difference between savers' guaranteed rights and the total assets) of almost ILS 140 billion in 2001 (Spivak and Yosef, 2005), of which ILS 110 billion was from the pension funds (Adva, 2009: 3). The state ended Histadrut control over the pension funds system through a series of reforms. On May 29<sup>th</sup> 2003, the Knesset passed the Law for the Economic Recovery Plan, designed to ensure the long-term structural efficiency of the public sector and to assist the Israeli economy (Nevo, 2003:5). In the framework of this legislation, Histadrut-owned pension funds were nationalised in the same year, transferred to the management of a state body (named Amitim). The state did not intend to keep its holdings in the pension funds, but to privatise them, allowing for the establishment of new pension funds (Adva, 2009).

Five of the pension funds controlled by the state were sold during the 2000s to the big insurance companies: Harel, Menora, Migdal, Clal, Phoenix, and Excellence. Mivtachim Pension Fund Ltd. was sold to Menora, controlled by two foreign corporations – Palmas Establish (30.93%) and Naiden Establish (30.93%) – with the rest controlled by the public; Makefet was sold to Migdal; and Meitavit was sold to Clal (Knesset 2010a: 3). By the end of 2004, the insurance companies controlled 93% of the pension funds' total assets (MoF – CMISD, 2005). These insurance companies were often connected to the new business groups: Eliyahu Group, IDB, and Tshuva Group (which controls the Phoenix and Excellence).<sup>84</sup> This privatisation injected enormous amounts of money into the financial system – the assets of the pension funds rose from ILS 148 billion to ILS 187 billion between 2004 to 2005 (Adva, 2009: 16). The privatised pension funds could now invest their capital in tradable government and corporate bonds and in the stock market (MoF - CMISD 2005). The reform in the pension funds, therefore, was a substantial step in the liberalisation of the financial sector—and in the take-over of it by the big business groups.

### ***The Rise of Institutional Investors***

As the dominance of the control of the banks over public savings waned and their ownership of real assets decreased, the role of institutional investors strengthened. It was also due to the fact that the government gradually scaled back its involvement in the capital market and allowed institutional investors increased freedom of operation, a process initiated in the mid-1980s and continued through the 2000s. Between 2001 and 2004, changes were enacted in the investment rules applied to institutional investors, allowing their access into the Israeli capital market and thereby creating an

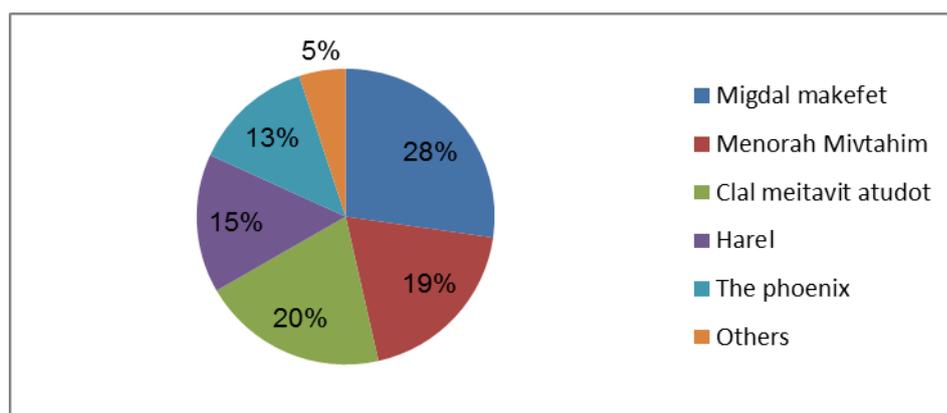
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<sup>84</sup> Harel (as discussed in the next chapter) was not one of them, but was widely associated with them, a part of the oligarchic 'club'.

alternative to the banks and enhancing competition in the financial sector. These changes lifted most of the restrictions that set quotas for investment in certain channels and reduced the scope of designated bond issues. In addition, a number of stability restrictions were introduced to ensure a minimum spread of investments by institutional investors (MoF, 2005; Nevo, 2009). Following the 2008 Hamdani Committee, more reforms were introduced (e.g. ISA, 2007 and MoF, 2008), designed to establish institutional investors as autonomous actors operating according to their own interests, rather than those of the banks.

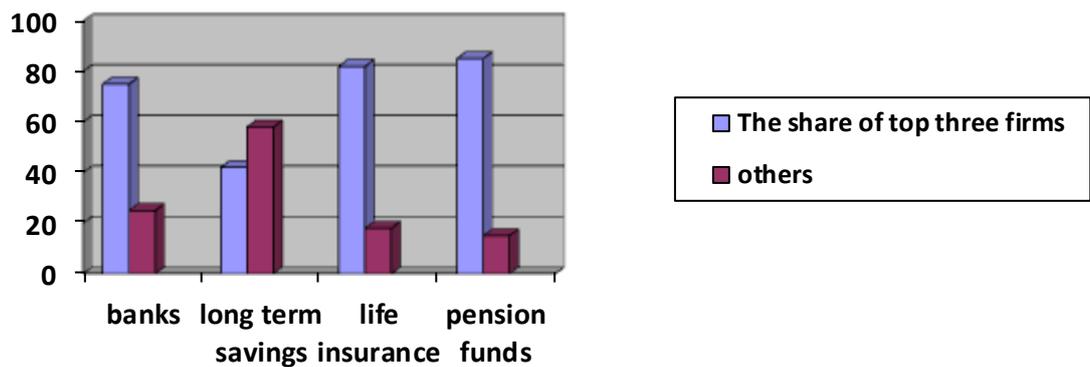
The state enabled the transfer of public savings, i.e. provident funds, mutual funds, pension savings and life insurance, amounting to circa ILS 1.1 trillion, as of 2013 (MoF – CMISD, 2013: 5), to the large insurance companies, some of which were controlled by the big business groups (IDB, Tshuva, Eliyahu), with the rest managing tight relations between themselves. Financialisation effectively led to dependence between institutional investors and public savings, the management of which, consequently, remained highly concentrated. Institutional investors gradually started to dominate the market for life and general insurance and for pension funds, with only a small number of mutual and provident funds managed by independents (IMF 2006, 89-90; Ben-Bassat, 2007). They have thus become the primary party responsible for managing public savings (see figures 4.3 and 4.4 below). Seven major non-banking companies - Migdal, Clal, Harel, Menora, Psagot Investment House, The Phoenix and Excellence - manage approximately 69% of the public’s long-term retirement assets, with Migdal and Clal Insurance together accounting for approximately 31% of such assets (Committee Interim Report, 2011). Migdal, Harel, Psagot and Excellence operate four mutual funds that together hold 51.5% of all public financial assets managed by mutual funds. Migdal, Clal, Psagot and Excellence together control 48% of the public assets managed by portfolio managers (ibid; TASE, 2010-11).

Figure 4.3. The market share of the big insurance groups for long-term public savings (pension and insurance), according to managed assets



Source: Milken 2011B: 1

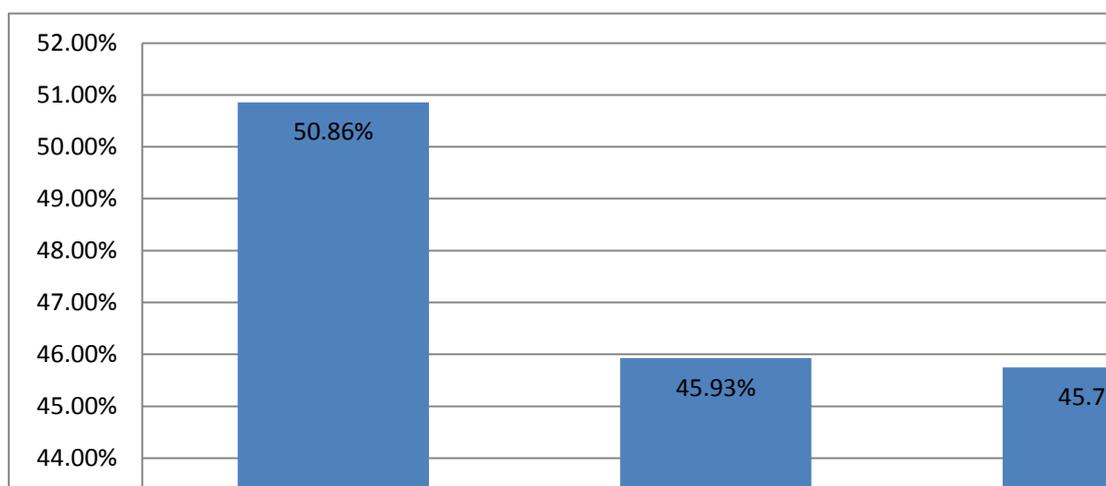
Figure 4.4. The share of the top three Israeli business groups (IDB - through Clal, Eliyahu - through Migdal and Harel) over public savings



Source: IMF, 2012a

In tandem with their increased control over the financial sector, the institutional investors were allowed to control industrial assets. The management of public savings expanded the scope of activity of the institutional investors considerably: they could invest in domestic public companies controlled by the same business groups they were affiliated to, and in companies affiliated to the other dominant business groups. Consequently, sizeable segments of public savings were invested in the big business groups (Hamdani, 2009). As a result, the role of institutional investors in the domestic capital market and in the broader political economy expanded enormously during the 2000s. The dependence of public savings on big business groups (see figure 4.5) created a conflict of interest similar to that of the banks before the Brodet Committee: investments of public savings and credit provision were now bound to considerations of business and personal ties.

Figure 4.5. The exposure of the pension savings to the ten big business groups by years<sup>85</sup>



Source: MoF - CMISD 2013: 13

<sup>85</sup> The exposure of the pension savings to the five big business groups in 2013 was 32.39%.

The concentration of public savings in the hands of the new business groups has had a number of consequences. Most importantly, the channelling of public savings to the capital market has radically changed their risk profile, a result of an asset portfolio shift away from risk-free government bonds to newer capital market instruments. Furthermore, excessive risks taken by controlling owners have genuinely jeopardised public savings. Sales of the business groups' bonds to institutional investors were inappropriate or irresponsible (Committee, 2010:11; Amazaleg et al., 2009). In addition, pension management fees in the new funds rose by 11.2% between the years 2005 to 2009 (Knesset 2010a: 3). The income of the big insurance companies from management fees increased from ILS 335 million to ILS 597 million between 2005 to 2008, and has kept rising (Adva 2009: 7). This process of power concentration in the hands of the new business groups eventually enabled the formation of an oligarchy.

The concentration in the banking system remained largely the same. The banking system is still dominated by 5 banks—Hapoalim, Leumi, Israel Discount, Mizrahi Tefahot and the First International Bank—which together manage 95% of public deposits. The rest of the system consists of three independent banks—Igud Bank, Jerusalem Bank, Dexia Bank—and four branches of foreign banks—BNP Paribas, State Bank of India, HSBC and Citibank (BoI 2006: 8). The size of Hapoalim Bank and Leumi Bank stand out, in particular. Each of these banks holds almost one-third of the Israeli banking sectors' assets, as well as 57% of public deposits (Leumi holds 29% and Hapoalim 28%). Discount Bank, the third in size, manages 16% (BoI, 2011: 9-11). Following financialisation, and also as a result of banking sector reforms from the 1990s, each of the five largest banking institutions in Israel is incorporated as a bank holding company, which typically comprises the main bank, one or more wholly-owned boutique banks, and several non-bank financial subsidiaries. They provide universal banking services and serve as brokers and custodians for a significant fraction of the securities owned by the Israeli public. The activity of the banks, nonetheless, is mostly domestic, and local businesses are almost wholly dependent on them. The role of the banks in enabling the rise of the oligarchy was central, as demonstrated in the next section.

The structure of the Israeli financial system was transformed from a state-led and bank-based structure to a market-based one, with substantial reallocation of power between economic actors, most notably the strengthening of institutional investors. The changing balance of power between actors in the capital market further served to increase the sources of credit for the business sector, contributed to the development of the financial sector, specifically the capital market, reduced the degree of concentration in the financial system, and decentralised decision-making among a greater number of entities (Hodak 2009:4). The financial sector, as a consequence, has grown rapidly in recent years, and is now composed of about 200 institutions following the reforms (Kosenko, 2008;

Sokolinski, 2012).

The concentration in the financial sector following the reforms is nonetheless preferable to the previous situation, since there are two power centres, banks and institutional investors, rather than the previous bank-dominated structure. However, power is still concentrated in dominant control cores, i.e. institutional investors, for the most part affiliated to the new business groups, through business and personal relations. In addition, they are not constrained by the same limitations and supervision applied to banks. The merger between financial and real holdings, previously prohibited from the banks, was authorised, or at least not explicitly disallowed, for the new actors in the public savings field. Consequently, the power transfer from banks to institutional investors, undertaken to create competition, was carried out by means of a simple exchange between two power structures. Although through financialisation competition between various segments of the financial sector increased, the problems of concentration and conflicts of interest remained.

### ***The Rise of Non-Bank Credit Market***

The rise of institutional investors and the growth of the financial sector, along with the role of the big business groups, created a developed and prosperous non-bank credit market, operating in parallel to the bank credit market.<sup>86</sup> The ability to raise capital had thus shifted from the state to the banks and finally to financial institutions and the capital market. Non-bank credit increased sharply, mainly through corporate bonds issued by the business groups, rising from ILS 12 billion in 2000 to ILS 150 billion in 2009, an increase of 1150%. Non-bank business credit increased from 33% of the credit extended in 2004 to 46% in 2009 (Hodak 2009:9). The share of business credit controlled by institutional investors grew from 6% to 26% of credit extended over the same period. Institutional investors currently account for approximately 25% of credit extended to the business sector (OECD 2011a: 29). They are also important players in the bond market, holding 64% of tradable bonds and a preponderance of non-tradable bonds, and are the primary driver of demand for non-government bonds (Hodak 2009:6).<sup>87</sup>

The non-bank credit market provided by insurance companies, some of which are controlled by the new business groups, has been able to offer credit both in the form of tradable credit, through the sale of corporate bonds, and non-tradable credit, through the sale of non-tradable bonds and the provision of direct loans to companies (Hodak 2009:9). The substantial increase in assets managed by institutional investors made it possible for them, along with the gradual retreat of the state, to

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<sup>86</sup>The shift to a non-bank credit market was a part of a global trend, largely a result of the reluctance of the banks to extend credit following the 2000s dot.com crisis, as analysed in chapter 2 (OECD, 2011a).

<sup>87</sup>Despite the rapid development of the non-government bond market, it is still not sufficiently developed or sophisticated in some areas. Unlike in Israel, many bonds issued in the US and UK are accompanied by contractual covenants and financial criteria to protect the bondholders. Furthermore, bonds are classified in a manner that makes it easier to identify the seniority of the series over other debt in the company. (Hodak, 2009:5).

invest more in non-government bonds. Public savings managed by these bodies, therefore, were largely directed to the capital market.

The state played a central role in channelling public savings to the capital market. The Israeli authorities encouraged institutional investors, since mid-2000s, to invest in the capital market through mutual funds,<sup>88</sup> urging them to play an “activist role” (OECD, 2011a). The institutional investors were allowed to invest freely in stocks, bonds, and industrial assets, domestically and abroad, simultaneous to the gradual liberalisation of investment rules and the dismantling of tax provisions favouring investments in domestic enterprises. Investments in the capital market were both a strategy to overcome the deficits in public savings and a means to strengthen the big business groups, through mutual exchange between them.

Against the development of a non-bank credit market, the share of bank credit increasingly contracted. In 2000, 83% of corporate credit was financed by the banking system (Bank of Israel 2006:154). In the early 2000s it still provided 77% of total business credit, compared to 23% by non-bank entities, such as institutional investors, mutual funds, non-residents, and households. Between 2003 and 2007, the banks' share of business sector finance fell by 25 percent. By 2009, the banking system provided 54% of business credit in the economy, with non-bank sources providing the balance (Knesset, 2013). This represents a real reform in the decentralisation of power in the business credit market, with Israel's composition comparable to other Western countries (Hodak 2009:5).<sup>89</sup>

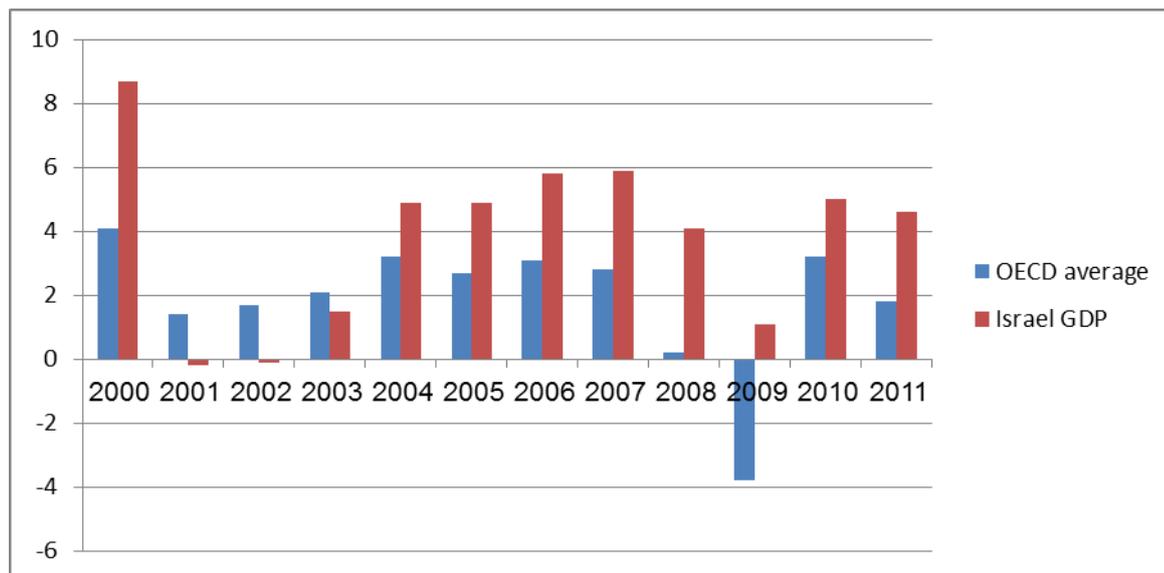
The investments of the institutional investors appeared essential, at first glance, to the solvency of many companies in the Israeli market. After pension funds were privatised and the banks divested their holdings in mutual and provident funds, the business sector had more options for obtaining credit. Accordingly, the accelerated development of the capital market allowed the saving public to benefit from a wide range of investment channels. Indeed, the Israeli long-term savings sector has been on the rise, led by the provident funds and followed by pension funds, insurance, and mutual funds (OECD 2011a:29). Furthermore, the groups could provide capital market benefits to the affiliated companies (Masulis et al., 2011). The growth rate in the Israeli economy from 2004 to the onset of the global financial crisis in 2007-8 (see figure 4.6) resulted in a steady increase of the assets managed by institutional investors (Hodak 2009:4). These growing investments contributed significantly to the high growth rates (ibid).

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<sup>88</sup>The state also offered guarantees for institutional investors' investments in bonds, but this was not carried out in the end.

<sup>89</sup>In recent years, 70% to 80% of credit in the US economy originates in the non-bank market, while in Europe the non-bank market ranges from 45% to 50% of credit.

Figure 4.6. Israel growth rate (in percent) in comparison to OECD growth rate



Source: CBS, Statistical 130, 2011

The rise of institutional investors and non-bank credit market has, however, resulted in a new biased allocation of credit, extended, most prominently, to the oligarchic 'club'.<sup>90</sup> It therefore did not indicate that the problem of concentration in the financial sector, which was previously associated with the banks, was solved. Specifically, the control of public savings remained concentrated. This outcome is not only symptomatic of the economy's financialisation, but effectively illustrates how state-business relationships were maintained, even if they consisted of new actors. As a result, the financial sector increasingly started dominating the political economy, which was itself now concentrated in big clusters of wealth and power, controlled by the market's new leading actors. The following section analyses the mechanism of this oligarchisation process.

<sup>90</sup> It is noteworthy that the increased power of institutional investors was not based on complex financial structures, as in the US; instead, it is a result of the financial power concentrated among the same groups to which institutional investors are affiliated, through bank and non-bank credit, then circulated back amongst themselves.

## **2. Oligarchisation through Financialisation**

The mechanism of oligarchisation through financialisation was based on both the state policy of transferring power to strong and capable hands, and on the 'clubness' – the special relations and mutual interests of the new economic actors (analysed in chapter three). This process consisted of three inter-linked mechanisms. The first was a biased allocation of credit, bank and non-bank, to specific business groups, who ultimately constituted the Israeli oligarchy. The rising non-bank credit market was integral to the oligarchisation process, as the new actors providing credit were either directly affiliated to the new business groups or linked to them through personal and professional connections. This was, the same group or club could control the supply and therefore the provision of credit. Second, the new business groups expanded using pyramidal structures, while the significant wedge between ownership and control, namely the outsized level of control obtained over firms in the expanding pyramid relative to capital invested, was a key tool of building the pyramids. Third, oligarchisation was enabled by institutional deficits and weak regulatory controls in the financial sector, most prominent among them were inadequate legislation and regulatory fracturing.

As a result, a selected group had the control over public savings, managing pension funds, provident funds and mutual funds, as well as over deposits managed by the banks. The following sections analyse these three mechanisms, featuring oligarchic processes (analysed in the first chapter) of privileged access to credit, organisational form of pyramidal ownership structures and poor institutional exercise. These mechanisms, sustained by both the state and the 'clubness' of the new big business groups, led to the formation of oligarchy in Israel.

### ***The Biased Allocation of Credit***

Biased allocation of credit was manifested at two levels. First, banks preferred to provide credit to the new business groups, who generally were seen as 'too big to fail'. The credit bias was further accompanied by inequalities in collateral requirements put forth by the banks (Committee, 2012). Moreover, the particulars of these personal relationships have not been fully transparent and accessible to the public (ibid). Second, the big business groups, who either controlled the institutional investors or were linked to them, created cheap access to credit for themselves to finance their expansion. These business groups, therefore, controlled the supply and the allocation of credit. Institutional investors had a tendency to provide credit within a closed circle. As the new business groups constituted the non-banking credit market, or were closely linked to it, they were its key clients. The source of capital in the non-bank credit market was primarily the public savings.

The provision of extensive credit lines by the banks and institutional investors was ostensibly

supported by the prospect of higher dividends from the business groups in comparison to other companies (Sokolinski, 2012). The heads of the new business groups used their familiarity with the financial market to introduce viable business strategies and promising profit plans. More importantly, nevertheless, it was the 'clubness' – personal or professional connections among the socio-economic circles, including senior bankers, accountants, lawyers, lobbyists and politicians – which enabled the biased allocation of credit. In effect, big business groups had privileged access to bank and non-bank credit because of their power in the market and their connections within the same 'club' (analysed in the next chapter). This meant that the oligarchy was both the provider and main beneficiary of banking and non-banking credit.<sup>91</sup>

The loan of ILS 150 million Hapoalim Bank provided in March 2009 and January 2011 to Tomhok, a private holding company controlled by Nochi Dankner, under IDB, a publicly traded company, is an example of a bank credit bias. The bank also approved a loan of ILS 750 million to IDB Development in 2009. The Chairman of Hapoalim at the time was Dani Dankner, the cousin of Nochi Dankner. The bank did not enforce adequate guarantees, nor did it charge the repayments (Avriel, 2014; Rochvarger and Ginzburg, 2013).<sup>92</sup> Likewise, in 2009, Leumi Bank waved dividend payments from IDB as payment on IDB's debt, instead choosing to extend the debt of Ganden, Nochi Dankner's private holding company. In effect, the bank took on all the risk for providing the loans, while not securing reimbursement of the principal and only collecting interest on it (Arlosoroff, 2013a).

An example of non-bank biased credit was the Maariv daily newspaper transaction. Discount Investments Corporations, under IDB, invested ILS 140 million in Maariv in March 2011, with an additional ILS 200 million to be invested in the following eighteen months. The reasons for the transaction were not economic, but were associated with the benefits of controlling a media body, namely extending and strengthening political-economic influence. The debts of Maariv then stood at ILS 660 million (Raz, TheMarker 2013). The directives of the board of directors were not revealed until TheMarker filed a court appeal to expose them in 2013 (ibid). The directors did not object to this risky transaction, thus failed to serve the public they represent. The expert appointed by shareholders to investigate the decisions which led to the failed transaction stated that there were no economic justifications or financial reasoning behind this decision, and that the motives remain rather vague (Amir, 2012).<sup>93</sup> The directives revealed the absolute rule of the controlling-owner, with the board of directors not objecting, questioning, or opposing his decisions.

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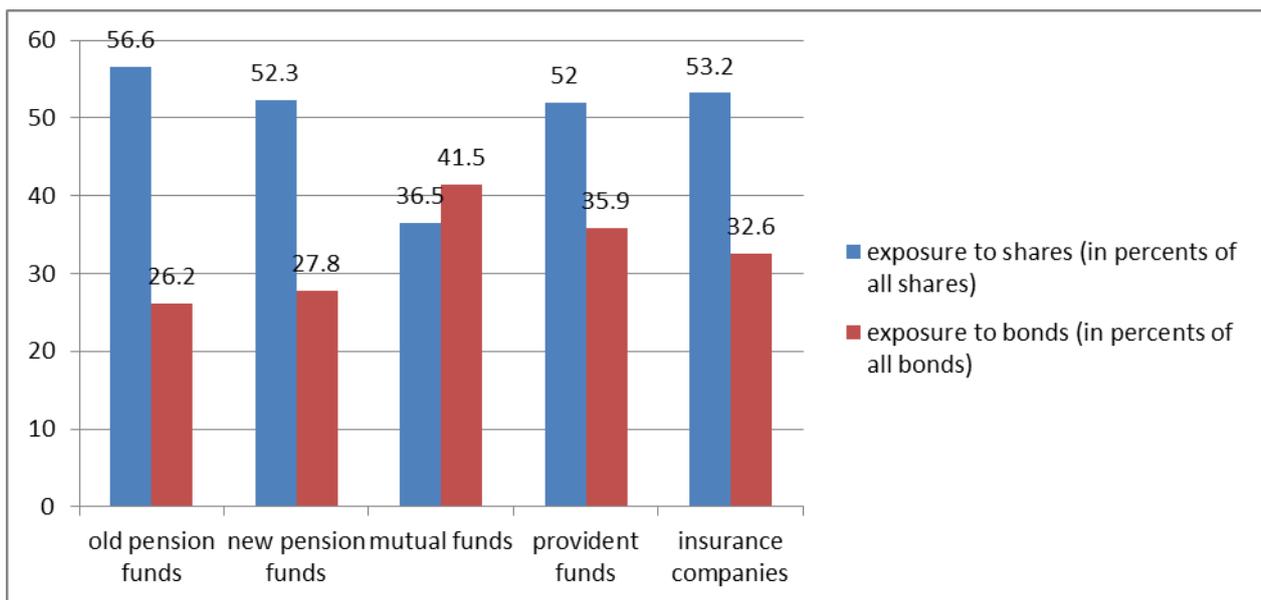
<sup>91</sup>This conforms to a global trend, according to which excessive amounts of capital obtained under excessively favourable terms is traditionally provided to firms affiliated with the dominant business groups (La Porta et. al, 1999; Wiwattanakantang et al., 2003).

<sup>92</sup> In 2014 the District Court was instructed to open an investigation regarding these loans, arguing that they might be questionable, based on personal acquaintances, provided without sufficient guarantees (Appelberg, Themarker 2014a). Hapoalim Bank, in response, is still trying to prevent the release of the documents which allowed for to the loans provision for Nochi Dankner (Appelberg, TheMarker 2014b).

<sup>93</sup> The shareholders filed a lawsuit against Discount Investments Corporations relating to this investment.

All in all, Israel’s non-bank credit market is heavily concentrated: 2.3% of the borrowers receive 71.7% of credit, while 14.7% of the borrowers account for 89.8% of the credit (Knesset, 2012). The 2009 Hodak Committee by the Ministry of Finance, which examined the institutional investors’ investments in non-government bonds, is important for understanding how credit is allocated. The committee was founded in light of the 2009 crisis of corporate bonds. The Israeli corporate bonds market rose from ILS 25 billion to ILS 200 billion between 2004 to 2008 (ISA, 2012). The 2007-8 global financial crisis resulted in an increased rate of insolvency, 13.2% in private placement, and in non-graded investments—in 2006, almost 20% of the debt was not graded (ibid). The committee stressed that the business groups secure institutional investors’ investments in corporate bonds through minimal personal pledges and general credit bias in the market. The publication of the committee’s conclusions in 2010 was a genuine turning point in the market economy. The report found that the institutional investors had become increasingly focused on the 10 big business groups. For example, 56.6% of pension funds’ money invested in shares is invested in the ten big business groups, and 26.2% of the pension funds’ total money is invested in the bonds of these groups. Figure 4.7 below illustrates the exposure of public savings managed by the institutional investors to the 10 big business groups.

Figure 4.7. The exposure of institutional investors to the biggest 10 business groups, by assets (March, 2011)



Source: State Comptroller and Ombudsmen 2013: 7

Conversely, the biased provision of credit to the big business groups was not officially declared by the banks (BoI, 2009, 2011). The business record of the banks is much more decentralised, and their limitations much more effective (ibid). At the same time, the credit portfolio of the banks does

indicate a certain level of bias in favour of the big business groups. The top six business groups (Tshuva, Ofer, Leviev, Dankner, Bronfman, Arison) accounted for over 25% of the bank business credit in the years 2009-2010 (see table 4.1 below).

Table 4.1: The credit weight of the six big business groups in the portfolio of the banks

<i>Credit allocation to the six big business groups (in ILS billions)</i>	<b>2009</b>	<b>2010</b>
Banks credit balance of the six big groups	97.5	105.3
Banks Extended business credit	387	409
Credit weight of the six big groups out of the banks entire business credit	25.2%	25.8%

Source: Knesset, 2013:3

The close relationships, or 'clubness', between the banks, the business groups, and the institutional investors not affiliated with them (most prominently Harel), enabled the business groups to obtain credit to expand their activities without risking substantial private capital. The controlling businessmen or families channelled this credit continuously to the new business groups, which, consequently, could reorganise the enterprises purchased, through mergers, acquisitions and new partnerships, in a way that would enhance their sectorial spread. Their power was thus further expanded, while the market economy became more concentrated.

A potential explanation for this credit bias is the networked business community, specifically the business elite, because of the stability associated with big power structures and the tendency to follow trends in the market. In addition, the Israeli financial market is small and concentrated, and there were hardly any segments in the market perceived as stable and safe for investments. However, the strength of these groups was rooted in their access to public savings, entangled with the perception that they were 'too big to fail'. These crucial features were enshrined by the reciprocal relationships within the oligarchic club. The groups were not competitive, but rather rent-seekers, and moreover, exploited public savings to generate private profits.

The implications of the biased non-bank credit market were hazardous for a number of reasons. First, non-bank credit was only accessible to a narrow business circle and public savings remained concentrated among a few parties. Public savings have become a significant channel of exchange within the oligarchy, as investments were made according to 'club' affiliation and personal considerations. The level of concentration did not benefit savers or the business sector in general (Committee, 2010; Committee, 2012; Trachtenberg Committee). Second, the biased allocation of credit has threatened the stability of the market economy as a whole. The investment structure of

the pension funds, as enacted in the pension reform, was set at 50% investment in government bonds, 20% in liquid assets, and 30% invested in the capital market (Nevo, 2003). As such, significant portions of Israeli pension funds became exposed to the business groups in this framework. Third, this biased allocation of credit posed a risk to market competition. While a concentrated capital market does not empirically prove centralisation of economic power (Hamdani, 2009), in a small market economy like Israel it almost inevitably does. Overcoming the conflicts of interest that inevitably arise is far more challenging in the context of ‘clubness’.

### ***The Expansion Through Pyramidal Structure***

Although a sort of two-layered pyramidal structure already existed during the 1970s (as analysed in chapter 2), it was financialisation in Israel that effectively facilitated the expansion of business groups. This was done through extensive and more sophisticated pyramidal ownership structures, which, in turn, led to the growth of the scope, scale and economic presence of the business groups, resulting in their far-reaching rule over the political economy as a whole. Due to the outcomes of the financialisation process, the new owners could obtain control of firms with relatively low equity capital, exercising a substantial wedge between their cash flow and their voting rights, or degree of control (BoI, 2010). With a median leverage ratio of 60-80% of initial capital (Sokolinski, 2012) they could expand across extensive market shares and sectors while minimising their risks. Such leverage was a central tool of building pyramids. Through pyramidal ownership structures with a holding company at their apex, these groups had more opportunities to expand in numerous sectors and industries, rendering them very powerful.

As discussed in chapter one, pyramidal-structured business groups, typically controlled by wealthy individuals or families at their apex, are the most widespread mechanism employed to control corporate groups and expand their activities (Morck et al., 2005). It is essentially a means for their owners to accumulate economic and political power, the latter in terms of the decision-making process and its outcomes (Khanna, 2000; Morck et al., 2005). In Europe and East Asia, separation of ownership and control and dispersed ownership allows families to exercise control with a relatively small (20%) ownership stake in their respective companies (Faccio and Lang, 2001, 2002; Claessens et al., 2000). The average proportion of companies active in the market under a pyramidal holding structure in Europe and the Far East amounts to 10% and 48% respectively. In Russia, by contrast, the pyramidal structure is less common, as the largest groups hold majority shares of both control and cash flow rights (Guriev and Rachinsky, 2004; Boone and Rodionov, 2001).

With respect to the pyramidal structure, Israel is not very different from developing states. The business sector in Israel is characterised by the extensive domination of pyramidal business groups,

commonly family-controlled. Most public companies, particularly the big ones, are controlled by the same small group of wealthy families, positioned as dominant share-holder. OECD reports, Bank of Israel analyses, as well as ratings agencies like D&B and BDI, have indicated that the market economy of Israel is extensively pyramidal by the parameters of dimension, depth, and the relative value of the pyramids. In many cases, one person or family controls a large number of companies, mostly through control pyramids (Hamdani, 2009; Kosenko, 2008). At the apex of the pyramidal structure stands a private holding company, meaning that wealth and power are associated with the individual controlling-owner or family. Business debts are accumulated on the lower levels of the pyramid. There are funders on every level, but on the bottom level there is a whole series of creditors (banks, bonds holders). One of the results of the pyramidal structure is that most public companies, particularly the big ones, are controlled by the same small group of wealthy families, positioned as dominant shareholder.

The new business groups have become quite complex and diversified since the late 1990s (OECD 2011: 17), by means of holdings across numerous market sectors and branches (Maman 2002: 741), through the pyramidal ownership structure. The latter is also the reason why the business groups were not defined as monopolies by the regulatory authorities, allowing them to diversify risks and obtain credit more easily than if they had chosen a different structure (Maman, 2008). Similarly, unlike most countries, the issue of dual-class shares (capital rights and voting rights – one share, one vote) has been barred in Israel since 1990, allowing further expansion of the pyramids.<sup>94</sup> Controlling shareholders who wanted to reverse the initial erosion of their voting power could either acquire more shares or, alternatively, in what seemed to be the preferred option, build pyramids as a substitute for dual class shares (Lauterbach and Yafeh, 2011). The formation of pyramidal business groups and expansion through pyramids has thus been a natural evolution of the old business groups, and, to a great extent, a product of the policies of the state. It has also been the prevailing trend among the new business groups, a process of imitation to better compete in the market.

The money of the public - 'other people's money' (Brandeis and Hapgood, 2009 [1914]) - was thus used by the consolidating oligarchy to accumulate more power and expand the pyramids. At the same time, the will to power dictated this structure. Indeed, the pyramidal ownership structure would have been feasible regardless of financialisation; however, the ability to expand and obtain further control was exacerbated by financialisation. Crucially, on the one hand financialisation has facilitated the expansion of oligarchic control over the economy of, and through, pyramidal ownership structures that have led to a greater concentration of control over the economy in the

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<sup>94</sup>In 1990, a new amendment to the Israeli Securities Law forced Israeli companies raising equity for the first time on TASE to issue only one share-one vote common stock (Lauterbach and Yafeh, 2011), enacted in Amendment 11 of the 1988 Securities Law.

hands of a few owners. On the other hand, the opportunities to build pyramidal business groups and to expand their control over the market economy were, in turn, enhanced by financialisation, rendering these groups very powerful and thus prompting the rise of an Israeli oligarchy.

To illustrate, in 2007 nineteen major business groups, mostly controlled by wealthy families, controlled 160 publicly traded companies (out of a total of 644), most of which were obtained through control pyramids (Kosenko, 2008).<sup>95</sup> These groups controlled 40% (ILS 298 billions) of the total income of the 500 leading companies in Israel (BDI, 2007).<sup>96</sup> In 2011, twenty-four business groups controlled 136 public companies out of 596 (23%) (Committee Interim Report, 2011). In 79% of the pyramid-structured business there are at least two layers of public companies, representing a market value of 68%. The estimated market value of companies independent of family business groups accounted (as of 2010) for only 34% of listed companies on TASE, and only 87 listed companies have widely dispersed ownership (Committee, 2010; Committee Interim Report, 2011).

Out of these nineteen groups, ten family-controlled groups represent the strongest concentration of economic power in the corporate sector, controlling key Israeli companies. These ten privately controlled business groups control 30% of companies listed on Tel Aviv Stock Exchange (TASE), representing 30% of the market capitalisation (Kosenko, 2008). This is among the highest rates of concentration in the Western world, a situation similar to that in Asian and Latin-American markets (ibid).<sup>97</sup> The biggest groups in terms of market share, representing the core of the Israeli oligarchy, are mapped and characterised in the next chapter. Such concentrated control by these business groups was considerably enabled due to regulatory failures, as analysed next.

### ***The Inefficacy of State Regulation***

Similar to other countries that have experienced economic transformation or reform, the role of wealthy families and individuals grew in Israel at the expense of the functioning of certain state institutions. This outcome does not counteract the dominance of the state, however, because the state has been playing an active role in the oligarchisation process and in preserving the power and celebrated status of the oligarchy. Yet, it does indicate vulnerability or institutional failures, as well as damage to the public interest. While the literature underscores tax cuts and subsidies as key instruments of the support of the state of the oligarchy, legislation and policies responding to the dynamics of the concentrating market are no less compelling. Furthermore, an oligarchy needs the

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<sup>95</sup>This research covers 650 companies in the years 1995-2005. Ownership type includes single owner or family, private corporation with decentralised ownership, governmental ownership, joint ownership (trusts, partnership etc.), and foreign ownership (parameters based on La Porta et. al., 1999).

<sup>96</sup>These groups include Alovitch, Arison, Borovitch, Bino, Dankner, Hamburger, Weisman, Werthaim, Zisapel, Levaiev, Federman, Saban, Ofer, Azrieli, Fishman, Schahar-Kaz, Strauss, Schmeltzer, and Tshuva.

<sup>97</sup>This places Israel in the top 10 out of 45 developed and under-developed countries, in terms of business groups' importance; it is among the highest in the Western world (Sokolinski, 2012).

state not only in order to defend its wealth, but also in order to accumulate it, for example through the elimination of competition.

In Israel, reforms in the financial sector were entangled with regulatory and legislative changes that aimed at creating an efficient and competitive capital market. Limitations on the capital market were steadily removed, and regulation of big corporations traded in the capital market, including the pyramidal business groups, was reduced. The big business groups, in addition, could influence more aggressively than other companies on tax policies, due to their size and the scope of their operations. Also, special conditions on currency exchange rates, interest rates, and tax rates were set for specific business groups, complementing the previous public concessions and government auctions awarded to the same groups (Committee, 2012:25-29).

Unlike developed countries around the world, where institutional investors have a long-standing capital market investment culture, it is only recently that the Israeli entities managing public savings began investing in the bond market in a significant volume. While sound legislation is widely applied in most areas of corporate governance in Israel, with relatively strong investor and creditor rights protection (OECD, 2013a), institutional investors were not under strong regulatory restrictions, which stands in contrast to the period of the domination of the banks over the financial system. In fact, a decade after the 1985 EESP, market concentration was further substantiated by legislation (OECD 2011: 8, 17) fostered through the Companies Law enacted in 1999 and put into effect in 2000.

The Companies Law concerns all corporations in Israel, and is the legal framework in which the pyramidal business groups operate. However, it was effectively attuned to the model of the business groups operating during the 1970s, a mixture of the German Konzern and the American Conglomerate (Maman, 2006b). The heavy reliance on the US legal model was consistent with Israel's political, economic and military dependence on the US at the time (ibid: 126).<sup>98</sup> Rather than trying to prevent concentrated ownership with the rise of the new groups, therefore, the Israeli approach has relied on a legal and regulatory framework shaped according to the business climate of the 1970s and the 1980s, gradually reforming it to address the agency problems arising from the new ownership landscape. Nevertheless, the 'Americanisation' of the legal culture (thus rejecting the German model) came at a price, as pyramids are not common in the US. Consequently, the law does not address the new pyramidal business groups formed in the past two decades. By excluding the dominant companies in the Israeli market, the law fails to provide a comprehensive corporate

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<sup>98</sup>It was Israel's Securities Authority (ISA) that introduced the most significant opposition to any reference to the business groups in the new corporate law (Maman, 2006b: 122). In addition, the designers of this law opposed the inclusion of the business groups, reluctant to comprise in the corporate law what was seen as 'exceptional' legal systems (ibid:125). On the other side of the controversy, several interest groups and professional associations tried to advance the business groups' inclusion, such as the Association of Publicly Traded Companies and the Manufacturers' Association of Israel (ibid:121-22). The conflict over the 'Companies Law' has thus been between two sets of logics: legal logic, based on the American model, and organisational-business logic (ibid: 127).

governance framework.

Drawn from the Anglo-American system of decentralised corporate control, the legislation focuses on the executives, mainly the management (Hamdani, 2009). However, as previously discussed, the Israeli market economy has been characterised in the past two decades by corporations under the centralised control of a dominant shareholder. These shareholders are the dominant actors, and they appoint the managers in such a way that substantiates their control in the business groups without ever holding a formal position in it. The directors, who are supposed to form a supervisory body vis-à-vis the controlling owner, are appointed by the controlling-owner himself (ibid), and are therefore committed to him, at the expense of their public commitment. The Israeli legal model can, thus, only partially respond to problems arising from the prevailing ownership structure in the market.

Other problems resulting from the exclusion of the new pyramidal business groups from the main Companies Law include the challenges of protecting minority shareholders' rights, and state agencies incapacity to intervene in the governance of their businesses (Maman 2006: 130). The law empowers minority shareholders by allowing them, at least in theory, to veto self-dealing transactions (Hamdani and Yafeh, 2013: 692), and indicates that all companies are autonomous legal entities.<sup>99</sup> However, it fails to protect shareholders in practice. To illustrate this point, it does not include a stipulation to comprise contractual covenants and financial criteria in trust deeds for the protection of savers' rights (Hodak 2009: 28).

The weakness of the regulatory framework, nonetheless, is not rooted in poor institutions but rather in governmental decisions and policy, and in poor structure. The regulatory system is generally strong. The Israel Antitrust Authority at the Ministry of Industry, Trade and Labour, the Banks Supervisory Authority at the Bank of Israel, the Capital Markets, Insurance and Savings Division (henceforth CMISD) at the Ministry of Finance (MoF), and the Israeli Securities Authority (ISA) are the gate-keepers of the financial system, whose activities have upheld the involvement of the state in the economy following market liberalisation. Similarly, the presence of the legal arm of the state in the economic arena - the courts and the Attorney General - is prominent. At the same time, the formation of the oligarchy was reinforced by institutional deficits arising from inadequate legislation, insufficient coordination between the different authorities, and a fractured regulatory environment.

This inadequacy, in turn, was more a matter of governmental decisions and policy and less a matter of the phenomenon of 'state capture'. This is because the state institutions do not lack power, but their organisation makes them vulnerable to the influence of the oligarchy. Unlike other states, in which one supervisory authority coordinates the various gate-keepers of the financial system (e.g.

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<sup>99</sup>In March 2011, Amendment 16 to the Companies Law introduced more efficiency to corporate governance.

the Financial Services Authority or FSA in the UK), the Israeli regulatory system is fragmented. Moreover, coordination within it is limited. This point was reinforced by the MoF 1996 Committee, which indicated that coordination between the various authorities in the financial sector was limited, and was not legally enacted (1996 Committee: 74). Financial regulatory responsibilities are shared by three authorities – the Banks Supervisory Authority, the Commissioner of Capital Markets, Insurance and Savings in the Ministry of Finance (CMISD), and the Israel Securities Authority (ISA).

A fractured regulatory environment is not the only structural problem in the Israeli regulatory architecture. The Banks Supervisory Authority is responsible for the oversight of the payments system and is in charge of regulating the credit extended to a single entity. Additionally, it is charged with assessing the good standing of owners, controllers, and managers of banks—and seeking the removal of key persons if necessary. Due to the continuing importance of the major banking groups in the Israeli economy, this supervisory role is critical to ensuring a financially sound and competitive banking system (Maman and Rosenhek, 2011). The Israeli Securities Authority oversees the securities sector, protecting lenders, while the CMISD at the MoF is primarily responsible for the oversight of the insurance and pension sector, protecting savers. The Tel-Aviv Stock Exchange (TASE) also has some supervisory responsibilities for its members. Of these authorities, only the BoI has an explicit mandate: to maintain and promote the stability of the financial system.

The division of responsibilities among the three regulatory authorities has created some gaps and overlaps. For example, banks that are traded in TASE are supervised by the BoI, while non-bank members that are traded in TASE are supervised by TASE itself. Both the Supervisor of Banks and CMISD are in charge of regulating the credit extended to a single entity. While ISA has responsibility for the oversight of bank subsidiaries, the BoI must also be closely involved since it underwrites security issues. In addition, the institutionalised arrangements for sharing information through a formal framework of cooperation between the supervisory authorities are currently not sufficient (IMF 2012a: 27-8), because they only apply specific guidelines and do not include critical areas of cooperation, such as credit provided by the banks to the institutional investors.

Each regulatory authority is concerned with a specific interest, mostly the stability of the systems supervised by it. However, the way they obtain these objectives is different, and conflicts of interests emerge. For example, the various commissioners of CMISD over the years were motivated by the same objective: the stability of the insurance companies, whatever the price to the economy. Consider, for example, the reactions of the different institutions—banks, insurance companies, and public companies—to the 2009 Hodak Committee (see Knesset, 2013). They were all dissatisfied by the Committee's conclusions, although they represented different interests. Each regulatory

authority was reluctant to allow changes and fought to maintain the status-quo, demonstrating how these entities were mostly concerned with their own specific needs, at the expense of the wider public interest. Consequently, no systemic regulatory was developed.

Furthermore, the regulatory system has insufficient means of enforcement. While many areas overlap, some areas of supervision are simply absent. For example, the Israel Antitrust Authority once employed only one commissioner to supervise cartels and monopolies—and none to supervise mergers. This meant that until the 1990s there was no adequate supervision on mergers, enabling thus monopolisation. In addition, some of the monopolistic enterprises in the market are not publicly traded, and thus are not subject to public transparency. While government monopolies are supervised, monopolies and cartels created by oligarchy rule are not subjected to the same regulatory framework (despite 2011-2012 proposals of systematic change). For example, Nesher Israel Cement Enterprises, until 2012 under the control of IDB, the biggest pyramid in the market, has a monopoly in the cement industry. It is not subject to government supervision, as it belongs to private interests, and is not subject to corporate legislation either.<sup>100</sup> The cellular cartel, in which three companies dominated the cellular market for over a decade, closing it off to competition, is another example which will be analysed in more detail in the next chapter.

Additionally, for both public and private sector actors, regulation is currently reactive by nature, at the expense of consolidated vision and initiatives. The OECD report indicated that the Israeli approach had been, as of 2010, to accept the status-quo of concentrated ownership and to act through ex-ante regulatory means (OECD, 2011a). Therefore, regulation has been disconnected from the reality of the Israeli market economy. For example, there were numerous flaws in the way these groups accumulated wealth and power, which were nonetheless not dealt with by the regulation system. These flaws included limited transparency in their complex dealings and deal making, which were often signed in closed circles and enabled in large part by the privately-held nature of the pyramid's companies; lack of clear criteria, objectives, and comparables for evaluating such transactions; and closed M&A agreements among the same circles (Knesset, 2009). The regulatory fracturing has enabled, in turn, the biased allocation of credit and the concentration of the financial sector (Knesset, 2013), a direct threat to financial stability. The absence of effective limitations on single loan-takers allowed for the extensive wedge between cash-flow rights and control rights discussed earlier. Without a systemic approach and clear strategic vision of the market economy's direction, the regulatory system has contributed to the expansion of the pyramidal business groups and, ultimately, the rise of the oligarchy.

The far reaching impacts of the reforms in the financial sector were not foreseen by either regulators or politicians. None of these actors anticipated the hazardous shift in power, at the

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<sup>100</sup>This information is based on a series of interviews with senior officials in the Israeli Antitrust Authority, carried out by the author of this research.

detriment of society as a whole. More generally, the lack of strategic understanding of the state points to either the improper functioning of the legislative and regulatory systems or to their absence, as well as to inappropriate norms originating in economic structures and political institutions (Committee, 2012:11). There are elements of poor institutional structure in the Israeli case, such as misconduct in political decision-making process, accommodating or absent legislation, weak and fractured regulation, and the lack of adequate legislation. The 'revolving door' of regulators and politicians is analysed in the next chapter. Nonetheless, there is weak empirical support for 'missing institutions' (Kosenko, 2013). Unlike other cases of oligarchic capitalism (such as Latin American, Asian, and post-Soviet cases), from its foundation, Israel has been a democracy with a strong and stable institutional structure. It was not the absence of fundamental institutions which was filled by wealthy families. Instead, it was a continuation of the state-big-business nexus that had dominated the political economy since the 1970s, enabling strong actors to take advantage of new opportunities in the market, throughout liberalisation. Most importantly, this process was sustained by state policies and their certain unintended consequences.

## **Conclusion**

While by mid-2000s the big business groups consolidated in the post-EESP era already had concentrated power, it was only with the financialisation of the economy that they started to form an oligarchic power structure. The transfer of power from the banks to institutional investors, with access to bank and non-bank credit, largely contained to a specific layer of businessmen, wealthy families and financiers, resulted in the oligarchisation of the political economy. The key mechanisms used to substantiate the power of the oligarchy were privileged access to credit, the organisational form of pyramidal structure of ownership and control, and poor institutional architecture of financial regulation. The new controlling owners obtained control over these groups with considerably low capital and great financial leverage. With their control over public savings, the business groups could expand across various sectors and industries, merging financial and industrial or retail holdings and adding floors to the pyramids.

Throughout the process of financialisation in the Israeli economy, competition in the financial sector increased, as did the number of active actors. Indeed, financialisation played a substantial role in improving the market and developing it towards a globalised and liberalised model. Conversely, while finance was more abundant and cheaper, it was largely allocated within the same club, and resulted in further accumulation of wealth and power by the pyramidal business groups. The way financialisation was implemented in Israel demonstrates the continuity of the pre-existing concentrated ownership structure in the political economy. These institutional changes are related to the objectives of the state in managing the political economy and the particular institutional instruments it uses to those ends (Maman and Rosenhek, 2012: 346). The state has changed its role, but its agencies have continued to play a crucial part in the economic arena.

At the same time, the oligarchisation of the market economy is still an outcome of regulatory and legislation deficits, lack of coordination between different government actors and institutions, and the inability of state agencies to envision that this process would result in an equally concentrated market structure. The fight over the power of the banks resulted in the genesis of a new power structure, centralising wealth and power, discouraging competition, and perpetuating the patterns of the closed club.

The constellation of wealth and power in Israel, as of 2012, incorporates old structures of power with new layers. Conversely, the new business groups also differ from previous structures. A substantial difference relates to the pyramidal ownership structure, which existed before, but which was broadened and become more sophisticated. Another issue relates to their share of the market. The extensive power of pyramidal business groups distinguishes them from the preceding groups. In addition, global trends and general business evolution, institutionally sustained by the state and its well-intended policies, as well as the lack of a systemic approach to the problem of market

concentration, are also crucial. Given the centralised structure of the market, the transition to a free market economy has not been completed.

Overall, oligarchic capitalism in Israel is most prominently a result of the transition of the state to finance-led economic growth during the 2000s. In this, it falls within other countries whose market economies are controlled by oligarchies. However, the case of the oligarchy in Israel is distinct from other countries by the predominant role of the state, and the peculiar relationship of the oligarchic club with the state, namely its substantial dependence on the support of the state, which in turn holds the authority to break it. It is also distinct by the 'clubness', and by the predominantly domestic basis of most oligarchic groups' wealth. The next chapter analyses these features in detail.

## CHAPTER 5

### THE ISRAELI OLIGARCHY AND THE OLIGARCHIC 'CLUB'

This aim of this chapter is to map and characterise the structure of the Israeli oligarchy as of 2011. The chapter argues that its core consists of ten pyramidal business groups, controlling substantial shares of numerous sectors in the market. What makes them an oligarchy is 'the club'. The club includes the controlling owners and the managers of these business groups, and other professionals, such as bankers, accountants, lobbyists, lawyers, managers, various 'consigliere', and other businessmen and business groups. The club has various roles, first and foremost coordination, both between the business groups and between the business groups and the government, including the regulatory system. However, the club is not the oligarchy as such, but an informal institution that transforms specific controlling-owners that participate in it to members of the Israeli oligarchy.

The analysis of the Israeli oligarchy is drawn on empirical data taken from various sources: international bodies, state agencies and ministries, think-tanks or research centres and ratings providers and business analysis agencies, as well as various publications in the media. Interviews, reports or public statements communicated by former regulators and politicians (e.g. Yaron Zelekha, Accountant General in the MoF in the years 2003-2007<sup>101</sup>; Dror Strum, General Director of the Antitrust Authority in the years 2001-2005; Einat Wilf, Member of Knesset (MK) for the Independence Party and the Labour Party in the years 2010-2013) are important sources of information as well. This data is complemented by the fieldwork conducted for this thesis.<sup>102</sup>

The chapter is divided into five parts, according to the five criteria that, when combined, enable us to distinguish oligarchs from other wealthy actors (as analysed in chapter 1). These include: (1) pyramidal ownership structure; (2) market concentration and a merger between financial and industrial holdings; (3) 'clubness'; (4) tight relations with the state; and (5) rent-seeking or non-competitive nature of oligarchs' activities. The first part of the chapter outlines the structure of the ten pyramidal business groups: IDB (Dankner), Ofer, Tshuva, Arison, Fishman, Werthaim, Bronfman, Bino, Eliyahu, and Azrieli. The second part analyses the concentration of the Israeli market. The third and the fourth parts analyse the main instruments or channels used to substantiate the power and control of the oligarchy: the 'clubness' or the oligarchic club, and its proximity to the political machineries of the state. Finally, the fifth part of the chapter analyses the 'competitive deficit' in the rule of the oligarchy, focusing on the key social, political and economic impacts resulting from its concentrated control over the political economy.

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<sup>101</sup> As the former Accountant General in the MoF (2003-2007), Zelekha had an integral role in the privatisation wave of the 2000s. His testimony on the shift of the Israeli market economy to a model of oligarchic capitalism, rather than a free and competitive market, is particularly important.

<sup>102</sup> Collecting the data to account for the structure of the business groups forming the Israeli oligarchy is not an easy task. The reasons for this are the diffused pyramidal structure of ownership, pertaining to shares holdings across industrial and financial sectors, but also the fact that a great deal of information about the member companies in the pyramidal structure is private.

## 1. The Pyramidal Business Groups Forming the Core of the Oligarchy

The following figures outline the core of the Israeli oligarchy, i.e., the ten big business groups. The nature of these business groups are united by two characteristics - pyramidal structure and wide sectorial spread with considerable market shares, primarily in the financial sector, while merging their holdings with industrial, retail, and service sectors assets, including national resources. This is entangled with the significant presence of family ownership (Sokolinski, 2012; Kosenko, 2008; Kosenko and Yafeh, 2010; Maman, 2006). The reforms discussed in the previous chapters, i.e. privatisation and most importantly financialisation, have resulted in the expansion of the big business groups through pyramidal structures. The pyramidal structure is not only a core characteristic of the oligarchy, it is also a central instrument for obtaining control without enhancing risk. It is therefore tightly linked to the non-competitive nature of the activities of the oligarchy. These groups manage strong connections with political, policy-making, and bureaucratic circles. As a result, the Israeli market economy is highly concentrated, with substantial power vested in the new business groups.

Delineating the structure of the business groups and the controlling-owners at the top of the pyramids, the following figures present the main sectors or areas in which the oligarchy is most dominant. These sectors include: <sup>103</sup>

FIRE - financial, insurance, real-estate: 

Retail and energy: 

Communication and media: 

Manufacturing and technology: 

Natural resources and infrastructure: 

The percentages in the lower levels represent the ownership stake held by the intermediary companies.

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<sup>103</sup> Sources: TASE, D&B, BDI, groups websites; OECD, 2011a; D&B, 2007-2012.

## **IDB**

IDB is a roll-over of the old business group pre-EESP (see chapter 2). It was founded in its current form in 2003, by Nochi Dankner, a member of one of the wealthy families in Israel. IDB was founded as a result of Dankner's own entrepreneurship. It is the biggest business group in the market, and the most diversified in terms of its activities.<sup>104</sup>

**Controlling owner:** Nochi Dankner

**Holdings:** IDB Holdings (49.5%); IDB Development (71.2%, through IDB Holdings); Discount Investments (73.51%, through IDB Development); Clal Ind. and Investments (62%)

**Finance:** Clal Finance (81.6%); Credit Suisse (2.5%)

**Insurance:** Clal Insurance (51.2-55%)<sup>105</sup>

**Manufacturing and technology:** Hadera Paper (59.4%); Mashaab (75%); Makhteshim Agan Industries (40.2%, held by Koor); Modiin (17%); Elron (78.71<sup>106</sup>); Given Imaging (43%)

**Retail (energy, food, tourism):** Koor Industries (41%-60.5%); Shufersal (48% - 57%); IDB Tourism (100%); Golf (69.1%); Isra-air (100%)

**Real-Estate:** Property & Building Corp. (83.4%, now 62.9%-78%); Gav-Yam (Bayside) (69%, held by Property & Building Corp.)

**Communication and media:** Cellcom (47.3% as of 2010); Netvision (70.7%); ECI Telecom (29.7%)

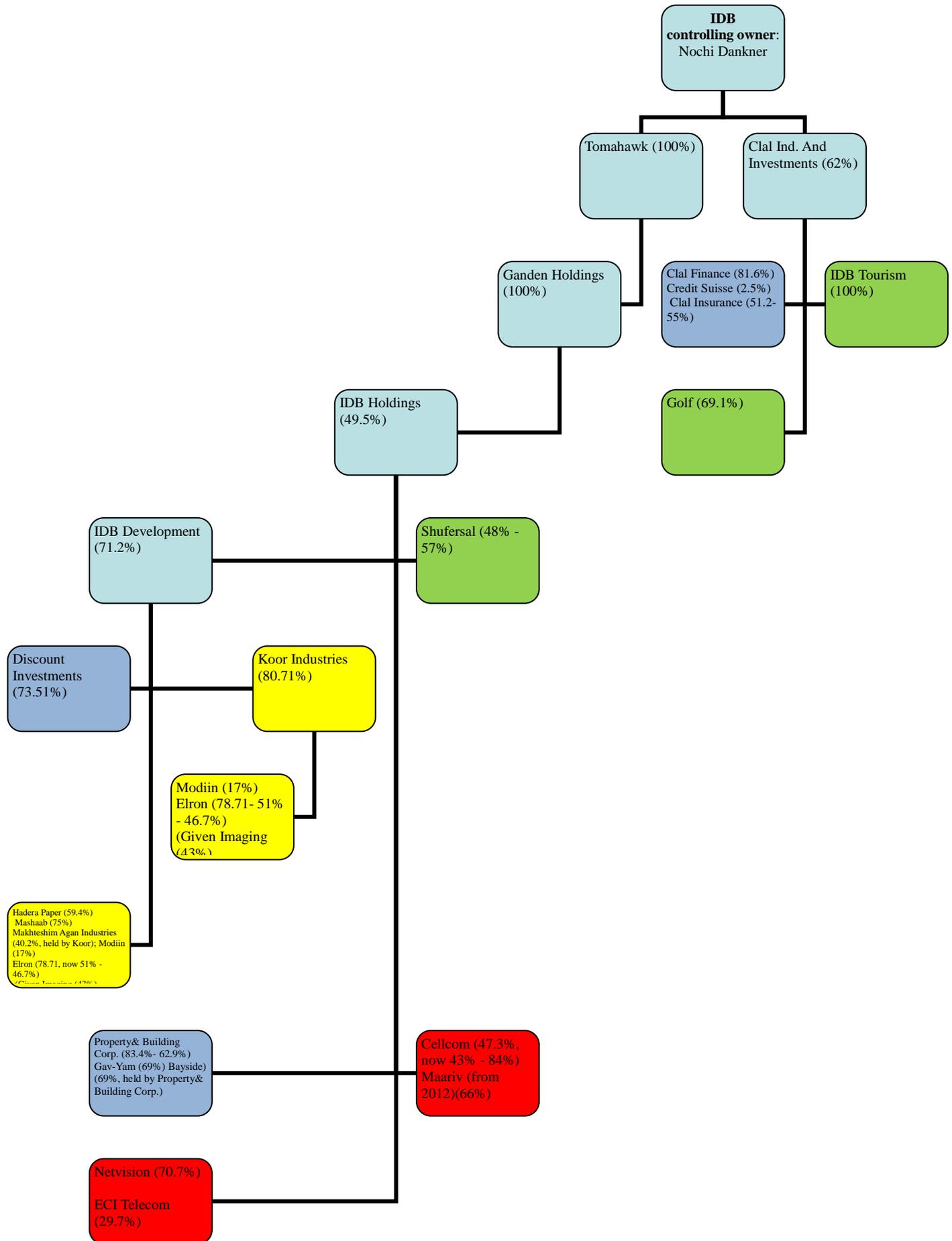
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<sup>104</sup> This is valid until 2013. For recent developments see the conclusions to this thesis.

<sup>105</sup> The ownership shares here and in some of the figures below are indicated in a range because the figures in different sources of information vary.

<sup>106</sup> In 2013, after several sales, IDB holds between 46.7% to 51% of Elron.

Figure 5.1. Structure of IDB Group



**Ofer family (XT Group, Ofer Brothers Group)**

Ofer Group was also one of the business groups of the pre-EESP era. It was founded on the long-lasting partnership between the Ofer brothers (Sami and Yuli), and was inherited by the family. Its current form is a result of a 1999 reformulation, when the Israel Corporation and ICL were purchased. Its principal activities are banking and shipping, and it also possesses ownership over national resources and other assets through the Israel Corporation.

**Controlling owners: Ofer family** - Eyal Ofer, Idan Ofer, Liora Ofer (sons and daughters of Yuli and Sami Ofer, the former controlling owners)

**Holdings:** Israel Corporation (53.72% - 54.2%)

**Banks:** Mizrahi-Tefahot (25.77% - 26.2%, through the Israel Corporation); Adanim Mortgage Bank (92.8%)

**Manufacturing and technology:** Tower Semi-Conductor (7.34% - 16.2%); TowerJazz (30.7%); Qoros (50%, based in China)

**Retail (energy, food, tourism):** IC Green Energy (100%)

Ofer maritime (50%); ZIM Integrated Shipping Services (- 98.3 - 99.7%);

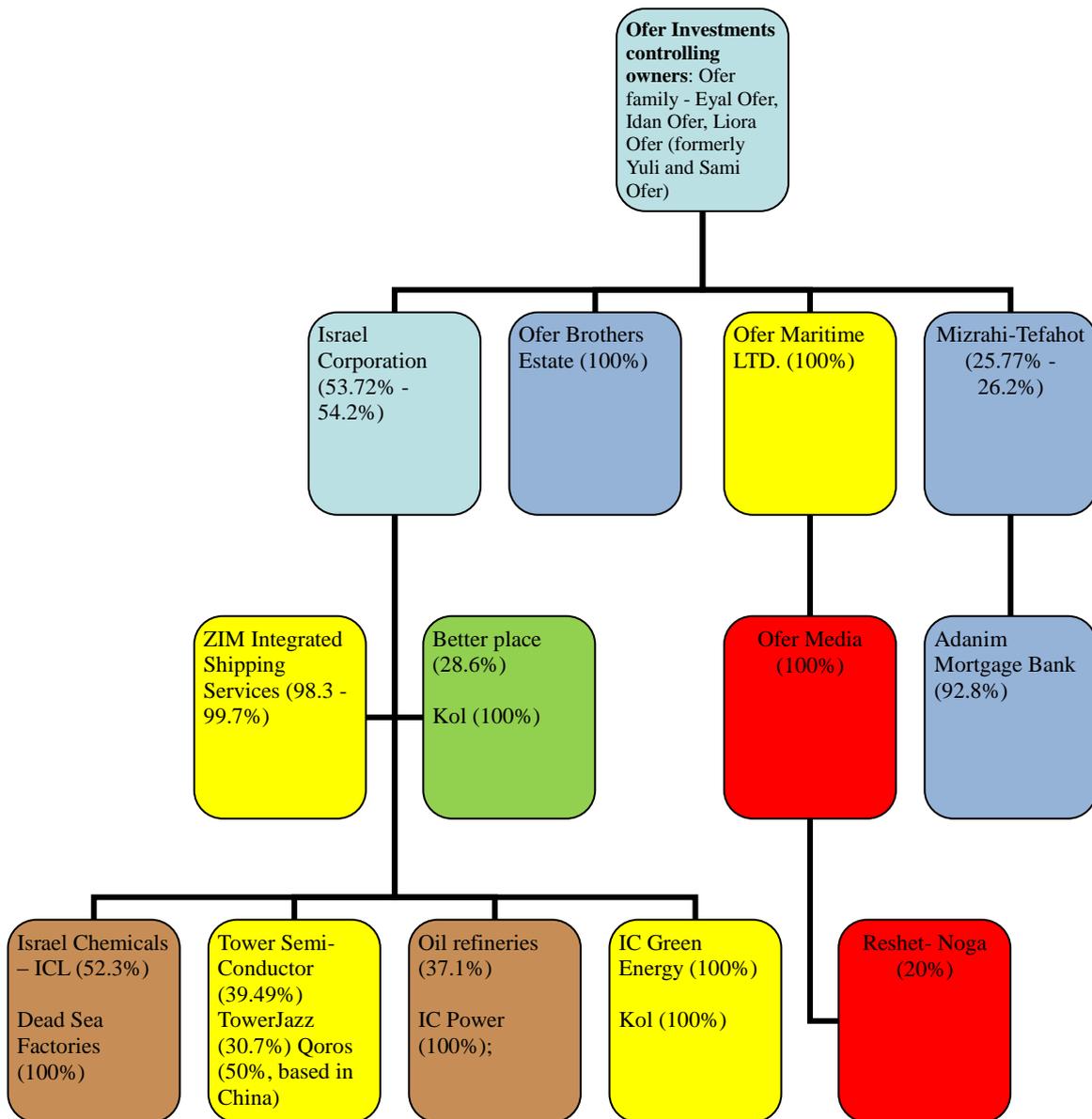
Better place (28.6%); Ofer Shipping (100%); Kol (100%)

**Real-Estate:** Ofer Brothers Estate (100%)

**Communication and media:** Reshet- Noga (20%, through Ofer Maritime)

**National resources:** Israel Chemicals - ICL (53.08% - 52.2%); Oil refineries (37.1%); IC Power (100%); Dead sea Factories (100%)

Figure 5.2. Structure of the Ofer Investments Group



## **Tshuva Delek Group**

Tshuva group was consolidated at the beginning of the 1990s, when Delek was sold to Itzhak Tshuva, an independent contractor with no prior family capital. It then expanded to takeover energy assets, real-estate, and insurance. The merger between financial and retail holdings is particularly prominent in Tshuva Group, which controls an insurance company and an investment house, in addition to wide holdings in the energy and industrial fields.

**Controlling owner:** Yitzhak Tshuva

**Holdings:** Delek Group (58.6%)

**Finance:** Excellence Nessuah Investment House (85%, Held by Phoenix Holdings Ltd.); Republic Companies Inc. (100%, a US-based holding company)

**Insurance:** Phoenix Holdings Ltd (61.6%); Menorah (14.4%)

**Manufacturing and technology:** Delek Automotive Systems (55.4%); Delek Petroleum (100%) (including Delek Energy Systems Ltd.; Retail Energy; Delek, The Israel Fuel Corp.(87%); Delek US Holding, Inc.; Delek Europe B.V.); IDE Technologies (Water Desalination, 50%); Independent Power Plants (IPP, 100%); Gadot Biochemical (76%)

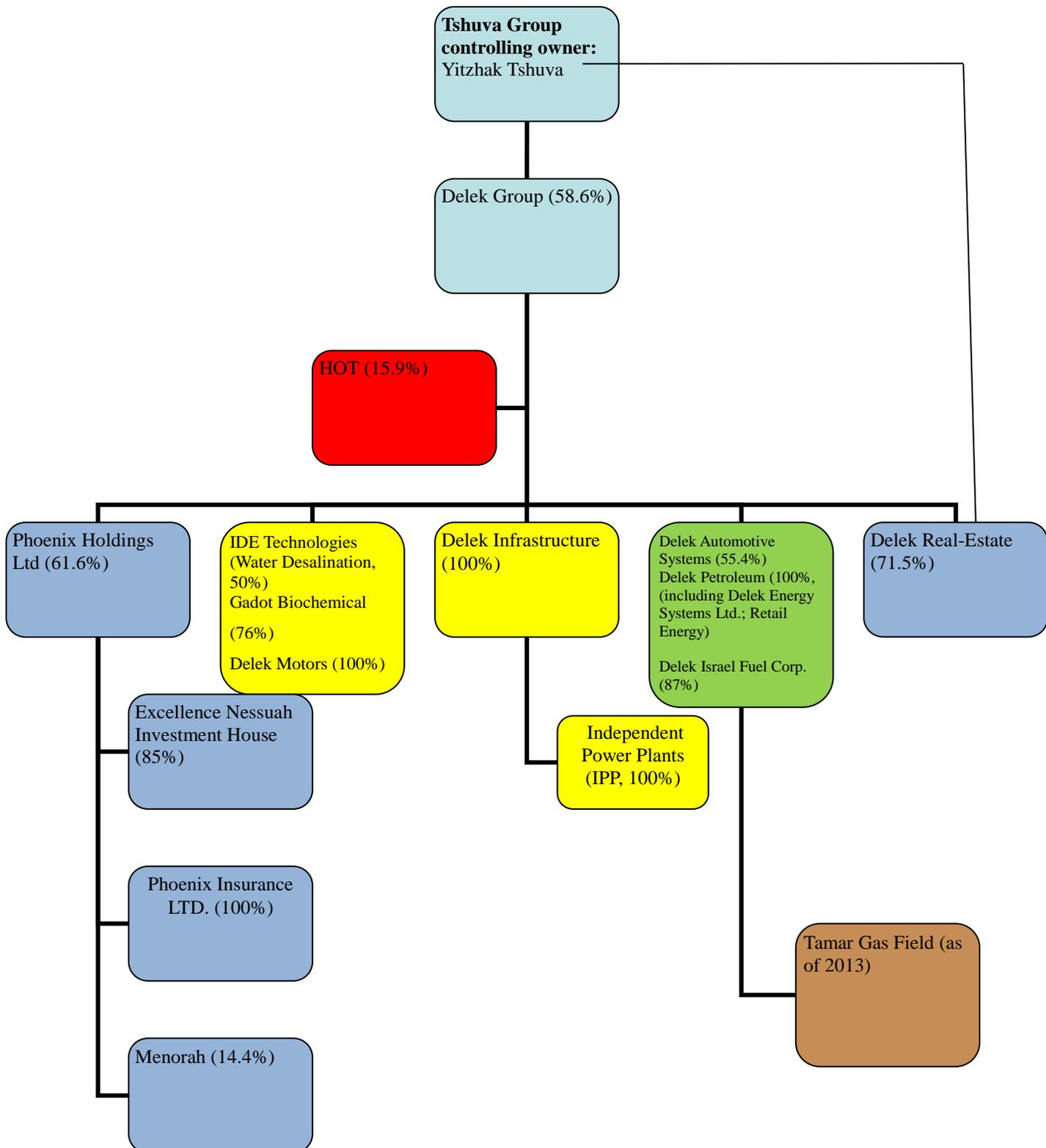
**Retail (energy, food, tourism):** none

**Real-Estate:** Delek Real-Estate (71.5%)

**Communication and media:** Hot (15.9%)

**National resources:** Tamar Gas Field

Figure 5.3. Structure of the Tshuva Group



## **Arison Group**

The Arison Group was consolidated at the beginning of the 1990s, following the purchase of the control core in Hapoalim Bank. The money was ‘old money’, made by Ted Arison in the US, whose holdings were inherited by his daughter, Shari. The group centres on banking and finance, and also has wide holdings in real-estate and a roll-over of privatised state-owned enterprises.

**Controlling owner:** Shari Arison, Mickey Arison (till 2011)

**Holdings:** Arison Investments (100%)

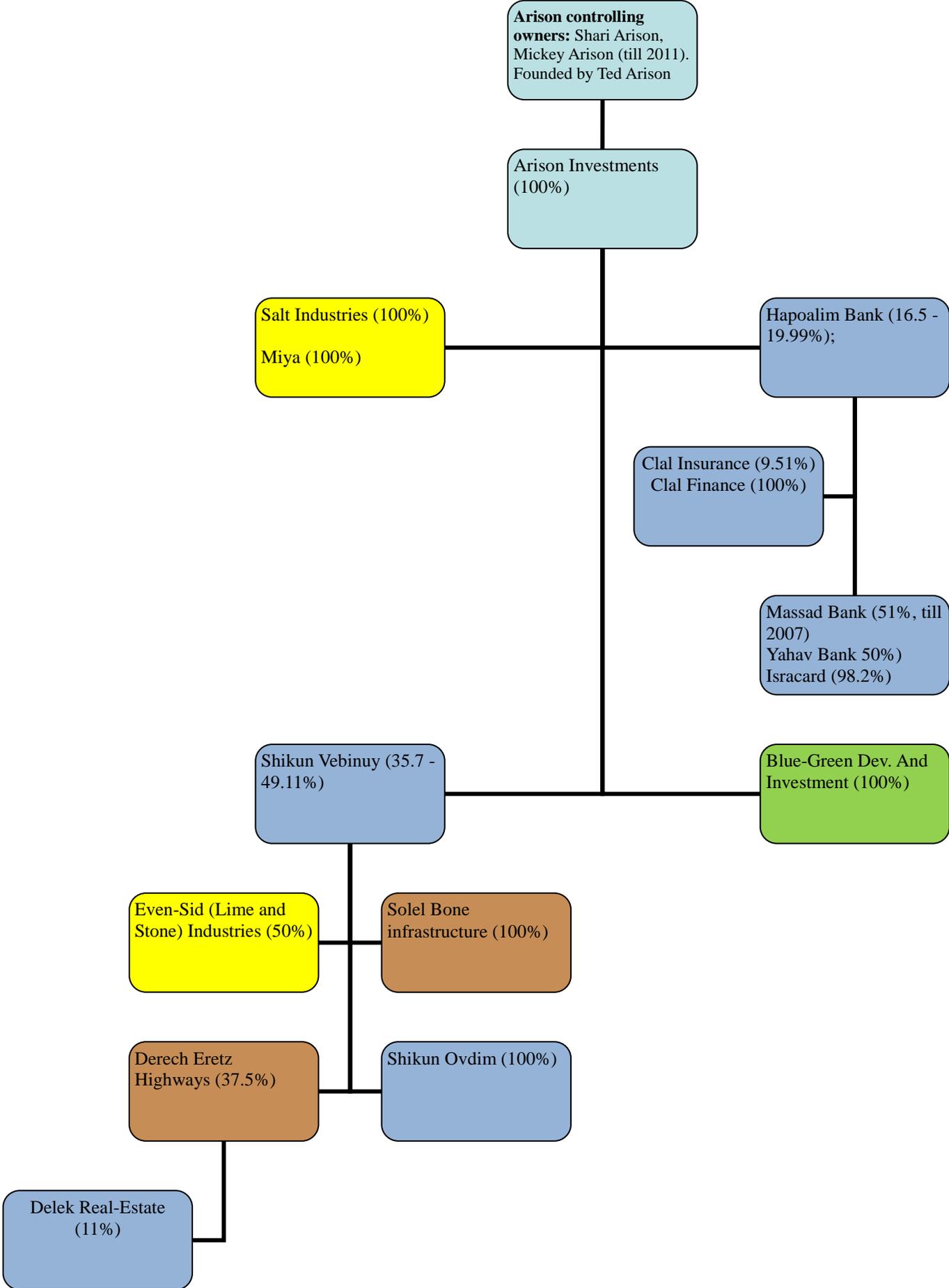
**Banks:** Hapoalim Bank (16.5 - 19.99%); Massad Bank (51%); Yahav Bank (50%)

**Insurance:** Clal Insurance (9.72-14.2%, through Hapoalim Bank)

**Manufacturing and technology:** Cement Industries (100%); Miya (100%)

**Retail (energy, food, tourism):** Lime and Stone Production (50%); Blue-Green Dev. and Investment (100%); Derech Eretz Highways (37.5%)

Figure 5.4. Structure of the Arison Group



## Fishman Group

Eliezer Fishman made his fortune in financial investments, including foreign currencies (most prominently the Turkish Lira during the 2000s), followed by successful industrial investments. The group, founded in 1989, is primarily involved in real-estate, in Israel and all over the world, as well as media and telecommunications.

**Controlling owner:** Eliezer Fishman

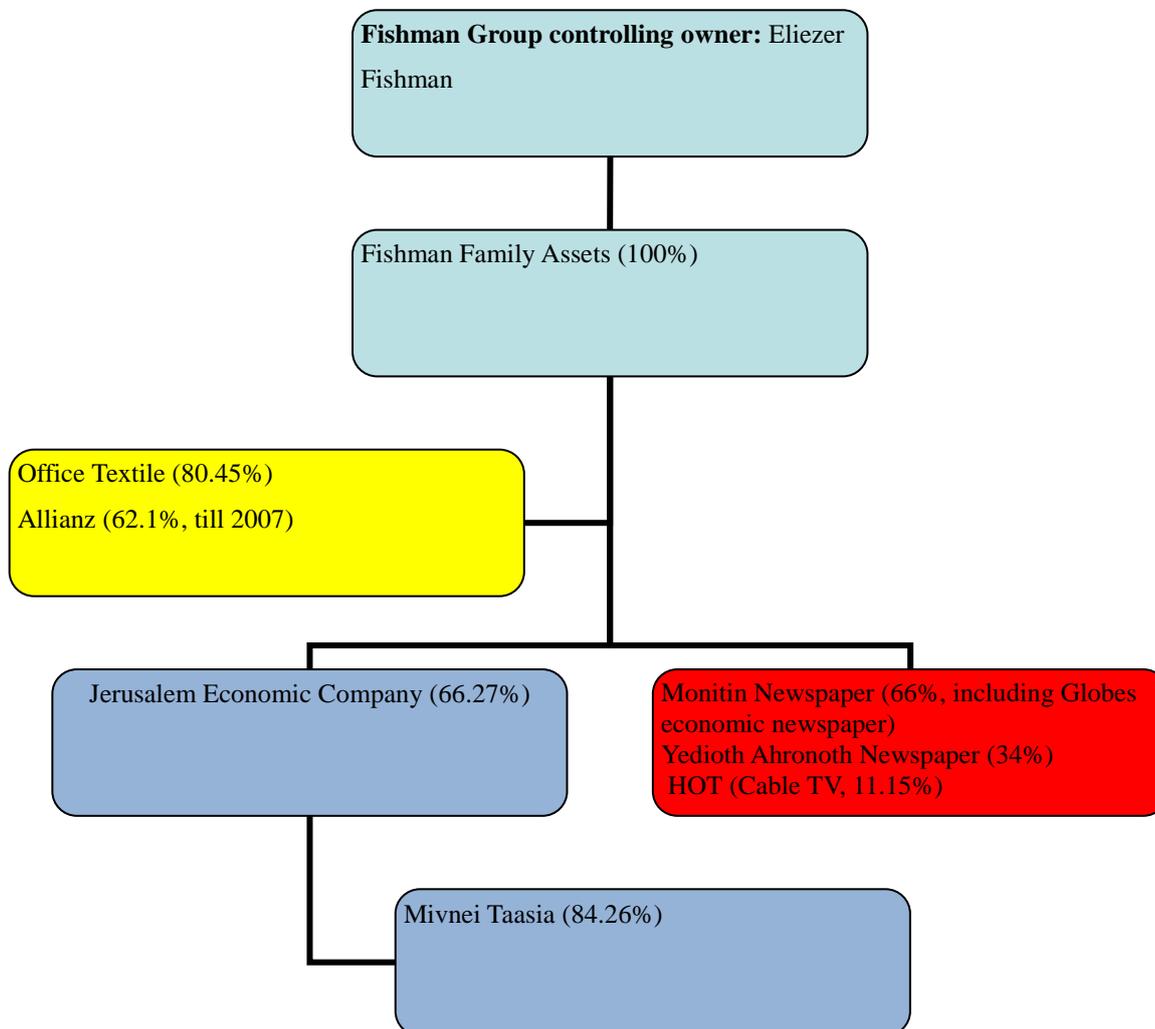
**Holdings:** Fishman Family Assets (100%)

**Real-Estate:** Jerusalem Economic Company (66.27%); Mivnei Taasia (84.26%)

**Communication and media:** Monitin Newspaper (66%); Yedioth Ahronoth Newspaper (34%); HOT (Cable TV, 11.15%)

**Retail:** Office Textile (80.45%); Allianz (62.1%, till 2007)

Figure 5.5. Structure of the Fishman Group



## Wertheim Group

The Wertheim Group, founded by Mozi Wertheim and inherited by his children, merges assets in the banking sector with vast real-estate and retail holdings, as well as a large interest in a large television channel.

**Controlling owner:** Mozi Wertheim, Drorit Werthaim, Dudi Werthaim (the children of Mozi Wertheim)

**Holdings:** Wertheim Group

Mizrahi-Tefahot (20.2%); Adanim Mortgages Bank (100%)

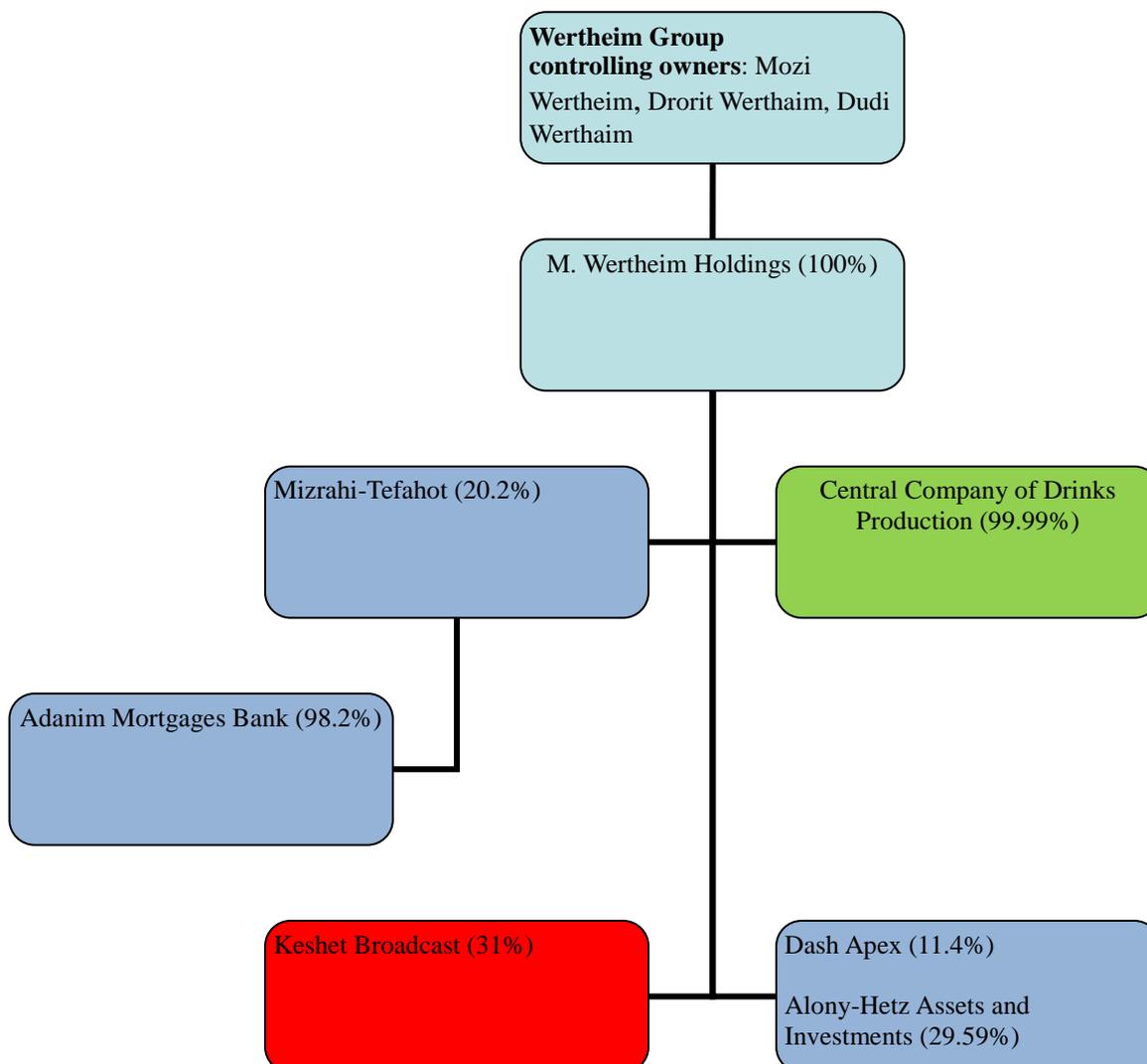
**Finance:** Dash Apex (11.4%)

**Retail (energy, food, tourism):** Central Company of Drinks Production (99.99%)

**Real-Estate:** Alony-Hetz Assets and Investments (29.59%)

**Communication and media:** Keshet Broadcast (31%)

Figure 5.6. Structure of the Wertheim Group



## Bronfman Group

The Bronfman Group, based on the fortune the Bronfman family made in the US, illustrates how control is exerted over the banking and retail sectors through cross-holding. It was established in 1989, following the acquisition of shares in Discount Bank and the privatisation of the Blue Square retail chain.

**Controlling owners:** The Bronfman family

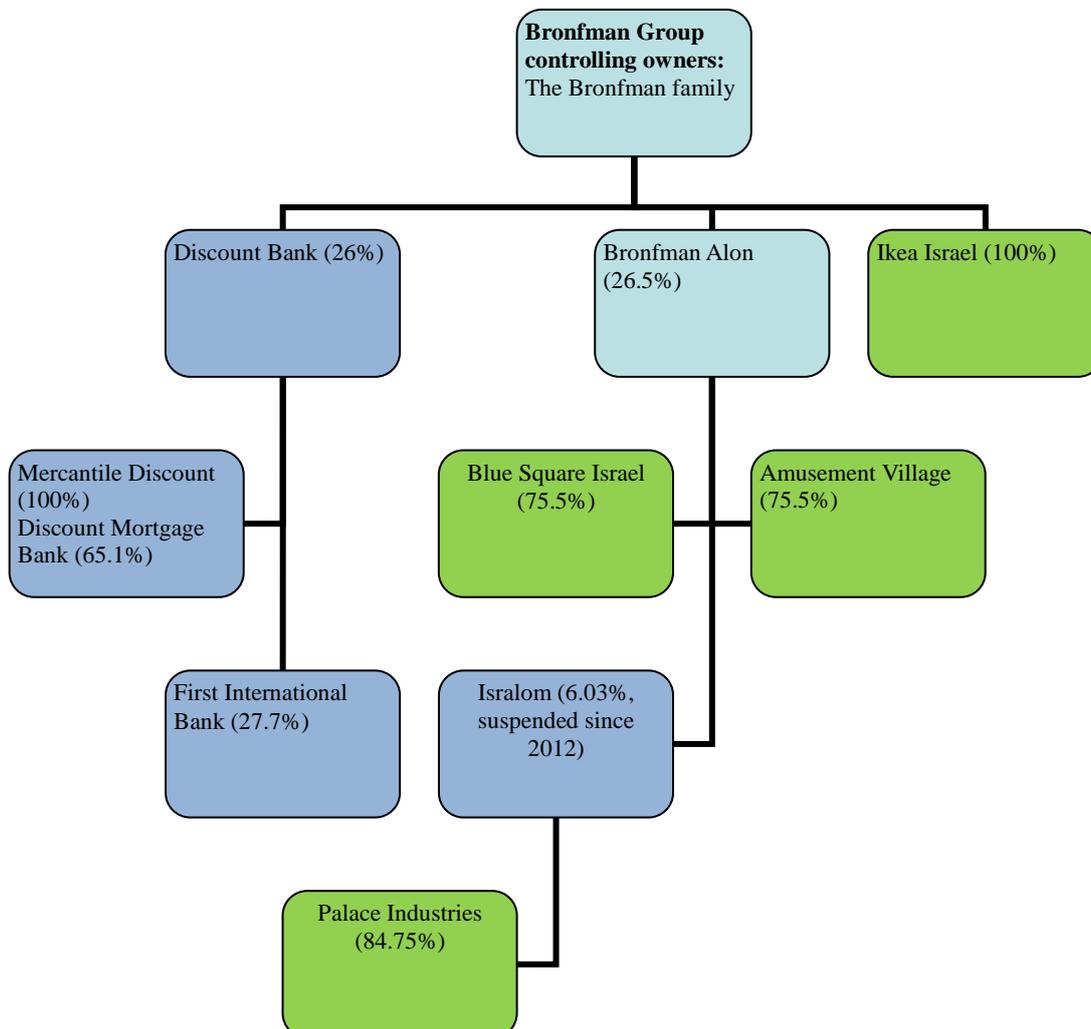
**Holdings:** No holdings or investment company ownership.

**Banks:** Discount Bank (26%); First International Bank (27.7%, Through Discount Bank); Mercantile Discount (100%, through Discount Bank); Discount Mortgage Bank (65.1%); Isralom (6.03%, suspended since 2012)

**Manufacturing and technology:** Bronfman Alon (26.5%)

**Retail (energy, food, tourism):** Blue Square Israel (75.5%, through Bronfman Alon); Amusement Village (75.5%); Ikea Israel (100%)

Figure 5.7. Structure of the Bronfman Group



## Bino Group

The Bino group holds national strategic assets, as well as a large interest in one of the five big banks.

**Controlling owner:** Tzadik Bino

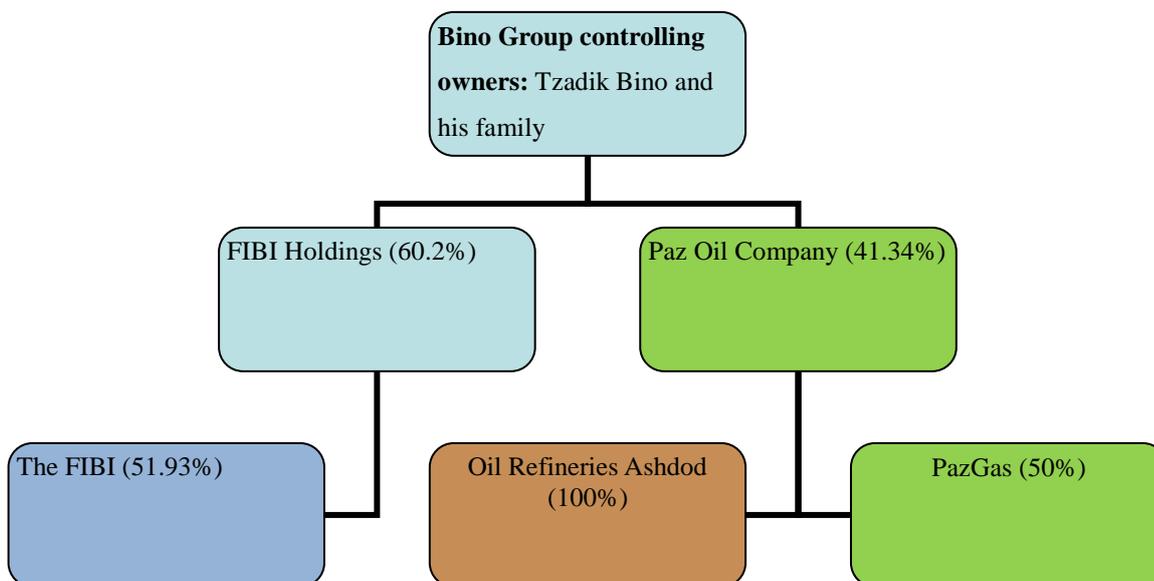
**Holdings:** FIBI Holdings (38.54%)

**Banks:** The FIBI (51.93%)

**Manufacturing and technology:** Oil Refineries Ashdod (100%)

**Retail (energy, food, tourism):** Paz Oil Company (41.34%)

Figure 5.8. Structure of the Bino Group



## Eliyahu Group

The Eliyahu Group demonstrates extensive cross-holdings, with control of insurance companies, large stakes in banks, and significant interests in the media and the energy sector.

**Controlling owner:** Shlomo Eliyahu

**Holdings:** Shlomo Eliyahu (100%)

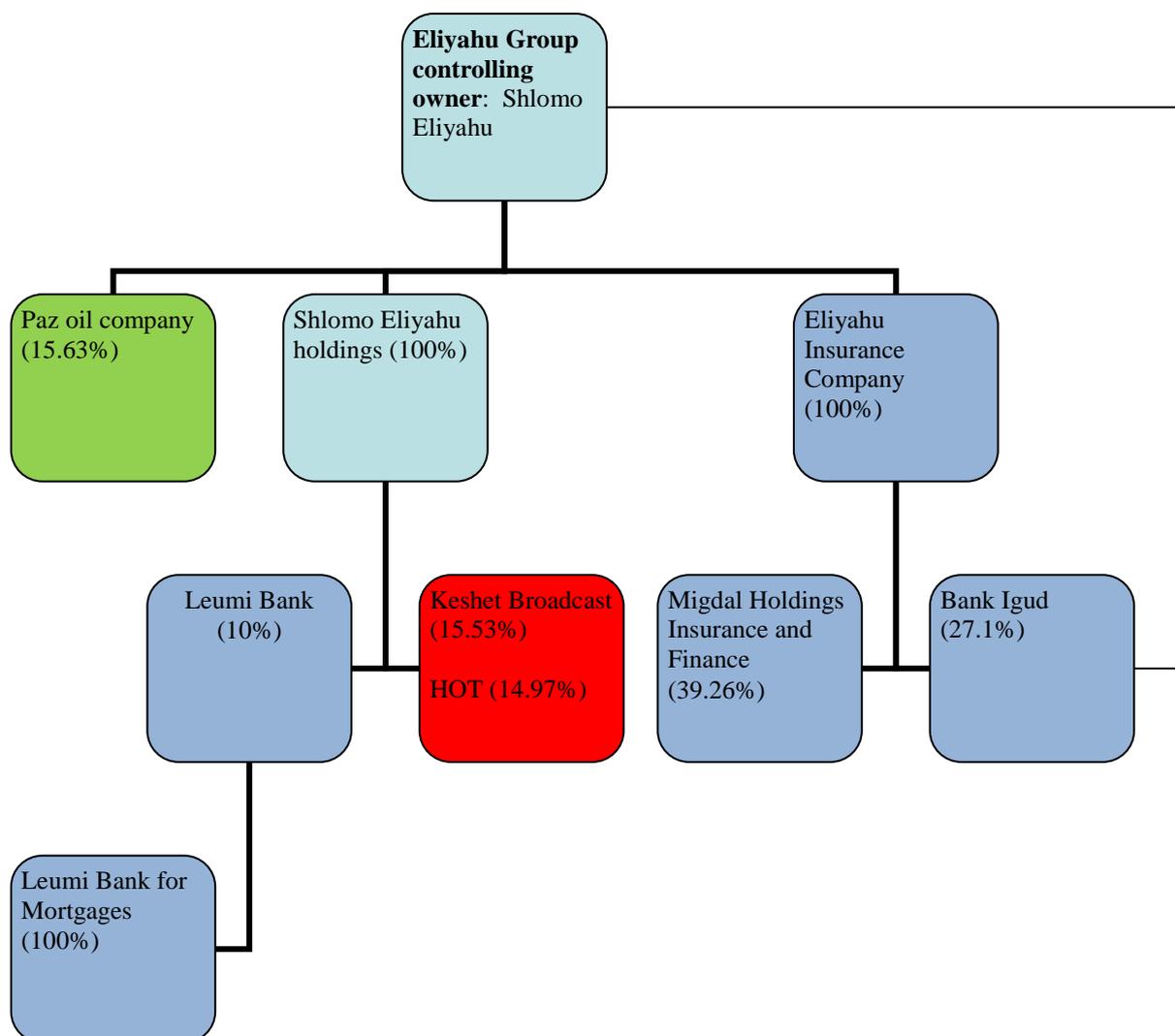
**Banks:** Leumi Bank (10%); Leumi Bank for Mortgages (100%); Bank Igud (27.1%)

**Insurance:** Migdal Holdings Insurance and Finance (9.85%); Eliyahu Insurance Company (100%)

**Retail (energy, food, tourism):** Paz Oil Company (15.63%)

**Communication and media:** Keshet Broadcast (15.53%); HOT (14.97%)

Figure 5.9. Structure of the Eliyahu Group



## Azrieli Group

**Controlling owner:** David Azrieli

**Holdings:** Canit Hashalom Investments (100%); Granite Hacarmel Investments (63.8%)

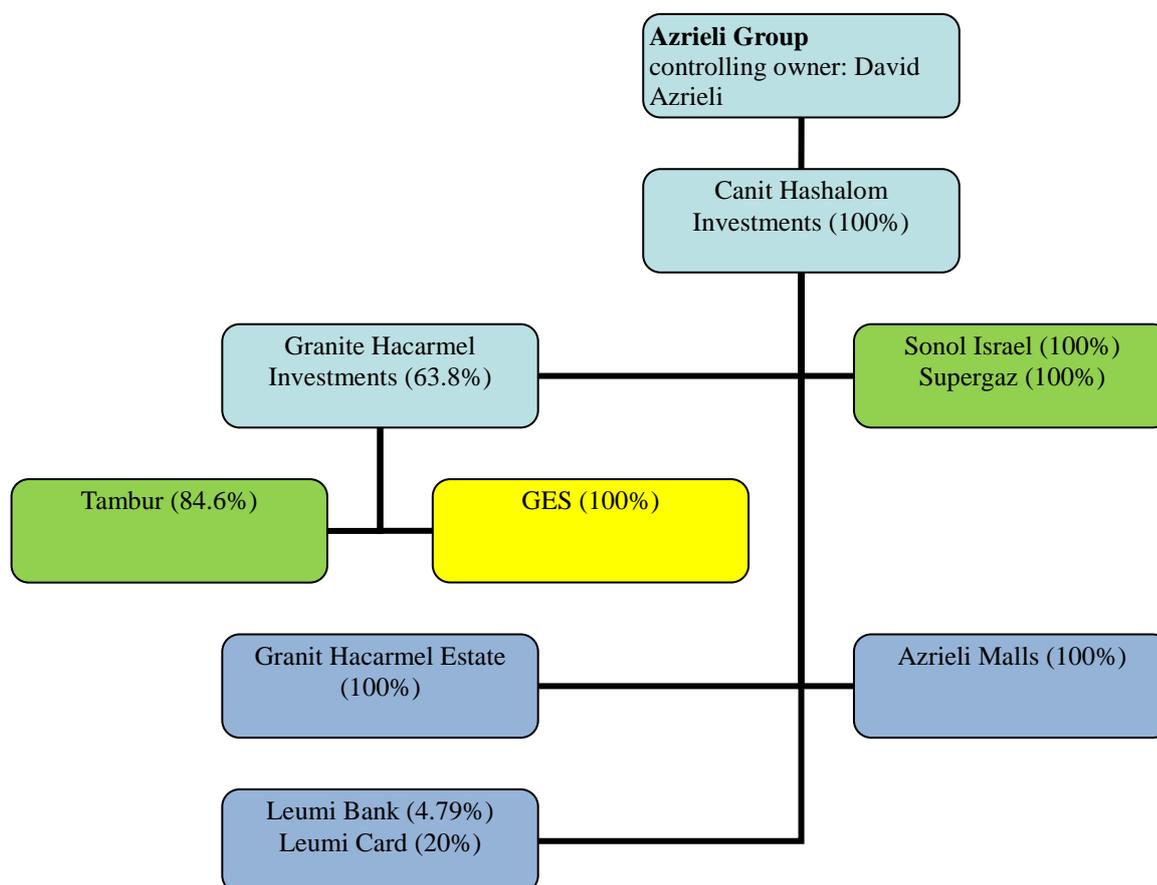
**Banks:** Leumi Bank (4.79%); Leumi Card (20%)

**Real-Estate:** Azrieli Malls (100%); Granit Hacarmel Estate (100%)

**Retail (energy, food, tourism):** Sonol Israel (100%); Supergaz (100%); Tambur (84.6%)

**Manufacturing and Technology:** GES (100%)

Figure 5.10. Structure of the Azrieli Group



While other business groups also have substantial power over the political economy, with wide control over numerous fields and sectors, they do not meet the five criteria indicated earlier in this chapter, distinguishing oligarchs from other wealthy actors, and are therefore not a part of the Israeli oligarchy. The following business groups are examples of such business groups, which are, nonetheless, important in the Israeli political economy and are connected to the oligarchic club.

The Leviev Group, controlled by Lev Leviev, has wide holdings and a substantial presence among the new business groups ruling over the market economy.<sup>107</sup> However, the group is not an integral part of the oligarchy for one main reason: There is no merger between financial and industrial holdings. Nevertheless, the Leviev group was one of the main groups to benefit from privatisation, taking over a key real estate company controlled by Leumi Bank (Africa-Israel), and subsequently raising significant credit in the non-bank credit market (analysed in chapter 4 and also in this chapter).<sup>108</sup>

Particularly important to the discourse about the Israeli oligarchy is the Hamburger Group, controlled by the Hamburger family, which controls Harel, one of the five big insurance companies. A dominant actor in the FIRE industries, with substantial holdings in the insurance, public savings, and investment sectors, it is still not a part of the oligarchy because the group does not have a pyramidal structure and does not require extensive leverage of cash flow, but has grown as a result of its success in the FIRE sectors. Nonetheless, it is one of the most dominant business groups in the political economy, tightly linked to the other business groups.

Other powerful business groups not a part of the core of the oligarchy are the Akirov Group, which has significant real-estate holdings, the Zelkind Group, the Strauss group, and the Weisman Biran Group (mapped below), which is dominant in the retail sector. The Weisman-Biran Group is co-controlled by the families' members, and has a prominent presence in the political economy (D&B, 2007, 2008) because of its substantial holdings in the retail sector. It is not included in the oligarchy because it is not an actor in the financial sector; however, its real-estate assets and retail holdings do make it an important actor and a part of the oligarchic 'club', therefore it is mapped here.

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<sup>107</sup>**Controlling owner:** Lev Leviev **Holdings:** Africa-Israel Investments (76.2%); Alon Delek (26.2%, through Africa-Israel Investments).

**Manufacturing and technology:** Packer Plada (42%); Gottex Models (50%). **Retail (energy, food, tourism):** Dor Alon Energy (89.7%) LLD Diamonds (100%). **Real-Estate:** Africa-Israel Residence (79.4%); Africa-Israel Properties (68.7%); Africa-Israel Hotels (86.3%);

**Communication and media:** Channel 9 (40.6%). Lev Leviev made his fortune in the diamond industry and founded the group in 1996, following the purchase of Africa-Israel. The group is primarily involved in real-estate, with investments in numerous other industries.

<sup>108</sup> The Leviev Group suffered tremendous losses in the aftermath of the 2007-8 global financial crisis, with a loss of ILS 4.9 billion in 2009, and in 2010 its debts reached ILS 7.4 billion (Africa-Israel in TASE). Leviev engaged in a massive debt settlement, which was unique in the Israeli market, as he managed to return 90% of the principal in 2014 (Rahimi, Calcalist, 2014).

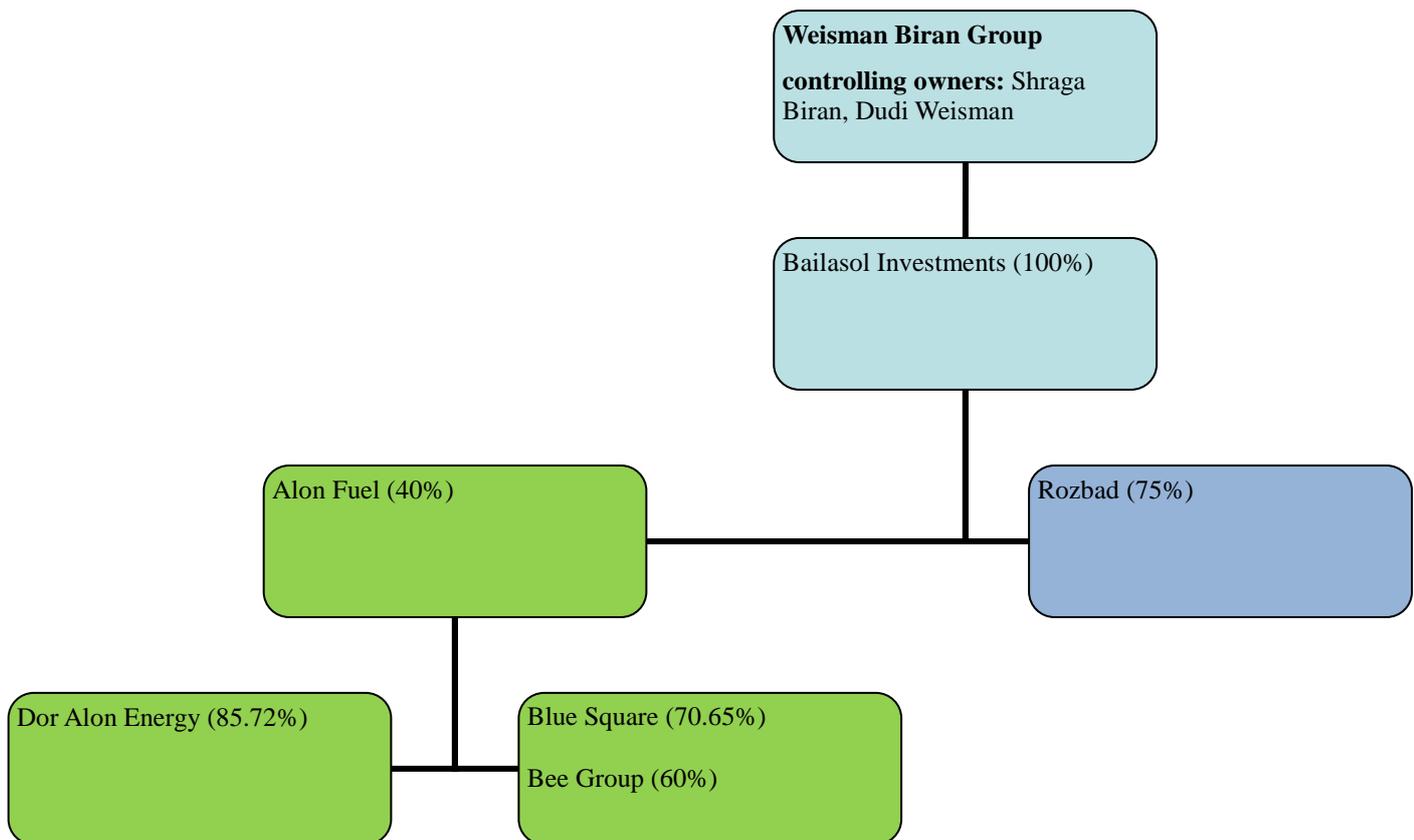
## Weisman Biran Group

**Controlling owner:** Shraga Biran, Dudi Weisman

**Retail (energy, food, tourism):** Alon Fuel (40%); Dor Alon Energy (85.72%); Blue Square (70.65%, in partnership with Bronfman Group); Bee Group (60%)

**Real-Estate:** Rozbad (75%)

Figure 5.11. Structure of the Weisman Biran Group



## 2. Market Concentration and the Rule of the Oligarchy

The concentration of the Israeli market and the expanding pyramidal business groups were barely discussed until recently. When TheMarker started to review market concentration in the mid-2000s, it was attacked on several fronts –economically, politically, and by fellow media entities (see for example Rolnik, 2010, 2011, 2012, 2013b, 2014).<sup>109</sup> A particularly important turning point was the Committee to Increase Competitiveness in the Market, appointed in 2010 to examine concentration in the Israeli market. In addition to its account of the concentration in the market economy, this committee signalled state acknowledgement, for the first time, of the problematic market structure. In parallel, the 2010 BoI Annual Report, published in 2011, specifically noted the concentration of the business sector, in both financial and real assets (BoI 2010:132). However, a paradigm shift, from the prevailing free market principles and from the perception of the pyramids as essential for market strength, to the understanding that the market is largely controlled by an oligarchy, was not immediate. Naturally, it took some time for the public to acknowledge that the market was effectively controlled by the pyramidal business groups, spreading across numerous sectors and industries, and that this was destructive for the public as a whole.<sup>110</sup>

The expansion of the business groups consolidated in the post-EESP period through pyramidal structures, analysed in the previous chapter, was one of the main results of the financialisation process. After these groups obtained significant shares of the privatised assets of the state, the internalisation of financialisation in the Israeli political economy resulted in the rise of the oligarchy, manifested in the merger of financial and industrial holdings with the subsequent control of vast market shares. The 2012 Committee examining crony capitalism determined that 75 percent of the key companies with real assets (defined as corporations which assets turnover is above ILS 6 billion) also controlled (as of 2011) essential infrastructure, such as water distillation and energy. For example, Delek controlled natural gas and has interests in the water distillation field, while the Israel Corporation controls oil refineries and is a dominant actor in the water distillation field. The concentration of the market economy in the hands of few business groups has turned them into oligarchy through various measures. Most significantly, the means used to maintain the power of this small group and entrench its ruling position have turned it into an oligarchy. The conception of oligarchy, as illustrated in the following sections, contributes to the understanding of the Israeli

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<sup>109</sup>TheMarker is a daily economic newspaper and magazine, the first and for many years the only publication which uncompromisingly addressed the concentration of the Israeli market. This probably has to do with its being an independent newspaper. Until 2008 it was under Haaretz Group, controlled by the Schocken family (60%), and since 2011 also by the Russian oligarch Leonid Nevzlin (20%), and the German publisher DuMont Schauberg (20%). This ownership structure is unique in the Israeli political economic climate, as it does not include the Israeli oligarchy; this is probably the reason TheMarker could confront the concentration in the market so intensively.

<sup>110</sup>An anecdote indicating the degree to which concentration and tight state-capital connections were denied or ignored: In 2012 Eldad Yaniv, one of the members of the 2012 Committee to Examine Crony Capitalism founded a new political party ('Eretz Hadasha' - New Country) for the 2013 parliamentary elections. The party branded itself as 'The front to topple the capitalist government'. Members of the Knesset filed a complaint suggesting such that state-capital connections could not be used as a slogan, as they had not been proven to exist. They eventually withdrew the complaint (see Zarchia, TheMarker 2012).

political economy. In accordance with the five criteria identified before, this section outlines and explicates the way in which pyramidal ownership structure and the type of ownership apply to the Israeli case.

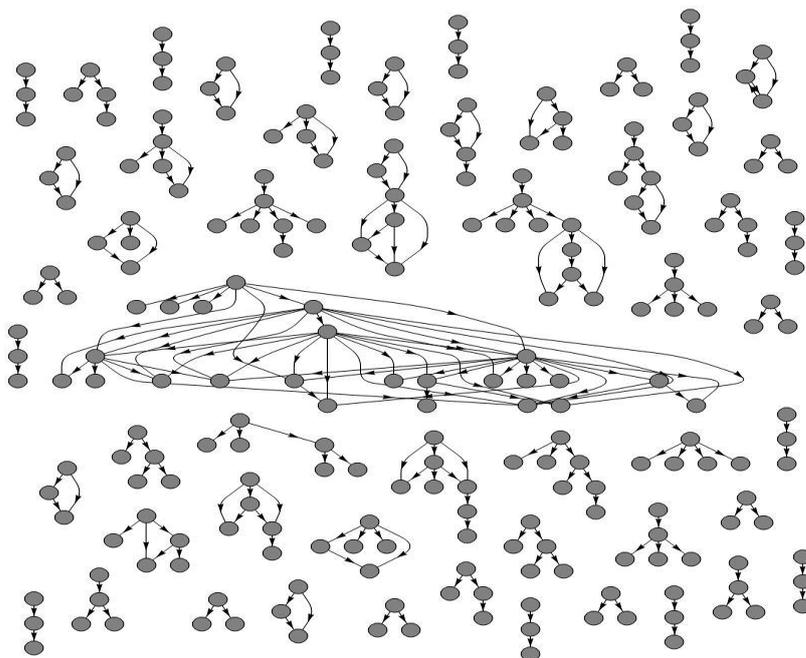
This market concentration is primarily enabled through the pyramidal ownership structure, dominating the business sector in Israel. The Israeli pyramids are constituted of a holding firm that controls a group of firms through a chain (or chains) of legally independent enterprises, with a controlling-owner at the apex. Every firm controls the one beneath, but does not hold 100 percent of its capital. The maximum level of control that is achieved in a publicly-traded company in Israel via a pyramidal structure is estimated at seven; that is, the holdings company at the apex of the pyramid achieves control of the companies down the pyramid via six other publicly-traded companies. Through controlling six public companies, the controlling-owner of the holding company at the apex of the pyramid, with a cash flow as low as three percent (as in the case of IDB, see the conclusions to the thesis), obtains full control. In other, non-pyramidal publicly-traded companies in Israel, by contrast, the controlling owner holds at least 25 percent of the company's capital, and his or her holding is higher than the combined holdings of the second and third largest shareholders (Kosenko and Yafeh, 2010; Kosenko, 2013). Affiliated companies are notable for a high disparity between ownership and control (the wedge parameter analysed in previous chapters); the concentration of control is therefore higher, and direct holding of equity in the affiliated companies is low. Generally, in light of strong investor and creditor protection rights, the pyramidal structure is also the result of the controlling families' natural desire to maintain their control; it is, to an extent, incentivised by the system.

For a developed market economy, this structure is relatively unique in its degree of concentration (Kosenko, 2008). Out of the TA-100 Index (The Tel-Aviv Stock Exchange 100 biggest companies) 52% of the companies are affiliated to business groups. Out of the TA-25 index – 75% of the companies are affiliated, and only 6% are widely held. The activities of the business groups were thus expanded, including in times of recession. The number of shareholders in general is very small – around 1700 holding 650 public firms (the total of the publicly traded firms on the Tel Aviv Stock Exchange). This implies that every 2.5 shareholders hold around 60 percent of a public firm, or every shareholder holds 24% of a firm. These owners are heterogeneous, and include local individuals (55%), private companies (21%), foreign owners (10%), publicly traded companies (8%) and trusts and partnerships (6%) (Aminadav et al., 2011). An examination of most of the big companies in Israel shows that 42% of them are affiliated to business groups (Kosenko, 2008).

More specifically, the percentage of all firms listed in the market that belong to a family pyramidal business group is 26.43 percent. This figure is exceptional in comparison to other states;

only Sri Lanka and Columbia exhibit higher percentages (52.14% and 41.07% respectively) (Masulis et al., 2011: 3569-70).<sup>111</sup> In 2010, 55 business groups controlled 178 listed companies, with an aggregate value equal to 43 percent of the total market capitalisation. During the 2000s the number of business groups and group-affiliated companies increased significantly (Sokolinski, 2012). Specifically, in 2010 the percentage of market capitalisation held by the family-controlled pyramidal business groups in Israel was 23.22 percent (Masulis et al., 2011: 3569-70). In addition, 80% of companies affiliated to business groups in Israel are held under a pyramidal structure (Kosenko, 2008). The vast majority of listed stocks are controlled by individuals. In 79 percent of the groups the structure includes at least two layers of public companies. On average, an Israeli business group, as of 2011, consists of 3.6 corporations, and most operate in a variety of industries and sectors (Sokolinski, 2012). Figure 5.12 below illustrates the Israeli pyramidal structures. It applies to how the big companies in the market are controlled through pyramidal ownership structure (the dots refer to the big companies, controlled by the pyramid or affiliated to another big public company), (as of April 2009). Table 5.1 delves into the pyramidal concentration of power.

Figure 5.12. The pyramidal structure prevailing the Israeli market economy



Source: Bank of Israel, Research Department, 2010<sup>112</sup>

<sup>111</sup> Masulis et al. (2011) reported family business group statistics for 45 sample countries.

<sup>112</sup> In Figure 5.12 the vertices represent firms and shareholders, and the arrows represent control relations. Shareholders within the same tree that are located above a firm and are connected to it by arrows are the controlling owners of that firm, and the apex of the tree is the ultimate controlling owner of the group. The very large tree in the middle represents IDB (Aminadav et al., 2011).

Table 5.1. Pyramidal concentration of power in Israel

Number of family business groups	20
Number of pyramidal family business groups	15
Percentage of listed firms that are affiliated to a family business group	40.09%
Percentage of firms that are affiliated to a pyramidal family business group	26.43%
Percentage of market capitalization held by the pyramidal business group	23.22%

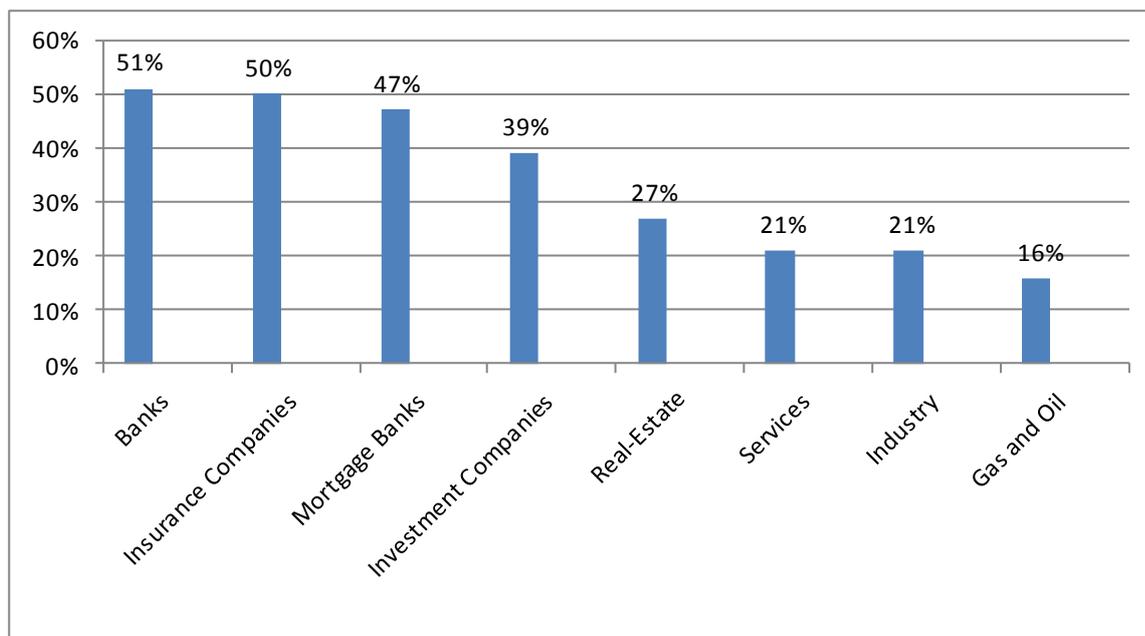
Source: Masulis et al., 2011: 3569

Among the 50 leading companies in the Israeli economy, by size and revenue, 40 percent (twenty companies) belong to the industrial sector, 14 percent to the services sector; five are big banks (Hapoalim Bank, Leumi Bank, Discount Bank, Mizrahi-Tefahot Bank, and First International Bank), and five are big insurance companies (Clal, Migdal, Harel, Phoenix, and Menora-Mivtachim). Infrastructure is represented by three big companies (The Electric Corporation, Oil Refineries, and Mekorot Water Group). Construction and health services are also among the big companies.<sup>113</sup> Of the twenty biggest companies in Israel, twelve are controlled by the oligarchy. Five of these twelve are industrial corporations and three are state-owned (D&B, 2012). Concentration is prominent in the infrastructure sector, where there is an advantage to size or to natural monopolies (water, gas, oil refineries, and ports); this sector is mostly controlled by governmental monopolies. A significant level of concentration is also found in the financial (and services) sector, i.e. banks, financial institutions and insurance companies, pointing to the nature of the Israeli economy. The retail sector, which includes food and tourism, and the media and telecommunication sectors are much centralised as well. While the main business groups are spread across all sectors, the market share of group-affiliated firms is most significant in the financial sector (as illustrated in figure 5.13 below).<sup>114</sup>

<sup>113</sup> The data was collected from BDI code, 2012

<sup>114</sup> In 2007, 64% of the shares listed on TASE were owned by the public. Institutional investors accounted for 18% of market capitalisation with foreign investors accounting for another 17%. Government ownership accounted for only 1% of market capitalisation (TASE, 2007). While the role of the state in the capital markets has been decreasing, the role of institutional investors has grown. The low government ownership is attributable to the fact that very few Israeli State-Owned-Enterprises (SOEs) are listed. In over a third of the listed enterprises the controlling owner owns less than 50% of the capital.

Figure 5.13. Business groups activities by sector (percentages represent market shares)



Source: Knesset, 2010; Kosenko, 2008.

A unique characteristic of companies traded on the Tel Aviv Stock Exchange is concentrated equity holdings by large owners in most private sector companies. This has been the result of the small size of Israeli companies (compared with firms in other western countries), and the relatively late development of the capital market. The rapid development of the market in recent years, the privatisation process, and the use of instruments for diluting control have nonetheless left the pattern of ownership concentration largely unchanged in Israel's publicly-traded companies. As a result, the percentage of Israeli companies' shares owned by the public (as of 2011) remains at around 40-45 percent (Kosenko, 2008).<sup>115</sup>

The financial sector remains highly concentrated. As of 2011, the five big banking groups hold the majority of public deposits (Leumi – 29.9 percent, Hapoalim – 29.2 percent, Discount – 16.8 percent, Mizrahi-Tefahot – 9.4 percent, the First International Bank – 8.9 percent, other banks – 5.9 percent, data by OECD, 2011a). The six big insurance groups (Migdal, Clal, Menora-Mivtachim, Psagot, Harel, and the Phoenix) manage 69 percent of public long-term savings (2010 Committee interim report, 2011). Almost all financial institutions in Israel are controlled by an individual owner (or a family), who in many cases simultaneously hold real assets. The big pyramidal business groups control three insurance companies – the Phoenix, Migdal and Clal; however, they do not have control over the banks. In fact, the Bank of Israel applied legal constraints to prevent them from purchasing substantial shares of banks in the privatisation of Leumi Bank in 2002 (as

<sup>115</sup>Data checked and updated by the author.

elaborated in chapter 3).

As for the banking system, the banking groups have 122 overseas offices including subsidiaries, branches, and representative offices. Assets and deposits in foreign branches and subsidiaries of Israeli banks comprise over 15 percent of system levels. On the other hand, the presence of foreign-owned banks in the Israeli market remains low, despite the openness of the authorities to foreign institutions. Only four branches of foreign banks managed to obtain the right to conduct the business in Israel (Citibank, HSBC, the State Bank of India and BNP-Paribas) (IMF 2006:107). The power of the business groups is extended across a variety of industries in the market economy. In the industry sector, the market shares of group-affiliated firms (defined as the ratio of a business revenue to the total revenue of the industry in which it operates) account, as of 2011, for 66 percent of wholesale, 99 percent of retail trade, 88 percent of industrial investments, 49 percent of real estate, 65 percent of agriculture, 45 percent of computer software, and 6 percent of food (Sokolinski, 2012). Likewise, intra-sectorial concentration is prominent in Israel.<sup>116</sup> In the financial sector, for example, the big business groups control 50 percent of the financial market and 70 percent of services and trade, monopolising the banking, insurance, communication, and energy fields. This concentration is largely facilitated through internal coordination among the groups, personal ties, and agreements. As a result of the concentration in the financial sector, the options available for households and small clients in need of banking services are very limited.

From 2002 to 2008, the new business groups' share of general market profits ranged between 4 and 26 percent (with a gradual increase). The communication and financial sectors were the most concentrated; business groups' profits in these sectors accounted for 84 percent and 53 percent of total sector profits, respectively (Committee Interim Report, 2011, appendix D). In general, the two largest groups accounted for 50 percent of the groups' profits and 12.5 percent of the general market profits (ibid).

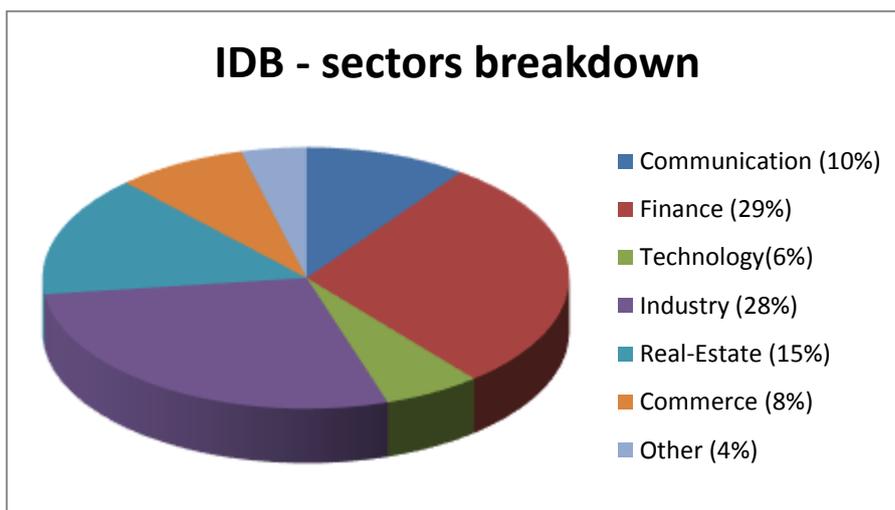
The most important example of the pyramidal ownership structure and the merging of financial and real assets is IDB (see figure 5.14, presenting IDB sectorial breakdown), the largest pyramid in the Israeli market until 2012, holding immense power over the political economy as a whole, with a controlling owner investing only a marginal share of the capital. The case of IDB elucidates how a pyramid is formed, with the controlling owner accumulating wealth and power. Nochi Dankner took over IDB in 2003 with private capital estimated at \$15-30 million (around ILS 50-100 million). He completed the take-over through his holding company, Ganden Holdings, using bank and non-bank credit (Wilf 2011: 4). IDB's highest value (in 2007) was ILS 1.8 billion. In 2010, it was ILS 136.822 million. Dankner's initial capital investment accounted for only 1 percent of market value. In 2009,

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<sup>116</sup> Essentially multimarket contacts, in which several conglomerates interact as competitors in different sectors or industries, which, in return, are centralised, enable the coordination of prices (Matsushima, 2001).

Ganden Holdings, under Nochi Dankner's private ownership, suffered great losses, after its foreign investments, in Credit Suisse and in Plaza Las Vegas, failed following the global financial crisis. In return, Dankner sold the privately-owned Ganden Holdings to the publicly-controlled IDB Holdings, so that the private debt becomes public debt. Effectively, he made sure that his private losses would fall on public shareholders. During these years, despite his losses, Nochi Dankner received a loan from Hapoalim Bank, whose chairman was Dani Dankner, Nochi's cousin (as mentioned in chapter 4). IDB itself started to collapse in 2010, largely as a result of reforms in the cellular market (analysed later in this chapter and in the conclusions of the thesis).

Figure 5.14. IDB sectors breakdown (as of 2012)



Source: IDB, 2012

### 3. The Oligarchic 'Club'

This chapter advances the concept of a 'club' to highlight the mechanisms through which the new business groups became an oligarchic power structure, concentrating wealth and power. This conception illustrates how oligarchy operates and how the principles for the political economy's functioning are derived. The chapter thus examines the particularities of the club, focusing on the influence and wealth obtained as a result of the affiliation to it, and the various means sustaining the clubness. As analysed in chapter one, the club denotes the organisational though informal form through which members of the oligarchy enhance their power and influence.<sup>117</sup> The 'clubness' refers to the networked alignment and the inter-relations that constitute the oligarchy. Clubs are held together by interaction and inter-personal coalitions in several forums, such as interlocking directorates, social gatherings, and family networks. The notion of a club implies collective attributes and values, collaboration between its members and mutually reinforcing interests (Tsingou, 2014). Club members effectively draw their influence from their affiliation to it. In parallel, the conception of a club also accentuates the importance of its influence over policy-making for the enduring relevance of the arrangements enabling and maintaining the power of the oligarchy. It explains how the actors who write the rules for the political economy work together.

This understanding of a club complements, yet is distinct from the notion of network (analysed in chapter one). The 'club' concept goes beyond the connections and institutional linkages between business groups, controlling owners and other wealthy individuals, and the generally friendly climate that enables their rise; instead, it is bound together by dictating the 'rule of the game' and calls attention to the specific actors, their motivations, and the mechanisms that lead to their influence on the political economic system, in order to accommodate their needs. It helps us to understand and study the relationship between individuals and institutional forms, illuminating the factors enabling the oligarchy to preserve its power. Specifically, it sheds light on the way the club works in order to constrain competition.

While Israel is a small, networked society, with inter-connections across the various elites and within them, the phenomenon of 'clubness' is rather new, mostly pertinent since the financialisation of the 2000s. It is the thread between the two central stages of the Israeli oligarchisation process, enabling the formation of a new economic elite, not comprising the members of the old one, and its accumulation of wealth. Unlike the American case, in which the power of oligarchs is mostly drawn from their wealth (Winters, 2011), the power of the Israeli oligarchs – and to some extent what

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<sup>117</sup> The notion of the 'club' is different from the literature on elites. As analysed in chapter one, oligarchy itself is a specific category of economic elite. The 'club', similarly, is a distinguished group whose members are part of the various elites, such as the business elite, the political elite, the media, and the cultural or academic elite.

makes them oligarchs and not only tycoons or 'fat cats' – is substantially a function of their 'clubness' – cooperating and representing shared interests. Put differently, the 'clubness' turns the Israeli pyramids into an informal institution of wealth and power in the political economy, more than the total sum of individual controlling owners. This clubness has thus been both a source of power and a key characteristic of the Israeli oligarchy; the analysis of it, therefore, is chronological yet thematic.

The Israeli club is a network that includes the ten pyramidal business groups delineated before, professionals (bankers, accountants, lobbyists, lawyers, managers, advisors, advertisers, and various 'consigliere'), former politicians and regulators, as well as other businessmen and business groups. The club is populated by roughly three hundred people (Rolnik, 2013a; Horesh, 2014<sup>118</sup>). It represents a wider alignment of networks, coalitions, and interests across sectors, institutions and actors. Economic actors who do not belong to the club do not wield as much influence or power in the political economy as those who are in the club. The key objective of the Israeli club is to constrain competition, thus preserving the status-quo of the dominance of the oligarchy over the market economy. This is done through barriers to entry, increased rent-seeking activities within the same circles, and a form of exclusivity. Most significantly, these barriers to entry are erected through favoured allocation of credit (analysed also in chapter four) to the pyramids, at the expense of their competitors. To illustrate, Judge Eitan Orenstein stated that the case of the credit provision to IDB by financial institutions was extreme; substantial amounts of capital were given without sufficient guarantees and without justification.<sup>119</sup> Moreover, no decisions of the credit committees of the banks were introduced to support such credit provision (Appelberg and Rochvarger, *TheMarker*, 2013). Judge Chaled Kabub likewise found that the deals between Hapoalim Bank and Tomhok (under IDB) were questionable (Appelberg, *TheMarker*, 2014). In both cases, the BoI did not publish findings about the malfunctioning of the banks, to maintain stability.<sup>120</sup>

Furthermore, the important economic positions in the market are reserved for members of the club or their allies, and the important decisions, legislative and institutional, are made by them, or with their permission. The members of the club loyally serve the ten business groups, providing them with the infrastructure, i.e. the professional services required to sustain the position of the business groups at the heart of the club. To put it another way, the rule of the Israeli oligarchy is perpetuated in part by the continuing presence of the club members, who possess government and legal knowledge, certain personal traits, and connections to politicians and bureaucrats.

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<sup>118</sup> This estimation was also provided during the fieldwork conducted in the framework of this research.

<sup>119</sup> Tel Aviv District Court Judge Eitan Orenstein approved on December 2013 a bondholder vote that wrested control of the company from Dankner in favor of two businessmen: Moti Ben-Moshe and Eduardo Elsztein.

<sup>120</sup> In fieldwork conducted for this research a prevailing argument was that the club is focused on preserving the interests of its members, inter-linked to each other. For example, if a bank provides credit to a retail chain, it would be unlikely to provide it to another one, even if such an investment was profitable. Such entrenchment is not analysed in the literature, and was hardly discussed until recently. Furthermore, as the criteria to allocate credit is not clear, there is no way to track biased allocation within a certain industry or sector.

There are no demographic variables typical to the members of this club.<sup>121</sup> The controlling owners include Ashkenazi males from wealthy families (e.g. Dankner, Weisman), Mizrahi males from lower socio-economic classes (e.g. Tshuva, Eliyahu), and one female at the head of a pyramid (Arison), as well as a more substantial layer of females in management positions, especially in banking.<sup>122</sup> The members of the oligarchic 'club', besides the controlling-owners or families at the apex of the pyramids, are often professionals who rose from the middle class to the top percentage of wealthy people in Israel as a result of affiliation to the club. This process was hastened by both privatisation and financialisation, when the new controlling owners needed strong professionals around them to make sure they could obtain power and maintain it. Some of these professionals were already active in the pre-EESP period (e.g. Ram Caspi or Jacob Neeman) whereas others became more powerful and influential as a result of privatisation and financialisation, for example former regulators (as analysed later).

A few names constantly appear in the context of business cooperation and intermediation, and more generally in social events and networking.<sup>123</sup> The prominent lawyers in the Israeli club include Ram Caspi, Pini Rubin, Yehuda Raveh, Dov Weissglass and Jacob Neeman, who also served as Minister of Justice (1996-7, 2009-13) and Minister of Finance (1997-8). Advertisers and PR managers include Eyal Arad, Rani Rahav, Moshe Teomim, Zamir Dachbash and Modi Kidon. Accountants include Itzhak Swary and Gad Somekh. Senior bankers who are members of this 'club' include Zion Keinan (Chief Executive Officer and President of Hapoalim Bank since 2009), Rakefet Russak-Aminoach (President and Chief Executive Officer of Leumi Bank since 2012), Yair Sarusi (Chairman of Hapoalim Bank) and Dani Dankner (the former Hapoalim Bank chairman and Nochi Dankner's cousin, charged in 2013 for fraud and breach of trust).

Affiliation to the hub of the club, i.e. the pyramidal business groups, can be based on both professional or personal motives, and results in very large salaries.<sup>124</sup> Senior executives are the most prominent example. To illustrate, out of the 20 record-breaking salary earners in 2011, 10 belong to the pyramidal business groups at the core of the oligarchy (5 in the financial sector, e.g. Hapoalim and the Phoenix, the rest include ICL, Machteshim Agan, and Shikun Vebinu real estate company). The other ten belong to businessmen associated with the oligarchy (e.g. Ben-Dov, Leviev), a big real estate company (Gazit Globe), and one is El-Al Airlines' CEO (Globes 2011b).

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<sup>121</sup>The traditional type-cast of the Israeli political and business elites in the pre-EESP period was male, Ashkenazi and educated, from medium-upper wealthy classes (e.g. Maman, 2006a; Shafir and Peled, 2002).

<sup>122</sup>To illustrate, the CEOs of three out of the five big banks are women (Rakefet Russak-Aminoach at Leumi, Smadar Barber-Tsadik at FIBI, and Lilach Asher Topilsky at Discount).

<sup>123</sup> This information was derived from a review of media coverage and the fieldwork research for this thesis.

<sup>124</sup> These figures are in relation to the Israeli market. The salaries in the US are much higher; to illustrate, Lloyd Blankfein, Goldman Sachs CEO and the highest paid Wall Street CEO, received \$23 million for 2013 (Gandel, Fortune, 2014).

Specifically, senior executives in the financial sector enjoy large salaries.<sup>125</sup> Table 5.2 indicates the annual salaries of senior executives in the banking sector.

Table 5.2. Salaries of senior executives in the banking sector in 2011

Name of senior executive	Role	Annual Salary (ILS million)
Eli Yunes	CEO of Mizrahi-Tefahot Bank	10.2
Zion Keinan	CEO of Hapoalim Bank	9.1
Reuven Spiegel	CEO of Discount Bank	7.8
Galia Maor	CEO of Leumi Bank	6
Smadar Barber-Tsadik	CEO of FIBI	4.9
Yair Sarusi	Chairman of Hapoalim Bank	9.4

Source: Reich, TheMarker, 2012<sup>126</sup>

More concerning, nonetheless, are the salaries at the insurance companies. Table 5.3 indicates the salaries of senior executives in the insurance sector in 2013.

Table 5.3. Salaries of senior executives in the insurance sector in 2013

Name of senior executive	Role	Annual Salary (ILS million)
Israel (Izzy) Cohen	CEO of Clal Insurance	18.1
Raviv Zoller	CEO of IDI Insurance <sup>127</sup>	11.9
Eyal Lapidot	CEO of the Phoenix	10.4
Shimon Elkabetz	co-CEOs of Harel	9.4
Michel Siboni	co-CEOs of Harel	9.2

Source: Sasson, TheMarker, 2014.

### ***The main mechanisms used to sustain the oligarchic club***

The inter-groups and intra-group connections sustaining the oligarchic club are developed and upheld through various means. The key principles of operation and the mechanisms of inclusion used to perpetuate the power of this 'club' and to mark the oligarchy as an informal institution of wealth and power in the political economy include joint ownership and interlocking directorates across the pyramidal business groups; the social interaction, or the inter-personal relations; the role of the media, with respect to both coverage and the considerable shares of control the oligarchy

<sup>125</sup> High salaries are not exclusive to the financial sector. For example, Ilk Rojansky, Delek's CEO, earned ILS 25 million in 2006, ILS 16 million in 2007, and ILS 11.5 million in 2008.

<sup>126</sup> In comparison, the average annual salary in the market for the same year was ILS 105,000 (CBS, 2011 Labour data).

<sup>127</sup> IDI is not one of the big five insurance groups.

holds over different media channels; and tight cooperation within the groups, combined with lack of competition. Each of these mechanisms will be dealt with below.

Joint ownership shares, both business partnerships and holdings shared between several members of the oligarchy, are an important mechanism to sustain the oligarchic club (Sokolinski, 2012).<sup>128</sup> These joint shares are de-facto barriers to entry; if a pyramidal business group controls assets in a firm from a certain industry affiliated to another pyramidal business group, it is unlikely to provide credit to a competing firm from the same industry, whose success might diminish the market share of the company in which the pyramidal business group has ownership shares. For example, the Arison and IDB groups are partners in their ownership of Clal; Ofer and Wertheim both have shares in Mizrahi-Tefahot Bank. Other examples of joint ownership across the pyramidal business groups include the Bino and Bronfman groups' substantial stakes in FIBI and the Azrieli and Eliyahu groups' shares in Leumi Bank. This is also true for the Bronfman and IDB groups' ownership of Discount Bank. Arison Group owns shares in Delek Real-Estate, controlled by Tshuva. Both the Eliyahu and the Bino groups own shares in Paz. Fishman and Eliyahu own shares in HOT Cable Company. Cooperation is also manifested in international investments, such as the common investments by IDB and Tshuva in Plaza Las Vegas in 2007 (a failed investment, resulting in losses of USD 620 million in 2012 - Globes, 2012; Calcalist, 2012). In addition to joint ownership, there is tight cooperation within the pyramidal business groups. To illustrate, Clal Insurance insures all the companies in IDB, as does the Phoenix for Tshuva Group.

Interlocking directorates in pyramid-affiliated companies are another critical mechanism in substantiating the power and control of the oligarchy. The process of appointing interlocking directorates, both within the pyramidal business groups and across them, is not spontaneous. There is great importance to personal acquaintance and trust between the controlling owner and the appointed directors, allowing the owner to enhance his or her power. The directors, therefore, serve the interests of the controlling owner, and are in many cases part of the 'club'. Some examples of interlocking directorates within the same business group include Yosef Bertfeld and Leora Pratt Levin, who are directors in Delek Group and the Phoenix, both under the Tshuva Group. Ilan Kliger is a director in Alon Fuel, Alon Transport Mega Retails and Blue Square Real Estate (D&B Directors database). In addition, the controlling owners are directors in most if not all the companies in the pyramid (e.g. Nochi Dankner in IDB companies, Dudi Weisman in Weisman Biran Group, *ibid*). Most importantly, the process of appointing the directorates is led by the controlling-owner himself. This creates dependency between the directorates and the controlling owner, creating doubt about the ability of directors to meet the standards expected of them (Hamdani,

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<sup>128</sup>Joint ownership across the pyramidal business groups and the inter-linked or common control over market niches is illustrated in the map provided above in this chapter.

2009). There is therefore a discrepancy between business reality and the declared aims of government regulation (ibid). The case of IDB analysed in part 4, concerning the loan taken from Leumi Bank, illustrates such a gap.

A similar problem concerns the senior management of these business groups, which has hardly any conflicts with the controlling owner. This is because the controlling owner is usually chairman and appoints the executives, who, in turn, are subject to his directives. In return, the executives enjoy exceptional salaries and promotions within the pyramid (e.g. Ilik Rojansky and Eyal Lapidot in the Tshuva Group, Nir Gilad at the Ofer Group), helping to maintain their consent to the controlling owner. On the rare occasion that there are conflicts, the controlling owner makes the final decision (Kosenko and Yafeh 2010: 479). For example, Shari Arison, the controlling owner of Hapoalim, had a conflict with Shlomo Nechama (the chairman of Hapoalim in 1998-2007), which ultimately led to him being removed from his position (Dagan, TheMarker, 2007). According to Nechama, this conflict concerned ownership struggles within the Dankner family, specifically Nochi Dankner and Dani Dankner (Raz, TheMarker, 2012). Similar conflicts between senior management and controlling owners are not known, probably because they are not prevalent in the culture of the club, where the controlling owners appoint managers who would best accommodate their interests.

Interlocking directorates across the business groups are no less relevant. Some examples include Yigal Landau, who is a director at Ratio (Tshuva Group) and Igud Bank (Eliyahu Group). Yeshayahu Landau is a director at Granite Hacarmel (Azrieli Group), as well as at Ratio and Igud Bank. Joseph Singer is a director at Granite Hacarmel and Sonol (Azrieli Group), and Poalim IBI (Arison Group). Menachem Einan is a director at Azrieli Group and Leumi Card (under Leumi, with Eliyahu Group as a shareholder). Niv Ahitov is a director at Discount Investments (under IDB) and Azrieli Group. Moshe Amit is a director at Delek Group and Excellence Investments (controlled by Tshuva Group), Poalim Capital Markets Ltd. (Under Poalim, controlled by Arison Group), and Mega Retail (under Weisman-Biran Group). Avraham Harel is a director in Phoenix Holdings, Excellence Investments, and Delek Group (controlled by Tshuva Group), and at Poalim Capital Markets (D&B Directors database).

A key aspect of the oligarchy and the club is social interaction. The personal connections within the oligarchic club become observable through social interactions, which also include related political circles.<sup>129</sup> These personal links are visible in various forums and social events, as well as frequent meetings between a small number of participants (Sokolinski, 2012; Committee, 2012). The media has covered numerous such events, like the weddings of Nochi Dankner's daughter,

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<sup>129</sup>TheMarker magazine published a detailed account mapping the complex connections of Nochi Dankner, head of IDB, in May 2013 (TheMarker 2013). The article discusses former politicians and regulators, partners, managers, consultants, and people from the military, industry, and legal system, who together form his network, sustaining his emergence and IDB's position as the biggest business group in Israel.

Shari Arison's son, and Yitzhak Tshuva's son (all of which took place in 2011), as well as holidays parties (e.g. the Independence Day party at Yossi Maiman's house, a well-known businessman who used to control a TV channel and had vast natural gas holdings), in which the controlling owners of the big business groups, politicians, bankers, senior managers, bureaucrats and former bureaucrats, lawyers, lobbyists, accountants, media representatives and other advisors all interact. Occasions such as weddings are not only a potential opportunity to transfer money through gifts, it is a demonstration of power, connections, and commitment. They also delineate the connections, interests, and influential actors. To illustrate, the same names constantly appear in media reports on social forums in which the oligarchy members participate, like the executives, PR executives, lawyers and accountants mentioned before (e.g. TheMarker: Halutz, 2010, Sadeh, 2011a, Halutz, 2011B, Halutz et al., 2012; Calcalist, 2011; Sadeh, 2013; Maariv: Sharoni, 2008, 2009; Haaretz, Rochvarger, 2008; Shpurer, 2013).

The origins of these intra-group connections vary. The familial structure of some of the business groups is marked by close relationships, both personal and professional, allowing narrow space for external incursion. They can be friendships or they can be a result of business cooperation and common interests, or, alternatively, of the proximity between the political and economic elites.<sup>130</sup> This alignment of personal and professional connections forms a club of only few hundred people, serving the interests of a handful of businessmen and wealthy families. The members are rewarded accordingly, with money, appointments, and prestige, but most of all in the power derived from affiliation to the 'club'.

The result is that the members of the club are above all loyal to the club, and this loyalty forms a necessary condition of their membership. Moreover, some members of the club are entrepreneurial agents that advance the interests of the controlling owners. As time goes by the club may suffer from three deficits: a deficit of trust, a deficit of professionalism, and a deficit of competitiveness. Trust is understood here in terms of consent and the belief of the public and public opinion makers that there is no better way to organise the political economy with respect to the current economic regime. Since members of the club are not chosen on merits alone, and since their loyalty is first and foremost to the club, there is a high risk that the club will advance policies and governmental decisions that come at the detriment of the public as a whole. Furthermore, it is likely that at some point, journalists, analysts and experts will hold the club responsible for its damages to the political economy. This undermines the trust in the club, and endangers its existence.

The following analysis by Guy Rolnik, one of the most influential journalists in Israel for more than a decade, exemplifies the problem of trust: "There is no longer any question that the great

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<sup>130</sup>Examples of such connections are the friendship between Rakefet Russak-Aminoach and Idan Ofer (Shpurer in Haaretz, 2012); the business cooperation between Tshuva and Dankner in Plaza Las Vegas; interests, such as credit provision to the oligarchy by the banks controlled by it, e.g. Hapoalim Bank, controlled by Arison, providing credit to Dankner.

business pyramids achieved their dimensions thanks to monopolism, toothless (or rotten) politicians and regulators, and a craven press... wireless communications is just one of many branches, and if everybody can be fooled for so long, if the watchdogs of democracy and fair play can be bought, that begs frightening questions about practices in other areas of the economy and society. It boils down to three clubs controlling the Israeli economy and awareness of millions of people: the oligarchy of the banks, the capital market and the private monopolies; the big unions calling the shots at the big monopolies; and the war-and-peace junta of the generals and peace-process industry." (Rolnik, TheMarker, May 2012).

These personal connections influence business decisions, and lead to decisions which would not be taken otherwise; these may often come at the expense of the public as a whole. To illustrate this point, in February 2012, in view of liquidity stress and concerns of insolvency, Nochi Dankner decided on a special stock issue of IDB Holdings, in order to lift the price and thus bring in more money from the offering. Ironically termed as the "Dankner Contributions Operation" (Shpurer, 2012), or "friends placement", it was a joint effort of members in the club (e.g. Eliyahu, Williger, Shamir, Tshuva) to help one of its key leaders. At least half of the ILS 340 million raised came from public savings through public companies, such as Willifood, Delek, and ILDC Energy, although institutional investors were not involved in the deal. Some of the central underwriting agencies in the market, mostly public enterprises or those affiliated to such, took part; among these were Poalim IBI (of Hapoalim Bank), Discount Underwriting&Issuing (under Discount Bank), Menora Underwriting (under Menora-Mivtachim Insurance company), and Migdal Underwriting Company (under Migdal Insurance company). It is noteworthy that Nochi Dankner himself has been the Head of the Credit Committee in Hapoalim Bank since 1997, including during his take-over of IDB (Haaretz, Sharvit, 2002; Shpurer, TheMarker, 2010b).

In another example, in 2006, during a record period of capital raising, the oligarchy managed to raise ILS 24.8 billion through private, non-tradable debt. IDB raised ILS 4.35 billion (ILS 400 million to IDB Holdings; ILS 520 million to IDB development; ILS 2.35 billion to Machteshim Agan; ILS 700 million to Discount Investments; and ILS 380 million to Cellcom). Paz Oil Company (controlled by the Bino Group) raised ILS 2.2 billion, and so did Africa-Israel (controlled by Lev Leviev). Delek (controlled by Tshuva) raised ILS 1.6 billion. The Israel Corporation (controlled by Ofer Group) raised ILS 1.3 billion. Eighty-eight percent of these debts were raised through non-tradable shares (Amit, Haaretz 2007).<sup>131</sup> They were assisted in this by the personal factor, based on the position of these businessmen in the market, despite the obvious shortcomings and the risks to public savings.

During the period when Dani Dankner was Hapoalim Bank Chairman and Zion Keinan was

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<sup>131</sup>The data was published in Haaretz newspaper and is based on a report produced by Natra Company, which is no longer available for public review.

the Head of Corporate Banking, the bank gave preferential credit to businessmen associated with them and with Shari Arison, the controlling owner (Weitz and Gabison, Haaretz, 2013).<sup>132</sup> First and foremost were loans provided to Dani Dankner himself (amounting to \$3.4 million), without guarantees, indications to the purpose of the loan, or the sources of the payments, and without properly reporting it (ibid). Furthermore, the value of the shares held by Dankner's private investment company (Elran) was ILS 813, 000; Dankner himself, however, reported the value to be ILS 59 million (ibid), to make a semblance of strong guarantees. The BoI inner report further found that Shikun Vebnui, the real-estate company controlled by Shari Arison, received preferential treatment in 2008, receiving a yearlong postponement on a loan of ILS 650 million and a balloon loan of ILS 160 million.<sup>133</sup> In another case, Hapoalim approved an exemption for the husband of Irit Izakson, a personal friend of Arison and a director in Hapoalim Bank (1999-2013), after failing to meet the threshold terms set by the banks to accept his company's (Y.A.D. Electronics) proposal for rescheduling repayment of ILS 17 million debt (ibid). As these cases demonstrate, familial and personal connections (e.g. Nochi Dankner and Dani Dankner; Arison and Izakson) enabled the provision of privileged loans without guarantees. The particular personal relations and the processes behind specific deals that enabled the oligarchy to accumulate its power, nevertheless, have not been fully transparent and accessible to the public (Committee, 2012).

The media is an important pillar in the power structuring of the oligarchy. The oligarchy has a massive footprint in the media and communications sector, substantial shares of which are controlled by the oligarchy. For example, Fishman controls Globes daily newspaper (57.1%), Yedioth Ahronoth newspaper (14.2%) and Hot Cable TV(6.6%); Dankner had controlled Maariv daily newspaper (60.97%, from 2010 till 2012) and local radio station (2.97%); Ofer Group (with Udi Angel) has a control stake in Reshet (51%) - one of the two concessionaires running the Israeli commercial television network, Channel 2. Tshuva has control over Keshet (20%), the second concessionary running Channel 2 (Knesset, 2013).<sup>134</sup>

The role of the media is central to the oligarchy consolidation. On the one hand, specific media entities, most prominently The Marker, are among the leaders in the public campaign against the oligarchy, covering the widening social gaps, the close connection between capital and political control, and the ensuing distortions. A continuous flow of articles, reports, and documentaries has been reviewing the strong connection between the narrow group of controlling owners and the state institutions and offices.<sup>135</sup> On the other hand, some prominent media bodies are controlled by the

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<sup>132</sup>Haaretz magazine exposed the BoI inner report; the BoI and Hapoalim Bank refused to reveal either the draft or the final report (Weitz and Gabison, Haaretz, 2013).

<sup>133</sup> A balloon loan allows for the debt to be repaid at the end of the term rather than fixed payments during the debt period.

<sup>134</sup> As mentioned before, in 2011 Leonid Nvezlin, a Russian (Jewish) oligarch acquired 20 percent of the daily newspaper Haaretz's shares (Haaretz, 2011). Nvezlin, however, is not a part of the Israeli oligarchic club, as analysed next.

<sup>135</sup>It is noteworthy, all the same, that the media was a central actor in stimulating public awareness to the centralised market structure, increasing inequality, and declining competitiveness. It was first and foremost TheMarker that assumed this role (as detailed in the introduction), but following

same pyramidal groups, resulting in captured journalism, biased coverage, and disinformation. For example, in 2012 Maariv newspaper, then under the control of Nochi Dankner, attacked the appointment of Professor Yishay Yafeh as a consultant to the Team to Examine Increasing Competitiveness in the Banking System (see BoI 2013). Prof. Yafeh, who has covered the pyramidal structure of the Israeli market (e.g. Kosenko and Yafeh, 2010; Khanna and Yafeh, 2007; Noyman, Haaretz, 2009), was attacked as 'anti-capitalist', and the paper asserted that his conclusions regarding the excessive power of the Israeli big business groups were based on business groups abroad (Sharoni, Maariv 2012). Another example is former Member of Knesset, Einat Wilf. In 2010 Wilf initiated a process to examine the market concentration and dismantle the pyramids, and filed a law proposal on that matter (Wilf, 2010c) which eventually contributed too to the establishment of the 2010 Committee on Increasing Competitiveness in the Economy. Globes newspaper, under the ownership of Fishman, critiqued Wilf on a personal and professional level in a series of articles (e.g. Globes - Zipori, 2010a, 2010b; Globes - Ron, 2010; Wilf, 2010b), fairly unprecedented for a new Member of Knesset (MK) with an impressive record of activities. These articles cast doubts on her capacities, interests, and general integrity. In addition to direct ownership of the media, advertising revenue usually comes from the larger companies in the market, many of which are associated with the oligarchy, directly or indirectly. This commercial-financial dependence is enough to further perpetuate the power of the club.

The ownership of media bodies as a means to centralise and further exercise power was rarely discussed. In 2009, Mordechai Gilat, a senior journalist at Yedioth Ahronoth (the most highly-read newspaper in Israel), filed a legal claim against the newspaper for a severance package, stating, among other things, that he was compelled to cover reports concerning senior politicians and businessmen close to the owners of Yedioth Ahronoth in a biased or partial fashion (Drucker, 2010). The lawsuit concluded with a compensation of ILS 600,000 paid to Gilat by the newspaper (Psika, 2010). In addition, Raviv Drucker, a leading investigative journalist in the Israeli media, alleged on his blog in 2012 that Dankner purchased Maariv daily newspaper as a means to combat TheMarker journal and its chief editor, Guy Rolnik (Drucker, 2012). Maariv was also accused of "buying" journalists from Haaretz, like Shai Golden and Mazal Mualem, in an attempt to undermine the hard line taken against the Israeli oligarchy by Haaretz, signalling the economic benefits which could be obtained as a result.<sup>136</sup>

Guy Rolnik argued in several occasions, in the media and other public forums (e.g. Rolnik 2012; Persico, 2013a, 2013b), that the media has decided to side with the oligarchy, most significantly during the years of TheMarker campaign against market concentration (until the 2011

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the 2011 social protests, the media as a whole started engaging with the concentration problems. The case of Nochi Dankner losing control of IDB (see the conclusion) is an illustration of the media's power.

<sup>136</sup> For more details about attempts to hire journalists from Haaretz, see Avraham, Nana10, 2011.

social protest). These claims are substantiated by fairly consistent coverage that stated, in effect, that there was no remarkable concentration in the Israeli market (e.g. Azran at TheMarker, 2012; Plotzker, 2006, 2010; Horesh, 2010; Sharoni, 2010). Moreover, the media is inclined to praise the controlling owners and their significant contributions to the political economy, which were extremely popular in the periphery, where they donated significant sums of money, and in society more generally. Nochi Dankner, the most prominent example, was chosen as 'The Man of the Year' in 2009 by Globes economic newspaper (Globes, 2009a). He has been praised for years for his skills, power, contributions, and influence (e.g. Federation 2009; Yacimovich, 2013).<sup>137</sup>

Finally, an important mechanism to exercise and maintain the power of the oligarchy is the lack of competition between its members, and furthermore, the tight cooperation between them. Not only they do not compete with each other—and there is no evidence of hostility in personal or professional relations—they coordinate and collaborate, thus preserving their power. This is partly due to the fact that before the privatisation reforms that launched the first stage of the formation of the Israeli oligarchy, the competition principle was largely absent in Israel. That is, there was essentially no market space for owners of businesses to compete against each other. This trend was further entrenched by the mode of privatisation reforms and became a 'mode of conduct' of the oligarchs once they became members of the selected club.

The familial context, as well as the 'clubness', functions to serve this power structure. There is therefore continuous cooperation and coordination, including agreements on 'who takes what' to manage reciprocal interactions. Pacts regarding the division of the market between various actors are perceived as common (Yaniv, 2013; Horesh, 2014).<sup>138</sup> This cartelised control over market sectors is a multiplying factor in the power of the oligarchy. The oligarchy activates powerful and united lobbies to advance specific interests (Kahlon, 2013a; Makover-Balikov, Maariv, 2013<sup>139</sup>), advocating its concentrated control over the market (analysed later in this chapter). It is not a coincidence, therefore, that the Russian oligarchs active in Israel (e.g. Arcadi Gaydamak, Vladimir Gusinski, and Leonid Nevzlin) are not a part of this club, despite being oligarchs and active in Israel; they are individualists who are not connected to the Israeli circles of power, and accumulated their wealth outside Israel.

To illustrate, in 2012 the cellular cartel of Cellcom, Partner and Pelephone was broken. The Minister of Communications at the time, Moshe Kahlon, led the reform, opening the telecommunication market to competition. The cartel leaders presented a united front in their battle

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<sup>137</sup> It is important to mention the Israel Hayom daily newspaper, founded in 2007 and owned by the Jewish-American casino magnate Sheldon Adelson. Adelson is the political patron of Benjamin Netanyahu, the Prime Minister since 2009, and the paper is commonly perceived to be biased towards him (see for example Eglash, The Washington Post 2014; Rachlevsky, Haaretz, 2014; Tobia, PBS Newshour 2014). Nonetheless, Adelson is not a part of the Israeli market, and Netanyahu is not associated with the oligarchy.

<sup>138</sup> This assertion is also based on findings from the fieldwork conducted in the framework of this research.

<sup>139</sup> It is noteworthy that this article was published in Maariv in the post-Dankner era (after Maariv's sale in 2012 to Shlomo Ben-Zvi).

against opening the market, and more specifically against Kahlon himself, predicting the destruction of the industry, and protesting against it as a socially irresponsible social move that would damage market growth (Forbes, 2013; Rotter, 2013). Rani Rahav, one of the most prominent PR executives in Israel, was interviewed extensively in the media, arguing that the reform would bring destruction, the loss of hundreds of jobs, and the collapse of the affected companies (e.g. Nissan, Globes, 2012). Both Cellcom and Partner appealed against the reform (Ziv, TheMarker, 2010).<sup>140</sup> They received assistance from within the Knesset. In 2009, when the idea of the reform was first discussed, former MK Yulia Shamalov-Berkovich tried to sabotage the reform in various ways. She met several times with Ilan Ben-Dov, the owner of Partner, set up committees examining the reform and objected to new regulations in the cellular market (Zarchia, TheMarker, 2010). By calling for discussions in the Knesset, she opened the door to lobbyists, controlling owners and senior executives in the cellular market, who argued against the reform (ibid).<sup>141</sup> The objection of the oligarchy to the reform, in effect, was substantially drawn on the fear that similar steps would be taken against other cartelised sectors controlled by it. Taking place following the 2011 social protests (see the conclusions), the reform compelled a united reaction by the oligarchy, fearing a fundamental change in market paradigms.

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<sup>140</sup> Cellcom and Partner cooperated in several cases in the past, such as in their appeal against the frequency fees they were charged (4033/04).

<sup>141</sup> The Ministry of Communication presented data showing that the public saved ILS 5.7 billion as a result of the reform (Levy, Calcalist, 2012).

#### 4. The Relationship of the Club with the State

The previous chapters demonstrated the importance of the inter-relations with the state and the statist condition under which oligarchy emerges and operates; they then analysed the retreat of the state in privatisation and financialisation, emphasising that the state, nevertheless, remained powerful, active and proactive. A key feature in the rise of the oligarchy as an informal institution in the political economy is its tight connections with the machineries of the state. These relations are particular to the ruling class (Van der Pijl, 1989, 2007). The close ties with political decision-making circles are a key mechanism employed by the oligarchy to accumulate wealth and power, and it is one of the main functions of the club. The power of the oligarchy is thus linked to its capacity to influence state decisions. The access to and influence on political decision-making processes, mainly through the club, turn it into a central political actor. This section analyses the ways in which the club both exercises power on the state and increases its power as a result of its connections with it, concluding that the power of the oligarchy, as a consequence, is mostly confined to the domestic arena.

The access of the oligarchy to political power manifests itself in various ways. Generally, these include campaign finance; political party debt to banks controlled by the business groups; lobbying; ownership over the media; and social interaction and networking through the club. Corruption, such as bribes, is also an instrument the oligarchy uses to influence political decision-making processes, but it is not common in Israel. Finally, a key mechanism is opening the club to new members from the political class and the public service. The latter is termed 'revolving door', referring to jobs in the business groups offered to politicians and bureaucrats at the end of their tenure. This mechanism leads to what is known as "regulatory capture" (Carpenter and Moss, 2013; Maggetti, 2009; Gely and Zardkoohi, 2001; Bratton and McCahery, 1994; Levine and Forrence, 1990).

The 1973 Political Parties Financing Law (Mevaker, 1973; Knesset, 1973; Nevo, 1973) and its various revisions and updates have limited financial contributions provided by a single person or a corporation. Politicians are prohibited from receiving donations from corporations or registered partnerships, in Israel or abroad, during both the general election and the primaries.<sup>142</sup> A candidate may receive one donation or several donations from an individual donor, the aggregate value of which cannot exceed ILS10K (\$2857 ca.) in primaries. An individual donor may provide donations to several candidates during primaries, the aggregate total of which cannot exceed 30,000 NIS (\$8571 ca.). A party or a candidate list may not receive any donation from a household exceeding 2000 NIS (\$571 ca.) in an election year, and ILS 1000 (\$285 ca.) in any other year. In addition,

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<sup>142</sup> The Law limits the total amount that may be contributed to an individual's campaign in the primaries to an amount equal to 405,000 NIS (\$97,237.00), plus 2 NIS for every voter above 100,000 eligible voters; or double this amount for a candidate for Prime Minister or Party Chairman in primaries with up to 50,000 qualified voters; and four times this amount in primaries with over 50,000 eligible voters.

there are limitations on campaign expenditures. As a result of these limitations, campaign financing has not been a pivotal mechanism employed by the oligarchy to gain access to political decision-making circles.<sup>143</sup> Likewise, most of the prominent examples of the negative influences of campaign financing did not involve people from the club but rather outsiders (like Moshe Talansky or Martin Shlaf, who allegedly financed PM Ehud Olmert and PM Ariel Sharon, respectively; see Navot, 2012).

Conversely, political parties' debts to the banks led, in effect, to dependence of the former on the latter.<sup>144</sup> This dependence, in turn, creates structural weaknesses in the political system in confronting the banks. Examples can be found in the Labour Party debt to Hapoalim Bank in the early 2000s (Zarchia, TheMarker, 2003; Levin, Globes, 2003) or the Kadima party's debt, also to Hapoalim (2011 court ruling). In March 2012 and in January 2013 Channel 10 aired reports in which the former Kadima Party treasurer Itzik Hadad accused the banks and political parties of managing tight relationships concerning loan provisions, maintaining the dependence of the political system on the banks (Channel 10, 2012, 2013). While this mechanism does not deviate from the law, it does indicate the tight connections and inter-dependence between the oligarchy and the decision-making circles. As a result, these parties cannot fight issues that contradict the interest of the banks, such as increasing competition in banking services, thus risking the control by the two big banks.<sup>145</sup>

Lobbying is another key mechanism that the oligarchy uses. The phenomenon of lobbyists' advocating the big businesses' interests vis-à-vis government officials was not common in Israel until the 1990s (Tal, IDI, 2010; for more general account see Leech et al., 2005; Woll; 2007; Ainsworth, 1993; Moloney, 1996). It is hard to obtain exact data about the scope and importance of lobbying; nonetheless, a few references indicate that there is a structural problem with lobbying in Israel. For instance, in 2012 a profile was published covering the 'behind the scenes' activities of the most prominent lobbyist in Israel, Boris Karasani. Since he was connected to various politicians, bankers, regulators, and managers, he had a key role in important processes in the market, such as prolonging the Dead Sea concessions to the Ofer Group and shielding the banking sector from competition (Sadeh, 2012a). In the same year, a TV report covered the dominance of lobbyists in the Knesset ('Uvda' - 7.2.2012, channel 2). The Association for Progressive Democracy has further demonstrated that the role of lobbyists has increased, creating severe conflicts of interests as a part

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<sup>143</sup>Conversely, in other states campaign financing has been a major source of funding, and crucial to political corruption, bias, and regulatory capture (see for example Hofnung 2003; Hacker and Pierson, 2010; Lessig, 2011).

<sup>144</sup> Lessig (2011) identified this kind of dependence as a form of political corruption.

<sup>145</sup>The Team to Examine Increasing Competitiveness in the Banking System (also termed as the Zaken Committee, after Banks' Supervisor David Zaken who led the team) published a summary report in March 2013, including its final recommendations, with the aim of bolstering competition and increasing the consumer power of households and small businesses. These recommendations included, among others, increasing competition in the provision of credit to households and small businesses by non-bank institutions; removing a main impediment to moving from one bank to another; and increasing online banking services.

of capital-political control relationships.

According to a recent report (The Association for Progressive Democracy, April 2015), 91 registered lobbyists participated in the 19<sup>th</sup> Israeli parliament (2013-2015). Most of the lobbying (54%) is done by four companies. Most of the lobbyists' clients (60%) are companies from the private sector, and not from the social sector. The 2012 Committee to Examine Crony Capitalism recommended reducing the lobbyists' influence and limiting their scope of activities (Committee 2012: 61-3). Following these reports, public awareness was raised, and the Knesset took several measures against lobbyists to prevent their interaction with politicians. For example, on December 2014 the Knesset's attorney ordered Ofra Shaked, one of the lobbyists, not to make contact with the chair of the Economy Committee, Avishay Braverman (because of personal acquaintance - she was his ex-assistant) (The Association for Progressive Democracy, April 2015).

A prominent example of the oligarchy use of lobbyists to influence government decisions is the case of Neshar Israel Cement Enterprises, controlled by IDB. On January 1<sup>st</sup>, 2011, the government raised the excise tax on fuel. Petcock, a particular fuel only used by the cement industry, was excluded. This exemption was enacted following an aggressive lobbying campaign by IDB on MKs, who finally gave in to the pressure and affirmed the exclusion. As a result, the state lost ILS 36 million of income (Zarchia, TheMarker 2010a). The Israeli population, however, paid more for their fuel. Another example of lobbyists' impact is the case of the Israeli energy laws. Between 2009 and 2013, large natural gas reserves were discovered in Israel (INSS, 2009; NaturalGasEurope, 2013; Bloomberg, 2013). The exploration was largely carried out by private investors, most prominently the Tshuva Group. The discoveries prompted a charged debate concerning the appropriate taxes the state should charge on the gas, and the equivalent royalties. The Minister of Finance at the time, Yuval Steinitz, appointed the Committee to Examine the Fiscal Policy on Oil and Gas Resources in Israel (Sheshinski Committee, after the head of the committee, Eytan Sheshinski) in April 2010 to investigate the matter. Steinitz revealed that he was exposed to intense pressure from lobbies and investors (Steinitz interview, Makover-Balikov in Maariv, 2013), operating as a united front to defend future profits from the gas discoveries at the expense of state revenue. Sheshinski also reported being lobbied by parties interested in keeping the lion's share of profits for the Tshuva Group (Ma'anit, Globes, 2011).<sup>146</sup>

The media, as analysed earlier in this chapter and in the first chapter, is another critical tool used by the oligarchy to accrue power. The existing ownership structure of media entities in Israel suggests that politicians need to be prudent in tackling the concentrated ownership structure of the wider market, controlled by the same actors. This results in further power of the oligarchy over the

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<sup>146</sup>At the moment, the natural gas market in Israel is a natural monopoly, and while taxation is partly regulated, the prices for consumers are still not supervised.

political economy. The control over the media, therefore, is also a direct mechanism in the influence of the oligarchy on the political decision-making processes, so that political measures taken against the oligarchy may, in this way, be discredited.

A crucial means of the oligarchy to exercise power is the phenomenon of the 'revolving doors' – the employment of civil servants, bureaucrats (especially ex-regulators), public officials, and politicians in the big business groups once their public service tenure is over. This creates 'captured regulators' and politicians. Some prominent examples of politicians working for the oligarchy are Eli Goldschmidt, a former MK, who was appointed to senior positions in the Ofer Group. Roni Milo, former Minister of the Environment (1988-1990), Minister of Police (1990-1992), Minister of Health (2000-2001), and Minister of Regional Cooperation (2001-2003), was appointed to senior positions in IDB (as the CEO of Azorim, and as director at other IDB subsidiaries). Dani Naveh, former Minister of Health (2003-2006), was appointed to a senior position in IDB (director IDB Development Ltd. and Discount Investments, and in 2013 he was appointed Chairman of Clal Insurance's board of directors). Avraham Shochat, former Minister of Finance (1992-1996, 1999-2001) and Minister of National Infrastructure (2001-3), currently serves as a director at several companies under pyramidal business groups, such as Mizrahi-Tefahot Bank, ICL, and Alon.

On another level, the social interactions and networking of the club constantly include senior public servants. Prominent examples of politicians interacting with the club are Dalia Itzik, former Minister of the Environment, Minister of Industry and Trade (both in 2001-2), and Minister of Communications (2005), who at the end of her tenure served as a director in companies under the Ofer group and Wertheim Group (Shpurer, TheMarker, 2014); and Yair Lapid, the Minister of Finance from 2013 to 2014, who was a prominent journalist before entering the government, thus enjoying close proximity to the media. Lapid became a politician after founding a new party, Yesh Atid, which won an unprecedented number of seats (19) for a new party in its first elections (2013).

An important example is the case of Ofer Einy, the Chairman of the Histadrut in the years 2006 – 2014. During the same period he also served as a director in Yahav Bank. Yahav Bank is controlled by Mizrahi Tefahot (50%), which is controlled by Ofer and Wertheim groups. The other 50% is controlled by the state and the Histadrut. Einy represented employees at big companies in the market controlled by these two families (such as the Israel Corporation, Zim, or the banks themselves), yet he himself was connected to the controlling owners through his position in the directorate. The conflict of interest was first of all systemic, enabling the chairman of the Histadrut to coordinate with controlling owners, whilst he was supposed to defend labour interests. Second, it was a conflict of interest on a personal level because the chairman of the Histadrut had vast connections with capital owners. Einy's transition from the Histadrut to employment in the oligarchy was fast; in October 2014, five months after the end of his tenure, Einy was appointed as

a special advisor to Discount Bank, on the issue of organized labour (Varon, Calcalist 2014). Such a fast transition inevitably raises doubts about coordination between the Chairman of the Histadrut and big employers in the market when they are in a position to be employed by them in the future.

Prominent examples of regulators who later worked for the oligarchy are Nir Gilad, the Accountant General in the years 1999-2003, who later became the Chief Executive Officer (CEO) of Israel Corporation, under the Ofer group. It was during his public tenure that the Oil Refineries and Zim transactions were executed (as detailed in chapter 3). Gilad led these controversial privatisations as the representative of the state, and shortly after (in 2006) joined the Ofer Group. His performance as CEO was widely criticised (see for example Peretz, Haaretz, 2013), however, the importance of 'revolving doors' appointments does not amount to merit solely. Arie Mientkavich, Chairman of the Board of Directors at Elron (under IDB) and a director in other IDB companies since 2006, and formerly the chairman of the Board of Israel Discount Bank Ltd. (1997-2006) was previously the chairman of the board of the Israel Securities Authority (1987-1997). Moshe Bareket, the former Director of the Corporate Finance Department at the Israeli Securities Authority (ISA) and also the ISA's former Chief Accountant (2006-2010), was appointed to a senior position in the Tshuva Group in 2011 (the Chairman of Phoenix Holding Group Inc. and Phoenix Insurance Inc., and the Chief Finance & Strategy Officer of the Tshuva Group). Roni Hizkiyahu, the former Supervisor of Banks at the Bank of Israel (2007–2010), was appointed Chairman of the Board of Directors at FIBI, under the Bino Group, in 2012.<sup>147</sup> Shai Talmon, the CEO of Clal Insurance Enterprises Holdings Ltd in the years 2007-2012 (under IDB) and Hapoalim Bank Deputy General Manager and member of its management (2000-2007, under Arison Group), was the Ministry of Finance's Accountant General in the years 1995-1999. Another example is Zohar Goshen, former Head of ISA, the state authority in charge of protecting public investments, often in the pyramids themselves and also through them. He was not appointed directly to a position in a pyramidal business group, but after quitting public service in 2011 he mediated an IDB transaction for a commission of ILS 3 million (Starkman, TheMarker, 2012). A considerable number of senior officers in the Israel Securities Authorities (ISA) have received lucrative positions in IDB - Eyal Solganik, Yoram Naveh, Lior Hanes, Shony Albek, Yehuda Elgarisi, and Moran Meiri.

The same is true for former police officers and senior military officials. Gabriel Last, the former CEO of Delek Group Ltd. (2001-03), the Chairman of Delek Group since 2001, and a member of the Board of Directors in the same group, was previously the Commissioner and Commander of the Tel Aviv Central District Police. Moshe Karadi, the former General Commissioner of the Israel Police (2004-7), was appointed in 2007 to be CEO of Delek Pi-Glilot, under Tshuva Group. Dudi

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<sup>147</sup>Hizkiyahu specifically was appointed to the Supervisor of Banks position after serving in senior positions in the banks. He was head of the Corporate Division as Deputy CEO at Discount Bank, the CEO of Maritime Bank of Israel, and served in a series of positions at the Hapoalim Bank Group.

Cohen, the former General Commissioner of the Israel Police (2007-11), is the CEO of one of Delek Group's subsidiary, Cohen Development Ltd., and provides consulting services to the Delek Group. Yom-Tov Samia, the former head of the Israel Defence Forces' Southern Command (2001 – 2003), was the President and CEO of Israel Corp (Biofuels), under the Ofer Group since 2005, and a member in the board of directors in other companies in the group (e.g. IC-Green Projects – Israel). Jacob Amidror, a former major general whose last position was the head of Israel's National Defence College (until 2002) and later became National Security Advisor (2011-1013), was, between these positions, a director in several companies under the Ofer Group, such as the Israel Corporation and Zim. Pinhas Buchris, the former head of The Israel Intelligence Corps Unit (8200) in the years 1997-2002 and later the Director General of the Ministry of Defence (2007-2010), was appointed as head of Israel Oil Refineries, under the Ofer Group, in 2011. Yaakov Perry, an MK since 2013 (in Yesh Atid) and the former Head of the Israeli General Security Service (ShinBet) in the years 1988-1994, was the CEO of Cellcom telecommunication company (1995-2003), under IDB, and then the Chairman of Mizrahi Tefahot Bank (until 2012), under the Ofer Group.

On the one hand, the revolving doors phenomenon is not unique to Israel (as analysed in chapter 1) and can be explained by the small market size and the networked nature of the society and its elites (Maman, 1997; Shalev, 2004), making such transitions somewhat inevitable. On the other hand, under such a small, concentrated and networked market structure, this phenomenon creates significant conflict of interests. The appointment of senior public servants to central positions in the pyramidal business groups of the oligarchy provides them with incentives to cooperate with the oligarchy while still in public office (Ezran, TheMarker, 2012; Navot, 2012; Shpurer, Haaretz, 2013). Such appointments signal to succeeding holders of public office the attractive employment opportunities available once public tenure is over. Some bureaucrats, politicians, and regulators may thus prioritise the needs of the oligarchy. In fact, this mechanism helps to turn these business groups into an oligarchy, by means of its power over the political economy as a whole. As for senior military officers, their appointment is a result of their respectable and authoritative position in Israeli society, entwined with their deep connections.<sup>148</sup> In a way, these people provide legitimacy to the rule of the oligarchy, due to their reputable social position in the Israeli society. In all cases indicated, these former officers lack the experience in the business sector, certainly not in senior management position. These appointments, therefore, similar to the appointments of bureaucrats, are designed to entrench the oligarchic position of the business groups in the political economy.

The situation in Israel is still far from that of the corrupted Russian 'apparatchiks' (Freeland, 2000; Goldman, 2004). Most of the members in the club probably do not deliberately intend to corrupt the system or violate the law. Moreover, they are not indifferent to the common good, and

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<sup>148</sup> The prominent position of the security system and its senior servants in the Israeli political economy is analysed in the second chapter.

most of them are likely honest people that would never pay bribes (not to mention use violent means in the political arena). Yet, it is proper to describe the system as being structurally captured in this employment matrix. This situation is in itself, whether bureaucrats and regulators are captured and biased or whether they are not, a facet of oligarchy. In addition, politicians often do not back regulators, since the politicians themselves are connected to capital-owners (Zelekha, 2008). There is thus a systematic deficit in the regulatory mechanism when regulatory actions contradict the interests of the big business groups (ibid). It is note-worthy that a similar problem was not prevalent before the second wave of privatisation at the end of the 1990s, only becoming prominent throughout the 2000s.

Unlike the business elite who was largely identified with a political agenda, and moreover – attempted to shape foreign policy (such as the business elite identification with the Labour party, advancing the Oslo Peace Process, see for example Ben-Porat, 2004), the oligarchy is distinguished by its lack of partisan identification, agenda, or attributes. The power of the oligarchy vis-à-vis the political machineries of the state is mainly designed to maintain the status-quo of market concentration and limited competition, and allow for the expansion of its activities. The aim of maintaining the status-quo is thus a key characteristic of the oligarchy. What makes it a political actor is its power on policy-making, sustained by the ‘clubness’. Through its political influence, the oligarchy can thus constrain the market in which it operates.

As a result of the 'clubness' and the tight connections of the club to political circles, the power of the oligarchy is very significant in the Israeli domestic economy. This is true both in terms of domestic sources of control and with respect to its ownership over domestic assets. Unlike other states, the social interaction, access to the decision-making circles and efforts to maintain the status quo primarily entrench the power of the oligarchy in the domestic arena. To study the Israeli oligarchy, then, is to study politics and economic inequality and how they are intertwined. Even though the Israeli oligarchy is not a political regime – as analysed before – it is the source of political and economic inequality, and of ongoing exclusion of the wider public from the decision-making processes.

This "domestic bias" can be seen also in the investments abroad the oligarchy conducts. Only on a few occasions have the pyramidal business groups channelled the public savings they manage to investments outside Israel. Examples are Dankner and Tshuva's purchase of the Plaza Hotel in Las Vegas in 2007, or IDB's investment in Credit Suisse. These investments, based on domestic debt financing, failed. IDB's investment in Credit Suisse especially illustrates this point. In 2008, in the midst of the global financial crisis, Nochi Dankner, through IDB (and more specifically, through Koor) purchased 3% of Credit Suisse (a multinational financial services company) for ILS 3.7 billion, and continued to purchase shares until IDB owned 3.3% of Credit Suisse (Grunfeld,

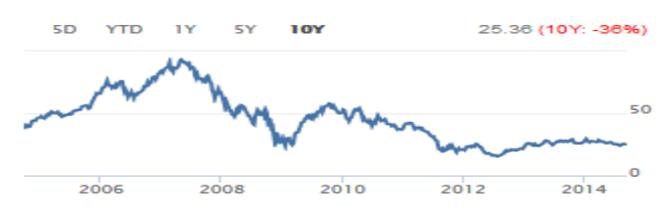
Calcalist, 2014). The shares' value was on the rise. In 2010 the share was declining, but Dankner purchased 3% more through Koor, and IDB had an exposure of ILS 6.4 billion.<sup>149</sup> In January 2014, after a few share sales, Koor announced that it would unwind its holdings in Credit Suisse (Shauli, Bizportal, 2014). Dankner, in effect, used a public company controlled by him to make a risky investment abroad, causing tremendous losses to the pyramid as a whole.

Delek Group, however, does manage extensive activities in the global market. These include control over various fuel and real-estate companies operating in the USA, Canada, UK, Germany, and Switzerland. Nevertheless, the expansion of Delek Group activities abroad relies on and is enabled as a result of debt financing from domestic banks and institutional investors, mainly through bonds (Kosenko and Yafeh, 2010: 480). With the capital raised in the Israeli market, Delek could expand its activities to the international markets as well. The risks, therefore, are the liability of the public and its savings. The profits, nevertheless, belong to the business group. A different, yet illustrative example of the domestic origins of success abroad is Israel Chemicals (ICL), under the Ofer Group. ICL is a leading provider of minerals, potash, and phosphate fertilizers originating in the Dead Sea. It can thus sell to the international markets, relying on national resources (how ICL obtained this control is analysed in chapter 3).

Conversely, Israeli corporations whose power is drawn from the international arena (e.g. Teva, Check Point) are not part of the oligarchy and do not need affiliation to the 'club' in order to accumulate power. These actors, who took advantage of global processes internalised in the political economy (although aided by state provision as well), represent the competitive side of the Israeli political economy, proliferating Israel's interactions with the global arena in line with the wider public interest. As such, Nochi Dankner, as the head of IDB, is distinguished from Gil Schweid, the founder of Checkpoint. This distinction also extends to wealth, as the Israeli oligarchs are not necessarily richer than other wealthy actors. To illustrate, in 2009 Nochi Dankner's personal fortune was estimated at between \$370 million to \$400 million, whereas that of Gil Schweid was in the range of \$1.1 to 1.2 billion (Lipson, TheMarker, 2010). The importance of the oligarchs' wealth, therefore, is associated with the way it has been accumulated.

The power of the oligarchy, although dominant in the domestic arena, is still limited. This

<sup>149</sup> Credit Suisse's traded at CHF50.79 per share in September 2008, rising to CHF 55.95 per share in September 2009, then falling to CHF43.81 in September 2010, CHF20.99 in September 2011, CHF20.99 in September 2012, and rising once more to CHF28.47 in September 2013, see graph of Credit Suisse below (Gurufocus, 2014).



domestic control does not indicate that the oligarchy cannot fail, or alternatively that its power is not limited. The oligarchy is an informal institution which is yet subject to the state rule, as illustrated by the success of the cellular market reform and other structural reforms, such as in the natural gas market (for more see the conclusions of the thesis); they represent, effectively, failures of the oligarchy. The power of the club, therefore, is limited. These limitations point to the extent to which the state is still a powerful actor; while decision-making processes have often been oriented towards maintaining the power of the oligarchy, the power of regulation, if exercised bravely and in line with considerations of the greater good, can overcome such specific interests.

To summarise, the inter-dependence and tight linkage of the oligarchy with the machineries of the state, resulting in its extensive influence on the decision-making process, substantiate it as an informal institution of wealth and power in the national political economy. As follows, it is a powerful political actor influencing and shaping the regulatory realm, the legal framework, and the socio-economic climate. These close relations enhance the rent-seeking capabilities of the oligarchy, allowing it to primarily establish its power in the domestic arena.

### ***The Israeli Oligarchy as an Informal Political Economic Institution***

The Israeli oligarchy can be understood as an informal political economic institution for several reasons. Its objective is normally to develop its rule over society by constraining competition in the market, and increasing, in return, its shares in the economy. Designed to a great extent by the state itself, it is a powerful actor in a national political economy. As such, the particular pyramidal structure is largely enabled by the specific ideas, mechanisms and coordination informing it. This institution dictates the rules of the game, which are widely accepted. The central objective of the Israeli oligarchy is to maintain its power rather than solely profit-maximisation; in that it aligns with the particular state-oligarchy relations, dictating the working rules enabling the oligarchy to emerge in the first place. Oligarchy, therefore, is not only about wealth or wealthy actors. It is the economic-political and social coordination which turns oligarchs into an oligarchy. These dynamics are then institutionalised by the state.

The influence of the club is greatly drawn on the reach of its control over the political economy and the way it operates to preserve it. The organisational structure and modalities sustaining the club, such as biased credit allocation, joint ownership and interlocking directorates, the control of the ideational sphere, substantially through control over the media, and the interaction with state agencies, result in the concentration of wealth and power in a small group of businessmen and wealthy families. These make the club distinct among similar networks of business elite, ultimately rendering it an oligarchy, and furthermore, an informal institution of wealth and power in the Israeli political economy, which shapes the political, economic and social activities and ideas.

The central idea that unifies the club is the objective of an exclusive control as possible over the public sphere and the ideational sphere. The mission of the club members is to maintain the power in the same circle, counting on public ignorance or asymmetric information, which would enable the oligarchy to be considered as a trusted business elite advancing the interests of the Israeli economy. They thus promote the message of free market, competition and openness, while at the same time – in a sophisticated and professional fashion – constrain the market and taking over it. The cohesion and agreements between the club members are essential to establish it as an informal institution, dictating thus the rules of the game.

The Israeli oligarchy is not reducible to business groups, nor is it reducible to the ‘club’. Moreover, the core of the power of the oligarchy is not the capital of each and every member in the club solely. Rather, the power of the oligarchy is in the social relationships between the members, and between them and decision-makers. In that sense, the Israeli oligarchy is an oligarchy without oligarchs; put differently, the importance of the oligarchy is not in the particular identity of its members, but in its position as an informal institution of wealth and power in the political economy. At the same time, Israeli oligarchs are influential in certain circumstances, and are not autonomous from other structures of power and authority, such as the formal state institutions, despite their influence on them.

It is important to note that the analysis of the oligarchic club as an informal institution does not contradict the fact that this club has been celebrated for years. The reason that the members of this club individually (most prominently Dankner) and the club as a group were praised in the media and among the public in general was that they were considered to be a trusted business elite. It was only in recent years (see the conclusions of this thesis) that the public started acknowledging that the power of this club in general and of the oligarchy in particular was in constraining the market and exploiting public resources, as its power was drawn on exclusive control over public savings and assets, rather than competitive economic merits. Such control was key in maintaining and augmenting the power of the oligarchy as an informal yet central political-economic institution.

## 5. The Implications of the Oligarchic Control

The most severe consequences of the rule of the oligarchy are the result of its substantial ratio of control over the financial sector. The reforms in the financial sector (as detailed in the previous chapter) were aimed at branches already loaded with market failures ('other people money,' agency problems, Histadrut failed management). Consequently, the new non-bank credit market largely became an instrument of the oligarchy. The credit provision increasing the wedge between ownership and control and the expansion of the pyramidal structure enabled the oligarchy to deepen its control over the market economy. This resulted in a volatile financial system, affecting the stability and strength of the market economy as a whole. The rule of the oligarchy accelerates a potential 'domino effect' to the political economy, as the pyramidal business groups in Israel are often perceived as 'too big to fail' (Kosenko and Yafeh 2010: 483). A fear of such a domino effect causing the system a comprehensive damage, has, ironically enough, further strengthened the position of the oligarchy. The oligarchy, therefore, could hold excessive political and economic influence (Stiglitz, 2010; Knesset 2010a: 4).<sup>150</sup> The banks as credit providers have become themselves a fundamental risk to the system as a whole (BoI, 2009).<sup>151</sup>

The network of exchange between the banking sector and the business groups allowed for biased allocation of credit (analysed in the previous chapters); this can be explained by the narrow market structure— only a small number of pyramidal business groups exist, which are in themselves attractive investment opportunities. More importantly, the mass effect or the 'collective action' dictates that investments in these business groups are safer and thus more popular (Olson, 1965). All the same, as most of the significant firms in the financial sector have a controlling shareholder (Committee Interim Report, 2011), the personal factor plays a leading role. Considering that different financial institutions are either controlled by the oligarchy or linked to it, aspiring to be 'the only game in town' (Wolfenzon, 2010), the oligarchy has a vested interest in causing the regulatory mechanism to malfunction. Biased allocation of credit is both an engine in the rise of the oligarchy and a central consequence, resulting in further entrenchment and reduced competition.

The non-bank credit market, through corporate bonds, has ultimately proved inefficient (Scharfstein and Stein, 2000). While it grew from 10% of general credit provided to 50% in the years 2003-2007 (Hemmings, OECD 2011a), the business groups constituting the oligarchy, the main beneficiaries from it, accumulated tremendous losses (as evidenced in The Tel-Bond 60 Index - TASE, and in a series of debt restructurings conducted in 2012-2013, for example, of IDB and Tshuva Group, as detailed in the conclusions). Institutional investors often fail to protect the legal

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<sup>150</sup> After several roll-overs, the law to increase competitiveness and narrow the concentrated power of the big business groups, which was filed in 2012, was approved in 2013 (see conclusions).

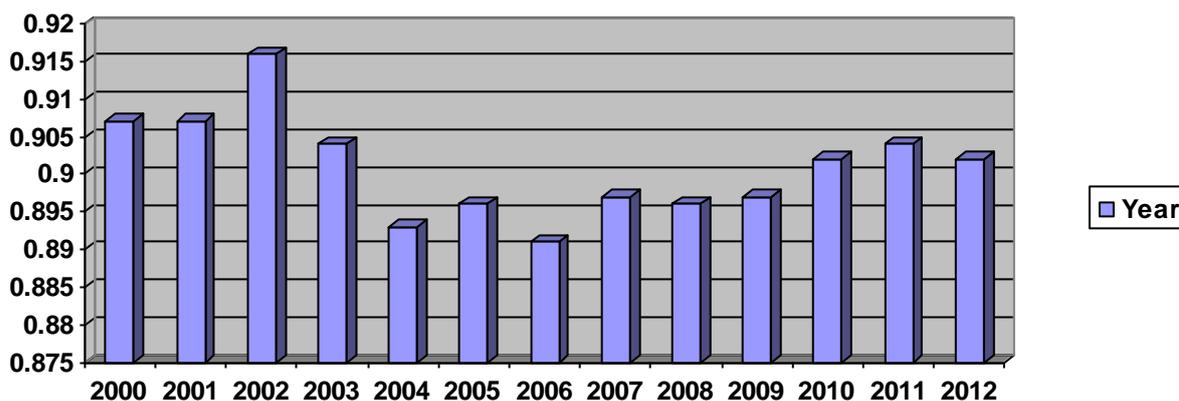
<sup>151</sup> The collapse of IDB, analysed in the conclusions, has proven that 'too big to fail' was a myth nurtured by the oligarchy itself.

rights of minority shareholders, namely the public, if not compelled to do so (Hamdani and Yafeh, 2013). The process by which institutional investors invest in corporate bonds issued by the oligarchy suffers from several defects. First, there is limited access to information. The issuing company, namely a pyramid-affiliated company, is the dominant party in the issuance process; therefore, institutional investors often face difficulties in receiving the required information (Hodak 2009:16). Furthermore, in case that the institutional investors are directly affiliated to the pyramid, they have no incentives in analysing and regulating corporate bonds (ibid). Second, institutional investors have no suitable protection against damages to minority shareholders' rights (Hodak, 2009). The third deficit is the institutional investors' inability to enhance the value of the bonds (Hodak, 2010). In addition, they tend to demonstrate weakness in debt settlements towards affiliated firms (Yafeh and Hamdani, 2010, 2013).

The absence of competition in the non-bank credit market (Hodak 2009: 28) is rooted in a systematic problem of 'product quality'- an absence of adequate means for assuring debt repayment, a proportionate interest rate, and compensation for the level of risk (ibid). Institutional investors tend to provide credit to high-risk companies, which, in turn, do not carry the risk themselves. The credit itself is poorly ranked; there is no appropriate system to report and process data, no limitations on over-exposure, and corporate bonds are highly volatile. Following the 2007-8 global financial crisis, with the losses of the pyramidal business groups, the market for non-government bonds has been drying out (Hodak, 2010).

Conflicts of interest rooted in the 'clubness' are no less pertinent for bank credit. In 2006, an IMF report found that low capital levels and a high rate of problem loans are an area of vulnerability in the Israeli banking system, with insufficient credit worthiness and collateral against outstanding credit (IMF 2006: 108-9). An example of this problem is the loan Hapoalim Bank provided to IDB Development, controlled by Nochi Dankner, and to Tomhok, his private holdings company, as detailed in chapter 4. As this loan was exceptional according to the bank's standards, it required the approval of the bank's management and the credit committee (Aizescu, TheMarker, 2013); however, most of the members on the credit committee had private connections to IDB. For example, Irit Izakson served as director in IDB Development; Pnina Dvorin was a director in Netvision, under IDB; Imri Tov was an external director in Shupersal, also under IDB, having thus a conflict of interest (ibid). Credit concentration favouring the oligarchy is thus a point of vulnerability in the banking system. The weight of the 10 big business groups in the credit balance of the banks was 34.5% of the entire bank business credit in 2011 and 33.4% in 2012 (Knesset 2012: 9). Figure 5.15 below illustrates the degree of concentration in the provision of bank credit in the years 2000-2012. The values range between 0 (equal distribution) to 1 (unequal distribution).

Figure 5.15. Gini index for credit concentration of the banks (2000-2012)



Source: BoI 2012: 51; Knesset 2013: 11

As a result of the bank and non-bank credit bias, there has been a great increase to the risk exposure of public savings in recent years (Knesset, 2009:2). Public savings are mostly concentrated in the hands of the oligarchic club, and are invested according to ‘club’ relations and agreements. In addition, the biased allocation of credit has enabled the controlling owners of the pyramidal business groups to see public money and the banks as a stable source of debt (Tayeg, TheMarker, 2012). The pyramidal business groups could thus distribute dividends from the assets of the affiliated companies prior to paying down their debt. The controlling owners could facilitate the inter-corporate transfer of dividends and other assets to support distressed firms, reducing overall group volatility and default risk, as the holding companies are located at the apex of the pyramids (Committee Interim Report, 2011). For instance, IDB distributed dividends in the years 2009-2012, while the enterprises at the apex of the pyramid were in debt; furthermore, it kept issuing bonds while its capital was decreasing and the risk to the entire pyramid was increasing. In the aftermath of the 2007-8 global financial crisis, two major investments abroad failed – Credit Suisse and Plaza Las Vegas; more importantly, profits at Cellcom, a key company in the pyramid, fell 46% in 2013 (to ILS 288 million, see TASE). The pyramid's capital, accordingly, shrunk (in 90%, to ILS 209 million within one year only, Bizportal, 2011). Irresponsible and manipulative dividend distribution was one of the reasons for IDB losses, and subsequently those of its public holders (Zelekha, in Shauli, Globes, 2013).

The presence of a dominant shareholder compromises the role of institutional investors in maintaining proper corporate governance in favour of the public interest in three ways: first, the prevalence of family-controlled business groups may create conflicts of interest with regards to the decisions of the institutional investors themselves. For instance, when they purchase securities of group-affiliated firms (Hamdani and Yafeh, 2013: 692), regardless of their lucrativeness or risk, or

appoint directors, as institutional investors allow the controlling owner to appoint his or her own people (ibid). Second, it limits institutional investors' influence, as the dominant shareholder holds the majority of voting rights in the concentrated ownership environment (Yafeh and Hamdani, 2010).<sup>152</sup> Furthermore, institutional investors tend to vote in favour of deals which benefit the controlling owners of these pyramids (ibid). Finally, in concentrated ownership environments, there is a diversion of resources by controlling shareholders through self-dealing and other forms of 'tunnelling'. 'Tunnelling', in the form of debt in favour of shares acquisition in subsidiary company, thereby extracting corporate resources from group firms – are frequently utilised. Same for the banks, as Israeli banks are effectively controlled by one shareholder, who is licensed to act in this capacity by the Bank of Israel (OECD 2011a: 15).

The emergence of the oligarchy and its subsequent entrenchment were enabled by a passive regulation system, or even lack of regulation (Knesset, 2010). Despite the dominance of the state, the strong political ties of the oligarchy (Kosenko, 2013) resulted in significant influence on policy-making, largely through captured regulators. The preferential provision of both credit and resources of the state to the very same group reflects its strong ties to political decision-making circles (Committee, 2012). The power of the oligarchy, consequently, increases at the expense of other actors, leading to its entrenchment in the economy. A high share of pyramid-affiliated companies in the financial sector and groups' holdings diversification are associated with entrenchment (Kosenko, 2013; Morck et al., 2005). Through such entrenchment, the oligarchy could maintain its monopolistic position, especially in the financial and the retail sectors (cellular, banking, food, gas etc.). This power was not dependent on management performance, which did not prove to be competent; managers enjoyed the fruits of success, but did not pay for failures (as in the case of the IDB and Tshuva groups following the 2008 global financial crisis).

The political influence of the oligarchy leads to policies that preserve its power and augment its resources. The political system, accordingly, is perceived as serving the interests of the rich, through policies responding to the dynamics of the concentrating market (as illustrated in chapter 4). This has resulted in a gradual decline of public administration and the weakness of relevant ministries.<sup>153</sup> The influence of the oligarchy, accordingly, has sparked a legitimacy crisis that threatens to undermine the stability of the country's democracy (Committee 2012: 97). The ownership structure of the media, as analysed earlier in this chapter, is in itself an indication of how the political economic system's contributes further to the power of the oligarchy.

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<sup>152</sup>Hamdani and Yafeh (2013) in more recent research examined how the Israeli regulation put in place several legal mechanisms designed to encourage institutional investor activism and to protect minority shareholders. Institutional investors rarely vote against insider-sponsored proposals, even when the law empowers minority shareholders. Institutional investors vote against compensation-related proposals more often than against related party transactions even when minority shareholders cannot influence outcomes. Potentially conflicted institutional investors are more likely to vote for insider proposals than stand-alone investors, regardless of their effect on outcomes (Hamdani and Yafeh, 2010).

<sup>153</sup> This was further reflected in the various legal processes taken against public servants and politicians (Navot, 2012; Committee, 2012).

The dependency of various market sectors on the oligarchy impedes economic development and growth, resulting in declining competition and decreasing levels of innovation and R&D investment. The oligarchy not only lobbies for policies that counteract competition; it strategically accesses sectors in which the government has vast interest to begin with (Kosenko 2013: 12). Most significantly, the control of the oligarchy over the market comes at the expense of small-medium enterprises (SMEs) and entrepreneurship (Committee, 2012; Committee, 2010), which are associated with the middle class. To illustrate, non-bank credit to SMEs (estimated at ILS 25 million) hardly exists, and the SMEs sector relies almost exclusively on banking credit (Knesset 2013: 9-11). Credit to SMEs in 2012 was only 10% of total business credit, while accounting for 40% of business production (Knesset 2013: 1). These numbers are especially low considering the weight of the big business groups in the credit balance of the banks, as analysed earlier in this chapter. In addition, there is a decline in the establishment of new SMEs, from a 10.5% increase in 2005 to a 9% increase in 2012. Along similar lines, in the years 2005-2010 the number of SMEs that went out of business increased by 8.7% (ibid: 4). While SMEs accounted for 51.1% of business sector employment in OECD countries in 2010, it was only 48% in Israel (OECD, 2013a). Consequently, the middle class has been eroded.

The oligarchy also damages the competitive advantage of the economy as a whole. The pyramidal business groups forming the oligarchy rely on diversification as central source of power, on rent-seeking, or alternatively – on monopolisation, rather than on competitive advantages in the sectors or industries in which they are active. The pyramidal business groups do not compete in sectors where Israel's traditional competitive advantage in innovation and R&D applies. Furthermore, besides *Machtshim Agan*, most of the big exporting companies in the pyramids effectively rely on state provisions or resources (e.g. ICL). In addition, as most of the investments are in businesses within oligarchic circles (Hodak, 2009), the money in the market, specifically public savings, is not used to advance other, more competitive sectors. To illustrate, institutional investors invest a very low percentage of their capital in Israeli venture capital funds (OCS, 2010). It was not until 2010 that the Ministry of Finance, together with the MOITAL, established a plan to encourage institutional investors to invest in technology and Bio-Medical industries, which stand at the core of Israel's competitive advantage (with 25% of the finance from the state) (MOITAL and MoF, 2011; MOITAL media statement, 2010).

Group affiliation, meanwhile, has no significant positive impact on profitability. While the concentration of the power of the oligarchy increases the value of the pyramidal business groups in the stock market, group affiliation, conversely, is associated with lower market valuation (Kosenko, 2008). Furthermore, affiliation to a business group has a negative influence on performance (ibid). The pyramidal structure enables losing companies to survive longer, even when they lose more than

other enterprises in the market, reflecting market inefficiency (Committee Interim Report, 2011, appendix D). Their cost to the public, considering public savings are heavily invested in the pyramids with limited transparency, is therefore higher than the benefits. The natural inclination of the Israeli market is not a competition, but a will to unite forces and create a cartel or monopoly (Strum, at Koren, TheMarker, 2010).<sup>154</sup>

With respect to the labour market, Israel's labour market had wide wage differentials in its first years, being a relatively small, split, and segmented welfare regime of immigrants with different cultural-educational backgrounds, economic means, and social opportunities (Cohen et al., 2007; Swirsky and Konnor-Attias, 2012). Nevertheless, the economic gaps, particularly between the wealthiest segment of society and the rest of the population, have widened substantially since the EESP was launched, resulting in a less flexible labour market (Cohen et al., 2007). The reason is widely attributed to the process of 'oligarchisation', rather than to the market liberalisation itself (for the limited utility of the concept of liberalisation in this respect see, for example, Hall and Thelen 2009). Nitzan and Bichler (2002:59) describe this 'corporate amalgamation' as socially traumatic, changing the entire balance of power.

The cost of living in Israel is very high, up to 46% higher than the OECD average as of 2011, even in comparison with states where the average wage is higher (The Taub Center, 2011). Along these lines, the GINI index of income inequality (OECD, 2013c) positioned Israel as third among OECD member countries in terms of income inequality during the 2000s (after Mexico and the USA). As Shlomi Parizat, the former Chief Economist at the Israel Antitrust Authority in the years 2008-2013, stated, life in Israel in general is badly influenced by the powers of such monopolies (in Koren, TheMarker, 2013). This inequality is not about the numbers only; in the short period of the market liberalisation in Israel, and mainly throughout financialisation, the excessive accumulation of wealth by only a few indicates institutionalised exercise of power, influence on behaviours – of politicians, regulators and businessmen, and systematic bias in favour of only a few.

The potential advantages of the market's oligarchic structure are debatable. Sheinin and Zadka (2010), in a widely controversial study ordered by IDB, described the benefits generated by the business groups and their structure, as of 2009. They argued that the assessment of market concentration is inaccurate, and that the Israeli market is not exceptional compared to other states. For that reason they saw no particular justification for regulation to reduce concentration. They further denied an aggressive take-over; market openness, they maintained, has provided business opportunities for all layers of society. Conversely, they attempted to demonstrate that pyramidal

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<sup>154</sup> To illustrate, Shaul Elovitch, a key Israeli businessmen, tried to establish a competitor to Bezeq for over six years, both through a new initiative, 'Ofek', and through applications for cellular operation licences through 012-Smile, a company controlled by him. When these attempts failed, he simply purchased Bezeq control core (30.3%) in 2009 (Gabay, Haaretz, 2007; Tayeg, Themarker, 2009; Rochvarger and Tayeg, Themarker, 2012). The monopolistic stance was therefore the only way to access the telecommunication market.

business groups provide many advantages in terms of size, variety, reduced conflict of interests, better management skills, decentralised risk, capital allocation, lower capital costs, higher leverage potential, and more business opportunities (ibid). While they did identify a clear negative correlation between the level of concentration in the market and the size of the economy, their analysis overlooked the socio-political implications of the pyramidal structure, especially in a small society like Israel. Their arguments were not supported by data, which was largely generated by committees appointed afterwards (e.g Committee, 2012; Trachtenberg Committee).

The 1995 Brodet report also accounted for the advantages of merging financial and real assets (in assessing the banks), such as financing advantages for small companies, companies which export to international markets, and distressed companies. These advantages, though, are mostly relevant in developing political economies, encouraging exposure to the global arena and accelerating economic liberalisation. In Israel during the 2000s, this merger causes hazards to the market. Given that the market economy and the institutional structure are relatively developed (Kosenko and Yafeh, 2010), the advantages of the oligarchic, pyramidal structure of centralised ownership are less applicable. Instead, this assessment indicates how the reach of the control of the oligarchy over the political economy comes at the expense of the public interest as a whole.

## **Conclusion**

While the exact holdings and power of the Israeli oligarchy can only be broadly estimated, it has, as illustrated here, a prevalent ratio of control over the market economy. Wealthy families and individuals came to dominate the market economy through control pyramids, spreading over numerous economic segments. The process to obtain such control and expand is not purely economic; instead, it indicates great influence on state institutions and actors, tight collaboration among these groups and entrenchment, at the expense of the public interest in general.

The definition of the oligarchy is further developed by characterising the mechanisms of operation of the oligarchic 'club', which include the strong professional and personal relationships and cooperation. The proximity of the oligarchic club to the machineries of the state further marks its power as an informal institution in the Israeli political economy. The personal networks are mobilised to raise capital, obtain political influence, and take advantage of the opportunities that the market offers, in many cases to the very same people. Such bias in favour of a very small group is systematic, and the reach of the control of the oligarchy over the market is institutionalised.

Examining the far-reaching implications resulting from the rule of the oligarchy over the political economy, greater economic inequality leads to greater political inequality, which in turn leads to government policies reflecting the interest of those at the top (Hacker and Pierson 2010:82). All the same, the understanding of the oligarchy as an informal institution indicates, to a great extent, its subordination to the state. Despite its vast control and influence on the political economy, it can still fail, and most importantly – needs the state in order to maintain its power.

## CHAPTER 6

### THE AGENTS OF OLIGARCHY:

#### THE RISE AND INSTITUTIONALISATION OF OLIGARCHIES IN LIGHT OF THE ISRAELI CASE

The purpose of this chapter is to examine the evolution of the Israeli oligarchy in the context of global political economy. Four central points emerged from the analysis of the Israeli oligarchy: (1) the proactive role of the state in the formation of the oligarchy, as well as the latter's substantial dependence on state support, which, in turn, holds the authority and capacity to break it; (2) the 'clubness' and the peculiar relationship of the oligarchic club with the state; (3) the specifics of the pyramidal ownership structure, including its family-based core structures; and (4) the predominantly domestic basis of wealth of most oligarchic groups, pointing to the interplay between domestic and international sources of power and the nature of their ownership.

These four key issues help distinguish 'oligarchs' from other wealthy actors. At the same time, these issues also help to distinguish oligarchy from oligarchs, and to shed light on another kind of oligarchs that is not acknowledged in the literature. While Winters primarily conceptualises oligarchs according to the wealth they possess, this research suggests thinking of oligarchs as those who occupy a dominant position within the political economy and abuse this position for accumulating and/or defending their rents. In the case of Israel, the agents of oligarchisation preceded the rise of the oligarchy, and in effect enabled the accumulation of wealth.

Likewise, oligarchy does not exclusively rise and prosper in a poor institutional environment. Rather, strong institutions sometimes enable oligarchy. The combination of agents of oligarchy, strong institutions, and certain state policies may encourage the rise of an oligarchy, not necessarily wealth itself, or the interest of the very wealthy few to defend it. Finally, oligarchy is also about institutionalised relationships that transfer economic benefits to the very few through political measures – for example through the state institutions. This chapter thus adds to the conceptions of wealth defence and poor institutions constituting the rise of oligarchies.

According to the four indicated issues, each section covers the main lessons of the Israeli case, then briefly examines central assumptions of the literature on the topic, and finally moves to analyse how the Israeli case can expand our understanding of oligarchy. These sections thus examine how oligarchy can be analytically distinguished from oligarchs, as an informal political economic institution.

## 1. The Proactive Role of the State

What significantly characterises and distinguishes the Israeli case is the proactive role of the state. That the rise of the Israeli oligarchy is strongly linked to the state is not particular to Israel; in any country, from Russia to China and the US, oligarchy emerges at some nexus of business and political power. At the same time, it is often under extensive liberalisation and privatisation that oligarchy emerges, processes largely enabled by state weakness, as seen, for example, in Russia or in Chile. In the Israeli case, conversely, the state has been proactive in shaping the emergence of the oligarchy and the role it plays in the political economy. The role of the state was manifested in advancing a pool of shareholders in a selective process, while also internalising global processes, such as privatisation and market liberalisation. The role of the state was also manifested in the mode of conduct of the banks under its control, and in the regulation of banks under private control. These particular political, economic and social choices made by the state institutions and their activities enabled and sustained the formation of the oligarchy, and helped determine its nature, its ownership type, and its role in the political economy.

The state did not diminish its role in the market because of genuine weakness; it was, in effect, a process designed to increase its ability to manoeuvre the market economy. Not surprisingly, the state continued to play a crucial part in the economic arena. Indeed, it was a process geared towards strengthening the interests of the state without threatening its economic and political sovereignty. The proactive and active role of the state, however, led to unintended and unpredicted consequences, namely the take-over by the oligarchy. Therefore, the state actions and its dominance in the process of oligarchisation go hand in hand with the malfunction of its institutions and the regulatory capture. That is, the impacts of the power of the oligarchy, as analysed in the previous chapter, brought critical state processes under its sway. Nonetheless, in Israel, the oligarchy, as powerful as it has been, was not a type of regime. To illustrate, ultimately, the power of the state was proven by its ability to dismantle the power of the oligarchy, as detailed in the concluding section of this thesis.

### *The Interplay between the Rule of the State and the Dominance of Big Corporations*

In the literature of the Marxist tradition, the central mechanism forming a monopoly is the process termed by Hilferding ‘finance capital’ (1910 [1980]). This process mostly accounts for the emergence of an oligarchy. The state, in turn, was perceived as a coordinator or organiser, facilitating the concentration of wealth and power, but not as main actor or agent. The state, for the Marxist tradition, has a structural dependence on capital (Przeworski and Wallerstein, 1988). The actions of the monopolies pre-determined their relations with the machineries of the state,

largely influencing the nature of its role, as a fairly passive facilitator enabling monopolies' expansion. The 'finance capital' process was twinned with imperialism, i.e. the rule of some states over others, which was seen as an evolutionary stage of capitalism, bound to monopolisation (ibid; Lenin, 1977 [1916], 1999; Cohen, 1970). The position of the state vis-à-vis the big corporations, then, is fairly secondary; yet, the tie to imperialism accentuated its central position in the 'finance capital' process. Various Marxist scholars endeavoured to bridge the ambiguity or conflict between the secondary role of the state in the process of 'finance capital' and its centrality in the process of imperialism; however, a clear consensus was not reached (Poulantzas, 1969, 1976; Miliband, 1965, 1973; Jessop, 1982; Held, 1995; Laclau, 1987; Abrams, 1988). This ambiguity was further attributed to the notion of the 'capitalist state', conceptually tied to the perception of capitalist processes, in which monopolies are central, and an agreed balance of power between them and the state is not clearly stated.

The position or role of the state was thus linked to its position vis-à-vis the capitalist system, which can be secondary or central. Miliband (1973), for example, suggests that the capitalist system is controlled by a ruling class of individual owners, who accentuate the secondary role of the state in the system. Along these lines, the state would probably prioritise the interests of these owners, even at the expense of the capitalist system as a whole. Poulantzas (1969), in contrast, emphasises the central role of the state in the capitalist system, suggesting that at some point the state would prefer to protect the capitalist system at the expense of specific owners, if their interests clashed. While the system might be led by capital owners, he implies, the state actually controls it because it has the decisive power to dictate its directions.

The corporate power scholarship also highlights the dominant role of big corporations in a political economy. While the role of the state is secondary, this approach captures the relations between the state and big corporations as institutional complementarities (Hall and Soskice, 2001; Hall and Gingerich, 2009; Hopner, 2005; Crouch et al., 2005; Morgan, 2005). The governments' support of big corporations includes looser bureaucracy and facilitating regulation (Mizuchi, 2004; Boies, 1989; Davis and Greve, 1997), infrastructure (Mintz and Schwartz, 1985; Robinson, 2004), tax incentives (Desai and Dhammika, 2006; Auerbach and Poterba, 1987), and state loans (Roy, 1997; Boies, 1989). The state, in turn, largely entrusts the management of the market economy to big corporations, resulting in an enhanced position for the state in the global arena (Sah and Stiglitz, 1986; Shleifer, 1998; Yergin and Stanislaw, 2008).

As comes out of the historical scholarship, oligarchy is most often a result of identification between the state and ruling corporations. Their relationship as well as their shared interests shape and determine the social, political, and economic alignment (Useem, 1984; Boies, 1989; Crane et al., 2008; Van Horn, 2009). These relationships reflect internal coordination within the state

institutions, which can either reinforce each other's incentives or compensate for each other's shortcomings to ensure the proper functioning and stability of markets, and successful economic performance. The power of the corporations over the political economy is further entrenched by the retreat of the state from the market (Strange, 1996; Swann, 1988; March and Olsen, 1998; Held, 2007; Waltz, 2000), geared to accommodate the changing balance of state-market relationship. Considering that global markets are sometimes more powerful than states, "to whom ultimate political authority over society and economy is supposed to belong" (Strange 1996:4), the retreat of the state is a mechanism to maintain its strength. Nevertheless, while delineating this symbiosis, the historical approach treats the role of the state as a facilitator, complementing, to a great extent, the prominent role of corporations in the political economy, at the expense of the rest (Mizruchi, 2004; Rajan and Zingales, 2003; Hacker and Pierson, 2011). Consequently, there is no hierarchy defining the balance between the rule of the state and the power of the corporations over the political economy.

The proactive and central role of the Israeli state positions the state as the major agent of capitalism. The Israeli case suggests that the choice of the state is not necessarily between pro-capitalists and pro-capitalism policies. Rather, the state support of individuals can create some variant of capitalism, without free market. More specifically, the capitalist system is characterised by the various layers constituting it, and can be concentrated, non-competitive and not entirely independent from the state. The state is not one of the components in the capitalist system, but a central actor shaping its evolution, with the power to dismantle that of these owners or corporations. More generally, the state is not structurally dependent on capital owners, who can themselves be dependent on the state.

The Israeli case suggests, therefore, that the key actor in the process of 'finance capital' and in the increasing importance of corporate power may be the state, rather than the corporations. More importantly, it demonstrates the extent to which the role of the state is significant in the domestic sphere, which is something the historical approach has traditionally overlooked. This contributes to the discourse on the retreat of the state, illuminating how it is effectively a state strategy to enhance its own power, and not necessarily a sign of its weakness. In view of that, the Israeli case enables us to unpack the organisation of the state-oligarchy relationship. The capacities of the state to command economic processes allow us to position the power of the oligarchy as complementary to the role of the state, rather than the state being subject to the interests and direction of the oligarchy. All in all, the Israeli case corresponds with analyses linking globalisation and the strengthening of the state (Hirst and Thompson, 1995; Held and McGrew, 1993, 2002; Held, 2007, 2010; Bieler and Morton, 2003; Giddens, 2000). This linkage points to the importance of a strong state in a globalised world, not only in terms of controlling and regulating the variants of the markets, but

also with respect to anchoring the stability of society as a whole (Mann, 1997; Amin and Thrift, 1995).

### ***Strong Oligarchy, Strong State***

The contemporary scholarship points to poor institutional structure, more specifically poor institutions or lack of administrative capacity, as sustaining the emergence of an oligarchy (La Porta et al, 1999; Morck et al., 2005; Payne, 1968; Fogel, 2006). This is the salient factor enabling the formation of the oligarchy as such, shaping, in return, the type of its ownership and the nature of its power, and as a result, its particular rule over the political economy. This paradigm of oligarchy is active in pre-determining state-oligarchy relationship. Similarly, the new wave of corporate power literature also highlights how the oligarchy influences the state to obtain and preserve its power, suggesting that the weakness of state agencies allows the oligarchy to prosper. The contemporary approach thus shows that the state-oligarchy relationships are not a result of a power struggle between the two. Instead, the oligarchy exploits the captured, sometimes weak and corrupted state institutions to accumulate wealth and power (Anderson and Cavanagh, 2001; Sauvant et al., 2008; Kim, 1997; Sklair and Robbins, 2002). While the rise of the oligarchy is regularly linked to the endorsement of free market paradigms, dubious means have often been used to obtain and increase the power of the oligarchy (Morck et al., 2005; Khanna and Yafeh, 2007; Morck and Yeung, 2004). The tight influence of the oligarchy on the state institutions enables it to preserve its power and to accumulate more wealth.

The Israeli oligarchy, in contrast, is not the result of poor institutional structure, or of a struggle between the state and the very wealthy few. Instead, the Israeli case brings forward the idea of poor institutional functioning or poor institutional performance under a strong state authority; put differently, it illuminates how strong institutions and a strong state can still fail in the way they fulfil their role of serving the public interest. Poor institutional performance entails, more concretely, capital market imperfections, fractured and captured regulation, partial legislation, and structural or systematic problems in coordination between state institutions. The Israeli case thus illustrates how institutional malfunctioning or poor performance is compatible with strong institutions, and that the former may be more important for the formation of oligarchy than the latter.

While there is no noticeable power struggle between the state and the oligarchy, the Israeli case, conversely, accentuates a clash of interests between them. This is illustrated by the failure of the state to provide for what is still perceived, under neo-liberal paradigms, as state duties to the public, such as growth, employment and equal opportunities (Hacker and Pierson, 2011; Higley and Burton, 2006; Kelly, 2009). The transition in Israel from state-centred economy to liberalisation, resulting in the market entrenchment, illustrates how the concerns of the state for the oligarchy

contradict concerns for the citizens or for the greater good. Through the Israeli case, then, this conflict of interest is more evident. The Israeli case calls attention to the inconsistency of the actions of the state with the broader public interest. Indeed, the conflict of interest of the state between serving the oligarchy and the public interest can be found in the social movement 'Occupy Wall Street' (Hardt and Negri, 2011; Van Gelder, 2011). The movement has been protesting against the power of big corporations over the government, resulting in the increasing inequality in society. The slogan "we are the 99%" demonstrated the inequality (Friedman, Foreign Policy, 2011), protesting against the overwhelming power of only 1% of the population (see for example Van-Gelder, 2011). Through the Israeli case we can see how the problem is not rooted in the power of the one percent solely (Keister 2014); instead, their power is also the result of the actions of the state and the way they enabled the consolidation of an oligarchy.<sup>155</sup>

The central and proactive role of the state in the formation of the oligarchy is key to understanding what enables the oligarchy to rise. The actions taken by state institutions vis-à-vis handfuls of business groups or corporations, or alternatively towards a specific cluster of businessmen and owners, enables us to derive a distinction between oligarchy and oligarchs. The state, in effect, enables a distinguished group to enjoy privileged conditions, accumulating power over the political economy in an organised way. This group, in turn, can cooperate to form a united front towards the state, as well as towards society. The rise of the oligarchy, therefore, is not only or always about poor institutions, although some kind of institutional weakness is indeed a factor. Instead, it is about the role of the state in creating a stable power structure that largely complements the state's own role—although often at the expense of the latter. More generally, the Israeli case raises interesting questions about states and the nature of their institutions, especially in providing for the needs of their citizens.

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<sup>155</sup> Along these lines, the dispute over the health care reform in the US (Clinton and Obama, 2006; Cutler et al., 2010; Jacobs and Skocpol, 2012) revealed the struggling voices over the question of state responsibility towards its citizens as against the interests of a narrow and powerful group, in this case the pharmaceutical industry and the insurance companies. These quarrels highlighted the power of an entrenched economic elite over society on the one hand, and the extent to which the former has the power to affect essential social, political and economic domains, at the detriment of the responsibility of the state towards its citizens.

## 2. The 'Clubness' - Social Ties as a Crucial Dimension of Oligarchisation

Adam Smith stated that "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices" (Smith, 1776: Book 1, Chapter 10). While the Israeli case challenges the low frequency of wealthy people's meetings as Smith described it, it does conform to their purposes, or at least their effects. The concept of 'clubness' serves to point to the small, networked nature of Israeli business community, with compact and closely linked decision-making circles, which nurture the power of the oligarchy (Maman, 2006a; Aharoni, 2007; Shalev, 2004; Maman and Rosenhek, 2012). The networked nature of the Israeli business elite, the coordination across and within various elites, along with the familial control over the pyramidal business groups have shaped, in effect, the evolution of the state-business nexus into an oligarchy. It was not wealth alone which led to and sustained the concentration of the market economy; it was largely the 'clubness' that made the Israeli oligarchy an informal institution of wealth and power in the national political economy, and turned the controlling owners into oligarchs.

The analysis of the central manifestations or traits of this 'clubness' refines the literature on networks and closely linked elites (as analysed in chapters 1 and 5). The Israeli case poses several challenges to this literature. It distinguishes the oligarchic club from the traditional economic elite, consisting of owners and managers of big corporations. However, as analysed in the previous chapter, the understanding of a club complements yet is distinct from the notion of network, and goes beyond the personal connections and business linkages across a specified group. The Israeli case shows how 'clubness' is not only about an institutionalised form of exclusivity, transparent barriers to entry, codes of behaviours and clear organisational principles, uniting a specific group of people; instead, it is a social phenomenon which core is a set of relationships, that is translated into a political-economic system, driven by shared interests and designed to preserve the power of the few by dictating the 'rule of the game'. The main mechanisms of this 'clubness', as illustrated through the Israeli case, include close ties with political decision-making circles, joint ownership and interlocking directorates, social interactions, control over the media and 'non-competition' agreements. These dynamics enable the rise of an oligarchy and nurture its power, along with the extensive efforts of actors providing the infrastructure of the club, e.g. professionals, bureaucrats, and politicians.

The consolidation of the club, therefore, is a result of contingent factors along with well-intended strategies and activities by its members. A part of the conception of a club entails an organisational aspect, drawing on personal acquaintances, military background, geographical proximity, unprompted interactions, partnerships and business interests. In countries like Israel, the

state institutions as well as the public can protest against flagrant corruption and consequently force out politicians enabling it. Therefore, the oligarchy as an informal institution is rife with reinforcing connections. These connections make coordination easier, and enable to keep a part of the activities of the oligarchy in secret, preserving its economic advantage. The notion of clubness sheds light on the extent to which the consolidation of an oligarchy is a strategic instrument or a more natural evolution of business elite. The following will examine what the 'clubness' notion, as defined in Israel, can suggest to the literature, and why it is significant to the debate.

### *The Agents of Oligarchy*

The Marxist tradition focuses largely on the conception of class, distinguishing the bourgeoisie class, which includes all owners and industrialists, from the working class, or proletariat (Parkin, 1979; Miliband, 1983; Bourdieu, 1987; Wright, 1997a, 1997b). However, this distinction is dichotomous, and does not account for the various layers and links connecting and constituting the ruling class. Specifically, the attribution of senior bureaucrats and bankers to this class remains inexplicit. While perceived to have facilitated the accumulation of wealth by the bourgeoisie, bureaucrats did not obtain ownership over the means of production or capital; as such, their affiliation in the literature is traditionally to the working class, serving the interests of capital owners. Nevertheless, the high income and control of bureaucrats over decision-making processes might enable them to accumulate capital that would ascribe them to the economic elite. More importantly, the role and participation of senior civil servants in the club suggest that they are as powerful as the bourgeoisie.

The same point is true also with respect to the role of bankers. Bankers, the Marxists maintained, are subordinated to the needs of industrial capitalism, facilitating the process of accumulation (Marx, 1977 [1867]; Harvey, 1982, 2010a; Brewer, 1984; Robinson, 1956). They can further assist capital owners with financial manoeuvres on taxes. For example, they have formed an alliance between finance, insurance and real estate (FIRE) to free land rent and monopoly rent gains as well as capital interest gains from taxation (Bryan et al., 2009). The Israeli case, conversely, emphasises the relative autonomy of banks (in comparison to industry and other players in the market) and the critical power of the decisions of bankers in the process of accumulation, similar to the power obtained by capital-owners or oligarchs. Accordingly, it illuminates the far-reaching position of bankers within the bourgeoisie (Panico, 1988) or in the corporate ruling class.

While the formation of the club is not necessarily intended for domination or exploitation, it does intensify interactions designed to accrue wealth and power. Bureaucrats and bankers, accordingly, are an active part of these interactions, and can thus be seen as a part of a 'club' rather than subordinated to a class. The 'clubness' notion encourages us, therefore, to examine the extent to

which the dynamics of capitalism are premeditated; specifically, whether powerful agents are aware of the social aspect of the economy, and to which end they create networks that help them preserve power and prevent competition. This contributes to our understanding of the relationship between agents and structure (Giddens, 1986). To clarify, the focus here is not only or mainly on the attribution of public servants or of bankers to one class or another, but on the wider problems in the Marxist class structure. These problems in the definition of the Marxist class structure stimulated a theoretical discourse, accounting for the tension in class labelling (Lukács, 1971; Giddens, 1979; Parkin, 1979; Wright, 1980, 1997a; Goldthorpe and Marshall, 1992). The analysis of the Israeli case thus challenges the Marxist understanding of the bourgeoisie's composition, traditionally identified with the owners solely. It shows that the power of the administrative actors in the economy, namely bureaucrats and bankers, is no less resilient than that of capital owners. Bureaucrats and bankers are, therefore, agents of oligarchy, whilst the state is the underlying structure.

The notion of 'clubness' also contributes to our perception of profit-maximisation (Brenner, 1977; Gintis, 1976). According to the Marxist theory of the falling rate of profit, the profit-maximising inclinations of capitalists will lead them to replace workers with machines (Capital, Volume III). Similarly, the corporate power approach highlights the profit-maximising objectives (e.g. Demsetz and Kehn, 1985; Jensen, 2001; Scherer, 1988; Shleifer and Vishny, 1986). The notion of 'clubness' challenges this paradigm, elucidating that the activities of this particular group or 'club' are not geared towards profit-maximising solely, but towards the accumulation and preservation of political-economic power. By providing privileged access to the members of the club, the system, in effect, bypasses considerations of profit-maximising or utility, replacing it with objectives to preserve power within the same circle, sustained by the interactions among the members of the club and with the decision-making process. This is further consistent with the inclusion of certain public servants in the oligarchic club.

### ***Club vs. Class – the Importance of Social Relationships and Cohesion***

On a similar note, the Corporate Power scholarship considers oligarchy an epiphenomenon of the dominance of money in society. The wealthy businessmen and businesswomen of the upper wealthy class are not associated with a particular 'club' or cooperating to form an institution in the political economy. Accordingly, the personal dimension or the unity of the oligarchy does not seem to have a role in this school of thought. Terms such as 'Cafe Society' or the more recent 'Jet Set' (Frank, 2007; Freeland, 2012; Hacker and Pierson, 2011; Korten, 2010) have been used to characterise a social class of very wealthy people. Also, the inter-relations within American elites and their substantial power over society were extensively analysed (e.g. Lerner et al., 1997; Rosenau et al.,

2006).<sup>156</sup> Still, this type of power structure, in line with Smith's view indicated before, is perceived as more diffuse in terms of unity and the common path of its members, while the social aspect is not central. In this way, both the accumulation of wealth and power and its preservation do not compel a particular affiliation to a group or a 'club'.

In the contemporary scholarship, the approach analysing the rule of family-controlled pyramidal business groups equates, in most cases, the owners with wealthy families. The new corporate power literature points to very wealthy individuals. The wealthy families or individuals generally manage inter-relations and choose a way to harmonise their economic objectives for the purpose of forming a united front against the machineries of the state. They therefore collaborate, if they do, when pursuing and defending common interests, namely influencing regulation, preserving the status-quo, and increasing the wealth of oligarchs. At the same time, competition between them can be fierce and even cruel (as in the Russian case, see Freeland, 2000; Goldman, 2004). Although such inter-relations differ across states, for the contemporary approach they are designed and structured to substantiate the oligarchs' power in the political economy, vis-à-vis their influence on the state.

The case of the Israeli club reveals that control over the means of production, or, alternatively, over corporations, is not sufficient to determine class affiliation or power relations. Nor is a specific sort of control, such as over the financial sector (Bryan et al., 2009; Hudson, 2010; Lebowitz, 1988; Niggle, 1988). Similarly, the degree of wealth or a certain class affiliation, such as in the case of wealthy families, does not account for such 'clubness'. A political or public position is not enough as well for this purpose. Therefore, this classification needs to be further refined, in order to better understand the meaning of class and social power. Put differently, the conception of 'clubness' that comes out of the Israeli case clarifies the need to rethink the basic categories of class and the sources of social power, highlighting the critical role of personal relations. These are no less important than ownership of capital, and can be the basis of social power, rather than ownership of property or capital, or holding political or public office.

The Israeli clubness provides three complementary contributions. First, it highlights the social dimension as an important factor in preserving the power of oligarchs, or even in its formation. In that, it is no less critical than factors such as wealth or success in the market (e.g. Ruiz, Forbes, 2008 or Tiger 21, a peer-to-peer network for top investors). The Israeli case therefore stresses a distinction hitherto unnoticed between wealthy people and those that are a part of a specific club, which is used, in turn, to fortify the economic and political power of its members. The common interests of this group and its united front towards public institutions and the public were most

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<sup>156</sup>Mills (1959), for instance, showed that America was not ruled by the people, but by the power elites comprising three central institutions: the big corporations, the military, and the federal government. Although those institutions seem separated, they constitute a unified elite governing America with not much consideration of voters' needs or interests. The basis of the elite is institutional proximity and interdependence.

evident in the aftermath of the 2007-8 financial crisis.<sup>157</sup> The 'clubness' notion, therefore, does not just typify corporate power as a cluster of wealth, but rather accentuates socio-economic agreements, based on common interests, which ultimately distinguish an oligarchy from individual oligarchs or wealthy families on their own.

Second, the Israeli case is also significant in its emphasis on the involvement of the state in establishing this 'clubness', or the oligarchic club. The Israeli case thus illuminates the role of the state in determining the particular power of the oligarchic 'club', and more generally, its formation as such. Such power can be manifested by corrupt institutions (Lessig, 2011; della-Porta and Vannucci, 2012), in which state decisions made by captured bureaucrats are biased (e.g. the Russian Apparatchik, see Macey and Colombatto, 1995; Aslund, 1995). Alternatively, the state can provide preferential access to members of the oligarchy over others, thereby shaping an exclusive oligarchic club. The Israeli case suggests that the way in which the state and capitalists are organised matters. More specifically, the activities of state agents create a more solid oligarchic power structure, determining the configuration of power of oligarchs and their political economic virtues.

Third, the possibility to join the club incentivises public servants and politicians to cooperate with it. Therefore, the fact that the club is not entirely closed is a crucial tool of influence for the oligarchy, side by side with other tools it uses vis-à-vis the state. The great advantage of the club, in terms of what makes the state-oligarchy interaction acceptable, comparing to lobbying let alone corrupted measures such as bribery, is that it is legal and not entirely transparent.

To conclude, the notion of 'clubness' illustrates how the oligarchy does not solely amount to a sum of its individual oligarchs. Instead, it accentuates the institutional aspect of the oligarchy, making it more than simply the upper wealthy class (or the wealthy 1%). No less important is the inter-relations of the club and, to an extent, inter-dependence with the state. The connections and the coordination within the oligarchic 'club' and its balance of power with the state serve to further sharpen the distinction of oligarchy from other power structures, and to mark the oligarchy as such. The notion of clubness thus brings forward the critical role of key actors within the club other than the very wealthy few themselves, turning it into an informal political economic institution.

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<sup>157</sup>An example is the case of the bailout requests of the heads of the automobile industry (Levs, CNN, 2008). It was their power standing together, rather than their achievements as individuals, which enabled them, in effect, to demand support from the state, regardless of their failures or their own wealth.

### 3. Pyramidal Ownership Structure

Pyramidal business groups, typically with holding companies at their apex, became the most widespread mechanism employed to separate ownership from control in Israeli listed companies. This was entangled with the ability of these groups to substantially leverage their capital (when the amount needed in order to obtain ownership is significantly lower than the share value). They could thus merge financial and real assets in the different layers of the pyramid (Almeida and Wolfenzon, 2006; Bebchuk, 2012; Morck, 2000; Sokolinski, 2012; Kosenko, 2008). The pyramidal structure is a mechanism facilitating the oligarchy's accumulation of power, which in return buttresses further expansion. It hinders competition, reflecting the failure of the state to protect the market economy.

In Israel, due the young age of the state, and considering that accumulation of wealth has only accelerated in the past three decades, most of the members of the oligarchy represent a first generation of wealth. Although some, such as Arison or Ofer, do represent family wealth, they have not ruled the Israeli political economy across generations. The pyramidal ownership structure is a means to accumulate power, rather than preserve power rooted in family ownership. Remarkably, the controlling owners of the pyramid are not always as rich as other economic actors, or at least do not need to be in order to control a pyramid. The pyramidal structure denotes favourable access to credit, both bank and non-bank. The banks and the institutional investors, by providing credit in a biased fashion (in favour of the oligarchic 'club') are influential actors in the expansion of the pyramids, and are key in turning the controlling owners into oligarchs. The tight relationships of the oligarchy with the state and the lack of proper regulation, legislation, or supervision to moderate the expansion of the pyramids further facilitate this process. The following will examine what the Israeli pyramidal ownership structure can suggest to the theoretical approaches.

#### *Ownership of Capital vs. Economic Power*

The theoretical approaches of the historical scholarship acknowledge the prominent role of bankers and managers (although not necessarily as a part of the bourgeoisie, as analysed in the previous section). Marx (1894 [1981]) denotes, in particular, the role of the banking system in allowing capital 'leverage', subordinating hitherto interest-bearing capital to the capitalist mode of production (ibid). The proliferation of the financial sector is conveyed in the form of dividends, fees and commissions, exorbitant management salaries, bonuses, stock options, and debt-leveraged gains, and its manifestations were regarded by Marx as 'fictitious' (ibid; Hudson, 2010). There is no reference, however, to pyramidal structures of ownership and control.

Similarly, the corporate power approach mainly focuses on the US and the UK, where pyramidal

ownership structure is not common. The 'Bank Control Theory' (Mintz and Schwartz, 1985) demonstrates how economic and political power is acquired through control of several firms, on their own or as a group of holdings controlled by a minority group, in which banks have a key role. In addition, the dispersed control over the corporations in the US was entangled with a sharper distinction between the owners and the managers (Holmstrom and Kaplan, 2001; Mizruchi, 1983, 2004; James and Soref, 1981; Jensen and Meckling, 1976; Lerner, 1971; Useem and Karabel, 1986; Shleifer and Vishny, 1986). In this theory, the managers, including those in the banking system and the broader financial sector, hold critical power in the corporation, (Sambharya, 1996; Prahalad and Hamel, 1990; Palmer, 1973; Mizruchi, 1983; Roe, 1996). The dominant position of the managers is thus different than in a pyramidal structure, where the actual power over the corporation or the business group is held by the controlling share-holder.

Pyramidal ownership structure in the Israeli case, in which bankers have had a focal part in facilitating its growth (often being a part of the oligarchic club themselves), enables us to elucidate the substantial economic power in the hands of bankers and managers. Bankers' economic power is manifested in mergers between industrial and financial assets, preferential provision of credit, and market concentration in general. It thereby leads to a distinction between economic power and ownership over capital. The Israeli pyramidal structure points to how the decisions of bankers, supported by the decisions of state officials, enable the leverage and expansion of the activities of capital owners. The oligarchs' accumulation of wealth and power is to a great extent an outcome of administrative decisions; at the same time, because of the fact that in pyramidal structures the controlling owners do not invest massive capital, the economic administration is one that allows banker to foreclose properties, and, as a result, obtain power over oligarchs.

The pyramidal ownership as witnessed in the Israeli case, therefore, challenges the conception of economic power, illustrating that it is not in direct relations with wealth. This economic power is largely held by banks, which are the critical factor behind the formation of a pyramidal structure. The Israeli case thus helps to identify and acknowledge the crucial role of banks (and bankers)—and the financial system as a whole—in the formation and substantiation of an oligarchy.

### ***The Critical Role of the Financial Sector***

The pyramidal ownership structure emphasises the importance of the financial sector (Posen, 1995; Orhangazi, 2008; Stolz and Wedow, 2010), as a fundamental part of the economic elite (King and Levine, 1993; Singh and Zammit, 2006; Rajan and Zingales, 2003; Johnson, 2009). In the US and the UK, until the 2000s the power of the financial sector had not been traditionally perceived as an outcome of an active manipulation of the economic system, but rather as part of it. However, in the

aftermath of the 2007-8 global financial crisis, the finance industry was widely perceived to have been responsible for the crisis, illustrating its critical position in the political economy (Reinhart and Rogoff, 2008; Nesvetailova, 2010; Mehrling, 2009). Accordingly, analyses conducted in that period point to how the banks are not only a central actor in the political economy, but a key factor behind the most severe global economic crisis since 1929 (Ivashina and Scharfstein, 2010; Taylor, 2009; Bernanke, 2007; Dewatripont et al., 2010; Beltratti and Stulz, 2009). The Israeli case not only corresponds with these analyses, but illuminates the extent to which the rule of the banks within the corporate power approach is critical.

As such, the Israeli case sharpens the implications derived from the structural power of the financial sector, such as expanding inequality and growth impediment. Zingales (2012), for example, analysing the normative aspect of the indispensable rule of the banks, explicitly describes how the banking system, designed to advance economic growth, has become a factor thwarting it. He used the concentration in the American banking sector (as the big banks controlled 40% of deposits in 2008) in order to illustrate a merger of interests in the financial sector, between banks, capital markets, insurance companies and investment houses, working together to subvert economic reform and tighter regulation. The Israeli case further heightens the way such concentration of power, rather than wealth alone, can turn specific wealthy individuals into an oligarchy.

Similar to bureaucrats, bankers can no longer be seen as serving an exclusively economic function; the accentuation of their critical role affects both their class ascription, specifically to the oligarchic club, and their rule over the political economy as a whole. The biased allocation of credit of the financial institutions to the same closed group is not random; it draws on the strength of certain businessmen and managers, who, in turn, affect the credit provision. Consequently, from within the oligarchic 'club', the financial system manages to generate the pyramidal power structure, and consequently – an oligarchy. As illustrated in the next section, the role of the financial sector challenges the linkage between families and pyramidal ownership structure.

### ***Challenging the Familial Context***

The contemporary scholarship analysing family control over pyramidal business groups in various states (e.g. La Porta et al., 1999; Morck et al., 2005) refers to wealthy families as ultimate controlling-owners, using the pyramidal ownership structure as an instrument of control. The familial context, according to this approach, is key in forming and deepening a pyramidal ownership structure. It is largely associated with tight relations with the political circles, thereby obtaining further power over the political economy as a whole. Such power, drawn on heritage rather than actual success in the market, is therefore perceived, more often than not, as negative.

The Israeli case challenges the way this theory identifies and interprets relations between families and pyramidal ownership structure. It illustrates, in effect, how favouritism towards the interests of the controlling-owners (La Porta et al., 1999) is far more crucial in forming the pyramidal ownership structure than familial affiliation. The role of the familial order presented in developing states is replaced by preferential access to credit in the Israeli case. This access is often the result of affiliation to the oligarchic club (such as the credit provided to Dankner and Tshuva, without personal guarantees, see chapters 4 and 5). It is mainly access to such credit, rather than the power of a family, that translates into an expansion through pyramidal ownership structure. While affiliation to a strong family can facilitate access to credit, it is yet not the family branches which obtain power across the pyramid. In fact, family control and pyramidal ownership structure can be disjointed (as in the case of Tshuva).

The Israeli pyramidal structure refines the literature on families, and is important in highlighting how social, economic and professional networks are more critical in the accumulation of wealth and power than the family itself. This can thus apply to other ‘young states’ or economies in the process of financialisation, because the expansion through pyramids is not so much about families deeply rooted in the market, in terms of time and holdings, but rather about how effectively and quickly new controlling-owners become a part of the club, extracting benefits or preferential access to state resources and agencies. Those new owners, nonetheless, can form influential family ownership structure themselves.

#### 4. The Interplay Between Domestic and International Power

The intensification of globalisation reduced the importance of national boundaries. Contemporary oligarchies are thought to have properties and goals different from oligarchies in the pre-globalised world (Khan 2012: 373). The Israeli case, however, is different. While the Israeli oligarchy is similar to other oligarchies around the world in terms of monopolistic stance, sectorial spread, and expansion of activities, it lacks an international dimension to its success and power. The interplay between domestic and international sources of power, evident in other cases, is hardly present in Israel.

This 'domestic bias' is related to the origins of the oligarchy and to its purposes. First, as shown in this research, the basis of the Israeli oligarchy is the state. Second, while in other democratic oligarchies wealth defence means mainly reduction of taxes (Winters, 2011), in Israel the primary objective of the oligarchy is to prevent or hamper competition. The predominant view in the literature on Israeli economic growth has been that it is peculiarly globally-led, a characterisation rooted in the dominance of the Military-Industrial Complex during the 1970s (see Mintz, 1985) or the success of the Israeli Hi-Technology industry during the 1990s (Senor and Singer, 2009; Nitzan and Bichler, 2001). These analyses, however, did not take into consideration the way financialisation was internalised (or were written earlier). The financialisation of the economy, conversely, indicated quite the opposite. My analysis engages critically with these arguments, and concludes that Israeli corporations that draw power from the international arena (e.g. Teva, Check Point) are not part of the oligarchy and do not need affiliation to the oligarchic 'club' to accumulate power. These actors, who took advantage of global processes internalised in the political economy (although aided by state provision as well), represent the competitive side of the political economy and proliferate Israel's interaction with the global arena.

With the intensification of globalisation after the collapse of the Soviet bloc (1989-1991) and with the Oslo Peace Process in the 1990s, the business elite, which consisted of the 'producing' side of the business sector, promoted de-colonialisation (Shafir and Peled, 2000; Ben-Porat, 2004).<sup>158</sup> These businesses most needed interaction with the global arena, both in terms of trade relations, accelerated following progress in the peace process, and with regard to cheaper zones of manufacturing, opened as a result of the peace process (e.g. Jordan or the Palestinian Authority). The industrialists and technology entrepreneurs acknowledged, therefore, the importance of the relations with the global arena, in particular de-colonialisation, in seeking to increase competitiveness. In this sense, they fulfilled the role ascribed to commerce by thinkers like David Hume (1752): encouraging de-militarisation and peace, but they were not a part of the oligarchy.

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<sup>158</sup> De-colonialisation refers to withdrawal from the territories occupied by Israel in the 1967 War: the West Bank and the Gaza Strip.

The financialisation of the economy explains how the group dominating the market economy is not linked to merits in the global arena and does not manage trade relations or manufacturing abroad—or at least does not depend on them. Accordingly, the oligarchy takes no political position with regards to foreign policy; for example, it never expressed an interest in advancing the peace process. Benefiting from as an entrenched a market as possible, the Israeli oligarchy has never actively resisted colonisation, and furthermore enjoyed its ensuing benefits, such as market entrenchment and restrained competition.<sup>159</sup> While leaders of the old big businesses and prominent members of the old business elite, such as Dov Lautman and Shaul Eisenberg, benefitted greatly from the opening of Middle-Eastern markets following the Israeli-Arab peace process or third-world markets, the Israeli oligarchy did not accumulate wealth and power due to global remits. It was, unlike other cases around the world, less a product of globalisation and more an outcome of the evolution of the Israeli state, or more specifically its state-business nexus.

### ***Oligarchy Outside the International Rule***

The Marxists contextualised monopoly capitalism with the international order, linking it to imperialism, and more specifically colonisation (Marx and Engels, 1959; Avineri, 1969; Brewer, 1990; Parry, 1987). They argued that the process of 'finance capital' would eventually lead, via international joint-stock companies, to the rule of strong states over others. Marx (1972) predicted that the bourgeoisie would aim towards expanding and creating a market on a global scale. The competition among producers would drive them to find new markets in order to create a new consumption base, as well as control of natural resources. For the Marxist approach, therefore, weaker countries would reasonably submit to the political-economic colonisation (Marx and Engels, 1959; Lenin, 1999; Wallerstein, 1979; Brewer, 1990).

The international dimension is also of great importance for the literature assessing corporate power. Big corporations are largely characterised by their success in the international arena, and accordingly their power has largely been a result of international accomplishments. The power of these corporations in the international arena, moreover, is correlated with the state interests, fortifying its position. Barlett and Goshal (1989) argue that TNCs respond to the needs of global efficiency, national responsiveness, and the development and dispersal of innovation internationally. Nye (1990) attributes 'soft power' to those TNCs, complementing strategies traditionally used by states. Sassen (2000), furthermore, describes the new 'geography of power' resulting from the power of these TNCs. Hence, the state has advanced TNCs, even at the expense of the public's interests, on the domestic and international level (Wilterdink, 2000; Reuveny and Li, 2003; Beer and

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<sup>159</sup>This is evidenced, for example, by various sanctions imposed by the European Union, subjecting progress in Israel-EU trade relations to progress in the peace process. For more on this conditionality in the EU-Israel relationship see Pardo and Peters, 2010; Casarini and Musu, 2007; Smith, 2005.

Boswell, 2002; Goldsmith and Blakely; 2010).

The Israeli case illustrates how the power of the oligarchy is not aligned with imperialism at any stage of its evolution, and not bounded directly to success in the international arena. Although the rise of the oligarchy is directly connected to processes of globalisation, mainly privatisation and financialisation, it does not hinge on success in the international arena. The Israeli case thus challenges the Marxist paradigms linking capitalism, imperialism, and colonisation to expansion of activities by exploiting resources in colonised countries. Similarly, it challenges the linkage between corporate power and competitiveness in the global arena. It therefore elucidates the possibility that oligarchy can be disconnected from global capitalism, relying solely on domestic sources of power. In what can be seen as a case of path dependence (Pierson, 2000; Mahoney, 2000; Bebhuk and Roe, 1999), the actions of the state and its vast connections with the oligarchy have led to the domestic nature of ownership of the oligarchy.<sup>160</sup>

### ***Domestic Rent-Seeking as Key to Political Power***

In recent years, especially following the 2007-2008 financial crisis, there is a growing acknowledgment that global and national wealth is increasingly concentrated in the hands of a very wealthy few, which are a tiny fraction of the population (Piketty, 2014; Oxfam, 2015). At least in US, their preferences are different from those of the majority (Page et al., 2013). Moreover, these very wealthy few have generated and sustained their wealth through political measures and not only or mainly through talent, hard work and competence, accounting for the common good (Hacker and Pierson, 2010; Winters 2011; Gilens and Page, 2014). Some of the corporations and the very wealthy few spend huge sums of money every year on various activities to create or maintain a policy that protects and enhances their wealth. Unfortunately, not only these activities increase inequality, they also impede economic growth, progress and innovation. However, despite the important works of recent years (e.g. Gilens and Page 2014; Page, Bartels and Seawright, 2013), the understanding of the wealthy few as political actors, by means of their influence on policy-making, is still limited (Beaverstock et al., 2004; Keister 2014, 361-362).

The contemporary approach associates the success of the oligarchy with exploitation of state resources, enabling the oligarchy accumulation of wealth in the international arena as well (Khanna, 2000; La Porta et al., 1999). This approach illuminates the international dimension of the ability of the oligarchy to exploit domestic resources at the expense of state or public profits. In states in transition, for example, the emergence of oligarchs is often connected to their take-over of national resources; post-Soviet Russia has enabled a small group of businessmen to take over coal, metals, or oil, which trade in the global markets, and has made them billionaires (Freeland, 2000; Aslund,

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<sup>160</sup> 'Path dependence' relates to the historical context of institutions and the evolution of economies.

2004). This was due to the concerns of politicians that access to and ownership of Russia's natural resources would be transferred to foreign TNCs. As a result, these assets were transferred to the rising oligarchs, without adequate demands for remuneration. Russian oligarchs, in turn, added nothing to the markets (Goldman 2004:35-6), barely engaging in restructuring or improving the assets they had acquired from the state (ibid: 40). Similarly, the new wave of corporate power literature emphasises the rent-seeking activity of the domestic financial sector. It illustrates how the control over it enables only a few to obtain and increase power, at the expense of society as a whole.

The Israeli case accentuates the linkage between the domestic and rent-seeking nature of the activities of the oligarchy and the conception of political power. While access to political power can often translate to the ambitions of oligarchs to become politicians themselves (e.g. Boris Berezovsky in Russia or Silvio Berlusconi in Italia), the Israeli oligarchs, conversely, have not yet tried to become politicians. Instead, they have become political actors by means of access to and influence on political decision-making processes, seeking to serve their interests, even at the expense of the public (Navot, 2012). Their political objectives mainly concern preserving a status-quo that allows for rent-seeking, perpetuating not just the oligarchs' own wealth, but also their power in the domestic arena. The Israeli case thus heightens both an important aspect of political power, namely influence over the political decision-making circles, and the significance of political power being exercised in favour of market entrenchment, in terms of the access to resources following privatisation and in constraining competition afterwards. This entrenchment suffices to preserve the rule of the oligarchy, without the need to penetrate international markets. Accordingly, the normative aspect is intertwined with such political power; the implications of the market concentration, such as an eroded middle class, increasing inequality, declining competition, and risk to democracy (as analysed in previous chapters), point to how the system has become more oligarchic in this process.

The political power of the oligarchy requires it to be anchored to the state for expansion and stability. Anchoring oligarchic power structures to the state is not only achieved by means of taxes paid to the state, subsidies provided by it, or coordination between the two. It also extends to the direct support of the state of the corporations or of the activities of the business groups inside state borders and abroad. The importance of anchoring such corporations to the state was convincingly revealed in the aftermath of the global financial crisis (Reich, 2010; Bremmer, 2010). Realising the problematic of the 'too big to fail' perception (Ferguson and Johnson, 2009; Baker and McArthur, 2009; Goldstein and Véron, 2011), the state not only saved failing TNCs, it was also responsible for recuperating a stable basis for managing the global market economy. This was most significantly witnessed in the federal bail-out plan, the 2008 Emergency Economic Stabilization Act to confront the financial crisis, executed by the US government (Karnitschnig et al., Wall Street Journal, 2008;

Cecchetti, 2009; Mishkin, 2010; Krugman, 2009). The crisis made it clear that the state, in effect, needed to regulate global markets (Nesvetailova and Palan, 2010; Cioffi, 2000). This is not a complete return to the Keynesian paradigm, but certainly an acknowledgement that the ‘invisible hand’ can be exercised by the government as well.

This notion of domestic power contributes to the contemporary approach by emphasising the relationship between the very wealthy few and inequality. As the new wave of corporate power literature focuses on income inequality between the top percentage of wealthy people and the rest of the population (e.g. Piketty and Saez, 2003, 2006; Alvaredo et al., 2013; Atkinson et al., 2009, Piketty, 2014; The Economist, 2012), the Israeli case helps to show that inequality effectively defines the domestic sources of power of the oligarchy and the way its activities are anchored to the state, even if conveyed through power in the international arena. This can be through the control of the oligarchy over national resources traded in the international arena, or by means of state provision to certain corporations or business groups, which can then use their power in the domestic sphere for investments or trade abroad. This position in the global arena, in turn, further fortifies the oligarchy as an informal institution of wealth and power in the national political economy, its activities characterised by rent-seeking.

### ***Oligarchy as an Informal Political Economic Institution***

On the basis of the two scholarships discussed, this thesis suggests that oligarchy can be understood as a power structure defined by institutionalised social relationships and wealth, specifically, an informal political economic institution.

To examine how institutions are defined and to clarify the conception of oligarchy as an institution, I shall incorporate the Institutionalism school of thought, both the old school of institutionalism (Commons, 1934; Veblen, 2005[1899]; Hodgson, 1996, 2000) and the New Institutional Economics (NIE) School (North, 1990; Moe, 1991; Shepsle, 1989; Williamson, 2000; Richter, 2005). The old school of institutionalism understood institutions as a set of rules that become effective once turned into shared habits of thought and behaviours. It saw their evolution as a constant process of change influenced by a complex structure of social and economic concerns. According to Veblen, institutions are “settled habits of thought common to the generality of men” (1909:626). They are determined by habits and ways of thinking, originated by material, technological and economic means. They constrain human behaviour and are not a product of its instincts or inclinations.

Following Veblen, John R. Commons (1934), using transactions as the main unit of analysis, interpreted institutions as a social structure whose uniqueness is embodied by its capacity to change social actors’ purposes or preferences. The framework through which the transactions are made is regulated, by means of a set of working rules or laws which determine the boundaries of individual

actions. The evolution of institutions thus depends on a constant deliberative and collective decision-making process. Their shape is defined by the working rules applied during transactions, constraining economic power or alternatively, liberating an individual from the coercion of another. Institutions are constraints as well as instruments of change in the capitalist model, which, in return, form a social order.

NIE scholars focus on the individual himself as the key to understanding institutional framework, analysing the role played by markets, economic actors, firms, and public offices, rather than institutions as the imposition of collective rules over individuals. According to NIE, both individuals in the market and the political arena act to maximise their personal interests. Furthermore, they are supposed to solve collective action problems, enhancing common good. The more powerful institutions allow economic actors to coordinate on equilibrium strategies, offering high returns and reducing individual uncertainty (Hall and Soskice: 10). In addition, the existence of an institution is in large part cognitive (Scott, 1995), shaped by the way people think, which nonetheless widely influences them.

North (1990), in distinguishing institutions from organisations, provided a bridge between these approaches. He defined institutions as a set of formal and informal rules, shaping political-economic and social interactions by constraining and enabling particular behaviours that guarantee their stability. They are 'humanly devised constraints' that actors generally follow, for normative, cognitive, or material reasons (ibid: 3). They are structures delineating the social realm, and the product of a specific ideological, cultural and theoretical trajectory. Institutions are not considered to be simple agreements or power structures created by individuals; instead, they direct codes of conduct and legitimise specific beliefs or ideas among society.<sup>161</sup> Institutional change shapes the way society evolves through time, and is the key to understanding historical change (North 1990:3).

Winters' theory of oligarchy (2011), and more specifically of Civil Oligarchy, further contributed to NIE. He emphasises the reciprocity in state-oligarchy relationship. The evolution of the oligarchy as an institution is embedded in the role of the state. The state is fundamental to understanding what enables the oligarchy to emerge as an institution. The state aims to create a distinct power structure, consisted of strong and stable pool of shareholders, whilst vigorously shaping its inter-relations with them. The actions taken by state institutions vis-a-vis business groups or corporations allow us to identify oligarchs and oligarchy. The retreat of the state helps to create a stable power structure whose operation ultimately changes the character of the state; even a strong state can facilitate the emergence of an oligarchy to serve its needs. Therefore, the ability to constrain external forces, to influence the ideational sphere and the specific interaction with the

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<sup>161</sup>Organisations, conversely, are durable entities with formally recognised members, whose rules contribute to institutions of the political economy (North, 1990).

state distinguishes institutions from other nets or even clubs, even though those embed the institution.

The conception of oligarchy as an informal political economic institution, therefore, makes several important contributions to the literature. First, it helps to better understand the statist condition under which particular clusters of wealth and power emerge and operate. Numbers representing market concentration and inequality or the basic notion of ‘the rule of the wealthy few’ are not always sufficient – understanding oligarchy as an institution sheds light on the evolution of institutional alignment and the political economy as a whole. Second, it enables a better understanding of the particular inter-relations and balance of power between ruling elites, socio-economic classes, and key state and non-state institutions. Third, the particular relationships within the oligarchy and between individual oligarchs are illuminated, including the cohesion of the oligarchic network or club. Fourth, understanding the oligarchy as an institution facilitates comparison of oligarchies around the world, highlighting what typifies and distinguishes them.

The analysis of oligarchy as an institution, then, is aligned with the objectives of the review conducted here. It refines the distinction between oligarchs and oligarchy, and corresponds with the analysis distinguishing oligarchs from other wealthy actors. It further illuminates the way in which state-oligarchy relations facilitate the accumulation of wealth and power. These relations make the oligarchy an institution whose power both originates from the state and is exercised over the state. This institution is sustained by a network or a club, formal or informal, of professionals, such as bankers, lawyers, consultants, accountants, lobbyists, and bureaucrats, as well as politicians or former politicians. Their well-deliberated activities shape the political decision-making process. Oligarchy, therefore, implies rule over politics, and oligarchs as political actors.

## Conclusion

Exploring how the Israeli findings may add a new perspective to the central assumptions of the identified literature, this chapter demonstrates that the pro-active and dominant role of the state in the rise of oligarchy, as witnessed in the Israeli case, suggests that the state is the central agent of capitalism, and shapes its relations with the oligarchy. The notion of ‘clubness’ challenges the traditional class categorisation, as well as the conception of power, while emphasising the social aspect in the consolidation of the oligarchy, making it more than just the upper wealthy class. The pyramidal ownership structure helps to point to the crucial role of the financial sector, rather than wealth in itself. The interplay between the domestic and the international illuminates the conception of political power.

As analysed in the first chapter, the literature on oligarchy is rather scarce. Winters' key work (2011) focuses on individual oligarchs rather than on corporations or other power structures, distinguished by their wealth and their aim of wealth defence. My work, instead, shifts the focus to *oligarchy*, and to the way in which it is an informal institution of wealth and power in a national political economy. The understanding of oligarchy as an institution alters conceptions of class or the notion that it represents a mere collection of wealthy individuals controlling a substantial share of the market economy. While oligarchy forms a concentrated and fairly closed circle consisting of oligarchs, the four key issues analysed in this chapter and all through the thesis enable us to segregate oligarchs from oligarchy, and oligarchy from a collection of oligarchs.

The specific interactions and the ways to exercise political and economic power institutionalise the oligarchy. It is sustained by the connections of and affiliation to the same club with professionals, bureaucrats, and also politicians, whose well-deliberated activities shape political decision-making processes and are supported by the state. Oligarchy, consequently, considerably implies rule over politics, with the oligarchs as political actors, retaining an interest in shaping and influencing the political system. The common interests of oligarchs as well as of other key actors in the oligarchic ‘club’, in addition to the coordination functions of the club, enable the oligarchy to monopolise the political economy. This ability renders the oligarchy an informal political economic institution whose power both originates from the state and is exercised over it. Tying these characteristics together, they not only make a wealthy actor an oligarch; they render a group of oligarchs into an oligarchy, which in turn forms an informal political economic institution.

## CONCLUSIONS

Summer 2011 was a watershed moment in the political economic history of Israel. A wave of social protest engulfed the Israeli streets, calling for social justice, denouncing the outrageous cost of living and the wider erosion of the middle class. This civil struggle was in part the result of the continuous coverage of TheMarker Media Group of the concentration of the market economy since the mid-2000s, now joined for the first time by the mass media, the academy, and various economic and political actors. The public grievances focused on the high cost of living in Israel, especially food and housing prices.

The series of demonstrations, largely supported and driven by social media activities, included, first, the 'Cottage Cheese Boycott', which began as a Facebook group in June 2011, calling on the public to stop buying this staple food product, after prices (per pack) rose from, on average, ILS 5.5 to ILS 7.5-8 in just one year (Ynet, June 2011; TheMarker, June 2011). The Facebook page reached 100,000 users in just few weeks. Another protest was the 'Prams Protest' also termed 'The Scream of Consumer Mothers', which started in July 2011. Also initiated as a Facebook group, seven thousands parents joined it, and on July 23 and July 28, 2011, hundreds of mothers and fathers went out on the streets, in cities across the country, to demonstrate against the distress of working parents in Israel (Calcalist, July 2011; Haaretz, July 2012). The most important pillar in this wave of the social demonstrations was the 'Housing Protest', initiated after a group of activists (led by Daphni Leef) opened a Facebook page and asked people for help in organising a protest against rising housing prices (which rose 21 percent between March 2009 to March 2010, see CBS 2014: 93). On July 14, 2011, Leef pitched a tent in the middle of Tel-Aviv (on Rothschild Boulevard), joined by hundreds of other tents in Tel-Aviv and, a few days later, in other cities. The culmination of this protest was a mass demonstration of 400,000 people (300,000 in Tel-Aviv and 100,000 in other cities) on September 3, 2011 (Ynet, July 2011; Ynet, September 2011a; Haaretz, July 2011).

The impact of the cottage protest was immediate: there was a decline of 25-35 percent in cottage sales within few days, and the price, in response, was dropped to ILS 5.9 (Haaretz, June 2011; Calcalist 2011b). Nonetheless, broader food prices kept rising: from 2005 to 2013 food prices rose by a nominal rate of 42 percent and real rate of 16 percent in Israel (the comparable OECD figures were 25.3 percent and 4 percent, respectively) (Knesset 2014:1, 5-7). The Prams Protest ostensibly managed to generate an actual impact; following the 2012 Trachtenberg Committee, appointed by PM Netanyahu following the 2011 protest, in order to examine and propose solutions to Israel's socio-economic problems (Trachtenberg 2012: 45-6), the government passed the Free Education Act for 3-4 years old children. However, it has not yet (as of 2015) been enforced (Haaretz, 2015). After the protests peaked with the September 3<sup>rd</sup> mass demonstration, the tents

were vacated (Ynet, September 2011b). Two protest leaders, however, later joined the Knesset (Stav Shaffir and Itzik Shmuli); in parallel, a series of government committees was established (e.g. the 2012 Trachtenberg Committee, the 2013 Committee to Examine Concentration in the Market Economy), recommending structural changes to the Israeli economy. Housing prices, nevertheless, kept rising, with a cumulative rise of 85.8 percent in the years 2007-2013 (CBS 2014: 93).

Despite the lack of tangible achievements, in the years following that protest discursive changes have gradually echoed in state actions. First, economic regulation has started to shift focus, from protecting the concentrated power of a few wealthy individuals and families, preserving market entrenchment and hindering competition, to new regulations designed to serve the broader public. A prominent example was the statement made by David Gilo, the Antitrust Commissioner, regarding the prevailing monopoly on natural gas;<sup>162</sup> he declared that he considers dividing the cartel control of Delek Group (under Tshuva Group, analysed next) and Noble Energy (an American corporation) on the two natural gas fields (Tamar and Leviathan), in order to prevent damage to the country's democracy (see for example Haaretz, December 23, 2014; Calcalist, December, 28, 2014). Second, the government committees mentioned-above were indeed a substantive response to the protest. To illustrate, the committee to examine the concentration in the Israeli market economy was appointed in 2010 by Prime Minister Benjamin Netanyahu, but did not publish any report, nor did it deliver any result. However, in 2011 it was re-appointed by Netanyahu, and published its conclusions in 2012. The culmination of this regulatory and legislative process was the enactment of the 'Business Concentration Law' in December 2013, designed to strengthen competition and restrain the excessive clout of a relatively small number of actors in the Israeli economy. Third, the biggest pyramidal business group in the Israeli market, IDB, collapsed in 2013. Fourth, extensive media coverage, especially by TheMarker along with both social and traditional media, stimulated public discourse and understanding, representing a fundamental change in the prevailing ideational sphere. Likewise, political rhetoric changed. The government has adopted the terminology of the protest and for the first time admitted that there is a problem of concentration in Israeli economy. In addition, it started to talk about the need to reduce costs of living and housing prices.<sup>163</sup>

Allegedly, the changes since the 2011 social protests were discursive; besides the changing political rhetoric, firm actions were taken to dismantle the power of the Israeli oligarchy. The most prominent example is probably Nochi Dankner, the controlling owner of IDB, the biggest pyramid in the market, who lost control of it and transferred it to new controlling-owners (Eduardo Elsztain

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<sup>162</sup>Large natural gas reserves were discovered in Israel between 2009 and 2013 (INSS, 2009; NaturalGasEurope, 2013; Bloomberg, 2013). The exploration was largely carried out by private investors, most prominently the Tshuva Group and Noble Energy, an American corporation. The discoveries prompted a charged debate concerning the appropriate taxes the state should charge on the gas, and the equivalent royalties.

<sup>163</sup> To illustrate this point, the triumphant Prime Minister Benjamin Netanyahu said in his 2015 victory speech that he would aim to form "a strong, stable government" that would tackle "security and socio-economic challenges." More specifically, he said that "We promised to take care of cost of living and rise of housing costs, and we will do it"(Jerusalem Post, 2015).

and Moti Ben-Moshe, see for example Haaretz, January, 2014). This could have been a potent symbol of the decay of the oligarchy—the most dominant oligarch losing control of the biggest pyramid in the market; however, reality is more complicated. IDB, to follow this example, was effectively transferred to two new controlling-owners without re-distributing its assets. More fundamentally, other oligarchs continue to have significant influence on the political economy. For example, in September 2012 the Tel-Aviv District Court approved a debt restructuring for Yitzhak Tshuva, whereby he defaulted on a debt of ILS 1.45 billion, equal to 64% of his outstanding debt to bondholders (channel 2 News, September 2012). Tshuva defaulted even though the gas discovery from 2009 stands to provide him (through his holding company) with an estimated profit of ILS 54 billion (TheMarker, December, 2014; Haaretz, January, 2015). There is, of course, no compensation whatsoever for the debtholders. The oligarchy, therefore, still stands, even as prominent members fail along the way.

Therefore, instead of extolling the transformation of the Israeli economic system and, more specifically, the dismantling of the oligarchy dominating it—which has not yet happened—this project aims to conceptualise this power structure: to delineate how it emerged, what are its characteristics, how it exercised power, and what are its primary implications.

In order to explain the problematic nature of the Israeli political economy I first conceptualised a prominent and unusually powerful segment of the business community as an *oligarchy*. Second, I entailed a re-conceptualisation of oligarchy. More specifically, I argue that the Israeli oligarchy is not a formal regime, but an informal political economic institution. Furthermore, the oligarchy should not be understood in terms of the wealth of its members, but rather through the economic processes and social relationships that allow very few individuals to garner substantial influence on the political economy and its decision makers. I also maintain that the objectives of the Israeli oligarchy are not exclusively focused on wealth defence, but mainly on wealth accumulation and hampering economic competition, executed through various social and political means, such as biased credit allocation and regulatory capture.

Oligarchy, as conceptualised here, appears to be a fundamental tool of International Political Economy (IPE) analysis. Indeed, while oligarchy normally refers to a type of regime, the research highlights how it can also refer to structural power and institutionalisation of specific and sometimes illegitimate influences in national political economies, in less formal ways. To illustrate that, I used the insights of the historical approach (e.g. Hilferding, 1910; Mintz and Schwartz, 1985), the contemporary approach (e.g. Morck et al., 2005; LaPorta, 1999), and especially Winters analysis (2011). Nevertheless, these approaches are focused on individual oligarchs, families or corporations which are chiefly distinguished by their wealth and their aim of wealth defence. In a sense, these schools of thought do not adequately capture the role of social positions, political

processes and the state in transforming specific businessmen into oligarchs and particular business dynamic into oligarchy. The limit of these approaches, then, lays in their associating of the oligarchic phenomena with wealthy players. Thus, they only partially explain the complexity characterising the component social, political and economic trends. My analysis, instead, shifts the focus to *oligarchy*, as a power structure that embodies the institutionalisation of economic, social and political processes.

Starting from Winters' theoretical constructions, my conceptualisation of oligarchy accounts for the contributions of socio-political institutional approaches and provides a more complete understanding of oligarchy and its evolution. The crux of the matter is that lack of competition and democratic deficit are not simply the result of sporadic decisions or individual attempts of powerful economic actors to accumulate wealth; instead, it is the result of a specific set of political economic processes, led first and foremost by the state. This analytical framework therefore allows a more flexible approach to examining power relations in political economies, and represents an alternative way of thinking about the root causes of high cost of living and damages to democracy, as well as the interconnections between them.

The state sells assets to oligarchs-to-be, usually on the basis of personal credentials, social relations, and economic strength, in order to advance economic development and growth; at the same time, it creates a power structure that actually reduces competition, endangers the power of the state, and creates conditions that affect the behaviour of all other actors in the political economy. Indeed, the objective of oligarchs to entrench the market lies in their capacity to efficiently increase their wealth as long as the state and society enable it. Accordingly, the success of some firms or business groups is not achieved on the basis of merit, competence, innovation, or efficiency, but rather as a result of their relationships with the state.

The political, economic and social conditions enabling the rise of an oligarchy dispel the idea that it is just an economic phenomenon; it is also indicative of a failure of the state to fulfil its responsibility towards its citizens. Yet, my conception of oligarchy contributes to the portrayal of the defined scholarships of the role of the state. In brief, it is not only a weakness of the state but also its strength that is important to the formation and sustainability of oligarchy. Likewise, it is not institutional weakness but rather the way these institutions, specifically decision-makers, function, that determines the future of oligarchy; this includes, for example, irresponsible and short sighted politicians, inadequate policies, or the advantages of would-be oligarchs over state officials.

One danger in re-conceptualising oligarchy is, undoubtedly, that it may repeat critical notions already made in existing literature on oligarchy or the Israeli political economy, only in different terms. Indeed, the suggestion that oligarchy can go hand in hand with democratic regime was made by Winters (2011). The role of a strong and democratic state is advocated by some prominent

scholars as critical to preventing oligarchisation. Fukuyama (2014), for example, maintains that we need strong democratic states and rule of law—as well as accountability—to prevent oligarchisation. Piketty (2014) argues that raising taxes on the wealthiest citizens is compulsory for that purpose. Likewise, different scholars also underscored the role of the state in liberalisation or in other pragmatic contexts (in the Israeli case see, for example, Ram, 2004; Shalev, 1998). Nonetheless, those accounts have not acknowledged the possibility of a strong state forming an oligarchy in a liberal market; specifically, the state as an agent of oligarchisation.

The understanding that the state is a prominent agent in the formation of an oligarchy is of genuine theoretical and empirical interest for several reasons. First, it shows that oligarchy can also be embedded in strong democratic states that adopt certain kinds of neo-liberal policies. My research reveals that capable, impersonal, and well-functioning state institutions are not always a sufficient condition for a healthy market economy. Second, oligarchies are a phenomenon of any variant of capitalism, not only a symptom of developing, peripheral capitalism where political and civil institutions are weakened or absent. One of the aims of the thesis, therefore, is to present a general account of oligarchy that can be of use in adjudicating similar disputes about the organisational mechanisms that enable an oligarchy to rise, and the ways to moderate the power of the oligarchy.

In this vein, the research suggests that certain economic ideas – like privatisation or competition– are no less important than traditional institutions. This conclusion is consistent with the criticism of the institutionalism approaches, with respect to the gap between neo-classical economics and economic reality (Hodgson, 2001; Aoki, 2001; Yonai, 1998; Finn, 1997). More fundamentally, my research suggests that the power of ideas in economic processes play important roles in the formation of oligarchy.

The conception of oligarchy in this thesis unfolds through the analysis of the Israeli case. Oligarchy began to develop in Israel in the mid-1990s, intensifying in the first decade of the 21<sup>st</sup> century. It consists of ten pyramidal business groups, controlled by individuals or families, and their affiliated professionals, i.e. accountants, lobbyists, lawyers, managers, consultants, and other businessmen and business groups. It controls substantial shares of the market economy and the public financial assets, managing tight relationships with state agents. The formation of the Israeli oligarchy was the result of the transformation of the Israeli market economy from a state-centred economic model, with state-big business coordination, into a free market economy. The transformation was, notably, actively and directly conceived and coordinated by the state and its machineries. It was rooted in the dynamics of the government actions and its tight coordination with big businesses, and the specific social, political, and economic needs at the time– or at least as they were perceived then.

The implementation of free market policies occurred through legal and competitive processes, namely privatisation and financialisation, which seemed like a feasible way to liberalise the market. These processes, although coerced by a strategic view of generating wide competition and fostering sustainable economic growth, were not reinforced by the state long-term vision or its ability to foresee the outcomes of transferring control to only a few hands. Currently, the transition to a free market economy has not been completed. The Israeli case integrates liberal market segments, such as the hi-technology industry, and vigorous practices of crony capitalism, along with a strong state role.

Analysing the Israeli case through the prism of the three approaches, Israel appears as a unique, hybrid case, in which the emergence of the oligarchy does not fully correspond with any of the suggested levels of analysis. Unlike the common Marxist interpretation of capitalism in general (Harvey, 2005) and of 'finance capital' in particular, it was not the Israeli old economic elite which benefitted from the oligarchisation; the latter featured the establishment of the big business groups, which power is domestic. Also, deviating from the contemporary approach, the rise of the oligarchy is not rooted in weak state institutions. The relationships between the big business and the political decision-making circle have formed the foundations of the market economy since the very first years of the state. Moreover, the pyramidal business groups are, to a great extent, subordinated to the state. Therefore, the Israeli case is not only about the dominance of wealthy individuals or families over the market economy; instead, it demonstrates an oligarchy without oligarchs.

This thesis makes three claims which will hopefully contribute to the conceptualisation of oligarchy. First, although oligarchs are wealthy actors, they are not necessarily defined by extreme wealth; their economic power, instead, may be rooted in their social positions and relationships. The latter is most important to defining oligarchs, making them political actors. The social position or capacity is used to obtain massive economic benefits and political power, and is, as a result, the most fundamental resource to wealth accumulation. This finding also sheds new light on the understanding of the sources of economic inequality, which do not amount to income from capital, with unequal ownership as the prime driver of economic inequality (e.g. Piketty, 2014). This ontological conclusion also has methodological implications, which is the second contribution of the thesis. If I am correct, and assuming that the Israeli case is not utterly exceptional, we should pay much more attention to social positions and networking in studying political economies, mapping the political actors with a vested interest in shaping and influencing the political system.

Third, my research suggests that the influence of institutions on political economy is more complicated than is commonly acknowledged. Institutions do, indeed, matter to the rise of an oligarchy, but differently than the literature suggests. Weak institutions are not the ultimate explanation for oligarchy, and strong institutions are not the ultimate solution. Strong states and

strong institutions do not always prevent the emergence of an oligarchy, even in liberal democracies, and furthermore, may be sources of economic problems and inequality. Conversely, the role of state agents that are committed to the public interest (i.e., competition, growth, unbiased distribution of resources) is no less compelling. In addition, as indicated before, such powerful agents can resist oligarchy after its emergence.

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Since the 2007-8 global financial crisis, there has been much academic interest in the study of market and governmental failures and how the market can be regulated to prevent oligarchic control. Regulatory failures are currently as prevalent as market failures, in unfettered and heavily regulated markets alike (Carman and Harris, 1986; James, 2000; Jessop, 1996; Acharya et al., 2011; Boyer, 1990; Aglietta, 1979; Lipietz, 1986). In this respect, the need to foster economic growth, but also control the power of the big economic players, is thus a fundamental challenge for good governance and the broader political economy (Fukuyama, 2013; Lessig, 2014; Piketty, 2014; Johnson, 2009).

Future projects need to be designed to provide lasting improvements that could be widely adopted. These will include, among others, transparency and public access to information, regulative consistency, enforcement of initiatives, and wider representation. One of the most salient challenges that developed market economies face is the introduction of a regulatory framework that would simultaneously preserve the competitive virtues of the market economy and serve the greater public interest. The main questions around which such researches concern shall include the reasons for success and failure of certain regulatory policies, the engines behind structural reform, and the ways to prevent the political economy from being recaptured by the oligarchy.

Recent developments in Israel provide a timely and unique case-study on the power of regulation in dismantling the grip of an oligarchy and nurturing competition, growth, and stability (Davidoff, NY times, 2014; Rolnik, 2014; Bebachuk; 2012; Committee, 2013). In view of the Israeli case, we can thus identify the conditions that make regulatory capture (Laffont and Tirole, 1993; Dal Bó, 2006; Baker, 2010) manageable, and enable new regulatory initiatives. In view of these discursive changes, if fully realised, Israel has the potential to project internationally a shift of ideological framework.

At present, however, it is not clear whether we will revert to a system in which the state exerts more positive influence over the market, as the oligarchy seems to have amassed such economic power as to be able to overturn political decisions. It is also unclear whether Israel can continue to be an oligarchic market economy to the extent it has demonstrated in the past decade, since the public discourse would unlikely allow the lack of transparency characterising the establishment of the pyramids in previous years. All the same, the Israeli case enables a shift in the traditional

discourse, of more or less regulation, into one of *how* to regulate effectively. It thus heightens the debate on how equality-oriented policies, which would return more power to the state, foster a more just, competitive, and equal market economy, and preserve the goal of efficiency while controlling the distribution of resources. Still, we can be optimistic and hope that these structural changes will possibly allow Israel to overcome the oligarchic capture of its political economy.

The main purpose of this study is not to find a direct new solution to economic problems, but rather to disclose the mechanisms through which oligarchy arises and develops into an informal political economic institution. On May 2015, David Gilo, Israel's Antitrust Commissioner, announced he was stepping down from his office. "The government, especially the Prime Minister's Office and the Finance and Energy ministries, will do everything they can to promote the outline that is being drafted for the natural gas market, an outline I am convinced will not bring competition in this important market," he said (Haaretz, May, 2015). This research has shown that such poor development is in line with the oligarchic power structure dominating the market economy. Indeed, it is difficult to remain optimistic about substantial changes in the political economy of Israel, as the oligarchy maintains a dominant position. Therefore, Israelis will need to be better educated and press more comprehensive demands on public servants and politicians, rather than vague calls for social justice, if they want to fundamentally alter the social contracts and political economic power structures of their country. I hope that by explaining the nature of the problem, this research contributes to the efforts of fostering such change.

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