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Israel: Economic Prospects

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Prime Minister Menahem Begin's month-old government, although preoccupied with preparations for possible Middle East peace negotiations, announced an economic program last weekend that closely parallels the budget proposals of the former Labor government—with a few new austerity measures tacked on. The new measures, designed to reduce the 40-percent inflation rate, call for restraint on wage demands and reductions in budget deficits through increased taxes on gasoline, elimination of food subsidies, and minimal cuts in military spending. These measures are largely cosmetic—the \$235-million proposed cut in government expenditures represents less than 2 per-

cent of the budget submitted by the former Rabin government.

Begin's tough public stance on wage and salary negotiations and his threat to institute compulsory arbitration in labor disputes have produced a counterthreat from leading officials of Histadrut, the labor federation, of nationwide strikes if the government attempts to force the anti-inflation measures. The opposition Labor Party, which controls the Histadrut, may find it difficult to resist demands from the federation's rank and file to oppose the government's new economic policies, but party leaders, who are still trying to regroup as an effective opposition after 29 years of rule, would prefer to avoid a confrontation with Begin for the time being.

Israeli economic policies under Prime Minister Begin—as under Labor—will

continue to be dominated by the overriding priority of defense. Labor shortages and austerity measures will hold economic growth to 2 percent or so, and the civilian economy will remain hamstrung even with sizable infusions of US aid. The anti-inflation measures announced last weekend, even if fully implemented, are not likely to have a significant impact on the country's other economic problems.

The Military Burden

Since the 1973 war, the Israeli defense establishment has been taking roughly 40 percent of gross national product, double the prewar share. Identified military imports have ballooned to \$1.6 billion this year, compared with \$500 million in 1972. Moreover, Israel is seeking an additional \$7 to \$10 billion worth of US military hardware over the next few years.

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A considerable portion of so-called civilian imports is material and components for military industries. The defense industry absorbs 15 percent of Israel's available manpower; half of this share reflects man-hours absorbed by reserve duty. These requirements create shortages of skilled labor in key civilian sectors.

Begin and other top officials probably will enlarge the role of the military. Defense Minister Ezer Weizman, an influential adviser, was instrumental in developing the Israeli aircraft industry when he was air force chief; he will no doubt push expansion of military output and further coproduction arrangements with US firms.

Domestic production of Kfir aircraft and the new Chariot tank and proposed coproduction of F-16s and hydrofoil patrol boats are expensive undertakings, both in terms of unit costs and manpower allocations. For example, coproduction of the F-16 would cost Israel 15 to 25 per-

cent more than direct procurement from the US.

If current Israeli military purchase and coproduction plans go through, military inventories could rise 25 to 50 percent between now and 1982, to levels twice as great as before 1973. Israel does not have the manpower to make immediate use of the military equipment it is receiving. Recent deliveries of A-4s went directly into storage because of shortages of pilots and mechanics.

The Civilian Sector

In the siege climate existing since 1973, labor shortages have been the main constraint on the civilian economy. The civilian labor force has increased by less than 5 percent since 1973.

- The standing army has increased from 110,000 to 160,000, and reserve duty has been expanded.
- Net immigration, which had been adding 30,000 people a year to the population, is now near zero.
- The pool of Arab workers from

the West Bank has shrunk because of more lucrative jobs in the Arab states.

- The growth of defense industries probably has absorbed a good portion of the small increase in the civilian labor force.

These manpower constraints, coupled with government efforts to reduce the 40-percent inflation rate, have cut economic growth from a prewar rate of 10 percent to 1 to 2 percent in 1975 and 1976.

Industry overall is operating below capacity, and the civilian construction industry is at a standstill, especially in government sponsored projects. A potential worsening in labor strife further dampens economic growth prospects in the months ahead.

Israel's foreign financial gap has widened considerably since 1972, when the current-account deficit plus debt repayments totaled \$1.5 billion. So measured, the financial gap reached a record \$4.3 billion in 1975, primarily because of sizable military imports and a slowing of exports. Last year, the gap narrowed to \$3.2 billion on the strength of a decline in imports and a large rise in exports.

The deficits were covered by private transfers and official loans, primarily from the US. Last year these were sufficiently large to allow Israel to increase reserves and reduce outstanding short-term debt.

A moderate economic improvement is likely in 1977: GNP should grow 2 to 3 percent, the overall balance of payments should show a \$500-million surplus, and inflation should drop several points. There is little Begin can do, however, to overcome labor constraints.

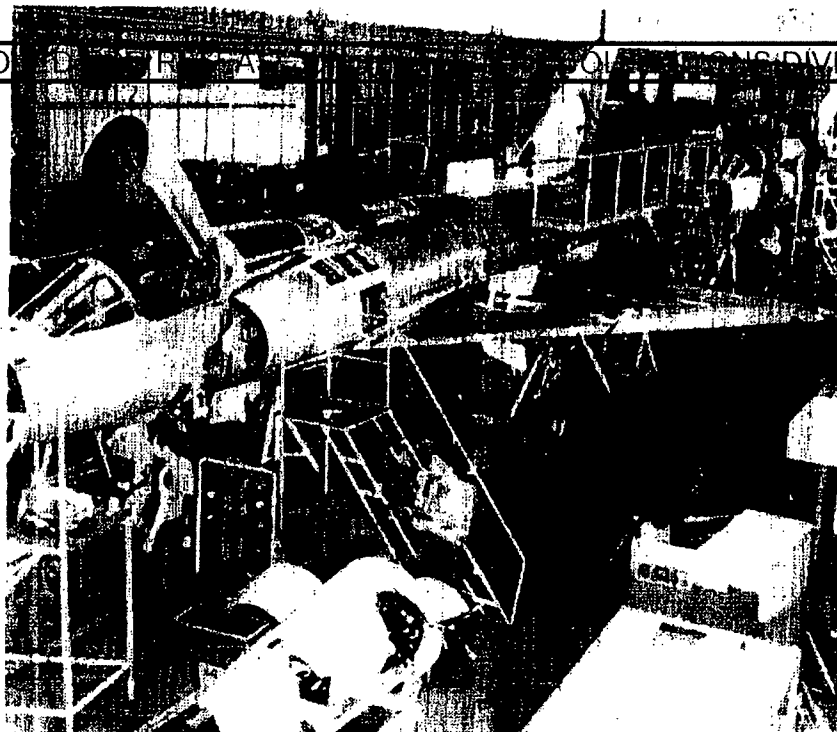
Israel's international payments outlook is relatively bright. Transfers and loans, including US aid, should more than cover foreign exchange needs. US assistance will remain the dominant element in financing Israeli requirements. Israel is now receiving more than \$2 billion a year in US aid—about two thirds on a grant basis—mainly for military purposes.

Half of US aid still consists of direct military assistance to underwrite



Prime Minister Begin at his desk with an adviser

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F-4U aircraft are shown under construction in Tel Aviv. Domestic production of such items is an expensive undertaking for Israel in terms of unit costs and manpower allocations.

purchases of US arms, even though this type of aid has declined in both absolute and relative terms since 1973. Economic aid has increased from \$50 million in fiscal 1974 to nearly \$800 million in fiscal 1977; some of these funds are used to cover military purchases.

Israel has made little use of the economic aid offered under the US commodity import program, which is designed to shift aid allocations from budget support to specific economic uses. Tel Aviv alleges that the paperwork involved in the program is burdensome and that the import list is too restrictive. In fact, the tight domestic labor situation prohibits initiation of large-scale civilian projects that could absorb substantial aid from the program. Furthermore, Israel does not want to import consumer goods that would supplant domestic production or support a consumer boom

ISRAEL

A series of recent actions by the Israeli government underscores Prime Minister Begin's intention to retain permanent control of the occupied West Bank and Gaza Strip. Begin considers the two territories part of his country's rightful patrimony; Arab leaders demand the return of the lands to Arab control in any peace agreement.

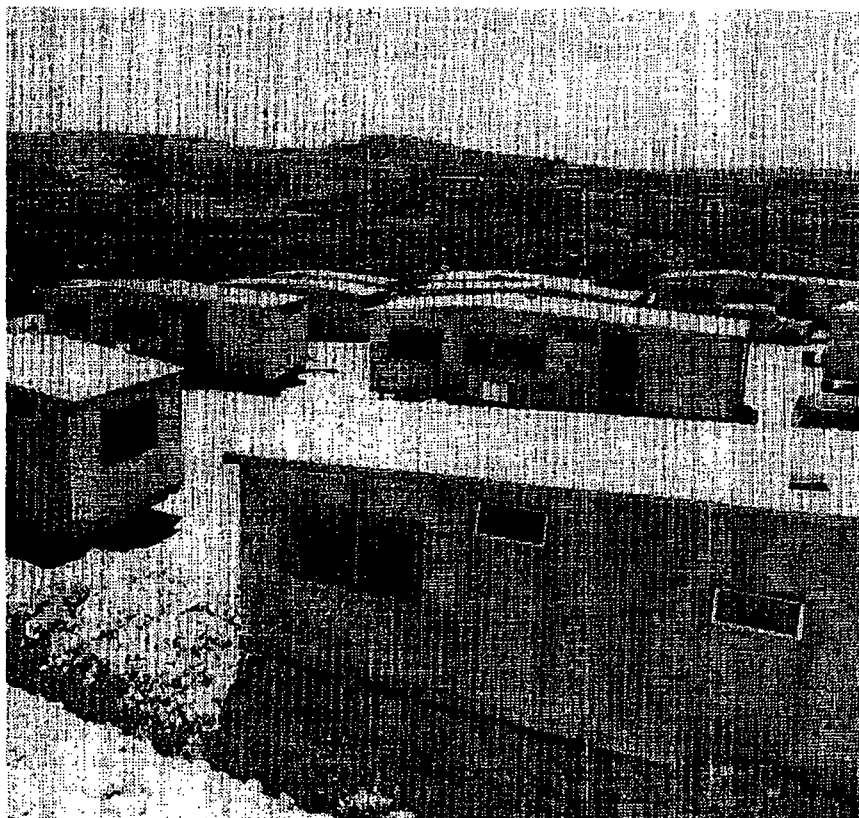
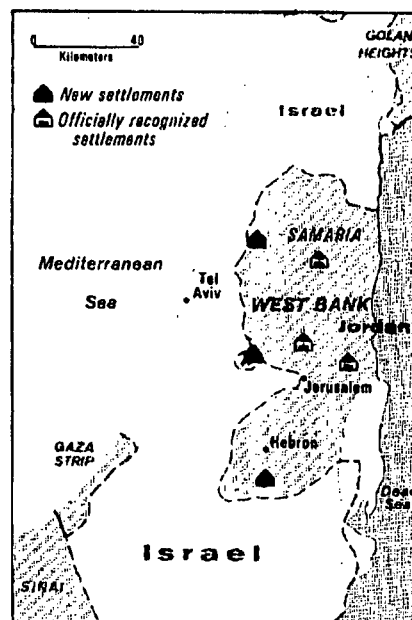
Two separate actions showed that the Begin government looks more favorably than did its Labor Party predecessor on the proliferation of Jewish settlements in the occupied territories. In an initial move in late July, the government officially recognized three West Bank settlements that had been set up some time ago by the ultra-conservative Gush Emunim organization near heavily Arab-populated areas of Samaria district. The former Labor cabinet had denounced one of the settlements as illegal and had never formally accepted the other two, although it had unofficially tolerated them.

On August 17, the government went a step further and approved the establishment of three new settlements on the West Bank. Two will be located along the western edge of Samaria. The third is to be located south of Hebron near areas heavily populated by Arabs and will be set up by followers of Gush Emunim which has plans for another settlement nearby. In an attempt to defuse anticipated US and international protests, a government spokesman emphasized that the Labor cabinet had approved all three settlements in principle.

Earlier this week, the government announced it was extending to Arabs in the West Bank and Gaza Strip health care and other social services enjoyed by Israeli citizens. Brushing aside charges of

"creeping annexationism" by the opposition Labor Party, government leaders defended the decision as "humanitarian." They said, however, that the government would not change the legal status of Arab inhabitants without the approval of the Knesset.

Palestinian spokesmen have attacked these recent actions by Israel. They have called for an increase in military operations inside Israel to protest the "annexationist" moves. Palestinian moderates probably are particularly dismayed by the Israeli actions, which are likely to make it more difficult for leaders of the Palestine Liberation Organization to agree on any public gestures of moderation in order to gain a role in future Middle East peace talks. This may have been one of the Israelis' objectives in planning their West Bank moves.



A recently legalized Israeli settlement on the West Bank

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