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PUBLIC POLICY LIMITS
IN THE ISRAELI DEFENCE INDUSTRY

by

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Submitted January 2006
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ABSTRACT

Scholars and journalists have criticised Israel’s governmental system as ineffective or unstable, pointing at shortcomings in its policy-making capabilities. However, explanations of what limits its performance have been partial, as they focus on formal attributes of government institutions or the characteristics and interactions of individuals and groups. They have neglected the causal relationship between institutional features, public policy decisions and capabilities.

The study seeks to address this gap in academic literature by offering an in-depth view into the system’s workings. It investigates the policy implemented by the Labour government in the defence industry, Israel’s largest manufacturing sector, when it sought to streamline and reorganise Israel Military Industries (IMI), Israel Aircraft Industries (IAI), and Rafael during their financial crises in the early 1990s.

In each case, access to sources and documents enabled the intricate chain of events to be traced and disentangled. The study shows how past policy choices and institutional constraints can influence the government’s ability to implement a chosen policy and impose financial losses on organised interests. By identifying how the institutional framework affects the actors involved, the study sheds a light on the constraints that shape policy outcomes. It argues that elected policy-makers preferred to maintain existing institutional arrangements, despite the serious impediments they posed to government, rather than forcing a particular policy on a reluctant constituency. The result was that some government capabilities remained impaired.
CONTENTS

List of Tables 6
List of Figures 6
Acknowledgements 7
Glossary 8
Symbols and currencies 8
Unpublished official papers 8

INTRODUCTION 9
State of Research 11
Research Design 13
The Theoretical Framework 17
Policy-making and Government Capabilities 23
Why Israel? 25
Research Scope and Methodological Limitations 28

CHAPTER 1
Assessing Israeli Government Capabilities 33
The Theoretical Path: New-Institutionalism 34
Assessing Institutional Influences in Israel 39
Israel’s Institutional Evolution 44
The Pre-state Institutional Legacy 44
Gradual Erosion of Legislature Authority 47
Rise and Demise of the ‘Party State’ 50
Empowerment of the Judiciary and Bureaucracy 55
Interest Group Influence 62
Israeli Government Capabilities: Tentative Propositions 66
Alternative Explanations 69

CHAPTER 2
Actors and Structures in the Defence Industrial Base 73
Main Components of the DIB 74
State Ownership and Control in the DIB: Vision vs. Reality 80
Duties and Roles of Main Actors 82
State owned enterprise 83
Defence Establishment 86
Government Bureaucracy 88
Interest Groups 93
Relational Patterns among Main Actors 95
IDF vs. MoD: Dilemmas of Preparation and Preparedness 95
Defence Establishment vs. Treasury: Bureaucratic Turf Wars 102
MoD and State-owned Defence Enterprises: Dilemmas of Divided Loyalty 109
Conclusions 113

CHAPTER 3
The Path from Success to Crisis 116
Seeking Self-sufficiency in Arms Production 116
Patterns of Accelerated Growth 126
Industrial Adjustments in the 1990s 133
Putting the Defence Industry on the Government Agenda 142

Bureaucratic Infighting 151
Conclusions 155

CHAPTER 4
Policy Implementation in the IMI Crisis 160
Passing the Buck to Rabin 160
Battling for Public Opinion 169
Setting the Political Stage 176
Cabinet Showdown 182
Unravelling the Recovery Plan 192
Labour Reduction: Delays and Cost Overruns 192
Political Opposition to the IMI Restructuring 195
Sales: Diminishing MoD Orders 202
Credibility Crisis at IMI 205
New Constraints on IMI 215
The Undoing of IMI’s Partnership Strategy 222
Conclusions 225

CHAPTER 5
Policy Implementation in the IAI Crisis 237
First Signs of Difficulties 237
Negotiations with the Workforce 243
Further Signs of Decline 253
Negotiations 264
The Premier's Involvement 266
Rabin's Brinkmanship 271
Conclusions 285

CHAPTER 6
Policy Implementation in the Rafael Crisis 291
  Government Conflict Management 291
  Inter-ministerial Tension 293
  Rafael's Restructuring Plan 295
  Effects of Unplanned Growth 297
  Government Reaction 302
  The Unions' Challenge: Lobbying and Legal Action 306
  Government Decisions 310
  In Search of Winning Strategies 314
  Implementation: Protests and Litigation 321
  The Impact of Rabin's Assassination 333
  Conclusions 339

CHAPTER 7
Cross-case Comparison 345
  The View from the Top 345
  Effects of institutional veto points 348

GENERAL CONCLUSIONS
Policy Capacities in the Israeli Defence Industry 354
  A Broader Research Agenda 358

INTERVIEWS 361

BIBLIOGRAPHY 366

APPENDIX A: GLOSSARY OF FINANCIAL TERMS 385
List of Tables

Table 2.1: Areas of responsibility of actors involved in the DIB 84
Table 3.1: Military research areas that facilitated civilian applications in Israel 122
Table 3.2: Israel’s progress in weapons and military technologies 127
Table 3.3: The state-owned defence enterprises in 1991 141
Table 7.1: Outcome and policy implementation (June 1992–May 1996) 347

List of Figures

Thesis Structure 14
Figure 2.2: Functional and hierarchical divisions in the DIB 103
Figure 3.1: Israel’s defence exports 134
Figure 3.2: Defence R&D investment in Israel 136
Figure 3.3: Employment through MoD’s orders in the local defence firms 139
Figure 3.4A: Principal expenditures of the defence budget (1986) 153
Figure 3.4B: Principal expenditures of the defence budget (1996) 153
Figure 4.1: IMI business results: projection vs. actual 161
Figure 4.2: IMI business indicators 184
Figure 4.3: Location of IMI’s Factories 188
Figure 4.4: IMI sales distribution: projection vs. actual 203
Figure 4.5: IMI recovery plan: workforce reduction and business results 206
Figure 4.6: IMI business results under Rabin–Peres government 226
Figure 5.1: IAI sales distribution 241
Figure 5.2: IAI: contracts and backlog 255
Figure 5.3: Location of IAI’s factories 275
Figure 5.4: IAI’s business indicators 284
Figure 6.1: Rafael: profit and cash flow 297
Figure 6.2: Rafael: sales distribution 299
Figure 6.3: Rafael: financial performance and workforce 300
Figure 6.4: Unemployment rate: northern districts vs. national 303
Figure 6.5: Location of Rafael’s main plants 306
Determinants of government policy capabilities in Israel: suggested illustration 360
Acknowledgements

The author is indebted to Dr Neill Lochery, Director of the Centre for Israeli Studies, University College London, and the author's supervisor, for his constructive advice since October 2001, and to Prof. John Klier and Dr Ada Rapoport-Albert of the Hebrew and Jewish Studies Department at University College London for their support.

Several organisations assisted the author: the Israel Ministry of Defence, Israel Ministry of Finance, Israel Aircraft Industries, Israel Military Industries and Rafael all provided archival assistance in the early stages of the research. The Graduate School of University College London provided funding for study trips to Israel and the Anglo-Israel Association and the AVI Fellowship Fund, Genève, also offered generous support. The author is also grateful to the many interviewees for sharing their insights and knowledge.

Finally, the author wishes to express his deep gratitude to his close family, his parents and fiancée, Galit, for their warm support and encouragement throughout this project. The following work is entirely the author's own, and he alone responsible for any errors in the content.
Glossary

DIA US Defense Intelligence Agency
DIB defence industrial base
DIS Defence Investigations Service of the US Department of Defense
IAI Israel Aircraft Industries
IDF Israel Defence Forces
IMI Israel Military Industries
MK Member of Knesset
MoD Ministry of Defence
MoF Ministry of Finance (also referred to as Treasury)
R&D Research and Development
Rafael National Authority of Armament Research and Development
UAV Unmanned Aerial Vehicle

Symbols and currencies

The $ and ₪ symbols refer to US dollars and New Israeli shekels, respectively. All financial details are in current prices unless stated otherwise.

Unpublished official papers

If no other source is indicated, the author holds copies of all such papers referred to.
INTRODUCTION

Time and again, the Israeli governmental system has been criticised for not being effective enough or for not being stable enough.¹ A leading Israeli commentator remarked recently: 'In Israel's 56 years of existence, there have been thirty governments, and only two have completed their terms.'² Some writers have noted that Israel is characterised by a reactive and crisis-driven policy-making style, which relies too much on politicians with short-term sectoral interests, rather than on well thought-out and long-term professional planning.³ Others have argued that there is something seriously and fundamentally wrong with Israeli democracy, and its governmental system is 'malfunctioning'.⁴

Such criticisms, which are supported by findings in comparative surveys,⁵ reflect unease with the attributes and capabilities of this system. Yet explanations of what limits its performance have been partial, at best, focusing mainly on the formal

² Yoel Marcus, 'Do not drive this country up a wall', Haaretz, 3 December 2004.
attributes of government institutions or on the characteristics, attitudes and interactions of individuals and interest groups. What such explanations have neglected is the institutional context in which these elements interact and the causal linkage between institutional features, policy decisions and capabilities. The relationship between institutions and policy outcomes needs to be illuminated, including the factors that influence government effectiveness.

This thesis examines the working of the Israeli governmental system during a policy process involving the nation's biggest manufacturing sector – the state-owned defence-industrial base. It shows how institutional constraints and the particular mechanisms relevant to the outcome of a selected case may affect certain policy-making capabilities, namely policy implementation and the imposition of financial loss on organised interests. This thesis identifies the effects of the institutional framework on political decision-making and shows how a given institutional configuration shapes political interactions and leads to policy outcomes, thus providing a better understanding of the Israeli governmental system. It also explains the operation of the political system as a whole in a specific policy sector.


State of Research

Current discussion of Israel’s governmental policy-making gives some insight into Israeli government decision-making. Some studies concentrate on a specific policy sector; others focus on the style and methods of policy-making or offer a normative account of policy analysis and how governments should structure themselves and address their policy limits. Some analyses examine Israel’s policy-making via a broader examination of political communication channels and government formation.

Many studies of Israel’s policy-making are primarily descriptive, and do not offer an explanatory framework backed by empirical evidence. Some describe the Israeli political system, or certain channels of operation, without providing a conceptual analysis of the political system as a whole and its implications for policy-making. The great majority of works on Israel’s policy-making focus on procedures

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and structures, concentrate on one aspect of the policy-making chain,\textsuperscript{12} or examine readily observable phenomena such as voting patterns and party election strategies.\textsuperscript{13} Only a handful focus on the practice of policy-making in defined sectors and policy domains, or assess the detailed formulation and implementation of policy choices,\textsuperscript{14} although they do not account for why a certain policy in a defined sector remains stable or is changed. Furthermore, there is no single study that examines policy change or continuity in the defence-industrial sector.

The literature on Israel's defence industrial base (DIB) is limited, and dominated by descriptive works. Several studies discuss the DIB structure and the factors that have influenced its operations and performance;\textsuperscript{15} some accounts offer

\begin{itemize}
  \item \textsuperscript{12} See, for example, David Nachmias and David H. Rosenbloom, \textit{Bureaucratic Culture: Citizens and Administrators in Israel} (London: Croom Helm, 1978).
\end{itemize}
historical perspectives on its growth and technological achievements. Other writers have examined the growth of the defence-industrial base as part of a broader analysis of a specific policy area, such as Israel's arms procurement or arms exports. These and other studies have highlighted important points about the main drives behind the Israeli defence enterprises and their operational attributes.

**Research Design**

Like most studies on the formulation and implementation of policies, this study is case-oriented (the figure on page 14 provides a visual description of how it is constructed and the analysis process). It investigates the plans to reorganise Israel's defence industry by restructuring and readjusting its three largest state-owned defence entities. Israel Military Industries, a 5,000-employee company specialising in ammunition, missiles and engines, underwent a major financial recovery plan between

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1992 and 1995; Israel Aircraft Industries, a 15,000-strong firm and a world leader in manufacturing satellites, aircraft and missile systems, was downsized in 1993 and 1994; Rafael, a 5,000-strong organisation within the Ministry of Defence, was the subject of a protracted restructuring process between 1994 and 1996 (which ended in 2002, when Rafael became a state-owned company).
After four decades of sustained growth in sales and workforce, these enterprises experienced a simultaneous drop in domestic and foreign orders. Their growing losses and hidden unemployment precipitated a financial crisis, which was addressed through a series of adjustment and restructuring plans ordered by the Labour government of the time. Their intended effect was to make these enterprises more flexible and efficient by reducing the workforce, lowering operational costs and relaxing managerial constraints.

Prime Minister Yitzhak Rabin stated as early as November 1992 that 'the defence industries are too big for Israel.' He stressed that they needed to adapt to changing circumstances in world markets. This, he believed, was necessary to improve the management of these state-funded enterprises and prepare them for privatisation. Differences in the enterprises' legal status, work force, geographical dispersion and expertise created the appearance that the government treated each one differently, but all three episodes (IMI, IAI, Rafael) involved the same process: implementing an industrial policy in a sector while imposing financial losses on powerful organised interest groups.

Each of the three episodes did indeed have a different outcome, but on the whole the Rabin-led Labour government was unable to meet its policy goals in full. Furthermore, although the industries' workforces were significantly reduced, especially in the cases of IMI and IAI, the workers' unions successfully fought off restructuring plans and only agreed to gradual layoffs and temporary pay cuts in exchange for expensive packages for redundant employees. All three enterprises maintained restrictive labour practices, and the Rabin government effectively abandoned plans for their privatisation. By presenting the intricate chain of events in

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each of the three episodes and explaining why their outcomes differed, this thesis seeks to draw inferences about some of the capabilities of the Israeli governmental system.

Using case studies to provide insight into substantive issues of politics requires a historical understanding of the specific episodes involved before a theoretical explanatory framework is applied. This study pieces together the story that accounts for the outcomes, identifying and exploring the mechanisms and decisions that generated them. It uses a wealth of information – official texts and reports, interviews with senior officials, politicians and experts; declassified documents from archives in Israel, the UK and the US, as well as secondary literature – to help understand the actors’ preferences and perceptions, the information they possessed, the expectations they formed, the strategies they adopted, their evaluation of alternatives and the constraints limiting their actions.

The narration of the restructuring plans provides a basis from which the research can draw tentative inferences about governmental capabilities in Israel. The research also corroborates, evaluates and adds to generalisations made in Pierson and Weaver, and Immergut21 on the effects of veto points and interest groups’ access, which these works did not explore in a low-hurdles party government system like Israel’s.

This study provides a useful reference to guide research on policy-making in Israel, and answers sharply posed questions geared to addressing issues in the

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academic discussion of government capabilities. For instance: how does Israel’s particular institutional configuration affect the government’s capacities and effectiveness? Is that configuration, at a macro-institutional level, ‘systematically biased’ against certain policy capacities in the sphere of the military industrial sector?

More specifically: what is the impact of intermediate institutional mechanisms on policy implementation in Israel? Do they hamper the government system’s capacity to implement policy that includes imposing financial loss on powerful organised groups? Is this situation unique to the defence-industrial sector, or is it applicable in other policy areas that involved organised interests?

The Theoretical Framework

Answering these and other broad substantive questions involves analysing actual experience. This requires a conceptual approach that can provide the appropriate framework and give theoretical guidance for collecting and analysing the empirical data. In public policy analysis a broad range of analytical methods can provide convincing accounts, including the new-institutional approaches, group and network approaches, rational-choice theory and idea-based approaches. (The different methods are separated here for convenience of exposition, although in reality they are intertwined.)

Institutional and new-institutional approaches put political and macro-constitutional elements at the heart of the analysis; they view these as structuring policy decisions and outcomes, hence they see institutions as affecting a government’s policy-making capacities. Group and network approaches suggest that associations

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and informal relationships, within and outside political institutions, shape or determine decisions and outcomes. Idea-based approaches focus on ideas, knowledge and doctrines as sources of solutions to policy problems; they have a life of their own, circulate and gain influence independently of interests in the policy process. Each method claims to be able to explain why policies differ across sectors and countries, and why some of them remain stable, change, or fail.

Here it is argued that, notwithstanding its limitations, the new-institutional approach is a suitable explanatory framework. In the 1970s and the 1980s new institutionalism 'rediscovered' institutions as a central subject of political research and moved away from the study of behaviour as the main element of analysis. Mainstream behaviourist theories focused on informal distributions of power and on the attitudes and political behaviours of individuals and groups to explain political outcomes, rather than on the formal attributes of government institutions. Hence they often missed crucial contextual elements, for example, the impact of the institutional landscape on the capacity of non-state actors, such as interest groups, to block policies. Concepts like 'policy legacies' or 'path dependence' (referring to the notion that current or new policies are constrained by earlier policy choices which often dictate the outcome of policy events\(^2\)\(^3\)) provided a powerful corrective to the implicit

behaviourist assumption that each decision constitutes a new roll of the political dice.24

Institutional analysis can provide powerful insights into the policy process in the case study at hand. Whilst the accounts of IMI, IAI and Rafael relate to state-owned enterprises with similar characteristics – all three operate in the defence sector, employ organised labour and manufacture weapon systems – the policy implementation and outcome of each episode was quite different. In IMI’s case, the Rabin government achieved most of its policy targets, albeit after much delay and at a higher financial cost than originally envisaged. In the case of IAI it made substantial compromises and gave up key policy objectives. With Rafael the government failed completely; its original objective was achieved only eight years later.

Here then, is a puzzle. How did a powerful and pervasive governmental machinery, whose influence over the economy is unprecedented among democratic regimes25 – the state controls or oversees most activities, from the labour market and infrastructure to the credit market – come to achieve such mixed results and to demonstrate at times patchy and seemingly inconsistent decision-making?

Institutions may explain this. Embedded in the organisational configuration of the polity, they surround elected and appointed decision-makers and structure


relations between individuals and groups.\textsuperscript{26} Institutions, therefore, are not merely ‘neutral arenas within which political behaviour, driven by more fundamental factors, occurs’;\textsuperscript{27} they are themselves a factor, influencing both behaviour and outcomes. Furthermore, by structuring the processes through which policy decisions are formulated and implemented and by constraining the choices open to the decision-makers, institutions strongly affect their governing capacity.\textsuperscript{28} Their effect can be direct or mediated by the broader socio-economic structure within which they operate.

The new-institutional approach has several important advantages. Institutions are more readily identifiable. In their simplest definition, they are the formal structures of government, presidential or parliamentary, that persist over time. Hence, all variants of institutionalism rest on the assumption that ‘the rules and systems of rules in any historically given society not only organise and regulate social behaviour but make it understandable, and in a limited conditional sense, predictable for those sharing in rule knowledge’.\textsuperscript{29} Their continuity creates greater regularity in human behaviour than would otherwise exist and enhances the explanatory and predictive capacity of political sciences.\textsuperscript{30} Individuals appear to be the primary driving force behind policy events, but they are not a permanent feature in any institutional

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structure: they come and go, change positions, resign or are ousted from office – sometimes they are even assassinated. Institutions, on the other hand, are likely to remain, and their presence enables researchers to predict behaviours and to test hypotheses that might not be possible without these structures. Indeed, following on from Huntington’s point about political development and the importance of structures that mediate between society’s demands and government, institutions create the predictable, regular behaviour necessary for a peaceful and effective political system.

In the case of the Israeli defence industry, intermediate institutional mechanisms – particularly the number and location of veto points in the government system and their influence over the policy-making process – determined when and how the government introduced and implemented policy regarding these enterprises. This study will show that policy outcomes can be explained by the opportunities and constraints created by the specific institutional configuration involved. These enhance and limit the options, perceptions and preferences of different actors, thus affecting some policy-making capabilities. Certain actors, like organised labour groups, can thwart policy implementation and the imposition of financial loss by using veto points, which exist both inside and outside the policy-making process. Finally, the Israeli governmental system’s capacity to implement policy and impose financial loss is restricted by non-institutional factors, such as agenda congestion, past policy choices and established practices of negotiation and settlement.

Critics point to several weaknesses in the institutional and new-institutional approaches. Actors and groups, for example, often circumvent institutions in pursuit of their interests, or use their resources to gain access to the decision-making process.

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Interest groups also have the resources to ensure that politicians and bureaucrats respond to their interests, whatever the legal and constitutional hurdles are. In certain cases, it is the realignment of political forces, rather than institutions, that explains new policies. Another difficulty is how to measure and assess the effectiveness of a given institutional set-up and its different elements.³²

Notwithstanding the above, institutions have a profound influence, not only because they embody legal and procedural arrangements and act as the formal apparatus of government, but also because they comprise norms and conventions of behaviour. They represent normative aspirations, which in turn affect the power of groups and individuals in the policy process. They are deeply rooted in a country's history, largely inherited and are not open to easy modification.

The institutional structure, therefore, has a significant impact on the executive as well as on the interest groups who wish to influence policy. Within this set-up, leaders and competing interests operate and are evaluated. Heads of states and leaders of interest groups could choose to ignore the rules, try bypassing them or forcibly abolishing them (even though the last of these options would fall outside the realm of acceptable democratic politics). The institutional structure of the polity is therefore crucial for understanding of the dynamics and outcomes of the policy process.

Policy-making and Government Capabilities

Before turning to the impact of national institutions on political actors in Israel, it is worth considering some issues related to policy-making. Many accounts of how public policies are made divide the process into five phases: societal demand, political interaction, policy proposal, policy decision and policy implementation. These can be viewed as a sequence set in a broader political, economic and social context which generates demands for policy. Policy means things that governments do or do not do: actions, inactions and proposals that affect people, values and financial resources. As policy is produced, so it has effects on that context, and these lead to other demands for policy or demands for a different policy, and so on. The way this sequence works in practice changes from one specific policy setting to another, and may vary between policy domains.

The actual policy process does not correspond to this linear model except in the minimal sense that a formal policy has to be proposed, legislated and then implemented. However, the distinction between phases helps to identify different kinds of activities and different types of actors involved with each, even if their role and involvement does not necessarily start or finish at the beginning or end of particular phases. The issues, bargaining patterns, and the structure of opportunities and constraints in each policy sector create a particular type of politics that may or may not resemble that suggested by national political traditions and norms.

The relative influence of politicians, bureaucrats and interest groups differs according to the nature and perceived importance of the policy sector, be it security,
health or education. Each sector should be studied in its own right; it has politics of its own, a unique blend of attributes and problems, and different combinations of producer and consumer interest groups that conflict or co-operate to achieve common or group-based goals. These relationships within policy sectors affect the type and degree of party competition and the extent to which bureaucrats and ministers have and exercise power.

Between policy and politics causation works in both directions: the two affect and shape each other, and are not only influenced by constitutional traditions. The effects of institutions on policy-making can therefore be conceptualised in terms of what government can do in a coherent and co-ordinated way. In a thoughtful analysis of the effects of political institutions, Weaver and Rockman distinguish ten specific policy-making capabilities, regardless of the policy objectives and the institutional structure of governments: the ability to set and maintain priorities; to target resources; to innovate when old policies have failed; to co-ordinate conflicting objectives into a coherent whole; to impose financial losses on powerful groups; to represent diffuse, unorganised interests; to ensure effective implementation; to ensure policy stability; to make and maintain international commitments; and to manage political cleavages.34

This list is not exhaustive, but it does capture most of the tasks expected of government. Weaver and Rockman also note that these capabilities are not independent of each other, nor should we assume that certain capacities fit, or relate to, some policy sectors better than others. Rather, they should be assessed as a whole

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(bearing in mind that in certain cases some capacities are more evident than others) in the light of the task at hand.

At the root of each capability lies the fusion or separation of executive and legislative power. Parliamentary systems reflect more fusion of power and greater centralisation of decision-making in the cabinet. Heads of government are usually selected by the legislature, and their tenure depends on retaining its confidence. The broader the legislative support, the stronger the concentration of executive power, and presumably the higher the chances of successfully implementing a policy. However, more often than not, governments encounter difficulties in execution or discover that a policy is inadequate. Tracking who participates in the decision-making process and assessing the attributes of decision-making and how they affect the way these actors make key decisions can help us understand (and later to explain) why policies change or fail. The main objective of this thesis is to evaluate some of the generalizations in Weaver and Rockman's and Immergut's studies by adding another case – Israel – and thereby to contribute to the study of public policy and comparative politics.

**Why Israel?**

Choosing Israel to illustrate the workings of political institutions has some limitations. The country is relatively small, both in size and population, and has distinctive characteristics and policy dilemmas which differ in detail and intensity from those of other countries.

Closer examination, however, suggests the distinctiveness argument is flawed. As a western-style democracy, with freedom of political discussion, orderly changes of government and a highly developed economy, Israel is not significantly different from other countries in this category, like Australia or the countries of North America and Western Europe. It has the political structure and formal procedures of a
parliamentary democracy, and its politicians and policy-makers cope with severe and pressing problems much like their counterparts in other democracies. Notwithstanding differences in priority and presentation among parliamentary democracies, several policy issues – public education, health services, public transport and housing, to name a few – are common to all these countries, and they reflect continuous and usually consistent commitment by the state to the welfare of its citizenry.

This thesis is designed to allow for transnational comparison and offers some clear advantages as a multi-case study. First, the study focuses on policy-making and the relationship between institutions and policy-making capabilities in Israel, but its design – a structured narrative of episodes, which, at the second stage, is assessed in terms of a theoretical framework – makes it usable for comparisons in political science, especially comparisons of policy implementation between nation states. Secondly, given the importance of Israel in the Middle East, an insight into the working of the Israeli institutional set-up and policy-making process is useful and important. And finally, Israel – with its strong organised unions, institutionalised labour protection and unstable political system – offers a fascinating case study of the effects of political institutions and interest groups on policy-making capabilities. As Gitelman and Sharkansky note, Israel, with its numerous divisions (religious, ethnic, ideological) and unstable geopolitical conditions, makes a useful laboratory for studying how a democracy functions in extreme conditions. And, even if one overlooks Israel’s particular characteristics, understanding how a government operates

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in strained and intense circumstances provides insight into democratic institutions and into how democracy does and does not work, and why.

The specific case of restructuring Israel’s defence-industrial base is important as well. The Israeli government dominates the sector, controlling about 70% of it (in terms of output and workforce), compared to the European average of 15%. And the defence enterprises themselves provide an exceptional net contribution to Israel’s economy; a recent study puts the overall financial input of the Israeli defence industrial base (DIB) at 3.3% of GDP in 2000, a far higher figure than applied in the US (1%), France (0.9%) and the UK (1.6%).

The necessarily secretive nature of this sector puts substantial difficulties in the way of external scrutiny and has prevented a systematic examination of policy-making in the sector until now. Defence-industry restructuring was also the most ambitious industrial policy undertaken in Israel’s history, politically, operationally and financially. There was no plan for such far-reaching structural reform in any other industry during the 1990s. Furthermore, those affected – a large group from all segments of society and distributed throughout the country – were not closely identified with a particular party. All parties sought the electoral support of defence-industry workers, whose combined vote was equivalent to the electorate of three or more of the Knesset’s 120 seats at the beginning of the 1990s. This made it impossible to see mass redundancies and pay cuts in the defence industrial sector as politically costless.

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37 Ibid., p. 127.
Research Scope and Methodological Limitations

While research on the Israeli defence-industrial base has increased in the past five years, it is still limited in scope. This is partly because of certain methodological challenges: difficulty of access to research materials, and the risk of selecting cases that fit the author’s theories.

Security reasons, commercial sensitivity and political considerations determine that only limited information is publicly available, some of it heavily censored. And certain material, such as discussions of the Security Cabinet (the Ministerial Committee for National Security in Cabinet), details of military programmes and investments in defence infrastructure remain classified and will not be released in the foreseeable future. However, recent years have seen a noticeable change in attitude by Israeli authorities, with greater tendencies towards transparency and accountability becoming apparent. Defence companies’ business results and details of arms exports are now published regularly, and companies and official bodies reveal far more about themselves and their activities – including details regarded as state secrets only a decade ago, like details of the development of new weapon systems. This has helped to build up a more accurate picture of the defence sector’s activities, and complements the wealth of information obtained during the author’s research in Israel and abroad.

Interviews and unpublished sources form the essence of this thesis. Primary sources, including decision documents, internal memos and protocols of discussions at various levels and loci of decision-making have been consulted and analysed. Documents have been collected from the Israel MoD and IDF archive, the UK’s National Archives and the National Security Archives at George Washington University, Washington DC. However, even in these places it was not possible to
obtain unfettered access to all possible material, as many documents are still classified. Some documents were obtained through private sources.

Critical paths of decision-making were checked through multiple sources. Senior officials and prominent personalities who took part in the policy process during the period of the research were interviewed, including present and former politicians (among them former prime ministers), leaders of labour unions and former civil servants. The discussions, in the form of open-ended interviews, were grounded around the same themes, and the interviewees were free to express themselves in an unscripted manner.

Almost all the interviews were conducted after the events, when many of the interviewees had already retired or moved on to other positions. One could assume that their views might therefore be skewed, geared to different audiences at different times, and so might differ from their original or real point of view. The author also accepts that some interviewees did not share all their information, nor did they divulge sensitive details – either for personal reasons or out of concern that this might reveal tactics that could be employed in future political battles. With this in mind, the interviewees’ accounts were supplemented and cross-checked against secondary sources and selected literature, including pamphlets and personal memoirs. The author also made extensive use of the archives of newspapers, differentiating between opinion articles and news reports for the purpose of gathering as much factual information as possible. To ensure consistency in the interpretation of historical and documentary evidence, the author has heeded King, Keohane and Verba’s assertion
that 'the most important rule for all data collection is to report how data were created and how we came to possess them.'

Some critics of institutional analysis, and especially of historical institutionalism, claim that case studies and small-n comparisons cannot generate valid knowledge, because cases are not selected randomly, and there may not be enough statistical 'degree of freedom' to test all conceivable hypotheses rigorously.

Others are concerned that the institutionalists' proclivity for tackling significant issues predisposes them to 'selection on the dependent variable': choosing cases where a phenomenon of interest has occurred, while ignoring the instances where it has not.

Another criticism concerns the absence of an unproblematic 'historical record', when political scientists use history as a laboratory for theory development and testing.

These are valid points, but one should consider that in all research traditions, whatever theories or research methods are deployed, individual works build upon one another, often extending lines of analysis, retesting arguments and correcting earlier assumptions and generalisations. Some historical institutionalist scholars have focused primarily on the theoretical characteristics of arguments about temporal causality, but their reflections also set empirical standards to be met in case analyses and

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40 Geddes, 'How the Case You Choose Affect the Answers You Get'; King, Keohane and Verba, *Designing Social Enquiry*.

41 Ian S. Lustick, 'History, Historiography and Political Science: Multiple Historical Records and the Problem of Selection Bias', *American Political Science Review*, vol. 90, no. 3 (September 1996), pp. 605–618.
comparative studies that aim to establish the presence of causally relevant processes or events.

Methodologically oriented works have also made the case for circumstances in which in-depth case studies and small-n to medium-n comparisons are an optimal research strategy.\textsuperscript{42} Random selection of cases is often not appropriate, and it is far from the only way to test hypothesis rigorously; hypotheses can be tested even when scholars cannot sample large numbers of truly independent cases. Alternative strategies for causal inferences were developed and applied because there are important advantages, intellectual and practical, to focusing research agendas on a small number of cases, including instances of substantively compelling outcomes and arrangements that we want to explore and understand.\textsuperscript{43}

The choice of this particular multi-episode case study stemmed from professional interest in the subject matter. Personal considerations aside, though, the author argues that this study offers a multitude of empirical observations that can be used for formulating and testing hypothesis about the mechanisms that connect causes to effects. It offers a rare opportunity to examine and evaluate the Israeli government system in action, building on, and adding to, an explanatory framework that has been used in multiple case studies.

The thesis employs historical analysis to trace the evolution of policy over a long period. Notwithstanding the limitations noted earlier, the chronicle of events


\textsuperscript{43} Paul Pierson and Theda Skocpol 'Historical Institutionism in Contemporary Political Science', in Ira Katznelson and Helen Milner (eds.), \textit{The State of the Discipline} (New York: Norton, 2002).
presented in subsequent chapters should be treated as if it were, so far as is known, a
description of what actually took place in the past. The use of this method was
dictated by the nature of the research problem: government capabilities cannot be
observed directly but must be inferred by looking at policy outcomes, and this
requires retracing the decision-making patterns and characteristics through which
government capabilities are channelled. Choosing a single case, or a case with a small
number of episodes, makes the analytical inquiry more explicit in its efforts to
demonstrate how institutions influence political outcomes, either through path
dependence, empowering certain actors, or constraining the preferences of political
actors. It also emphasises the causal significance of institutional arrangements and
structures.

As noted earlier, the main aim of the research design chosen here was to invite
other scholars to evaluate, replicate and extend the analysis to other case studies in
different policy areas. The measures and caveats specified here afford some protection
against biased case selection and a skewed interpretation of findings; however, readers can decide for themselves after examining the case evidence.
CHAPTER 1
Assessing Israeli Government Capabilities

What enables or impedes policy-making has been a central concern in the literature of comparative politics and public policy analysis. Elected leaders are expected to address their publics’ demands by devising and implementing new policies that replace outdated or defunct ones. However, their ability to do this depends as much on their personal traits as on the attributes of their country’s political process and institutions.

What, then, determines a society’s capacity to adjust its policies in the face of changed circumstances or the failure of previous policies? What determines the ability to sustain policies long enough to elicit adequate responses from political actors? This chapter attempts to provide a basis for answering these and related questions in the context of the Israeli government system. It proposes an explanatory framework that identifies the determinants of the country’s public policy-making and points at ways in which its political institutions shape and influence policy outcomes.

The first part of the chapter explores the usefulness of new-institutionalism as a conceptual tool that guides the study of government capabilities. Then follows a discussion on determinants of policy-making, which highlights the factors that affect overall policymaking effectiveness and identifies the dependent variables for this research. The second part of the chapter discusses the formation of Israel’s institutional landscape, highlighting the significant developments and factors that influence the country’s decision-making processes. The final part compares and contrasts the explanatory framework offered here with some alternative perspectives.
The Theoretical Path: New-Institutionalism

The role of political institutions in the policy process is of central concern to political science. March and Olsen argue that

Political democracy depends not only on economic and social conditions but also on the design of political institutions. The bureaucratic agency, the legislative committee and the appellate court are arenas for contending social forces, but they are also collections of standard operating procedures and structures that define and defend interests. They are political actors in their own right.¹

That institutions provide the strategic context in which political actors make policy choices is common ground for both major analytical traditions within new institutionalism – historical institutionalists and rational-choice institutionalists. Institutional contexts, they argue, frame actors' strategic choices and define the role of policy entrepreneurs and organised interests, thereby shaping public policy.² Political institutions influence the policy process by limiting the nature and scope of political actions, by placing constraints (i.e. rules and norms) on political actors, and by insulating political elites from public pressures. New-institutionalist scholars have thus offered explanations both for variation in policy outcomes in several countries and for policy continuity and change within countries.³

Some institutionalist accounts concerned with explaining broad and enduring patterns of public policy show that conflicts over policy are structured by political interests and institutions created as a result of earlier decisions. Such societal and state institutions shape how political actors — individual, collective and corporate — define their interests and structure their power relationships with other groups. Because of the constraints of rules and norms of conduct, when making decisions these actors do not ask ‘how do I maximise my interests in this situation?’, as rational-choice scholars would argue, but ‘what is the appropriate response to this situation, given my position and responsibilities?’. In other words, rather than being utility maximisers, political actors are utility satisfiers. Another insight advanced by historical institutionalists concerns ‘path dependency’ (the idea that, once a particular policy is chosen, it is difficult to change it — even when it outlives its usefulness — because of the expensive and laborious process of agreeing a new policy) and the accumulation of historical commitments as defining future behaviour.

This dissertation, therefore, attempts to illuminate how institutional analysis can account for policy-making effectiveness, assessing inter alia the extent to which competing institutional actors have the power to influence political decision-making. A meso-level account, it aims to explain inter- and intra-organisational relations

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within a single political system and in a particular policy area, specifying institutions as a central explanatory variable. However, as Thelen and Steinmo point out:

Institutions constrain and refract politics but they are never the sole ‘cause’ of outcomes. Institutional analyses do not deny the broad political forces that animate various theories of politics ... Instead, they point to the ways that institutions structure those battles and, in so doing, influence their outcomes.7

This view was echoed by March and Olsen, who contend that ‘while institutions structure politics, they ordinarily do not determine political behaviour precisely’.8 Policy outcomes, therefore, can be appreciated fully only by understating the complex interaction between political actors and the institutional framework.

A policy outcome is contingent on a number of historically embedded, country-specific factors, so one must unravel the historical episode to examine, explore and understand the process and the causal factors that brought about that outcome. Despite Bismarck’s view that ‘Laws are like sausages – it’s better not to see them being made’, tracing the evolution and implementation of policies – as discussed in the following chapters – is essential for assessing the effect of institutions on Israel’s policy-making capabilities.

Before embarking on this, though, we need working definitions of two key terms used in this thesis: effective government (or governance) and institutions.

Governments across the world differ greatly in their ideologies, political support bases and policy inheritances. These and other factors affect their performance – but how one defines and measures governmental effectiveness has not been universally agreed. As Dunleavy and his colleagues note, when one attempts to assess a policy outcome it is almost impossible to trace exactly what is due to

7 Kathleen Thelen and Sven Steinmo, ‘Historical Institutionalism in Comparative Politics’, in Steinmo, Thelen and Longstreth (eds.), Structuring Politics, p. 3.

government action and what to other, often structural and institutional factors. Furthermore, there is no universally accepted standard for what constitutes effective governance. What is seen as desirable and effective by one scholar might be contested by another.

However, the academic literature suggests some criteria for measuring government efficiency. One possibility is to determine a government's effectiveness by its ability to implement the policies it advocated during the election campaign. If it has met its manifesto commitments, then it has acted effectively. Another widely used way of evaluating government effectiveness is to measure the populace's well-being via acceptable indicators like human development (literacy, life expectancy, infant and maternal mortality, access to safe water and basic care, etc.) or economic performance (gross domestic product (GDP), GDP per capita, national debt, inflation and balance of payments). A third common criterion is the government's responsiveness to the will of the populace through particular policy outputs – for example, increased spending on public services – while keeping other commitments intact. However, these specific outputs are a matter of political choice and therefore may vary across different countries.

For the purpose of this study, government effectiveness is assessed by the ability to perform and implement specific tasks. This thesis examines the performance of the Israeli governmental system and asks what it is that limits its ability to impose financial losses on powerful interest groups and to effectively co-ordinate and

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implement a chosen policy in a specific sector. These capacities are the dependent variables for this study.

Defining *institutions* has also caused some controversy in the academic literature, as the term does not have any single, clear and consensual meaning. This is regarded as a problematic concept, encompassing norms, practices, rules and organisations.\(^\text{11}\) Some writers tend to focus narrowly on sanctioned rules that effectively change the costs and benefits that an actor can expect when following a certain course of action.\(^\text{12}\) Others stretch the meaning to include not only social norms or entities capable of purposive action\(^\text{13}\) but also things as diverse as the structure of labour–capital relations and the position of a country in the international economy.\(^\text{14}\) In all cases, an institution (some scholars use the term structure\(^\text{15}\)) is an enduring organisation or practice that allocates, or at least significantly affects the allocation of, important values like prestige, status, wealth and education.

In this thesis, the term ‘institution’ encompasses the structural framework through which a state’s policy-makers (elected and non-elected) take decisions. It refers in particular to formal institutions of government (the executive, the legislature and courts), as well as to the values, norms and informal conventions that govern social exchanges between actors. Arguably, this definition is wide but nevertheless necessary, because values and norms ‘frame’ the way actors perceive the options open

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12 North, *Institutions, Institutional Change and Economic Performance*.
13 March and Olsen, *Rediscovering Institutions*.
14 Hall, *Governing the Economy*.
to them. Dominant rules (like majority voting among cabinet members) or informal practices (such as the unwritten goal of seeking consensus whenever possible) can mould the behaviour of national government representatives in ways that governments neither plan and envisage nor control. This argument might counter one of the main criticisms levelled at the new-institutional approach: that it crams too many aspects of political life into one category, to the point of making them indistinguishable.  

Assessing Institutional Influences in Israel

Political institutions structure the pathways via which policy decisions are made and influence their characteristics; these characteristics strongly affect the polity's governing capacity. The institutional structure of the polity is therefore particularly important because it shapes the public policy-making process, determining which issues and problems are given consideration and in what order.

Weaver and Rockman argue that varying institutional constraints, such as electoral rules, norms of government formation and government types, lead to decision-making processes that differ from one political system to another. These differences encourage or discourage certain types of attributes, such as the level of party discipline in the legislature, the degree of centralisation of legislative power in the cabinet and the degree of accountability. These and other factors affect the capacity of government to perform certain tasks (see Figure 1-1).

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16 John, *Analysing Public Policy*, p. 64.
17 North, *Institutions, Institutional Change and Economic Performance*.
18 Weaver and Rockman, 'Assessing the Effects of Institutions', pp. 7-9.
Figure 1-1: Determinants of Policy-making Capabilities

Institutional constraints

encourage or discourage certain types of

Attributes of decision-making processes

that enable or deter the emergence of

Policy-making capabilities

that influence the government’s ability to make strategic

Policy choices

that influence but do not necessarily determine the quality of social and economic

Policy outcomes

Source: Weaver and Rockman, *Do Institutions Matter?*

The causal link between institutional characteristics and government policy-making capacities has been demonstrated in various case studies. For example, it has been argued that the concentration of legislative power and party discipline in a parliamentary system is likely to enhance governmental capabilities to target resources effectively and co-ordinate conflicting objectives, by providing a centralised forum where alternatives can be compared directly and efficient trade-offs considered.

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19 See the case studies in Weaver and Rockman (eds.), *Do Institutions Matter?*; Thatcher, *The Politics of Telecommunications.*
Another factor to play a part in determining policy-making capabilities is the geopolitical setting within which a polity emerges.20

Since this study examines the implementation of industrial policy, it is worth noting that the academic literature has identified several prerequisites for successful formulation and execution of such policy: a political context that includes consensus on the goal of promoting economic growth through a rational industrial policy; a relatively centralised, professional and cohesive policy-making process, and sufficient autonomy from partisan political pressures; the expertise of the bureaucrats and government agencies involved, and the co-operation between the government and societal actors, which is essential in times of major policy shifts or organisational changes.21 Charting the historical circumstances pertinent to the case study, as well as the institutional set-up, is therefore essential in assessing any polity’s governing capabilities.

What, then, determines the Israeli government’s capacity to decide on and apply effective industrial policies that affect major interest groups? The hypothesis being tested here is that intermediate institutional features – the existence of multiple policy veto points inside and outside the executive, as well as the influence of broad institutions, in the form of the judiciary and the bureaucracy – greatly influence government capacity to implement policy and impose loss on powerful groups. Furthermore, the location of veto points in the course of the policy process affects the considerations applying to different actors and, ultimately, the policy outcome. Interest groups will attempt to thwart a policy proposal, first by approaching and

applying pressure on political veto players; if that fails, and the policy proposal is nevertheless approved, they will approach an institutional actor (like the courts) in order to block or delay the policy’s implementation as for long as possible until political circumstances (for example, looming elections) render it null and void.

By ‘veto points’, we mean ‘areas of institutional vulnerability’ in which the mobilisation of opposition can thwart policy innovation and implementation. In such areas, the approval of institutional or political actors is necessary in order to adopt and implement decisions binding on the polity. In the case of Israel, this means the Supreme Court, the bureaucracy (in particular, the Ministry of Finance) and senior non-elected authorities (like the Attorney General’s Office or the Civil Service Commission, which is an independent unit within the Finance Ministry), and specific political mechanisms like the inner cabinet. The power to veto political decisions is an institutional manifestation of political contestability; the more potential veto locations throughout the policy process, the greater the opportunities for thwarting policy innovation and implementation. A multi-party system (like Israel’s) is particularly challenging: as the number of political parties in a coalition government increases, so does the number of potential veto points for policy decisions. It is also argued here that the intent (perceived and real) to use these veto points, as well as their actual use, influence the tactics and choices of actors involved in the policy process; these veto points, therefore, may impede or facilitate several policy capacities (for example, innovation and implementation of policies).

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In her study of health policies in three West European countries, Immergut points to the fluid nature of these veto points in different political systems to explain why interest groups (physicians) with similar characteristics and resources had different degrees of success in achieving their objectives in the three countries. She argues that their willingness to compromise was motivated or influenced by their expectations about the likelihood of successfully appealing against a policy decision beyond the legislature.24

This study argues that the different outcomes of the three case studies, all taking place within the same political system, might stem from the different characteristics — in terms of size, resources and political clout — of the interest groups involved and (crucially) from the use they made of lobbying and appeal avenues — or veto points — open to them: in court, before state agencies and within cabinet and party settings. It is argued here that the institutional configuration in Israel, with its numerous veto locations, presents a number of opportunities to thwart policy innovation and implementation, thus placing the state’s actors — elected executive, ministries and official bodies — at a disadvantage. Non-institutional influences, such as past decisions and policy legacies, also limit and inhibit the government’s policy-making capacities, including policy innovation and implementation and imposition of financial losses on powerful groups. In order to examine the validity of these claims, our next task is to chart the institutional set-up in Israel and its likely impact on policy-making.

Israel’s Institutional Evolution

Institutions embody cultures that are distinctive to each country and its political system. The three organs of the State of Israel – the legislature, the executive and the judiciary – operate according to a relational system designed to ensure that each branch should remain within the confines of its authority, and that no branch should wield unlimited powers. According to Chief Justice Aharon Barak, the prime purpose of this constitutional structure was not to ensure government efficacy or political accountability; it was rather to ensure the liberty of the individual.25

The nature of executive-legislature relations in Israel looks similar to that in other parliamentary democracies. The state’s organs are a product of Israel’s Basic Laws, and as such were assigned equal constitutional status.26 Other important actors in policy-making are the non-elected executive (the bureaucracy or civil service) and interest groups: business organisations and professional associations representing private or public organised expressions of policy preference by a segment of the general population. (Examples are the Reserve Officers Forum, Israel Women’s Network, and the labour federation the Histadrut and affiliated trade union organisations, like the National Committee of the Electric Company Employees.)

The Pre-state Institutional Legacy

Israel’s institutional configuration has been shaped under strained conditions, being adopted in haste against a backdrop of existential threats and pressing needs, including massive immigration and nation-building. The Israeli founding elite had

26 Ibid.
hoped to replace the transitional order with permanent political institutions enshrined in a written constitution, but, faced with acute challenges, adopted the pre-state electoral and legal system that was in use under the British mandate.

This pre-state endowment included a legal and institutional framework, comprising a mixture of Ottoman Empire rules, English common law and British Mandate regulations (the last two also rooted in the doctrine of *stare decisis*, i.e. the pre-eminence of legal precedent within the Israeli system) in addition to local representative bodies that became part of the emerging Israeli polity.\(^{27}\) The Jewish community under the British Mandate (known as the Yishuv) developed organs to administer and supervise the community’s internal needs. One of them, the Executive of the Jewish Agency, functioned as a national government without sovereign status, comprising various departments similar to ministries.\(^{28}\)

The governing bodies of the Yishuv, along with the World Zionist Organisation, which represented the worldwide Jewish community, were similar in structure, with broadly-based elected assemblies in turn electing smaller bodies from their own membership. Each system’s base assembly held elections according to proportional representation of parties without reference to geographical constituencies.

The founding elite’s chosen institutional arrangement – a single national constituency and a pure proportional representation rule with a low threshold of 1% of the national vote (1.5% since 1992) – reflected the governing arrangements and


practices of the pre-state era: a multi-party system, in which each organ was structured in a pyramidal hierarchy. The two dominant institutions – the Elector’s Council of the Yishuv and the Executive of the Jewish Agency – thus became the basis for the legislature (the Knesset) and the executive (cabinet and government ministries), respectively.29

Such a configuration, inclusive and consensual in nature, catered well for the plethora of organisations, movements and parties all claiming a stake in shaping the new-born Israeli society while at the same time advocating different, even diametrically-opposed agendas.30 In such a highly divided society, the emergence of a consensual and consociational government structure was not only a reflection of Israel’s distinctive historical, social and cultural circumstances, it was also instrumental in finding common ground between ideological divides.31 Reaching consensus has proved to be a workable means of settling internal divisions and confronting geo-political challenges – including wars, terrorist attacks, heavy immigration, boundary disputes, economic uncertainty and ethnic and religious clashes – that Israel has suffered from ever since its inception.

Another decision taken by the founding elite was not to formalise the fundamental political principles of Israel in a binding, written constitution or bill of rights, despite an explicit commitment to do so in the Declaration of Independence. As soon as the various parties started debating this topic, it became a contentious and highly divisive issue, and forcing it through was deemed impractical and

29 For a discussion on Israel’s transition from community to state, see David Vital, ‘From ‘State within State’ to State’, Israel Affairs, vol. 5, no. 4 (Summer 1999), pp. 32–42.
30 Drezon-Tepler, Interest Groups and Political Change in Israel, pp. 17, 20.
counterproductive. Instead, in 1950 the Knesset adopted a piecemeal approach, which meant that the constitution would be an uncodified one, comprising separate chapters, in the form of individual Basic Laws of Israel.

**Gradual Erosion of Legislature Authority**

Coalitions consisting of several independent parties have always characterised the Israeli parliamentary system. No party has ever won an absolute majority in national elections, so the head of the party with the most elected representatives is usually asked to form a coalition government with one or several smaller and ideologically disparate parties and, if eventually successful, to become the Prime Minister. This government coalition, which represents parties holding at least 61 seats in the 120-member single house, the Knesset, controls the parliamentary system. The coalition partners agree on mutually acceptable principles and policies and divide up ministries, with the most important taken by the major party (or major parties, in the case of a national unity government).

The decision of the country's founders to adopt the parliamentary procedures of Europe – and, with its single electoral constituency and high number of competing

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32 For arguments for and against a constitution for Israel, see the Knesset website: [http://www.knesset.gov.il/description/heb/heb_mimshal_hoka.htm](http://www.knesset.gov.il/description/heb/heb_mimshal_hoka.htm) (accessed 13 January 2006).

33 Eleven basic laws have been approved since then, covering most social, judicial and political principles that govern the life in the State of Israel. A leading constitutional expert argued, however, that they lack some limiting clauses or provisions requiring that changes be made only by special majorities; these deficiencies, he asserted, rendered them unfit to be included in a future constitution. See Amnon Rubinstein, *Constitutional Law in Israel* (Tel-Aviv: Schocken, 1991), p. 449 (Hebrew).

parties, \(^{35}\) Israel is an example of a representative democracy that is more prevalent in continental Europe – meant that it has skipped the protracted evolutionary process that in other countries led eventually to the acceptance of parliamentary supremacy. However, even though the Israeli institutional system has many procedural aspects in common with parliamentary systems in Western Europe, it lacks certain checks and balances. The strong party system, from which the legislature and executive drew their legitimacy in the country’s first decades, created a unified force of power that institutionalised and centralised decision-making in the cabinet. The stronger the legislative support, the greater the latitude of executive power.\(^{36}\)

This development was a result of a gradual erosion of the legislature’s role. As in other parliamentary democracies, the only institution with popular legitimacy in Israel is the legislature, the Knesset; government derives its authority from having the confidence of the Knesset, or, if it lacks a majority there, from the Knesset’s acceptance of a minority government between elections. In principle, Members of Knesset wield significant powers: they initiate bills, ratify the executive’s decisions, amend policies and, through various committees, oversee the work of the different ministries. Collectively, they appoint prime ministers; approve new governments and dissolve ones they have lost confidence in. The legislature can also influence the substance of policies via coalition and cross-party manoeuvrings.

In practice, however, Members of Knesset have seen their powers of control and oversight diminished significantly. First, Members are not empowered individually, and their discretionary powers are limited. They are expected to support

\(^{35}\) Israel’s proportional representation system of elections attracts many lists and parties to compete. The record was set in 1999, when 33 different lists and parties formally competed; it usually ranges between 20 and 27.

their party leaders' policies (and government policies, should their party be in the coalition) or face sanctions – and to ensure party cohesion in the legislature, party leaderships employ a wealth of incentives and disciplinary measures, from placement on party lists (before the introduction of party primaries), via public and party endorsements, to promotion to ministerial positions or other coveted roles.

Secondly, the bureaucracy, which has grown in size and scope, has evolved into a power base in its own right, with strong vested interests in the public agenda and significant influence and control over the policy process,\(^{37}\) owing in part to its increased expertise, specialisation and longevity compared with other policymakers.\(^ {38}\) Foreign and domestic crises, especially the economic crisis of the mid-1980s, have reinforced the centralised power of the executive at the expense of the legislature, either through administrative decrees or through legislation. The autonomy and oversight capacity of Knesset members – for example the vetting and authorisation of Finance Ministry proposals by members of the Knesset’s Finance Committee – has been further curtailed by certain practices which undermine the ability of legislators and cabinet ministers to apply sufficient scrutiny to critical issues.\(^ {39}\)

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37 David Nachmias and Itai Sened, 'Governance and Public Policy', in Nachmias and Menahem (eds.) *Public Policy in Israel*, p. 17.
39 A prime example is bills relating to the annual State Budget and the Economic Arrangements Law being delivered late by the Finance Ministry’s budget department to cabinet ministers and Knesset committees for review and approval. These bills and their accompanying notes run to thousands of pages and contain dozens of smaller amendment bills and proposals for structural and budgetary changes; nevertheless, they are submitted under a tight deadline – the bills must passed no later than 31 December – which prevents proper scrutiny by cabinet, the relevant ministries and the Knesset. See: ‘The Preparations of the Finance Ministry for the Legislation of the Economic Arrangements Law’, *State Comptroller Report 53B*, (Jerusalem: Government Printer, 2003), pp. 33, 41–44.
Thirdly, the resources under the control of Israeli prime ministers and the powers conferred upon them by law are significant in view of their role as the head of the executive branch as well as the head of a major party. They may dismiss ministers, appoint new ones, reshuffle ministers and reorganise ministries. Their pre-eminence is further enhanced by access to administrative and professional units that assist them in official duties and day-to-day activities while providing them with a constant flow of comprehensive information, including data from privileged and classified sources (the two intelligence organisations, the external espionage agency Mossad and the domestic security service Shin Bet, report directly to the prime minister). With the help of aides and administrative staff, they direct and maintain control of the government agenda, and, occasionally, influence the public discourse through the manipulation of the mass media. These abilities and resources put the Knesset members, collectively and individually, at a disadvantage. The upshot of this and the other factors mentioned has been that the executive branch and its chief executive have become the locus of political power.

**Rise and Demise of the ‘Party State’**

A feature of the institutional makeup of Israel in its first three decades was the emergence of a single dominant party, the Labour Party (also called, at various times, Mapai or the Alignment). Its rise largely followed the classic party state model, (Hebrew); David Dery and Emanuel Sharon, *Bureaucracy and Democracy in Budgetary Reform*, (Jerusalem: Israel Democracy Institute, 1994), pp. 29–30, 32 (Hebrew); Arieh Kaspi, ‘Legislators Against Themselves’, *Haaretz Magazine*, 9 November 2001, pp. 12–13.  

On the use and abuse of statutory rights regarding the mass media by prime ministers and senior officials and their manipulation of other arrangements aiming at curtailing and channelling the flow of information, see Moshe Negbi, *Freedom of the Press in Israel: The Legal Aspect* (Jerusalem: Jerusalem Institute for Israel Studies, 1995), pp. 37–52, 159–160, 190–193 (Hebrew).
according to which an ideological party has a specific programme for governing. In order to obtain and to hold this governing power, the party organises participation, aggregates interests and serves as the link between social forces and the government. By taking the initiative and organizing groups within the party or associated organisations, it assumes the role of mediating political interaction while setting policy itself.41

In this case, a confluence of two factors helped the Labour Party to institutionalise itself as the exclusive prime policy-maker, monopolise the public agenda and permeate the policy process. These were, firstly, the strong ideological dimension of Israel's political culture in its formative years and, secondly, the penetration of like-minded organisations, first and foremost the general federation of labour, the Histadrut, in almost all aspects of organised social and economic activities.

In general, the political elite saw Israel as a welfare state responsible for the well-being of its citizens. This world view, widely held in the state's first decade, was complemented and reinforced by the Histadrut, which before the declaration of independence played an instrumental role in the build-up of the state-to-be. Universally acknowledged as the most important organisation in the country and a critical component of the 'state-in-the-making', the Histadrut allocated resources for absorbing new immigrants, operated cultural and educational centres and built infrastructure. After sovereignty had been gained the Histadrut was considered a partner equivalent in standing with the state itself.42

From the outset, the state's leadership sought to provide a substantial array of social services and public goods, and this led to the creation of a significant public

41 For an elaboration on the party model see Huntington, Political Order in Changing Societies.
42 Shalev, Labour and Political Economy in Israel, p. 23.
sector. Services, ranging from education to electricity, were provided by both government ministries and agencies or by highly subsidised monopolies, which were established and controlled by political parties. The Histadrut, which was controlled by the Labour Party and owned powerful business and financial conglomerates, continued to provide health services to about three-quarters of the population after the establishment of the state.

In the early years of independence and the next two decades, the power of the political centre was enhanced by the state’s all-encompassing functions and activities. Membership of one of the main political parties, especially Labour, became an essential ‘admission ticket’ for securing access to basic services and job offers. Politicisation was rife, with administrative positions being nearly identical to partisan positions.

As in other democracies, patronage practices played an important part in galvanizing the parties into action. The parties expanded their policy involvement and placed their supporters in positions in the government bureaucracy and in public-sector enterprises. Interest groups and organisations were co-opted directly to the party or indirectly in government policy-making, thus integrating the parties into the state. Such a configuration institutionalised cooperative arrangements (with the government, the Histadrut, the labour unions and manufacturers meeting to work out wage guidelines and national wage agreements) that marked a departure from the

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44 Arian, Nachmias and Amir, Executive Governance in Israel, p. 33.
consensual, consociational politics of the pre-state Yishuv era. In the event, the head of the dominant Labour Party became remarkably powerful in policy-making, checked only by the need to reach agreements over policy issues with coalition partners and the head of the Histadrut. Indeed, the long period of Labour dominance ensured a high degree of coherence, stability and predictability in public policy at the expense of party democracy, government accountability and effectiveness. A predictable institutional setting was also important in helping individuals form expectations about the behaviour of others and of governing institutions.

This state of affairs did not last long, however. The political parties’ grip on public administrative positions has gradually lessened since bureaucratic reforms that were introduced by the political elite in the 1950s and 1960s. In formal state bodies and institutions more merit-based, professional norms have slowly replaced party patronage practices – a process which continued throughout the 1970s and was accompanied by a series of lawsuits brought by the Attorney General’s office against senior directors and civil servants suspected of corruption.

The prime goal of these reforms was to introduce more professional, impartial conduct in the civil service and to institutionalise regulations for political neutrality.

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Although doubt has been cast on the overall effectiveness of these, two important executive departments, the Ministry of Defence and Ministry of Finance, have been singled out as having outstanding authority and impact on the shaping of public policy in Israel. Gradually, the public bureaucracy has become a salient feature covering every aspect of Israeli life, amassing vast independent resources, institutional expertise and professional prestige.

A further erosion of the Labour Party’s role and position in the Israeli body politic was noted after the experience of the 1973 Yom Kippur War, which led the public to question the aptitude of the political and military echelons. Tacit criticism, gradually intensifying over the years, contributed to the emergence of new parties, and finally culminated in the political upheaval of 1977, which removed the Labour Party from power after thirty years. This legitimised the Likud as a governing party, thus introducing party competition and a strong incentive for the two largest parties, Labour and Likud, to converge at the centre of the domestic policy spectrum, which had been increasingly taken over by the public bureaucracy and sectarian interest groups.

51 In 1989, an official public enquiry (the Kubersky Committee) pointed to shortcomings in the workings of the Israeli civil service, suggesting that Israel does not have senior civil servants with sufficient experience. See: The Public-Professional Committee for the Comprehensive Examination of the Civil Service and State Budgeted Entities (Jerusalem: Government Printer, 1989) (Hebrew).

52 Yitzhak Galnoor, David Rosenbloom and Alon Yironi, 'Reform in Israel’s Public Administration', in Nachmias and Menahem (eds.), Public Policy in Israel (Jerusalem: Israel Democratic Institute, 1999), p. 122 (Hebrew edition; the English edition cited elsewhere does not contain this chapter).

Empowerment of the Judiciary and Bureaucracy

Since the late 1970s the Israel has moved away from the party state model. It has developed instead into a complex and pluralistic society, concerned by a wide diversity of issues that has led to a crowded and disjointed public agenda.\(^{54}\) Smaller, sectarian parties increased their power in the Knesset, leading to a significant redistributive policies aiming at advancing and aiding their direct support base.\(^{55}\) Control of national resources by the political parties has weakened further as reforms of public administration have replaced the partisan sources legitimising executive power and centralisation. These developments, coupled with growing pluralism in Israeli society and the failure of the main parties to effectively aggregate and integrate the multiplicity and diversity of interests, have led to a marked decline in party membership during the 1980s and the 1990s.\(^{56}\) In response, Labour and Likud introduced reforms into the process of selecting their parties’ Knesset nominees – party primaries – in an attempt to regain their membership base.\(^{57}\)

As in other parliamentary democracies, further autonomous centres with policy veto capacity emerged: the judiciary and the bureaucracy. While the Prime Minister and the cabinet have still maintained control of the Knesset, and to a certain extent even over outcomes of cabinet decisions – through partisan forums in the form of inner cabinets (‘Our Ministers’ in Labour, and ‘Our Colleagues’ in Likud) established to ensure a co-ordinated policy stance and an agreed party line in cabinet

\(^{54}\) Arian, Nachmias and Amir, *Executive Governance in Israel*, p. 92; Arian, *the Second Republic*, pp. 228, 245.


\(^{57}\) Arian, Nachmias and Amir, *Executive Governance in Israel*, p. 158.
vis-à-vis other parties\(^58\) – their powers have become more limited and constrained, requiring them to adjust to new forms of checks and balances.

The empowerment of Israel’s professional bureaucracy is closely linked to the successful handling of the economic crisis that engulfed the country in the mid-1980s. In July 1985 the government adopted the Economic Stabilisation Programme, which involved the simultaneous implementation of several measures: devaluation of the exchange rate, stringent control of domestic prices, wage stability in the public sector, a tax increase and a $750-million budget cut that included, for the first time, a major reduction in the defence budget (see Chapter 3). Emergency legislation, with the Economic Arrangements Law (*Hok Ha-hesderim*) at its heart, was passed by Knesset to combat hyperinflation, enabling the Ministry of Finance to keep a tight grip on government expenditure.\(^59\) The central bank, Bank of Israel, also took part in the stabilisation efforts, exercising its overall responsibility for monetary policy through a series of measures aimed at keeping the economy in check, independent of government policies.\(^60\)

The Stabilisation Programme’s impact on the inflation rate, which had peaked at 445% in Fiscal Year 1984, was significant. By the end of 1986 inflation had stabilized at 20% – the lowest rate since 1972 – and fell still further in the 1990s. Many factors explain the plan’s success, but its execution was credited to the professional, imperturbable performance of the bureaucracy, and especially of the Finance Ministry, which convinced the Cabinet that maintaining firm control over the

\(^{58}\) Ibid., p. 45.


national budget process improves its effectiveness and efficiency. Although the government administration had conceived this program as a short-term one, the emergency legislation remained in force, despite Israel’s economic recovery and strong reservations of members of Knesset. The implications of this were significant: the Ministry was able to maintain a tight grip on state finances and overall spending allocations, constraining to a large degree prime ministers’ power over budgeting by ministries and individual Knesset members’ ability to promote sectarian interests.

Except in the case of the Ministry of Defence, the Ministry of Finance actively monitors and oversees all financial-related activities of the other government ministries. It has permanent representatives (accountants who are subordinate to the Accountant General, also known as ‘referents’) who participate in key deliberations throughout the public sector before budgetary decisions are made, at times vetoing plans and projects. In doing so, the Finance Ministry effectively reprioritises (and in some cases de facto dictates) other ministries’ agendas and policy goals.

This development has made the Finance Ministry the most powerful ministry (alongside the Defence Ministry), equipping it with an intensive oversight capacity far exceeding the Knesset’s. Subsequent legislation – for example the Mandatory

61 Dery and Sharon, *Bureaucracy and Democracy in Budgetary Reform*, p. 20.
63 Dery and Sharon, *Bureaucracy and Democracy in Budgetary Reform*, p. 19.
64 The Ministry of Defence agreed to the appointment of an external auditor – a Ministry of Finance employee – to monitor its budgetary affairs but with restricted access to information, as discussed in chapter 2. See Aviezer Yaari, *Civil Control of IDF*, Jaffee Center for Strategic Studies (JCSS), Memoranda 72 (Tel-Aviv: Tel-Aviv University, 2002), pp. 46–47 (Hebrew).
Tenders Law of 1992, which stipulates a tender process for services and goods procured by the public sector (purchases by the central government represent about 12% of GDP\textsuperscript{67}) – has been initiated and promoted by the Finance Ministry in order to further regulate and moderate state-funded expenses, such as contracting and outsourcing.

The strengthening of the Finance Ministry also meant that prime ministers, as heads of cabinet, and irrespective of their party's ideology, needed close co-operation from the Finance Ministry's bureaucracy to secure budget appropriations and the implementation of policies. The Ministry's position became so entrenched, that it has successfully blocked proposals for internal restructuring, including the transfer of the important Budget Department to the Office of the Prime Minister.\textsuperscript{68}

Further adjustment of the division of power between judiciary, executive and legislature took place in the early 1990s, following the introduction of three important laws. In 1992 the Knesset enacted legislation providing for the direct election of prime minister, to occur simultaneously with the election of the Knesset. This move came in response to the undue influence accorded to small factions which, in return for joining the ruling coalition, made demands inconsistent with their relative size. The legislation, which was to come into force in the next elections, vested substantial powers in the hands of the directly elected prime minister, largely at the expense of other Cabinet members and the legislature.\textsuperscript{69}

Two other laws – The Freedom of Occupation, and Human Dignity and Liberty – were also passed in 1992 but as Basic Laws. Their passage through the


\textsuperscript{68} Arian, Nachmias and Amir, \textit{Executive Governance in Israel}, p. 49.

\textsuperscript{69} Ibid.
Knesset enshrined for the first time in Israeli law the pre-eminence of human rights such as liberty, mobility, privacy and property. The implication of this act was significant. For the first time, the Supreme Court was granted explicit authority to overturn any law that violated human rights and to strike down actions by the executive and the IDF. In practical terms, the Supreme Court was authorised to act, de facto, as a constitutional court, an evolution which greatly enhanced its tendency towards judicial activism, which had already been evident in the mid-1980s.

Influenced by judicial traditions from the North American court systems, the Israeli Supreme Court adopted in the 1990s the doctrine of reasonableness, known in the US as substantive due process, to invalidate legislation or administrative action if it was unreasonable in the extreme. This doctrine signified that the Court had now come to perceive its role in the political system as going beyond adjudication to the application of substantive criteria in reviewing law and policies. By requiring public authorities to act reasonably and in good faith, the court also saw fit to examine the suitability of candidates for senior civil service posts as well as socio-political issues.

At the same time, the Supreme Court made itself more accessible to the public. Its willingness to hear any petition it deemed to be in the public interest stemmed in part from the public criticism of the executive's judgement after the Yom Kippur War.

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71 For a discussion on the Supreme Court's judicial activism, see: Gad Barzilay, 'Courts as Hegemonic Institutions: The Israeli Supreme Court in a Comparative Perspective', *Israel Affairs*, vol. 5, nos. 2–3 (Winter-Spring 1999), pp. 15–33. For a critique see Evelyn Gordon, 'Is It Legitimate to Criticize the Supreme Court?', *Azure*, no. 3 (Winter 1998), pp. 50–89.
72 R. Adam, 'Petitioning the Supreme Court as a strategy adopted by interest groups in Israel', *Kesher*, no. 18 (1995).
of 1973 and the Lebanon War of 1982. This pointed up the Court’s recognition that a range of contentious policy issues had not been handled adequately by the executive, and the Court’s attention and intervention was therefore required.

Enactment of the new basic laws ushered in a new era in judiciary-executive relations. Hitherto, the Supreme Court had usually sided with the view of the country’s leadership, and many of its decisions had been reversed by statutory means. The new Basic Laws, however, were an important milestone in ensuring its independence. Chief Justice Barak has described their ratification as akin to equipping the judiciary with ‘non-conventional’ weapons vis-à-vis the legislature and the executive, granting it powers similar to those of other influential Supreme Courts (such as the ones in the US and Canada). With the power of constitutional interpretation, which cannot be overruled by legislation, the Supreme Court has become a veto player. Chief Justice Barak has turned the Supreme Court into the most activist judicial force in Israeli history, using the 1992 Basic Laws to second-guess government regulations and parliamentary laws that infringe human rights,

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while deterring members of Knesset from submitting sectarian or controversial bills that the Supreme Court might declare invalid.  

The empowerment of the Supreme Court gave the courts a central role in a wide range of governance and policy-related issues. Increased exposure to judicial scrutiny has had a significant impact on the executive branch. It has required the Attorney General, as the senior independent counsel to the government on issues of law and legislation, to place further checks on potentially damaging or unlawful acts by the executive branch, the legislature, and in certain cases also the IDF. This development originated in part in the Supreme Court contention that the Attorney General is the official interpreter of the law, and his or her position on the legal issues in question is final and binds the government and its agencies.  


78 See, for example, the Attorney General’s decision in February 2005 to overturn a cabinet decision entitling the state to confiscate without compensation all East Jerusalem property owned by thousands of West Bank residents; *Haaretz*, 1 February 2005. The Attorney General considered revising of the law concerning appointments to the position of Central Bank Governor; *Haaretz*, 12 January 2005. And he asked the Ministry of Finance to ensure that a decision to cut the state budget could stand a potential judicial review; *Haaretz*, 22 April 2003.

79 The Attorney General asked the members of the Knesset’s Constitution, Law and Justice Committee to remove from a bill a clause permitting incitement to physically harm terror suspects; *Haaretz*, 21 June 2001. He also registered his objection to an initiative by Members of Knesset to enact a law allowing candidates without special skills to be appointed as board members of government companies, presumably to pave the way for appointing members of the main parties’ Central Committees; *Haaretz*, 2 November 2001 and 8 November 2001.

80 Military operations that may have significant political and legal implications, especially in relation to human rights issues, are also closely monitored by the Attorney General. See ‘[Attorney General] Mazuz examined IDF’s recommendations for the destruction of hundreds of houses in preparation for the disengagement plan’ (Israel’s withdrawal from the Gaza strip), *Haaretz*, 13 January 2005.

The strengthening of the judiciary after the passage of the Basic Laws in 1992 did not pass unnoticed. Interest and pressure groups (including anti-corruption organisations such as the Movement for Quality Government, human rights activists like the Civil Rights Association, as well as other NGOs including the Society for the Protection of Nature) have seized the opportunity to challenge the authority of the executive branch in the High Court of Justice, taking advantage of its judicial activism. They have succeeded in numerous cases, in the process creating legal breakthroughs and undermining the hegemony and authority of significant public agents, including the powerful defence establishment. As it has turned out, the appeal process could take several years, which might result in de facto defeat of a policy, due to the relatively short electoral cycles in Israel; in other cases a court decision could force the government to reverse its policies.

**Interest Group Influence**

The influence of interest groups in the policy-making process (and in particular, that of organised workers of major state-owned enterprises) has grown steadily since the 1980s. Three factors contributed to this: social and legal changes, the introduction of party primaries, and interest groups' entrenched relationship with the bureaucracy. In

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83 See, for example, the decisions of the Supreme Court to ensure gender equality in the admission process for combat pilot training courses and to force the MoD to discuss the location of military installations with representatives of municipal authorities. See, respectively, *Supreme Court Decision 4541/94: Alice Miller vs. the Minister of Defence and others* and *Supreme Court Decision 5827/98: Menashe Regional Council vs. the Ministry of Defence*. 

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combination, they created numerous access points via which Israel’s centralised decision-making structure might be influenced.

As already noted, the empowerment of the judiciary offered organised interests (namely, trade unions) new opportunities to mitigate the executive branch’s increasing power, and applications to the courts were on the increase. Labour courts, known for their tacit pro-worker bias and slow response,84 did not hesitate to overturn government policies if they breached Basic Laws and other protected rights.85 Equally important, though, were the changes in the party system, such as the process for selecting Knesset nominees (primaries), which allowed organised interests to extend their influence to additional structures of power.

Indeed, interest groups could no longer rely on traditional party channels to advance their causes, or on the diminished influence of the Histadrut, which had experienced organisational and financial difficulties and a steady decline in membership since the mid-1980s.86 The primaries offered a different way of

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85 See, for example, the National Labour Court ruling that the Transportation Ministry acted illegally in introducing a second bus company in the city of Beer-Sheba in Haaretz, 3 March 2005.


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consolidating their power. The main effect of the primaries was to marginalise party administration and weaken party unity, because individual candidates have a strong incentive to represent distinct policy interests within the party membership and, once elected, less reason to support leadership policy positions.

This gave organised interest groups a clear opportunity to influence both politics and policy. By enrolling in large numbers and becoming party members, organised interests from the public sector and elsewhere established a support base inside the party, especially on the main parties' Central Committees, from which a significant number of the appointees recruited for the boards of government companies, including the state-owned defence industries, were selected. As the State Comptroller noted in 1998, about a third of the directors and almost half of board chairpersons in state-owned enterprises were members of, or affiliated to, the executive bodies of the main parties. Having acquired a foothold inside the parties, interest groups could gain access to decision-makers but, equally importantly, could also influence and secure the nomination of certain candidates, some of them former or present group members or senior activists (for example, the employees of large

88 In 1992, for example, 700 public-sector employees were selected as members of the Likud's Central Committee, the party's 3,093-strong upper institution, which nominates its candidates for Knesset, see Yediot Ahronoth, 19 January 1992. Unions and employee organisations dominated registration for the Labour party's primaries in 2005, see Haaretz, 22 May 2005. On the allegedly corrupting influence of Central Committee members on the Likud party, see Shalom Yerushalmi, 'The Courage to Ask for More', Maariv, 27 May 2005.
state-owned corporations). A simple transaction was thus struck: in exchange for the support of party members belonging to the same organised interest, the employee-turned-politician would maintain and advance their interests during the legislative process.\footnote{This was evident in the case of the IAI employees' leader, Yaakov Sheffi, who was elected to the Knesset in 1992. See chapter 5 for further discussion.} Organised interest groups were also in a position to punish politicians who had initiated bills running contrary to these groups' interests.\footnote{Gdalia Gal, the former chairman of the Knesset's Finance Committee, supported a bill to break the monopoly of the Israel Electric Company (IEC). The IEC workers were instructed by their union, the National Committee of the IEC Employees, to join the Labour party and not to vote for him in the 1996 party primary. Thousands of IEC employees enrolled as party members and Gal subsequently lost his position on the party list. See: Tel-Aviv Newspaper, 26 July 2002; Haaretz, 9 July 2004.} Gradually, interest groups have acquired an influential role in policy-making and the make-up of party candidate lists. The only salient disadvantage of this activity has been its increased visibility. In Israel, as in other countries, interest group activity is usually covert, conducted behind closed doors and without much fanfare.\footnote{Arian, The Second Republic, p. 285.}

Another point of access to policy-making was made possible through the long-term, entrenched relationship between the public bureaucracy and interest groups. The academic literature notes that civil servants and government ministries tend to foster direct and close relations with interest groups.\footnote{Johan P. Olsen, ‘Integrated Organizational Participation in Government’, in Paul C. Nystrom and William H. Starbuck (eds.) Handbook of Organizational Design (Oxford: Oxford University Press, 1981), pp. 492–516.} The Israeli bureaucracy has been no exception: some ministries – for example, those in charge of defence, energy or agriculture policies – have advocated the preference of interest groups as though they were the interest groups themselves. Indeed, one of the major bases of bureaucratic power is the external support of interest groups, which can be used in the politics of...
policy-making. Equally, such groups are directly affected by the ministries’ operations and available budget, and so the relationship between the two is one of reciprocity.\textsuperscript{94} The study of interest groups also points to such government officials, their associations and their departments or agencies as playing interest-group roles themselves, lobbying on behalf of their own interests.\textsuperscript{95} (Official policy-influencing activity is often not very different from that of private interest groups, for instance, when a senior official briefs members of Knesset in support of certain legislation.)

\textbf{Israeli Government Capabilities: Tentative Propositions}

The institutional make-up of Israel shows that many factors and actors participate in public policy-making. Inclusive political institutions structure a non-zero-sum landscape which has facilitated compromise, rather than confrontation, between political actors. However, the prevalence of coalition governments means that, in comparison with countries with single-party governments, Israel has a less cohesive government elite, because the parties that make up a coalition are likely to be competing against one another in the next election. Cohesion has tended to be particularly low in the run-up to an election, when parties see advantage in establishing a distinctive political profile and so walk out of coalition agreements, as has happened several times in Israel’s history.\textsuperscript{96}

Israel has become a society characterised by individualism and economic liberalism, but the levers of power remain firmly in the hands of the executive and

\textsuperscript{94} Nachmias and Sened, ‘Governance and Public Policy’, p. 17.


\textsuperscript{96} In 1990 Labour’s Shimon Peres tried to replace the national unity government headed by the Likud’s Yitzhak Shamir; in 2004, the Shinuy party resigned from the coalition with the Likud.
non-elected bureaucracy, and influential interest groups have been able to retain some leverage over the decision-making process. The highly fractionalised Knesset, which reflects a divided electorate, can attempt to influence the substance of policies primarily through coalition politics, but it rarely initiates policies. Beyond the sphere of executive and legislative power, we have seen also the important role of the judiciary, and particularly the Supreme Court, in influencing policy.

How can this array of influences, actors and competing interests fit into the analysis of policy-making capabilities? Several factors are present at any given time, shaping the decision-making processes and constraining the policy-making capabilities of the governmental system. Before proceeding with the three case studies, it is helpful to establish a baseline of expectations about how Israel's institutional arrangements and political institutions are likely to affect both the policy capabilities examined here: implementing policies effectively and imposing financial loss on powerful interest groups.

Institutional arrangements that separate or fuse executive and legislative powers can have several effects on government's capacities. As Weaver and Rockman argue, the higher the concentration of power, the greater the chances of effective policy implementation. On the face of it, then, parliamentary systems in which the government enjoys wide coalition support – and governments in Israel have formed oversized coalitions as well as minimum winning coalitions (the minimum size needed to have a parliamentary majority) – should be better able to implement policies effectively once the parliament (or Knesset, in this case) has decided upon them. That said, considerable reliance on the bureaucracy for the execution of policies may weaken their effective implementation if career civil servants oppose the government's policies or judge them infeasible, either because of insufficient funding
or because they were hastily agreed and adopted without adequate consultation. Such a scenario also increases the likelihood of policy reversals. Another impediment to effective implementation might be too-independent courts that are likely to give opponents of a policy more opportunities to block it.  

The prospects for governments to effectively impose losses on powerful groups – for example, forcing through a significant number of redundancies or inflicting other financial penalties – seem to be better in a parliamentary system. Ostensibly, the concentration of executive/legislature power lowers the number of effective veto points for such initiatives; governments may therefore stick to their proposals out of fear that to accept major amendments will make them look weak and vacillating.

However, several factors may undermine a parliamentary government’s capacity to impose financial losses. An independent judiciary may weaken the concentration of executive/legislature power. Also, especially where party primaries are involved, swings may occur in the support of individual MKs for particular aspects of party policy, which undermine the party as a whole; this alone makes governments in parliamentary systems more reluctant to take actions that could offend important constituencies.

Furthermore, concentration of accountability may weaken or offset many of the benefits associated with the concentration of legislative power. Opposition parties, for example, are far less accountable to their voters than those in government and more insulated from blame, and hence they are freer to cast blame on the government of the day. This situation may predispose governing parties to a more risk-averse attitude that would make them forgo loss-imposing opportunities that concentrated

power would otherwise have allowed them to undertake. In such cases, governing coalitions can act to prevent groups from suffering losses or to indemnify them for those losses.

**Alternative Explanations**

What renders policy-makers and governing institutions less effective has been widely discussed in the academic literature. A review of the political science suggests that several explanations may account for policy-making shortcomings or incapacities, four of which are presented below.

A **rationalist-choice explanation** for policy-making ineffectiveness focuses on the actors who define the policies. It assumes that the political system, which is made up of bureaucrats and politicians, has objectives which it is able to rank, and can then select the option that maximises its interest and delivers the greatest benefits at the least cost. Failure to achieve a certain goal is due to errors of execution: perhaps not all procedures were followed, or errors occurred when a certain step was taken.98 Rational-choice theorists consider that political culture may also determine the effectiveness of policy-making. A long history of co-operation in a society can create trust in government. If societies solve collective action problems at an early period of their history, they can continue solving them at a later date. In some societies, where there is little ‘social capital’ (the level of individual investment in co-operation and networks), governments cannot get policies implemented. In others, maybe by

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historical accident, there are virtuous circles of co-operative behaviour that result in well formulated and implemented policies.99

The suitability of rational choice as an explanatory framework for analysis of policy-making has been widely criticised. Policy-makers are unable to consider all possible alternatives, keep them simultaneously in their heads and compare them systematically, so as to choose the one that would meet their goal at the least cost.100 Ample evidence suggests that human beings cannot reach an optimal, purposive decision, due to information-processing shortcomings and the tendency to incorporate certain intangible elements (beliefs, sentiments, emotions, etc.) into the decision process.101 Some writers question the ability of rational-actor models – which they deem too simplified – to produce a credible stand-alone account of a policy-making event.102

The organisational explanation focuses on the tendencies of government agencies to give top priority to their own interests and to oppose policy options that may advance the position of rival agencies. In the Israeli context, this usually takes the form of departmental power struggles in which units and departments within ministries express conflicting points of view while ministers and ministries fight

99 In his influential study, Putnam examines southern and northern Italy, where the north developed a high level of social capital while the south remained trapped in an untrusting political culture. Consequently, northern regional authorities were able to develop more solutions to collective action problems than their southern neighbours. See Putnam, Making Democracy Work.


102 See, for example: Graham T. Allison, Essence of Decision: Explaining the Cuban Missile Crisis (Boston, MD: Little, Brown, 1971), pp. 3–4, 247, 252–255.
among themselves over policies. The result is that no clear policy is articulated, let alone implemented.\textsuperscript{103} A case in point was the \textit{Lavi} fighter aircraft project, which was cancelled in 1987. The Prime Minister and the Defence and Finance Ministers held diametrically opposed positions on this matter and after a Cabinet decision was reached did not present guidelines for future large-scale projects in the defence sector.\textsuperscript{104}

\textbf{Bureaucratic politics} can provide another perspective on ineffective policy-making. If interactions within bureaucracies explain policy-making as much as the intentions of politicians, then policy ineffectiveness might stem from competition between bureaux for resources and influence on policy: often the outcome of an uncoordinated fight between government bureaux.\textsuperscript{105} Bureaucrats have the capacity to frustrate the goals of policy-makers; they can either promote them or delay them indefinitely if their own preferences are not met.\textsuperscript{106} Interest-group politics models, which account for a group’s pursuit of its goals at the expense of other overriding national interests, could provide another explanation. By responding to the will of interest groups and sharing power with them through mutual arrangements of collaboration, the state in effect cedes some of its bureaucratic control over decision-making, thus making it potentially less effective.\textsuperscript{107}

These perspectives suggest that, in policy research, policy issues can rarely be fully appreciated through a single ‘lens’. Some of these alternative explanations do indeed account for the extent to which competing institutional actors influence

\begin{itemize}
\item \textsuperscript{103} Arian, \textit{The Second Republic}, pp. 339–340.
\item \textsuperscript{104} Ben-Meir, \textit{Civil-Military Relations in Israel}, pp. 167–168.
\item \textsuperscript{105} Allison, \textit{Essence of Decision}, pp. 89, 93, 146.
\item \textsuperscript{106} Judith E. Gruber, \textit{Controlling Bureaucracies: Dilemmas in Democratic Governance} (Berkeley, CA: University of California Press, 1987).
\item \textsuperscript{107} Yisahi, ‘Interest Politics in a Comparative Perspective: The (Ir)regularity of the Israeli Case’.
\end{itemize}
political decision-making – for example, the bureaucratic explanation. However, they are mostly one-dimensional and static, in the sense that they do not capture the interplay between actors or the conditionality that institutional norms impose upon them. These norms not only define the actors’ competencies and action resources, they also specify particular purposes and shape their associated cognitive orientations.

Another weakness of these alternative explanations is their little attention to institutional influences on policy outcomes. Such explanations do not account for the effects that formal arrangements have on policy through their capacity to influence the formulation, co-ordination and implementation of public decisions. Crucially, none of the above perspectives explains the empirical difference in the ability of Israel’s executive and bureaucracy to apply a specific policy consistently in the same sector area, as the following three case studies demonstrate.

The explanation offered in this thesis focuses on the interaction among purposeful actors – organised interests, the bureaucracy and the like. As Scharpf points out, even though only individual human beings are capable of intentional action, interaction-oriented policy research would be impossible if explanations had to be sought at the individual level in every case and at every juncture. The actors are typically acting in the interest of, and from the perspective of, larger units than themselves. This allows us to simplify the analysis by treating a limited number of large units as composite actors with relatively cohesive action orientations and relatively potent action resources, thus making the analytical task altogether more manageable.

\[108\] Scharpf, Games Real Actors Play, p. 12.

\[109\] Ibid.
CHAPTER 2
Actors and Structures in the Defence Industrial Base

Each policy sector has a unique blend of attributes: specific patterns of bargains and negotiations, varying degrees of interest-group participation, and certain instruments and resources that are available to decision-makers. These characteristics create a distinct interaction between the actors involved in each sector’s policy-making process, which in turn may affect some government capabilities.

The Israeli defence sector is a case in point. Because national defence is the most valued of public goods and is perceived as fundamental to the collective survival of an emerging community, the Israeli defence establishment has been incorporated into the pervasive collectivist Zionist ethos and protected by it.¹ No other policy area is therefore more endowed with resources and attention from decision-makers.

The large share of GNP devoted to defence expenditure and the significant defence-related production have given rise to strong and influential interest groups, in the form of the Israel Defence Forces’ (IDF) career personnel and the workforce in the state-owned defence enterprises. The sheer size of the sector and the secrecy surrounding defence matters produce a certain type of relationship between politicians, officers, bureaucrats and interest groups that is not obvious to those outside the inner circle of decision-making.

This chapter, therefore, seeks to identify the considerations and attitudes of the key government actors in this policy area: the Defence and Finance Ministries, the

IDF, and the three state-owned firms, Israel Aircraft Industries, Israel Military Industries and Rafael. Building on the previous chapter, which offered an overview of the main institutions in the Israeli policy-making process, this one presents the framework that governs policy formulation and implementation in the defence industrial base (DIB). It starts with a characterisation of this sector, and then outlines its actors, their roles, responsibilities and core objectives. The second section charts the patterns of interaction between the main actors, highlighting their areas of decision autonomy. The chapter ends with some observations on the influences of these relationship subsets on setting and implementing policy.

**Main Components of the DIB**

Before delving into the issues surrounding the defence industrial base in Israel, it would help to establish a common understanding of what it stands for. The academic literature suggests that there is no universally accepted definition of the terms ‘defence industrial base’ and ‘defence enterprises’. One school of thought suggests that there is no such thing as a ‘defence industrial base’ as a stand-alone sector: a country has a single industrial base, and those who meet its defence needs comprise a small part of the larger, more comprehensive whole.\(^2\) Official Israeli statistics, for example, do not categorise defence-related enterprises under a separate heading, as these are usually included in the broader industrial segment of the economy. On the other hand, the literature of defence economics points to various factors that may be used to classify an enterprise as a defence company, including the type of product (e.g. artillery, submarines, missiles) and end user (e.g. armed forces, ministry of

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defence) or the percentage of turnover generated from defence and security-related sales.³

In the Israeli context, the term defence industrial base has been defined as 'the amalgamation of capabilities in the areas of development, production and maintenance which are designed for and are capable of supporting the defence establishment's efforts in war (or in crisis) and in its preparations for such scenarios'.⁴ It can be divided into three broad components, which differ from each other in terms of operation, function and ownership. These are a research and development component, a production component, and a maintenance and repair component, each of which includes private- and public-sector employees and facilities. The base can also be divided into three tiers: prime contractors, subcontractors, and parts suppliers.

In this multi-layered structure, one can find state-owned firms, privately or publicly owned companies, military logistic and maintenance depots, academic research laboratories, and autonomous units⁵ that operate within the Ministry of Defence. From the perspective of the defence establishment (a term which refers jointly to the MoD and the IDF), this infrastructure serves three critical purposes: keeping a logistical back-up for the Israeli military in peace time, maintaining an overall deterrent posture against threats, and ensuring the availability of immediate operational means during conflict.⁶

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Surprisingly for such an essential sector, the defence industrial base has evolved without government guidance on its roles and objectives. David Ben-Gurion, the country's first prime minister and defence minister assigned the Ministry of Defence to be the chief co-ordinator and controller of this base. However, partly because of bureaucratic in-fighting between the MoD and the IDF and partly because of the almost complete autonomy the defence establishment enjoys in respect of budget allocation, human resources and arms procurement, none of the official bodies publishes binding guidelines or objectives for this sector. (In May 1993, the ministers of defence and finance approved a draft for a defence industrial policy in the defence industrial base but it was neither discussed nor accepted as an official government strategy by Cabinet.)

Instead, the defence establishment has relied on a collection of 'tried and true' rules, arrangements and principles aimed at meeting the operational needs of the IDF

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8 An attempt by the then MoD Director General David Ivry to define the vital industrial infrastructure that needs to be protected and subsidised through the defence budget was blocked in 1991 by the IDF. See: Zeev Bonen, 'The defence industry – Sholem Aleichem's mare?' in _The Israeli Defence Industry_, Begin-Sadat (BESA) Center for Strategic Studies, Studies in National Security no. 9 (Bar-Ilan University, Ramat-Gan, 1995), p. 40 (Hebrew).


and other security services. These practices, which have been changed from time to
time, have been applied to two components: the defence firms (both state and
privately owned) and the military logistic centres. (Suppliers of non-military goods or
goods that are easily replaceable have not been regarded as part of the defence
industrial base.)

Without a binding government strategy, the approach of the elected
representatives towards the DIB has at times been inconsistent. In some cases,
decisions on major industrial reforms taken by the Defence Minister or the MoD
Director General have been reversed by their successors. Sometimes, the attitude of
policy-makers has seemed chaotic and short sighted. On two separate occasions, for
instance, Prime Ministers Peres and Netanyahu decided to transfer the responsibility
for the defence industry from the MoD to other ministries as part of political wheeling

11 Gerald Steinberg, 'Israel', in R. Singh (ed.), Arms Procurement Decision Making Processes: China,
India, Israel, Japan, South Korea and Thailand (Oxford: Oxford University Press, 1998), pp. 91–
12 Author's interviews with Haim Adar, head of Procurement Directorate at the MoD, 18 January 1998
and 25 June 1998; Ministry of Defence, How to work with the MoD’s Procurement and Production
Directorate (November 1997) (Hebrew, internal booklet); Ministry of Defence, The Procurement
and Production Directorate (April 1995) (Hebrew, internal document).
13 Defence Minister Arens decided in August 1984 to turn IMI into a state-owned company; Defence
Minister Rabin reversed this decision in September 1985. IMI eventually became a company only in
1989. See State Comptroller Report on Organisations connected to the Defence Establishment,
(Jerusalem: Government Printer, 1994), p. 60 (hereafter: State Comptroller special report on IMI's
incorporation); MoD Director General Pinhas Zussman recommended incorporating Rafael and
turning it into a government company. His successor, Joseph Maayan, cancelled this plan in 1978.
See Zeev Bonen, Rafael: From the Laboratory to the Battlefield (Haifa: NDD Media, 2003), pp. 42–
43 (Hebrew).
and dealing; these decisions were quickly abandoned following strong objections from the defence establishment and the media.\(^\text{14}\)

The absence of a binding governmental strategy has given the industry greater freedom, and indeed much of the growth in this sector originated from within, as a result of commercial initiatives or new technology-driven ideas.\(^\text{15}\) Indeed, the extent of the enterprises' growth has been influenced, to a large extent, by the preferences and management styles of Defence Ministers and MoD Directors General. However, the latter's attitudes have varied greatly, zigzagging between low-key involvement and intensive intervention in day-to-day operations of the DIB. At times, the Minister or the Director General has favoured a centralised style of management, dictating not only which projects would be developed but also where and for how much;\(^\text{16}\) at other times, the MoD has taken a hands-off approach, acting only as a regulator with the

\(^\text{14}\) Prime Minister Peres planned to transfer the ministerial responsibility for the Home Front Command and the state-owned defence enterprises from the MoD to the Interior Security Ministry for internal political considerations; the planned was shelved following strong objections by the MoD. See: *Haaretz*, 23 and 27 November 1995. See Reuven Petazur, 'Industries as a leftover', *Haaretz*, 27 November 1995, and 'Hasty and unnecessary reform', Editorial, *Haaretz*, 27 November 1995. Prime Minister Netanyahu planned to shift responsibility for the DIB to the newly formed National Infrastructure Ministry, headed by Ariel Sharon. The plan was cancelled after objections by Defence Minister Yitzhak Mordechay; see *Haaretz*, 1 July 1996.


\(^\text{16}\) Bonen, *Rafael*, p. 39.
minimal possible interference in the firms' affairs. Some Directors General have openly pushed for accelerated expansion of the DIB (whether state-owned or not), while others encouraged investments in duplicate infrastructure to ensure competition among several suppliers, at home and abroad. Their successors, though, have been at pains to reverse this, advocating industrial cooperation, mergers and joint ventures.

Indeed, the rise of a competitive privately owned defence sector led to a greater awareness of the differences in financial performance between state and privately owned defence firms. Privately held companies are judged by one yardstick: they must bring added value and a high return on investment to their owners and shareholders. Profits and positive cash flow are the main criteria by which their managements are assessed.

In state-owned enterprises the situation is different, and in some respects more complicated. State ownership means that several government actors are involved in this sector at any given time. On the operational side, the structure and relationship between the various components within a state-owned defence company are governed by the 1975 Government Companies Law, which also specifies the responsibilities of the board and management of the firm, the government bureaucracy, and the defence

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17 Ivry interview, 1997.
18 Bonen, Rafael, p. 199; Greenberg, Defence Budget and Military Power, p. 154.
19 Bonen, Ibid, pp. 162, 199.
establishment.21 These components are, in effect, three separate but nevertheless representative organs of the same body, the Government of Israel.

In addition to government decision-makers, one can also find that the major employees’ organisations, which represent the workers in each industrial entity, are significantly involved in the operations of defence enterprises. Over the years, leaders of these interest groups have extended their influence to such a degree that they have, de facto, been co-opted into the firm’s decision-making, as discussed later. Additional actors include the State Comptroller and the Bank of Israel, which are involved indirectly in the state-owned industrial base, while other entities, like the courts, may take part during disputes between the main players. Some non-state actors, such as the mass media and academic think tanks, are also involved, albeit indirectly.

State Ownership and Control in the DIB: Vision vs. Reality

The Israeli Government conducts its commercial activities through three major types of organisation – departmental undertakings (departmental sub-units or autonomous units that organisationally are part of a ministry), statutory authorities, and government corporations established by company legislation. Public enterprises are incorporated as limited companies in which the State owns part or all of their shares.

Government companies are required to follow laws and regulations – state laws, ad hoc government decisions and internal procedures of the ministry in charge – that specify their objectives and regulate their activities. Chief among them is the 1975 Government Companies Law, whose article 4(a) stipulates that ‘a government-owned company should operate in accordance with the same business considerations

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as a non-government-owned company, unless instructed otherwise by the government with the approval of the [Knesset’s Finance] committee. In other words, a state-owned company is expected to operate on a commercial basis, and to post profits and increase its revenues in the same way as any other company.

This, however, was not the initial goal of the Israeli arms producers. From the outset, their purpose was to respond to clear defence needs, such as non-dependency on foreign suppliers and the development of new weapons for the IDF. This was why the three main enterprises were established initially as autonomous departmental units, operating within the Defence Ministry. The primary goal of an autonomous unit was not to post profits at the end of the fiscal year, but to meet annual work plan targets within the time and budgetary limits set for it by the government. Furthermore, workers in these defence entities were employed on a tenured basis and governed by the Civil Service Regulations. Historically, then, the profitability of the state-run defence enterprises was not a prime consideration.

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22 Government Companies Law - 1975, clause 4 (A). Before this Law was enacted, government-owned companies were incorporated according to the Companies Ordinance, but, after public outcry over losses and significant irregularities in some companies, more rigorous legal checks and responsibilities were imposed upon senior office-holders. For a comparative overview of the legal bases of government-owned companies in Israel and abroad, see Avraham Weinroth, Government Companies: The Application of Administrative Law (Tel Aviv: Bursi, 1995) (Hebrew).

23 In a rare public visit at Rafael, on 23 July 1959, the Prime Minister and Defence Minister David Ben-Gurion praised the work carried out in this unit: ‘You are engaged in work which many people, perhaps almost all of the people, know nothing about. But perhaps there is no other job that is as important as yours.’ See Monia M. Mardor, ‘Rafael’, in Ilan Kfir and Yaakov Erez (eds.), IDF in Its Strength, vol. 17: The Defence Industry (Tel Aviv: Revivim, 1982), p. 47.

24 Autonomous units were not required to submit their accounts for audit by independent accountants and therefore did not monitor their performance in a business-like manner. This was evident in IMI and Rafael, which started their export activities in the 1960s while being run within the MoD; their annual statements were widely criticised as insufficient by the MoD and the MoF. See State
As their business activities grew further, the main defence manufacturers sought greater administrative and operational leeway. But even after they had been incorporated and officially become profit-driven companies — Israel Aircraft Industries in 1966, Israel Military Industries in 1989 and Rafael in 2002 — their activities remained heavily restricted and regulated. Their wage agreements, for example, were tied to the national wage agreements negotiated between officials of the Finance Ministry, the Histadrut’s Trade Union Division and the Coordinating Committee of the Employers. These agreements obliged management to index workers’ salaries to other sectors of the economy, as agreed between the Finance Ministry and the Histadrut, and to pay them wage supplements irrespective of the company’s actual financial performance.25

State-owned companies also needed to take other factors into account in their decision-making, including regional development (providing employment and promoting economic development according to government policies, particularly in peripheral and rural areas of the country26) and maintaining industrial infrastructure designated for state purposes only. This was in sharp contrast to public and privately-owned companies, which faced far fewer administrative and operational requirements.

**Duties and Roles of Main Actors**

Israeli law uses two parameters to determine the extent of government involvement in an enterprise: participation in management, and financial support required. In this

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26 Steinberg, Arms Procurement Decision Making Processes, p. 98.
respect, the Israeli government’s involvement in the country’s defence firms is direct and significant. It is exercised through the firm, the defence establishment and the government bureaucracy, each with its own functions and powers of control and oversight (see Table 2-1).

State owned enterprise

During the period covered by this study, the government bureaucracy oversaw two types of commercially-oriented defence enterprises: a departmental undertaking – an autonomous unit within the MoD (Rafael) – and two companies (IAI and IMI). An autonomous unit is an integral part of the state administration, and is therefore subject to all Civil Service rules and regulations, which are governed by the Civil Service Commission (an independent unit within the Ministry of Finance). In budgetary terms, a departmental undertaking like Rafael operated and was governed as a closed economic entity with its own dedicated budget, which gave it greater autonomy and flexibility than ordinary government departments. However, since the budget of such an undertaking is dependent on funding from its parent ministry – in this case, the MoD – the undertaking is also subject to the Foundations of the Budget Law.27 The organisational form of the departmental undertaking is particularly suitable for enterprises that are largely concerned with providing public services and in which the profit motive is not paramount. In the period covered by this thesis, Rafael was referred to and handled as such a departmental undertaking. Even after it was turned

into a government company in 2002, about a third of its workers remained civil servants, regulated and bound by Civil Service regulations.  

Table 2.1: Areas of responsibility of actors involved in the DIB

<table>
<thead>
<tr>
<th>Actor</th>
<th>Domain/Responsibility</th>
<th>Affected actor(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cabinet</td>
<td>Approves arms deals and, at times, restructuring or privatisation plans of government-owned enterprises in the DIB</td>
<td>Defence industry, Bureaucracy</td>
</tr>
<tr>
<td>Knesset and its committees (particularly Finance Committee)</td>
<td>Approves state budget and requests for financial assistance by cabinet and state-owned defence enterprises</td>
<td>Cabinet, Defence industry</td>
</tr>
<tr>
<td>Ministry of Finance</td>
<td>Sets and monitors fiscal policy; prioritises allocation of budget; inter-departmental oversight</td>
<td>Other ministries (except MoD)</td>
</tr>
<tr>
<td>Ministry of Defence</td>
<td>Prioritises defence budget uses; oversight and regulatory powers (export activities; technology declassification)</td>
<td>Defence Industry (management)</td>
</tr>
<tr>
<td>Attorney General</td>
<td>Law interpretation</td>
<td>Cabinet, Bureaucracy</td>
</tr>
<tr>
<td>Government Companies Authority</td>
<td>Privatises and monitors government companies</td>
<td>Defence industry</td>
</tr>
<tr>
<td>Bank of Israel</td>
<td>Sets monetary policy (affects borrowing costs, interest rates, foreign exchange rates)</td>
<td>Defence industry</td>
</tr>
<tr>
<td>State Comptroller</td>
<td>Comprehensive audits at ministries and public enterprises</td>
<td>Bureaucracy, Defence industry</td>
</tr>
<tr>
<td>Supreme Court</td>
<td>Law interpretation; policy overrule</td>
<td>Cabinet, Bureaucracy</td>
</tr>
<tr>
<td>Labour courts</td>
<td>Settle labour disputes; interpret labour laws</td>
<td>Employees’ organisations, Firms’ managements, Ministries</td>
</tr>
</tbody>
</table>

Government companies, on the other hand, enjoy greater autonomy in matters such as budgeting arrangements, appointments, dismissals and conditions of service (subject to the government’s general policy guidelines and the terms laid down in the firms’ collective bargaining agreements). The board of directors, which is confirmed by Cabinet and includes several senior officials, is responsible for the general policy, corporate plan and annual budget of the particular enterprise. Once appointed, the board members are required by law to pursue the company’s interests and not those of the government (and this applies also to board members who are also state officials). They cannot be replaced before their tenure is up, usually after three years, save in exceptional circumstances. The specific powers of the management and board of directors are laid down in Government Company Law, but these bodies are also required to follow the guidelines of the Government Companies Authority, a government agency which supervises companies in which the state holds over half the shares. For security reasons, the Israeli Government holds all the shares of state-owned defence companies.

Despite the financial independence a government-controlled company enjoys, it needs state approval for a wide array of decisions. Changes of objectives, increases in registered capital, export deals, changes in the holding rights of shares, closure or merger with another company – all require the approval of monitoring and regulatory bodies in the defence establishment, the government bureaucracy and the legislature. Board directors are appointed jointly by the Defence and Finance ministers, and they must approve the nomination of candidates for the positions of CEO or Director

30 Ibid., clauses 10, 11.
General. The ministers must also be kept informed of the decisions of each company’s Board of Directors.\textsuperscript{31}

**Defence Establishment**

The second major institutional actor in the defence industrial sector is the defence establishment, which comprises the political echelon (the Minister of Defence), a civilian arm (the Ministry of Defence) and the military (the IDF). The primary task of the MoD has been to attend to the IDF’s needs in manpower, arms and financial resources, to enable it to carry out its mission of ‘defending the existence, territorial integrity and sovereignty of the State of Israel’.\textsuperscript{32} The two components, the IDF and the MoD, are perceived as a unitary body, a façade which they present \textit{vis-à-vis} other government units and the public even though their interests do not always overlap.\textsuperscript{33}

The defence establishment exercises several roles with respect to the defence industrial sector, in its capacity as a supplier of a public good (national defence and security). First, it is a major \textbf{buyer} of technologies, weapon systems and services. With an annual spending budget of about 5–6 billion shekels ($1.5 billion), the MoD is one of the most important sources of income for the domestic enterprises. Secondly,

\textsuperscript{31} Appointing suitable directors and chairpersons for the boards of IAI and IMI ran into difficulties in recent years. The ministers in charge failed to reach consensus on agreed candidates, leaving both companies without the minimum number of directors required by law for prolong periods. IMI did not have a board chairperson for almost a year and IAI did not have one for more than three years. See \textit{Haaretz}, 30 July 2001, 2 September 2001, and 17 December 2004. See also \textit{State Comptroller Annual Report no. 564} (Jerusalem: Government Printer, 2005), pp. 327–328.


as the executor of the national security policy, the defence establishment sets and defines the requirements and expectations of the defence industrial base and its military-affiliated components. It also invests in maintaining strategic infrastructure and earmarks a portion of the defence budget for R&D and long-term projects. In addition, it acts as a regulator, issuing export permits, monitoring contacts with officials and declassifying technologies for export purposes. As the official export licensing authority, the MoD is also authorised to block negotiations and major deals, even if they were given initial approval. In addition, it monitors contacts with foreign clients (including visits), and sanctions mergers and acquisitions, including in the private sector.

Thirdly, the defence establishment owns the state-owned defence enterprises, even though the exact responsibilities attached to this status were not specified by law. When the need arises, and as long as it has sufficient means at its disposal, the MoD offers credit lines, underwrites loans and provides advance down payments. It also acts as a sales promoter through a dedicated export division within the ministry (SIBAT).

During the period covered in this dissertation, the MoD also acted as the employer of Rafael, and was therefore required to satisfy statutory requirements, such as health and safety regulations at the workplace, and to provide its workers with fringe benefits and other services as set out in their employment agreements. In fact, it employed three different populations, each with its own set of terms and professional

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34 Ministry of Defence, Guidebook for Exporters of Defence Equipment and Know-how, pp. 12, 18: the MoD banned IAI from selling satellite-related technologies and products because it contravened a prior understanding with the US (Ivry interview, 1998).


affiliations: IDF soldiers (career officers and regular conscripts, paid for by the military), civil employees at military logistic and maintenance depots, and Rafael’s employees. All were funded from a single budgetary source, the defence budget. By wearing several hats simultaneously – buyer, owner, regulator and employer – the defence establishment was potentially in a conflict of interests. This multiplicity of roles also illustrated the complex decision-making within government.

**Government Bureaucracy**

The third component, government bureaucracy, is spread across a number of ministries and state agencies with different interests and areas of responsibility. Bodies within the executive, such as the Finance Ministry, Justice Department, Office of the State Attorney, Government Companies Authority, and Authority for Industrial Cooperation, are involved to a varying degree in the day-to-day affairs of the state-owned enterprises. Statutory authorities, such as the State Comptroller Office (the supreme audit institution, which is empowered to examine the financial and administrative activities of public enterprises, and to refer cases to the Attorney General for criminal investigation) and the Bank of Israel (the independent central bank, which sets interest and exchange rates that affect borrowing and export transactions) are also influential, albeit indirectly. As part of its responsibility for an effective allocation of budgets and resources, the government bureaucracy monitors

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the performance and the activities of state-owned enterprises. However, rather than profit maximisation, its main concern is to ensure that these entities adhere to formal rules and regulations and do not register losses.

The most influential of these actors is the Ministry of Finance (MoF), which has been guided, since the mid-1980s, by three objectives: devising and executing a disciplined macro-economic policy that meets internationally recognised benchmarks; ensuring the efficient use and allocation of public funds by government bodies; and moving towards greater competition and transparency in the economy (through trade and financial liberalization, privatisation and domestic deregulation).

The broad and complex nature of the Finance Ministry's remit requires close cooperation and coordination between its main policy and oversight divisions: the Accountant General’s Department, the Budget Department and the Wage and Labour Accord Unit, which have garnered significant power within the civil service. So great is their authority that even prime ministers need the close cooperation of the heads of these departments to secure budget appropriations for their policy initiatives. According to a former MoF official, as each department has its own set

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39 Prime Minister Sharon's address at the event marking the 50th anniversary of the Bank of Israel, 29 November 2004 (http://www.pmo.gov.il/PMOEng/Communication/PMSpeaks/speach291104.htm, accessed 26 April 2005).
41 Comments by the Director of the Budget Department, Ministry of Finance, quoted in State Comptroller Annual Report no. 53B, p. 36.
42 Galnoor, No, Mr Commissioner, p. 507.
43 Arian et al, Executive Governance in Israel, p. 49. On the Israeli bureaucracy's position and interests, see: Nachmias and Sened, 'Governance and Public Policy', p. 17; Arian et al., Executive Governance in Israel, p. 152.
of responsibilities and practices – and as each head of department was equal in rank and salary to the Ministry’s Director General\textsuperscript{44} – they operate rather independently.\textsuperscript{45} (The former Economic Adviser to the MoD observed that, unlike the hierarchical structure of the Defence Ministry, the MoF resembled a federation of departments whose co-ordinating mechanisms were rather weak, and there was little effort to synchronise and integrate its policy output.\textsuperscript{46})

Founded in the 1950s and modelled after the budget department in the Dutch government,\textsuperscript{47} the Budget Department is grounded in the universal principles of market economy and disciplined government spending. The department plays a leading role in planning the state budget and presenting it to the Government and to the Knesset. It attempts to improve efficiency and economy in government administration through better budgeting techniques and by increasing awareness of the importance of budgeting on the part of the Ministries. It is responsible for examining and evaluating proposed projects to be financed out of the state budget. As all changes in the authorised budget during the financial year must first be approved by the Budget Department before being referred to the Finance Committee of the Knesset, the Department in effect follows up on the implementation of the budget throughout the year.

The Accountant General’s Department acts as the national treasurer and is responsible for implementing the state budget. It releases budget funds to government ministries over the course of the year and is in complete charge of their accounting

\textsuperscript{44} Galnoor, \textit{No, Mr Commissioner}, p. 216.


\textsuperscript{47} Galnoor, \textit{No, Mr Commissioner}, pp. 116–117.
systems – the accounting officers (also known as referents) in each ministry are the Department’s employees and therefore report directly to the Accountant General. The Department draws up the national accounts that are submitted to the Knesset and the State Comptroller. It is also responsible for paying the wages, salaries and pensions of all civil servants. Its other functions include managing loans received by the Government other than those managed by the central bank.48

The Accountant-General is bound by the Foundations of the Budget Law (1985), which was designed to increase budget control by stipulating in detail, among other things, the structure of the annual budget, the manner in which it may be updated and otherwise changed in the course of the financial year, and the instances in which the approval of the Finance Committee of the Knesset must be obtained (for example, approval of emergency appropriation of funding for state-owned enterprises). In addition, the Law places limitations on the borrowing power of the local authorities, and other restrictions on both them and bodies directly or indirectly supported out of the State Budget, including the state-owned defence industries, thus strengthening Government control over their finances, manpower and wages. The Law also restricts the right of the Government to borrow from the Bank of Israel and from other banking institutions.49

In an explicit effort to enforce stricter compliance with budgetary ceilings, the Law calls for the cessation of activities started, cancellation of contracts signed, and dismissal of workers hired where adequate coverage in the budget is lacking, and it makes it a disciplinary offence for civil servants not to abide by the restrictions set in

49 Ibid.; see also Foundations of the Budget Law – 1985; see, e.g., clauses 6, 11, 12, 20, 29, 43 and 45; Government Companies Authority Report 2001, pp. 5–6.
the annual Budget Law. It also requires that the source of financing be explicitly
designated in all bills tabled in the Knesset and in all administrative regulations
issued.50

Because of these statutory limitations, the Accountant General is entitled to
override or simply ignore agreements that were signed or otherwise approved by the
Budget Department, the Wage and Labour Accord Unit, and other ministries. In
recent years, the MoD and defence companies such as IMI have complained that the
Accountant General did not release funding agreed by the two other divisions at the
MoF, resulting in financial loss or other material damage to them and to suppliers and
individuals with whom they had contracts or prior contractual commitments.51 This
kind of decision underline the different concerns of each MoF department: while the
Accountant General views itself as the gatekeeper of public funds and acts
accordingly (that is, it strives to improve the state’s balance sheet and raises as much
funding as possible), the Budget Department is interested in meeting macro-economic
objectives, improving efficiency in state-owned enterprises through structural changes
and reducing government expenditure in any way possible.52 The Wage and Salary
Accord Unit, on the other hand, wants to achieve and maintain labour relations that
are as stable and cooperative as possible, so as to minimise disruptions to the national
economy.53

51 See for example: 'Ministry of Finance stopped funding for pensioners of IMI', Haaretz, 5 September
2000.
52 Author’s interview with Imri Tov, 6 July 1998 (hereafter: Tov interview, 1998); Granit interview,
1998; Livni interview.
Interest Groups

The fourth participants involved in decision-making are interest groups in the form of large national shop committees (commonly referred to as ‘workers’ organisations’ or ‘employees’ organisations’) in the state-owned enterprises, which represent the employees through the Histadrut. Although not part of the Histadrut’s administration, these associations nevertheless have become significantly influential, not least because the state has granted them formal rights, such as negotiations over salary terms; in the case of major disputes with management or the state (as an employer), the organised interests were entitled to seek recourse from the courts (Labour Courts and the Supreme Court). This ‘integrated participation’ in decision-making, a characteristic of the arrangements prevalent in Israel, has been further strengthened by the involvement of committees’ representatives in the Histadrut and as a result of close association between employees in state-owned defence enterprises and the defence establishment itself.

Over the years, the role of the employees’ organisations has evolved from merely representing employees in order to promote narrow interests, such as increased salaries, welfare and fringe benefits to non-official involvement in the enterprises’ day-to-day managerial affairs. Shop committee leaders proved useful intermediaries between management and employees, and so have become privy to commercially


55 Some of these privileges were outlined in collective agreements, for example, in Special Collective Agreement for the Employees of IMI, 31 October 1990, pp. 52–53.

confidential discussions, asked to give their consent for structural and strategic initiatives, and to take part in meetings with politicians, ministerial advisers and high-ranking guests, sometimes alongside management representatives. In some other instances they have approached ministers directly to advance issues that are usually in the domain of management, such as soliciting for state aid. Finally, the independent standing of the employees’ organisations was maintained by having their own budget (in the form of annual membership fees, deducted at source from the employees’ salaries by management). This budget – in the case of the IAI Employees’ Organisation, it amounted to about $3 million a year – was used towards payment of the union leaders’ salaries, legal services, special operations (lobbying activities, ads, etc.), and welfare and recreation activities. Some money also went to relief and assistance funds. That the management collected the fees for and on behalf of the employees’ union was a further proof of the trust and close cooperation between the two in the state-owned defence enterprises; it also manifested the institutionalisation of interest group autonomy.

57 Author’s interview with Haim Katz (Secretary General, the IAI Employees’ Organisation 1993–Present), 29 June 1998 (hereafter: Katz interview); the IAI employees’ organisation consistently blocked plans for joint ventures with rival companies. See Yedioth Ahronoth, 5 November 2001 (on IAI/Elisra collaboration in marketing electronic warfare systems), Globes, 19 July 1998 (on IAI/Elbit collaboration in aircraft upgrades), Haaretz, 9 July 1997, 31 July 1997 (IAI/Silver Arrow proposed collaboration in the production of unmanned aerial vehicles).

58 See further discussion in chapters 4 and 5.

59 Haaretz, 3 May 1996; ‘From the Lavi aircraft to Summer Camps’, Davar, 18 August 1991 (interview with Yaakov Sheffi, then Secretary General of the IAI Employees’ organisation).
Relational Patterns among Main Actors

The interests and roles of the various actors are illustrated in relationship subsets that have evolved over the years within the DIB. This section presents the main characteristics of three subsets – IDF vs. MoD, IDF/MoD vs. Ministry of Finance, and MoD vs. state-owned enterprises – in the context of the defence industrial base. This overview serves as a lens through which to explore the main developments and interactions to be discussed in subsequent chapters.

IDF vs. MoD: Dilemmas of Preparation and Preparedness

In the early years of the state it was David Ben-Gurion, Israel’s first Premier and Defence Minister, who set the precedent for the MoD’s superiority within the national security establishment. Since then, the MoD has become the most powerful ministry, dominating all other government bodies in defence issues. However, over the years it has become apparent that the Ministry exists in the heavy shadow of the IDF, usually following its recommendations in formal decisions and planning documents. Furthermore, even in those spheres in which the Ministry’s formal authority was recognised – for example, budget oversight – it did not succeed in exerting it. The MoD’s weakness was further demonstrated in the power struggle with the IDF over the control and allocation of the defence budget, which had a significant impact on local defence enterprises and especially the state-owned ones.

60 Greenberg, Defence Budget and Military Power, pp. 139–147.
61 Galnoor, No, Mr Commissioner, p. 204.
62 Technically, the MoD is supposed to supervise the IDF budgeting process, but an attempt to appoint the head of the MoD Budget Department (who also serves as Financial Adviser to the IDF’s Chief of Staff) to monitor implementation of the defence budget, as the Foundations of the Budget Law requires, was blocked by the IDF. See State Comptroller Annual Report no. 46 (Jerusalem: Government Printer, 1996), pp. 890–894; Tal, National Security, p. 106.
The division of responsibilities between the MoD and the IDF was first demarcated by Ben-Gurion. He differentiated between civil functions to be carried out by the Ministry and military functions to be performed by the IDF’s General Staff. The separation of functions was defined in 1960s, during Prime Minister Levi Eshkol’s time, as follows: ‘The IDF determines what is needed, how much and when; the MoD decides how, where from and for what price’. 63

Such a distinction, however, was not precise enough to settle concerns about the practical division of functions between the two bodies that fuelled periodic disputes and disagreements. For example, who was to decide how much money to allocate for training and how much for arms development? Who should deal with long-term planning and the purchase of new weapon systems? Did they fall within the realm of the civilian arm, because of the financial and technological considerations involved, or that of the military as the ultimate end-user?

These conundrums were settled following the Yom Kippur war of 1973. The Agranat Committee report, the national commission of enquiry which investigated who was responsible for Israel’s lack of military preparation for the war, exonerated the political echelon but placed the blame firmly on the shoulders of the IDF. The report’s conclusions led to a major overhaul of the army’s doctrine and operations, a

63 Greenberg, Defence Budgets and Military Power, pp. 147–148; Peri, Between Battles and Ballots, p. 200; Ministry of Defence, How to Work with the MoD’s Procurement and Production Department, p. 2; author’s interview with Pinhas Zussman (MoD Director General, 1975–1977), 6 July 1998 (hereafter: Zussman interview). Zussman was once told by a senior army officer that the difference between the two bodies was ‘the IDF determines its needs and the State of Israel signs the cheque’; he concurred.
process which was accompanied by a substantial allocation of state resources for arms acquisition. According to Assistant Defence Minister, Maj.-Gen. (res.) Moshe Peled, following the publication of the Agranat report, the IDF became far more dominant than the MoD with respect to procurement issues, determining where to buy [military supplies], how to buy them, when and for how much; in fact, the balance of power has definitely tilted in favour of the IDF at the expense of the MoD.

This shift was formalised in 1975, when the then MoD Director General, Prof. Pinhas Zussman, decided to give the armed forces authority to determine the size and uses of the defence budget.

Zussman, who had previously served as Economic Adviser to the MoD, argued that the end-user is ‘best placed to efficiently allocate and invest its resources’, echoing similar views expressed earlier by chiefs-of-staff Mordechay Maklef and Yitzhak Rabin. Zussman concluded that the General Staff, as the body

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66 Zussman interview. An independent committee, which was appointed by the Defence Minister to investigate the procurement practices of the defence establishment, concluded that the decision to transfer the responsibility for central budgets from the MoD to the IDF ‘did not prove itself for many reasons’. The committee discovered that this arrangement has yielded undesired consequences, such as the creation of concealed and deliberately underused reserves in the defence budget, and called for this situation to be reversed. See Ministry of Defence, Final Report of the Public Committee for the Examination of the Lessons from the Dotan Affair (July 1991), pp. 6–7, 22; former MoD Director General David Ivry also thought that Zussman’s decision was a mistake ‘because he did not envision the far-reaching consequences of that step’ (Ivry interview, 1998).

67 Greenberg, Defence Budget and Military Power, 143–146, 152–153. General Maklef insisted that ‘If the General Staff prepares the annual work plan which is then submitted for the approval of the Defence Minister, it must also prepare the budget. The General Staff must be able to set and determine its priorities within the budget’ (said in the Government Session, 15 November 1953).
that sets the IDF’s requirements and operational parameters – which include its build-up and structure, the specifications of its weapons systems, and its combat doctrines – should be vested with the ability to determine its needs as well as the scope of consumption, a principle otherwise known as ‘consumer sovereignty’. Consequently, he transferred the budgetary responsibility for almost all the development projects from the MoD to the IDF, save for a small central budget.68 The lion’s share of the defence budget was placed in the hands of the Chief of Staff, who, with the consent of the Defence Minister and the MoD, divided it amongst the three main branches: Ground Forces, Navy and Air Force (otherwise known as ‘the budget-owners’) for their uses.69 This shift granted the military significant resources, putting it in control of both ends of the warfare spectrum: battle preparation (augmenting future military capabilities) and preparedness (immediate operational readiness).

With this development, the question of weapons development came to a head. Historically, the military has given a higher priority to short-term threats, emphasising the need for off-the-shelf arms supply and available funding for operations, maintenance and upgrades. The General Staff and heads of branches have thus given higher priority to ready access weapons and lower priority to the development of long-term R&D programmes involving a high degree of uncertainty. In contrast, the MoD has tended to reverse these emphases, giving priority to R&D and the development of industrial infrastructure in response to long-term threats.70 According

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68 Bonen, Rafael, p. 39.
70 Ivry interview, 1998.
to Shimon Peres (who served both as Defence Minister and the MoD Director General),

the role of the MoD is to face the future, not the present. The [IDF’s] Chief of Staff serves three or four years, at most; I, on the other hand, need to think ten years ahead.71

The marked difference in the preferences of the MoD and the IDF was further underlined by the ‘consumer sovereignty’ principle. Its implementation reduced the MoD’s scope of responsibilities, initially relegating it to little more than ‘a supplying ministry for the army’ as the IDF had preferred it to be.72 By giving the IDF overall budgetary authority for build-up as well as for operational matters, gradually less money was channelled into R&D and indigenous weapons programmes. More budgets, on the other hand, were assigned to salaries and pension schemes, partly in order to ensure the IDF’s competitive position vis-à-vis the civil job market. (Throughout the years this preference was closely guarded by defence ministers, most of whom were former army officers themselves.73 Prime Minister Rabin, for example, vetoed many attempts by the treasury to cut the salaries of career IDF officers.74)

Consequently, the share of salaries and pensions in the defence budget shot up from 25% in 1980 to 50% in 1992 (according to the Ministry of Finance; IDF insists on a slightly lower figure of 33%), while the number of career officers remained the same, as did the size, in real terms, of the defence budget itself.75 So worrying was this trend that Defence Minister Moshe Arens instructed in 1992 that ₪800 million

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71 Shimon Peres, quoted in Greenberg, Defence Budget and Military Power, p. 153.
73 Trop interview, 2001; Telegraph (Israel), 17 October 1995.
(about $330 million) should be designated for maintaining the spending level in the
domestic defence industries;\textsuperscript{76} a year later the Cabinet allocated further N3 billion for
military purchases from domestic suppliers.\textsuperscript{77} However, the IDF had other preferences
and it consequently cancelled weapon orders from IMI, froze missile purchases from
Rafael and reduced its spending with other local firms.\textsuperscript{78} According to the Ministry of
Finance and the State Comptroller, IDF procurement from local suppliers actually
halved between 1983 and 1995.\textsuperscript{79}

Over the years, the MoD has persuaded some defence ministers of the need to
lessen the IDF's budgetary grip. Strategic and long-term projects funded through the
defence budget became managed through separate directorates. These were formed as
part of the civilian arm - the MoD - and reported directly either to the Defence
Minister or to the Director General. In this way, they were spared arbitrary cuts at the
hands of the General Staff.\textsuperscript{80} In addition, the MoD has found ways to increase the
R&D budget from sources outside the defence budget, including joint research
ventures with foreign armies, special agreements with the Ministry of Finance, and

\textsuperscript{76} Telegraph (Israel), 17 October 1995.

\textsuperscript{77} Nachum Barnea, 'The man who exposed the pay slip', Saturday supplement, Yedioth Ahronoth, 18

\textsuperscript{78} See, for example, letters by the MoD Procurement Directorate (which handles weapons acquisition
for the military) to IMI announcing the IDF's decision to terminate further orders of certain types of
ammunition from the company. See letter from MoD Procurement Directorate to IMI Director
General, headed 'Acquisition of 5.56mm ammunition from IMI', 30 January 1992; and letter from
MoD Procurement Directorate to IMI Director-General, headed 'IMI - acquisition of 155mm
artillery ammunition', 30 January 1992. At Rafael, the Air Force purchased Popeye missiles between
1985 and 1988, but did not renew its orders until 1997. During that nine year period, Rafael was able
to keep the production line running through foreign orders. Author's interview with Yitzhak Gat

\textsuperscript{79} Yedioth Ahronoth, 18 August 1995; see further discussion in chapter 4, 5 and 6.

\textsuperscript{80} Trop interview, 2001; a salient examples was the Merkava battle tank, which is partially funded by
US annual military aid given to Israel and handled by a separate directorate within the MoD.
arrangements with the United States.\textsuperscript{81} These steps helped to offset cuts in the locally funded military R\&D,\textsuperscript{82} as well as overriding objections raised by the IDF about certain programmes promoted by the MoD, such as the reconnaissance satellites project and the ballistic missile defence programme;\textsuperscript{83} the IDF later admitted it had erred in opposing both.\textsuperscript{84}

Former MoD Director General David Ivry maintains that 'the IDF has been accorded a disproportionate influence which destabilised the delicate balance between short-term and long-term military requirements'. Ivry believes that because of pressing needs and the high intensity of security-related events in Israel, 'no Defence Minister had dared to confront or challenge the dominance of the IDF'.\textsuperscript{85} The budgetary autonomy of the military has therefore remained intact.

\textsuperscript{81} These arrangements included scholarships to gifted scientists, tentative agreements with MoF for the increase in the military's R\&D budget, and a $55-million special annual budget earmarked for Rafael's R\&D infrastructure.

\textsuperscript{82} Ivry interview, 1998.


\textsuperscript{84} Moshe Arens, 'Lavi, Ofek, Arrow', \textit{Haaretz}, 5 August 2004; Tov, 'The economic aspects in the civil–military relations', p. 57. Arens insisted that the army would allocate funding for the development of a radar system for the Arrow anti-ballistic missile project. When the Arrow radar system's development was completed, it succeeded in detecting hostile missile launches. See: \textit{Israel Air Force Magazine}, no. 140, August 2001; \textit{Haaretz}, 3 July 2001. Prime Minister Barak admitted he had made a mistake opposing the decision to develop the Arrow radar when he served as Chief of Staff and thanked Arens for his persistence. See: \textit{Haaretz}, 30 October 2000.

\textsuperscript{85} Ivry interview, 1997.
Defence Establishment vs. Treasury: Bureaucratic Turf Wars

Government policy-making in the DIB is overseen and directed primarily by the defence establishment (which consists of both the IDF and the MoD) and the Ministry of Finance (MoF). In addition to the dialogue between these bureaucracies, MoF and MoD officials conduct a separate, parallel and simultaneous discourse with the elected echelon. This four-cornered relationship between MoD, military, Ministry of Finance and the political echelon can be characterised by a vertical and horizontal division of duties and functions (for a schematic illustration see Figure 2-2).

Within this institutional hierarchy, the interaction between the participants is shaped largely by their spheres of responsibility and resembles what Aberbach et al. describe as image three: politicians and bureaucrats involved together in the policy-making process.\(^{86}\) Cabinet and individual ministers bound by coalition agreements and government guidelines, and further constrained by political cost calculations and chronic agenda congestion, only rarely initiate potentially confrontational reforms.\(^ {87}\) Instead they are urged by the public bureaucracy to consider changes to existing policies, which are proposed and advanced mostly by the bureaucracy.\(^ {88}\) In the case of the defence industrial base, this bureaucracy is comprised of two components. One integrated structure, the defence establishment, consists of civil and military arms and is responsible for producing a public good (national security); a separate organisational structure, the Finance Ministry and its associated units (such as the Civil Service Commission), is responsible for matters relating to national finance, including budget and resource allocation.

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\(^{87}\) Granit interview, 1998; Gilad interview, 1997.

\(^{88}\) Tov, 'The economic aspects in the civil–military relations', p. 54.
Figure 2.2: Functional and hierarchical divisions in the DIB
The literature of civil–military relations in Israel suggests that these two bureaucracies appear to behave more as competing units struggling over authority, power and influence than as integrated parts of a coordinated machine. The main bone of contention is the defence budget. Unlike the budgets for civil ministries, in which the MoF decides both the overall allocation and the internal distribution of funds, the defence budget has been an exception. Under instructions from successive prime ministers, the MoF has refrained from interfering in the internal structure of the defence budget, reducing itself to being merely 'the cashier for the defence establishment'. It has simply set an overall spending ceiling, which it has been unable to impose effectively, and left it at that.

This approach changed following the growth of the defence budget in the second half of the 1970s. After the near defeat in the Yom Kippur war, defence spending rose from 11% of GDP in the mid-1960s to over 30%, in some years consuming up to 50% of the state budget. Since then, the MoF has been striving to keep the defence establishment in check, stepping up calls for internal reforms and pay cuts in the wake of the financial crisis of 1985, which led to emergency legislation that included a substantial one-off cut in the defence budget.

The defence establishment has fended off countless attempts to place the internal distribution of the defence budget by the IDF under closer scrutiny, and to

89 Aviezer Yaari, Civil Control of the IDF, Jaffee Centre for Strategic Studies, Memoranda no. 72 (Tel Aviv University, Tel Aviv, October 2004), pp. 41–50; Peri, Ibid, pp. 213–231.
90 Dery and Sharon, Bureaucracy and Democracy in Budgetary Reform, p. 21.
91 A quote attributed to Finance Minister Pinhas Sapir in 1968; see Peri, Between Battles and Ballots, p. 221.
93 Zvi Shor, 'Military power in the grip of budget' in Zvi Offer and Avi Kober (eds), Quality and Quantity in Military Build-up, (Tel Aviv: MoD Publishing, 1985), p. 308 (Hebrew).
curtail the many perks conferred upon the career personnel over the years. This pressure was part of a deliberate MoF strategy to encourage government ministries towards greater efficiency and cost cuts; a more disciplined and economical MoD could have set an example and contributed greatly towards that aim.94 (One interviewee also suggested that self-serving considerations were at play, as certain MoF officials owed their career advancement to successfully placing budgetary hurdles in the path of the Defence Ministry.95)

A partial break in this stand-off was noted in 1993, when the IDF agreed to examine the operations of its logistic and maintenance depots, which the MoF viewed as costly and in many cases utterly redundant, compared to the industrial capabilities outside the army.96 The defence establishment appointed a committee to examine how much infrastructure inside and outside the defence establishment was duplicated and to recommend policy guidelines for using it more efficiently. Implementation of the committee’s recommendations, however, was fraught with difficulties and only partially executed.97 The IDF also rejected a proposal for external defence companies to run its manufacturing and logistic centres, which could have yielded significant economic advantages.98

94 Tov, 'The economic aspects in the civil–military relations', p. 58.
96 Gilad’s speech at the Herzliya Conference; Haaretz, 17 August 2004.
98 Gilad’s speech at the Herzliya Conference. IMI, for example, suggested in 1994 that it should lead a consortium of companies that would manage the IDF-controlled Merkava battle tank plant, but the military turned down the offer on the basis of operational considerations.
A further compromise was reached in July 2002, when the MoD agreed to appoint a representative from the Accountant General’s office to monitor implementation of the defence budget.\(^9^9\) The MoF agreed in return not to oversee certain key areas, including the administration of salaries and expenses, which it normally monitors in other ministries.\(^1^0^0\)

The defence establishment’s insistence on the last concession was no accident: such autonomy in budgetary matters was crucial for meeting intense operational needs, but at the same time it also facilitated the introduction of many fringe benefits which, under the veil of secrecy, were shielded from the prying eyes of other elements of the public sector.\(^1^0^1\) For example, the defence establishment has a separate pay scale, on average about 80% higher than that of other government ministries.\(^1^0^2\) Moreover, IDF career officers are offered many perks not available to other civil servants and can retire at 40 on full pension (statutory retirement age is 67).\(^1^0^3\) And, unlike the practice in other parts of the civil service, appointments to senior positions in the defence establishment are handled internally and not opened to public tender.\(^1^0^4\)

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\(^9^9\) MoF spokesperson press release, 29 April 2003.

\(^1^0^0\) Tov, ‘The economic aspects in the civil–military relations’, p. 57; Yaari, JCSS 72, p. 47. In an illuminating example, the IDF prevented Income Tax Authority inspectors from visiting its Paymaster General’s Office. \textit{Maariv}, 6 December 1992.

\(^1^0^1\) \textit{Haaretz}, 14 March 2003; \textit{Globes}, 23 August 1996; Gilad interview, 1997.

\(^1^0^2\) \textit{Haaretz}, 15 September 1997.

\(^1^0^3\) These perks include summer camps for children, free medical care (including dental treatment), free holidays and heavily discounted goods. See Reuven Pedatzur, ‘the truth about the defence budget’, \textit{Haaretz}, 30 January 1995. Many career officers have also taken advantage of cheap quality housing in new towns that were planned by the defence establishment for the purchase and use of selected career personnel. See Suliman and Cohen, ‘IDF: From the people’s army to a professional army’, \textit{Maarachot}.

\(^1^0^4\) Galnoor, \textit{No, Mr Commissioner}, pp. 71, 204.
Indeed, the centrality of the security issue in Israel has allowed the defence establishment to torpedo any attempt to reform the preparation and implementation of the defence budget, and also to resist efforts to subject it to wider civil supervision.\(^{105}\)

Reflecting on this, Finance Minister Binyamin Netanyahu noted in 2005 that such external control had become practically impossible because ‘the defence establishment, with its workers and generals, is the strongest union in the country.’\(^{106}\)

The MoF’s long-held view on the preferences of the defence establishment (Finance Minister Yaakov Neeman claimed in 1997 that ‘the IDF neglected its military build-up for the sake of better salaries’\(^{107}\)) was rejected by former Prime Minister, Shimon Peres, who also headed the Finance Ministry in the 1990s. According to Peres, the MoF world view is dominated by short-term considerations: ‘They [MoF officials] had their own calculations, and these calculations were not always objective’.\(^{108}\) Nevertheless, former senior MoD officials – one served as IDF’s Chief of Staff – maintained that the IDF, with its exclusive benefits and closely

\(^{105}\) The Knesset’s powers of oversight in the areas of the defence budget and security policy are limited. Only a handful of carefully vetted MKs are authorised to examine the defence budget in its entirety and most of the deliberation were done behind closed doors. See Haaretz, 28 December 2004, 29 December 2004; Dery and Sharon, Bureaucracy and Democracy in Budgetary Reform, p. 21; Peri, Between Battles and Ballots, pp. 175–192, 225–227; Yaari, pp. 23–30.

\(^{106}\) Interview with Haaretz-The Marker, 21 April 2005.

\(^{107}\) Finance Minister Yaakov Neeman, in an interview with Haaretz, 12 September 1997.

guarded privileges, has an inward-looking approach that is predominantly focused at furthering its own material advantage.¹⁰⁹

The defence establishment found itself increasingly competing with other policy areas, especially from the early 1990s onwards, when national priorities changed, and social and welfare sectors were allocated significantly more resources (reflected by in-kind services and transfer payments) – up from 15% of GDP in 1991 to 21.3% in 2001.¹¹⁰ This shift, which was also enshrined in legislation and accompanied by pay rises ranging from 20% to 70% in the public sector (especially for those in education, health and academia), reversed the spending restraint of earlier decades.¹¹¹ Furthermore, the Budget Deficit Reduction Law of 1992 required the government’s overall budget deficit, as a percentage of GDP, to decline year by year.¹¹² This meant that the sheer size of the defence budget (about $8–10 billion per year) singled it out, year in year out, as an easy target for MoF demands for budget cuts.¹¹³

These attempts were vehemently resisted by the defence establishment. One way of deflecting the pressure for cuts was for the MoD to threaten that any further


¹¹¹ Gilad interview, 1997; and Granit interview, 1998.


damage to the defence budget would affect IDF purchases of advanced weapons systems from local defence enterprises.\textsuperscript{114} The MoF retorted by accusing the defence establishment of treating the defence industries as if they were its ‘stepchildren’, sacrificing their interests in the interest of ‘short-term, self-serving calculations’.\textsuperscript{115} The MoF had long advocated privatisation and restructuring of the defence industry as a means to raise income and reduce the government’s exposure to potential losses in this sector.\textsuperscript{116} It therefore viewed the fall in IDF orders from local industry and the simultaneous increase in career officers’ salaries (over which the MoF had no control) as ultimate proof of the need for an external check on the defence budget.\textsuperscript{117} Nevertheless, it regarded the state-owned defence industries as part and parcel of the defence establishment – and, as such, mainly the responsibility of the MoD.

\textit{MoD and State-owned Defence Enterprises: Dilemmas of Divided Loyalty}

The founding fathers of the state assigned the defence enterprises to the control and guidance of the Defence Ministry, because they perceived their activities to be of national importance rather than commercial value.\textsuperscript{118} The history of relations between the MoD and the state-owned enterprises broadly divides into two periods: before the national financial crisis of the mid-1980s and afterwards. Until 1985, the MoD was the prime powerhouse behind the enterprises, encouraging their growth and influencing their industrial development. Relations between the state-owned enterprises and the MoD were strong, both in terms of contracts and overall

\textsuperscript{114} Haaretz, 17 August 2004.
\textsuperscript{115} Gilad’s speech at the Herzliya Conference.
\textsuperscript{116} Neeman interview.
\textsuperscript{117} Gilad interview, 1997; Galnoor, \textit{No, Mr Commissioner}, p. 310–311.
preferential treatment. This preference was explained as necessary on grounds of security and operational requirements, but also on the basis of these enterprises’ technological achievements and price. \(^{119}\) There were also significant financial incentives at play: the MoD used part of the revenues and advance payments from foreign clients to firms under its direct control (e.g. IMI and Rafael, when these were autonomous units within the MoD), as a means to increase its disposable budget beyond its nominal one. \(^{120}\) At times, political and personal considerations affecting the incumbent Defence Minister – most of them viewed the defence firms as a political base \(^{121}\) – also played a part in perpetuating favouritism. This attitude helped nurture a perception of the MoD as the ‘guardian angel’ of the state-owned industry.

The national financial crisis of 1985 marked a sea change in the relationship between the MoD and its enterprises. It forced the defence establishment to make major budget cuts and to re-examine budgetary resources, a reassessment that led eventually to the cancellation of the *Lavi* aircraft project and to a gradual shift of arms orders from local producers to the US (see further discussion in Chapter 3). \(^{122}\) This

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\(^{120}\) Author’s interview with Aharon Fogel (Director General, Ministry of Finance 1992–1994), 26 June 2001 (hereafter: Fogel interview).

\(^{121}\) Two notable examples were Shimon Peres and Moshe Arens who kept close relations with IAI’s management and employees. Defence Minister Peres awarded IAI budget for a provisional study of a future combat aircraft, which later became the *Lavi*, see Yaniv, *Politics and Strategy in Israel*, p. 290 and Reiser, *The Israeli Arms Industry*, p. 172. The IAI Employees’ Organisation assisted Peres during election campaigns. Author’s interview with Eitan Haber (Head of Prime Minister Rabin’s Bureau, 1992–1995), 21 December 1999, Ramat-Gan (hereafter: Haber interview). Defence Minister Arens sought asked the IAI management to promote several pro-Likud activists, who worked in the company. See *Al Hamismar*, 30 April 1991.

\(^{122}\) Ivry interview, 1997.
change soon showed in total orders from domestic suppliers, which dropped from ₪7.4 billion in 1984 to ₪3 billion in 1995, and stabilised at a level of ₪5 to 6 billion per annum.\textsuperscript{123} Weapons and ammunition previously purchased locally, such as rifles, artillery shells and radio systems, were ordered instead in the US.\textsuperscript{124} Furthermore, certain Israeli-made weapon systems that the IDF could not buy from its own local budget were relabelled as American-made – through joint ventures between a local producer and an American firm – and then paid via the US annual military aid given Israel.\textsuperscript{125}

Contractual practices also underwent major reform. The MoD hardened its purchase terms for local industries, which were now expected to absorb the majority of R&D costs even if the customer (IDF) changed its specifications (an approach known as ‘Fly before Buy’).\textsuperscript{126} It also tied purchases of new weapon systems to export deals in which the development costs were borne mostly by the foreign customer, and insisted on buying equipment from later production batches to ensure the cheapest possible unit price (this falls as the production cycle progresses). A later development, in the form of the Mandatory Tenders Law of 1992, introduced competitive bidding for government contracts and transparent selection methods by government ministries,
including the MoD, thus effectively ending any ostensible preference for single-source agreements with state-owned suppliers.\textsuperscript{127}

These developments unveiled the conflict of interests inherent in the multiplicity of roles the MoD assumed \textit{vis-à-vis} the main defence enterprises under its control. On at least two occasions, senior MoD officials tendered their resignation from the IAI board of directors when they realised board membership was incompatible with their official duty. In the first case, the Economic Adviser to the MoD, Zvi Trop, resigned in 1987 when he was assigned to negotiate the severance packages awarded to IAI’s workers following the cancellation of the \textit{Lavi} project. On earlier occasions he had rejected pressure from the then IAI Director General, who ‘reminded’ him of the MoD’s legal obligation for the company’s finances.\textsuperscript{128} Then, in 1991, the MoD Director General David Ivry decided to leave the board of IAI because of pressure by the company for preferential treatment: ‘Workers and management assumed that just because I was serving on the board, I was automatically biased in their favour. They simply refused to accept that I was capable of separating my role as MoD Director General from my role as board member of IAI; when I was sitting in the office of the MoD Director General I employed the considerations of a client; when I was sitting on the board of IAI, I was acting in the capacity of an owner.’\textsuperscript{129} According to Ivry, the way to entertain both objectives was by addressing the enterprises’ problems pragmatically. For example, by issuing export permits for weapon systems the MoD helped to increasing the enterprises’ order book and

\begin{footnotesize}
\begin{enumerate}
\setcounter{enumi}{127}
\item State Comptroller Annual Report no. 43 (Jerusalem: Government Printer, 1993), pp. 747–749 (Hebrew); this law, for all its merits, created some complications for the MoD and slowed down its acquisition processes. See Galnoor, \textit{No, Mr Commissioner}, p. 203.
\item Trop interview, 2000.
\item Ibid.
\end{enumerate}
\end{footnotesize}
revenues, which in turn helped to keep employment levels up and reduced production costs (and also helped to push down the prices paid by the IDF for the same weapons).\textsuperscript{130} 

However, the MoD's pragmatism did not sit well with the employees' unions. During disputes and periods of tension over financial losses and redundancies, violent behaviour by workers became commonplace. Managers and directors at Rafael, IMI and IAI were subject to abuse, humiliation and intimidation, accompanied by deliberate acts of damage, mostly to their offices and cars. At times, the concern for their personal safety was such that they were accompanied by bodyguards.\textsuperscript{131} These incidents, which were hushed up and left mostly unchallenged, gave the impression of a weak MoD and indecisive management, unwilling or incapable of standing up to unruly unions.\textsuperscript{132}

**Conclusions**

In Israel, the very nature of the executive authority's involvement in the defence industrial base suggests that the conflict of interests built into the framework of decision-making renders any attempt at structural reform in this sector politically and financially costly, if not impossible. In other words, its execution, including policy implementation and imposing financial penalties on powerful organised groups, is likely to face great difficulties. The multiplicity of government actors involved in the sector also suggests that there is no single point of contact, in the form of one department that assumes overall responsibility for the state-owned defence industries.

\textsuperscript{130} Ibid.

\textsuperscript{131} See specific examples in Chapters 4, 5 and 6.

\textsuperscript{132} The MoD discussed in 1987 a suggestion for temporarily shut down Rafael in response to the workers' behaviour. After much deliberation the idea was rejected. Trop interview, 2001.
This state of affairs has been exacerbated by prime ministers who seemed to view the defence industries at times as if they were merely chattels, a sort of consolation prize to pacify disgruntled political allies.

The main government bodies, the Ministries of Finance and Defence, perform different tasks and hold diametrically opposed positions that influence their relations with the defence enterprises – epitomised in the battle over the defence budget. This long-lasting conflict suggests that the ministries’ deeply entrenched views stem largely from their organisational roots as well as from traumatic events in the history of the state. The Yom Kippur war of 1973, in the case of the IDF, and the national financial crisis of 1985, in the case of the MoF, were formative experiences that were accompanied by internal reforms and wide-ranging legislation. The introduction of the 1975 ‘consumer sovereignty’ directive in the defence establishment and the enactment of two major laws in 1985, which vested the MoF with new powers, shaped the course of action and strategic preferences of both actors for many years to come, thus pointing to a certain ‘path dependency’. The IDF showed a clear bias towards having readily available resources for short-term objectives, a view it was able to assert by virtue of its sheer dominance. The Budget Department and the Accountant General’s office, on the other hand, favoured strict enforcement of budgetary discipline, to be achieved by placing as many checks as possible on government spending. These contrasting views inevitably led to bureaucratic in-fighting, in which the state-owned defence firms at times became embroiled in the power struggle over budget allocations between MoD and MoF.

While this bureaucratic in-fighting was gaining momentum, the employees’ organisations discreetly augmented their own power. Increasing involvement embedded the employees’ leadership in the corporate affairs decision-making chain,
and they became protagonists of equal importance in the policy process, protected by legislation and the courts. The influence of these interest groups was further boosted by exploiting emerging opportunities in the political arena: first and foremost the introduction of primaries in the main parties. This enabled the organisations to establish a formidable power base at the heart of the political system. The combined effect of these developments equipped the workers with an effective capacity to undermine, and possibly even to thwart, government policy initiatives.
CHAPTER 3
The Path from Success to Crisis

The Israeli defence industry owes its remarkable growth to a combination of policy and circumstances. In Israel's early days, its policy-makers encouraged rapid expansion of the defence industrial base due to recurring arms embargoes and pressing security needs. Over the years, however, Israel came to realise that for economic and technological reasons it was unrealistic to strive for self-sufficiency in arms production. Furthermore, the Israeli armed forces ceased to view the domestic industry as their preferred supplier, which forced the local industry to direct most of its output abroad.

This chapter explores the evolution of the defence industry, starting with the security considerations and factors that affected its inception, continues by examining the industry's rapid build-up during the 1960s and the 1970s, until the domestic financial crises in the mid-1980s and the beginning of the 1990s. It concludes by discussing Yitzhak Rabin's election as Prime Minister in 1992, the implications of this for the domestic defence industrial base and the response of the government bureaucracy to the enterprises' looming crises.

Seeking Self-sufficiency in Arms Production

The circumstances that led to Israel's establishment, its constant struggle for survival and disappointments with foreign suppliers dictated the development of domestic arms manufacturing capabilities. During the pre-state years and afterwards Israeli leaders were acutely aware of the imbalance between Israel and its Arab neighbours, resulting from its small territory and population, as well as its lack of natural
resources. The constant threat to national survival forced the country to seek external sources of weapons and military technology. It did not have much faith in the goodwill of the international community, but it sought to balance the resource asymmetry vis-à-vis Arab rivals by securing support from big powers, and so successive governments sought either alliance with, or guarantees from, major Western powers like Britain, France and the US.¹

However, initial attempts to buy weapons and warfare-related equipment were fraught with difficulties, as arms suppliers were reluctant to develop a steady relationship. Most of the major arms-supplying countries preferred to sell to the Arab states – mainly for geostrategic reasons, and because of their growing dependency on oil – while Israel lacked both political and economic resources as well as an adequate defence industrial infrastructure.

The US, for instance, refused to sell non-defensive equipment to Israel until 1968 and imposed selective embargoes as part of a policy of neutrality in the Middle East, which meant that for many years Israel could not rely on unreserved supply from the US.² That policy was reversed during the presidency of John Kennedy, and more evidently in the 1970s during the administration of President Richard Nixon, who saw the Arab–Israeli conflict through a Cold War prism, with the Middle East as a place to win client states and avoid superpower war.³

In many cases, dealing with foreign arms suppliers showed Israel that arms sales are largely a continuation of diplomacy by other means. Western governments, especially those with a global or regional agenda like the United States, Britain and France, have all attempted to use arms supplies to gain diplomatic and political concessions. In more than one case, supplying countries have ignored (or sometimes unilaterally cancelled) written agreements with Israel, proving yet again that, when challenged by different or new circumstances, governments are committed first and foremost to their own interests. Furthermore, Israel was sometimes trapped in disputes between rival ministries of the same foreign governments over arms procurement deals.

Frequent rejections of Israel’s requests for both weapons and technologies, recurrent arms sanctions, and intensified rearmament by Arab nations during the 1960s worried Israeli decision-makers. A growing fear that the needs of the Israel Defence Forces (IDF) could not be met convinced the Israeli leadership to embark on

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4 The United States, for example, has reneged 12 formal, binding commitments on arms supplies to Israel – five of them in the late 1970s and the beginning of the 1980s – mostly in response to Israeli military and intelligence operations. Source: Planning and Control Division – Israel Military Industries, ‘The need for technological and manufacturing infrastructure of heavy ammunition in Israel’, July 1994, annex A (internal briefing document).

developing a broadly based indigenous arms production capability. This realisation was reinforced by the French decision to halt weapon supplies to Israel in 1967.

The French embargo led the Israeli government to conclude that 'it would be virtual suicide to leave production of vital equipment in non-Israeli hands', and that, if Israel wished to retain sufficient political leverage and to do everything necessary for its survival, including exercising the right to exercise self defence, it should strive for self-sufficiency in arms supply. This led on to a programme for indigenous production of advanced aircraft, tanks and naval craft, as well as missiles, electronics and other subsystems.

This decision temporarily settled a debate that had been going on inside the Defence Ministry in the 1950s and 1960s. One camp, headed by the then Director General of the Defence Ministry Shimon Peres and Chief of Staff Lt. General Zvi Zur, stressed the importance of self-sufficiency and insisted that most, if not all, necessary equipment, including platforms and battle systems, should be produced indigenously. The other camp, led by Maj. General Yitzhak Rabin, preferred buying foreign equipment that was already available abroad, preferably from the US, and insisted that 'the decisive viewpoint in building up a military force must be that of the men who employ the arms, not the men who buy or manufacture them'. He also held the local industry's achievements in low regard, referring to them as the product of 'copying,
imitating or stealing foreign technology. Indigenous defence industry, he maintained, should focus on low-risk R&D programmes and be confined mainly to maintenance and improvement of subsystems, a view which was also accepted by Prime Ministers Levi Eshkol and Golda Meir.

Over the years, Israel developed a dual-track defence procurement policy. It continued taking every opportunity to buy weapons abroad, but it also invested heavily in establishing a sophisticated defence industry, mostly via hidden reserves in the defence budget kept for this purpose outside the reach of the military. Several considerations were at play: defence equipment manufacturers and associated research laboratories could give valuable logistic back-up for the IDF and could provide solutions for operational problems that were also useful in furthering Israel's relations with foreign armies. In addition, advanced, defence-oriented research and development facilities would enable the defence industrial base to tailor existing weapons to specific IDF needs and develop new ones not available elsewhere. Such an industry would also generate employment and export income, inspire innovation in related civilian fields (see Table 3.1) and help urban development in certain parts of

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11 Quoted in Efraim Inbar, Rabin and Israel's National Security (Baltimore: Johns Hopkins University Press, 1999), p. 80.
12 Greenberg, Defence Budget and Military Power, pp. 98–99; Zur interview; Peres interview.
13 Zur interview; Inbar, Rabin and Israel's National Security, p. 79.
15 Israel Aircraft Industries developed special insulators for the fuel tanks of the French Mirage aircraft, following a leakage problem that forced the Israel Air Force to ground its entire Mirage fleet in 1962. Israel passed information on the new product to the French authorities. See: Michael Meron, Memories of the Past (Tel Aviv: self-published, 1999), p. 49 (Hebrew).
the country, contributing to the government policy of population dispersal.\textsuperscript{16} Most importantly, reducing dependence on arms imports would make Israel less susceptible to embargoes and give it greater operational leeway.\textsuperscript{17} As David Ben-Gurion, Israel’s first Prime Minister, asserted in his address to Rafael (the National Armament Development Authority) employees on 27 June 1963:

\begin{quote}
We could not put our trust for our existence, security and well being on others. We could only do so upon ourselves. And the only way to assure our safety and prevent war is by having effective weapons that deter our enemies.\textsuperscript{18}
\end{quote}

Four considerations guided local development and manufacture of weapons:\textsuperscript{19}

- Political: The refusal of foreign powers to sell critical weapon systems (or the breach of contractual commitments to supply battle systems).
- Economic: The lower cost of domestic production compared to imports, and the ability to prolong the service life of combat systems through upgrades. Also, the potential contribution to the national economy of increased domestic production volumes and efficiency, which would lead to higher employment and contribute to the balance of payments.


\textsuperscript{17} Peres interview; Zeev Bonen, The Israeli Defence Industry – Past and Future, (Technion, Yad Neeman, 16 February 1994), Lecture transcript, p. 35.


• **Military**: Achievements of Israeli developers that helped the IDF acquire a decisive advantage on the battlefield: for example, in electronic warfare.

• **Strategic**: The production of special weapon systems needed to facilitate a regional deterrence posture, and which were unavailable from other sources.

### Table 3.1: Military research areas that facilitated civilian applications in Israel

<table>
<thead>
<tr>
<th>Field</th>
<th>Subject</th>
<th>Contribution/Application</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aeronautics</td>
<td>Structure and aerodynamics</td>
<td>R&amp;D of business jets</td>
</tr>
<tr>
<td>Electronics</td>
<td>Radar</td>
<td>Air traffic control radar</td>
</tr>
<tr>
<td>Communication</td>
<td>Encoding</td>
<td>Cellular phones and networks</td>
</tr>
<tr>
<td>Electro-optics</td>
<td>Image processing</td>
<td>Image processing for printers</td>
</tr>
<tr>
<td>Control</td>
<td>Gimbal control</td>
<td>Medical scanners</td>
</tr>
<tr>
<td>Micro-electronics</td>
<td>Sensors &amp; signal processing</td>
<td>Medical equipment</td>
</tr>
<tr>
<td>Computing</td>
<td>Software</td>
<td>Internet software</td>
</tr>
<tr>
<td>Agricultural engineering</td>
<td>Rapid entrenchment</td>
<td>Mechanized digger</td>
</tr>
</tbody>
</table>

Consequently, the Israeli government allocated many resources in order to establish an independent military industrial base. A comprehensive knowledge base was set up in universities and government laboratories through global networking and by applying practices such as reverse engineering, industrial espionage and smuggling of specialists and equipment in covert operations. A classified report, written by the US Department of Defence, stated:

> The Israelis have established an intelligence service capable of targeting military and economic targets with equal facility. The strong ethnic ties to Israel present in the US coupled with aggressive and extremely competent intelligence personnel has resulted in a very productive collection effort. Published reports have identified the collection of

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20 Zeev Tadmor, Lecture transcript, Yad Neeman Institute, Technion, September 1997.


scientific intelligence in the US and other developed countries as the third highest priority of the Israeli Intelligence after information on its Arab neighbours and information on secret US policies or decisions relating to Israel.

The impact of growing investment in the domestic industrial base was quickly felt. Local enterprises supplied 62% of Defence Ministry requirements between 1967 and 1972. Over the years, though, Israel realised that maintaining a sophisticated defence industry base requires significant additional funding, which was beyond the nation's financial ability. This recognition, and the rising costs of new developments, highlighted the attractions of exporting arms. Israel was quick to offer foreign customers operational solutions, based in part on the IDF’s combat experience. These proved highly successful, due to three factors: considerably shorter development cycles, involvement of the end user (IDF or foreign client) in the development process, and ground-breaking concepts that revolutionized warfare operations.

The rapid rise in export revenues – from $40–70 million in the 1970s to about $2.2 billion at current prices, which amounted to about 8% of Israel’s total exports in the late 1990s – subsidised the R&D costs of new weapons and increased the

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23 The report of the US Department of Defence’s Investigations Service (DIS) on Israel appeared with a picture of the original document in Haaretz, 31 January 1996.
26 Defence News (US) ranked Israel third among top defence exporters, after the US and Russia. See Associated Press, 19 November 2003; Yossi Ackerman, 'The policy from the viewpoint of the privately and publicly owned industry', in Tov (ed.), Defence and Israel's National Economy, p. 128; Yaakov Toren, 'The impact of US military assistance on industrial policy', Ibid., p. 104.
27 Author’s interview with Yekutiel Mor (Deputy Director General for international relations, MoD, 1992–2003), 9 October 1997.
MoD's disposable income. Strategic weapons, including satellites and long-range ballistic missiles, were funded from revenues generated by arms sales to Iran (under the Shah), South Africa, China, Singapore and Chile. In many instances, export agreements included technology transfers and joint development of weapons. Such cooperation was risky: some joint projects resulted in heavy losses, and in other cases the Israeli MoD discovered that technological knowledge transferred to foreign firms was later used by them to compete against the original Israeli designs.

In most cases, though, Israeli arms exports were highly profitable. Not only were they important in offsetting Israel's trade imbalance, they also extended its clandestine reach. Arms sales helped to save Jewish communities and to maintain contacts with countries that refrained from open relations. India and China, for

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30 For example, China was co-developing its future combat fighter based on the technology of the cancelled Israeli Lavi fighter, see Aviation Week, 13 March 1995, pp. 26–27; Defence News, 2 September 1996, p. 6.

31 For example, the 1989 contract to develop the Phalcon Aerial Early Warning aircraft for the Chilean air force which brought a $120 million loss to IAI; see: Haaretz, 25 April 2000; Sales of IMI to several countries, such as Thailand, were done at a loss were done at a loss. See author’s interview with Brig.-Gen. (res.) Yossi Snir, IMI Vice President for Strategy (1992–1996), 30 August 2005 (hereafter: Snir interview, 2005b)

32 South African firms that received Israeli know-how later used it to compete with equivalent Israeli products or as part of systems sold to Arab countries. See Zeev Schiff, 'good and dubious deals', Haaretz, 17 June 1997, and Haaretz, 1 April 1997 and 25 April 2000.

33 Klieman, Israel’s Global Reach: Arms as Diplomacy, p. 35; Israel paid Sudanese and Ethiopian leaders with arms to countenance operations to rescue Ethiopian Jews in the 1990s.
example, established diplomatic relations with Israel only in 1992, after decades of
secret relations.34 Countries like Yemen,35 Indonesia,36 and Sri Lanka,37 which still
have no formal relations with Israel, were supplied with military systems, which
helped to maintain a level of dialogue. Israel Aircraft Industries (IAI) alone has
reported that its client-base reaches over 80 countries, while Israel Military Industries
(IMI), in its prime, supplied more than 60 foreign armies.38

The availability of foreign weapons sold to Israel was also influenced by its
technological and industrial capabilities. The more advanced they became, the fewer
restrictions on arms transfers were imposed, especially by the United States. Although
Israel gained greater access to the American arsenal as time went by, the US refused
many Israeli requests for technology transfers, on commercial, political or security
grounds: electronic warfare systems, advanced-generation air-to-air missiles, infrared

34 Moshe Yegar, 'Basic Factors in Asia–Israel Relations', in Moshe Yegar, Yosef Govrin and Arye
Oded (eds), Ministry of Foreign Affairs – The First Fifty Years (Jerusalem: Keter Press, 2002), pp.
35 Yemeni soldiers came to Israel for training in the 1960s and were supplied with arms as part of a
secret pact involving the Yemeni monarchist authorities (who were fighting Egyptian-backed rebels),
the Israeli government and also Britain. See: Michael Bar Zohar, Yaacov Herzog: A Biography,
36 Israel sold dozens of Skyhawk aircraft and armoured personnel carriers to Indonesia and carried out
military upgrade programmes. The relationship was first acknowledged publicly when Prime
Minister Rabin visited President Suharto in Jakarta in October 1993; the then energy minister, Moshe
Shachal, also revealed that Indonesia sold oil to Israel. Another meeting took place between Prime
Minister Shimon Peres and President Abdurrahman Wahid in Jakarta in August 2000. Indonesia has
been for many years one of Israel's main coal suppliers and maintains active commercial links. See
Yedioth Ahronoth, 22 October 1993, 29 March 2000, 3 November 2003; Michael Shannon, 'Israel's
37 Israel sold Sri Lanka five Kfir combat aircraft and six Dvora patrol boats during the late 1990s; the
38 1998/1999 IAI's official calendar; Shor interview.
detectors and other sensitive components were denied. In some cases, like that of the MLRS rocket system sold to Israel, the Americans attached operational restrictions. However, as soon as Israel demonstrated it had developed the technology to produce similar weapon systems, the US lifted its export objections. Previously refused systems, such as advanced medium-range air-to-air missiles (AMRAAM), were offered to Israel once the US realised that Israel had similar or better weapon systems.

**Patterns of Accelerated Growth**

Imported technology and Israeli innovation jointly boosted the defence industry's growth, which evolved through several stages. It started with small-arms production and the maintenance of more complex weapons, followed by licensed production and joint ventures, the adoption and upgrading of licensed systems, and local production and design of components (see Table 3.2). The French arms embargo of 1967 and the aftermath of the 1973 war served as a catalyst for the next phase, namely independent design and the production of major weapons systems and platforms, accompanied by a significant increase in production capacity. This rapid progress backfired during the 1990s, as a sharp fall in domestic and foreign demand led the industry to contract and focus on producing niche systems and components.

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39 Bonen, *Rafael*, p. 98; Zur interview.
42 The gradual evolution of the Israeli arms industry was a step by step process which resembled that of other emerging economies. See: David J. Louscher and Anne Naylor Schwartz, 'Patterns of Third World Military Technology Acquisition', in Kwang-il Baek, Ronald D. McLaurin and Chung-in
The origins of the Israeli defence industries go back to the 1930s, when the Jewish community in mandate Palestine was clandestinely making and repairing rudimentary weapons. This secret network of small factories was established to support underground paramilitary organizations opposing British rule in Palestine.43

Table 3.2: Israel’s progress in weapons and military technologies

<table>
<thead>
<tr>
<th>Decade</th>
<th>Product</th>
</tr>
</thead>
<tbody>
<tr>
<td>1940s</td>
<td>Hand grenades; submachine guns; mortars, armoured cars</td>
</tr>
<tr>
<td>1950s</td>
<td>Uzi submachine guns; small arms and ammunition</td>
</tr>
<tr>
<td>1960s</td>
<td>Fouga Magister jet trainers (licensed production); Gabriel anti-ship missiles, Jericho intermediate-range ballistic missiles; first-generation non-conventional capabilities</td>
</tr>
<tr>
<td>1970s</td>
<td>Unmanned aerial vehicles; laser range-finders and designators; Galil assault rifles; Reshef missile boat family; Kfir fighters; Merkava tanks; Barak surface-to-air missiles; Popeye air-to-ground missiles</td>
</tr>
<tr>
<td>1980s</td>
<td>Electronic-warfare systems, electronic intelligence and communication intelligence systems; thermal imaging and electro-optical systems; Ofeq reconnaissance satellite family; Jericho Mk 2 ballistic missiles; Harpy attack UAV; Lavi fighter (cancelled); secure communication systems; deciphering and encoding equipment; short and medium range air-to-air missiles; directed-energy weapons; advanced armour techniques</td>
</tr>
<tr>
<td>1990s</td>
<td>Multi-purpose attack UAV; complex composite structures; cyber-warfare; Arrow anti-ballistic missiles; simulators; electronic-warfare systems; communication systems; remote sensing; anti-tank guided missiles; cruise missiles; upgrade programmes; Merkava tanks (Mks 3 and 4)</td>
</tr>
</tbody>
</table>

Sources: Eliot Cohen et al., Knives, Tanks and Missiles, p. 44; Kfir and Erez (eds.), Defence Industry; Haaretz; US Institute for Defence Analyses (IDA)

From the late 1940s until the mid-1950s local production focused largely on small arms and ammunition and the refurbishing of old weapons – World War II


surplus – for use by the IDF. The practice of using available materials for upgrades and for extending the life of weapons at relatively low cost was established, as a small-arms industry slowly began to take shape. The pre-State underground network of arms manufacturing was grouped together as a department within the Ministry of Defence named Israel Military Industries (IMI). At the same time, an aircraft maintenance facility, Bedek, was founded in 1953 and became a department in the Ministry of Defence, specializing in maintaining and repairing military aircraft. Shortly afterwards, the workforce in defence facilities had reached 5,000.

The second phase, involving licensed production, lasted from 1955 to 1967. A confluence of political and military interests led to close cooperation between Israel and France, which culminated, among other things, in the Sinai-Suez War of 1956. During this period France sold Israel advanced aircraft, armoured vehicles, naval craft and other weapons. In addition, it provided the Dimona nuclear reactor, complete with a supply of natural uranium to fuel it and the technological knowledge for the Israeli ballistic missile programme. France also agreed to provide technological assistance for license production of combat fighters and jet trainers. And all this brought about a major advance in local arms capabilities.

The Sinai War of 1956 brought a rapid increase in the IDF inventories. Additional tanks, jet fighters, helicopters and new communication systems led to a swift growth of maintenance facilities. The responsibility for R&D was transferred in 1958 from the Research and Planning Branch of the Ministry of Defence to a separate

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unit, Rafael, but it remained part of the Defence Ministry. As a national laboratory, Rafael was required to address the critical demands of the IDF, including top secret projects.

At the same time, Israel Military Industries (IMI), once a small manufacturer of relatively simple components and light arms embarked on new projects for upgrading artillery platforms such as battle tanks and self-propelled guns. Bedek, which changed its name to Israel Aircraft Industries in 1960, turned from an aircraft maintenance and repair workshop into a full-scale manufacturer, specializing in avionics, missiles and the assembly of French jet trainers. The MoD, meanwhile, decided to help in setting up a defence electronics industry.

Under the guidance of the then Director General, Moshe Kashti, the MoD gave financial assistance to new private companies. These focused at first on upgrading imported systems and on low-tech products, such as lamps and batteries, but soon started developing more sophisticated components. One of them, Tadiran (set up and partially funded by the MoD, with Koor Industries as a partner), later became the fourth-largest defence firm after IAI, IMI and Rafael. Other companies greatly assisted by the MoD included El-Op (a small plant that specialised in electro-optics); Elbit (a joint venture established by Elron Electronic Industries and the MoD to supply electronic equipment for aircraft) and ISCAR (Israel Carbide), a

50 Yaniv, Politics and Strategy in Israel, p. 145.
51 Bonen, Rafael, p. 73.
52 Klieman and Pedatzur, Rerarming Israel, p. 72; Bonen, Rafael, p. 101.
company that specialised in metal-working and metal-cutting tools and was contracted to provide jet engine turbine blades. The expansion of the defence industry was reflected in the number of employees, which by 1967 had increased to 14,000, including 1,700 at IMI and 3,000 at IAI.

Israel’s search for qualitative superiority over its neighbours underlined the need for technologically advanced systems. This led to greater resources being made available to the defence sector, which quickly became a major component of the emerging Israeli economy. In 1966 MoD Director General Kashti presented a detailed plan for long-term platform development that was initially rejected by the General Staff, headed by Rabin, but it was later accepted after the 1967 French embargo and the accelerated expansion of the defence establishment that followed victory in the Six-Day War.

The euphoric atmosphere that gripped Israel in those years and the difficulties in arms procurement inspired the government to ambitious plans. In 1969 the Cabinet decided to produce a locally made fighter aircraft, and in 1970 it approved a plan to manufacture an indigenous battle tank (the latter decision being taken after the British government in 1969 rescinded its consent to the sale of Chieftain tanks to Israel and their license production in its factories).

Also in 1970, the MoD bowed to pressure from Rafael’s management and changed its designated role from a predominantly military R&D centre into a full-scale manufacturer of weapon systems. This change obliterated the previous

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53 Barzelay, ‘The weapon of the economy’.
54 Yaniv, Politics and Strategy in Israel, p. 146; Foreign and Commonwealth Office/JIC paper, Israel’s Defence Industries, Paragraph 1, 6 May 1970.
56 Ibid., p. 81; Uzi Eilam, L’Europe de la Défense, JCSS Memoranda no. 75 (Tel Aviv University, March 2005), pp. 86–87 (Hebrew).
horizontal division of function within the state-owned industrial base, under which Rafael focused on design and research, while IAI and IMI concentrated on production and maintenance. Turning Rafael into an arms producer heralded a new era, in which the defence industrial base evolved vertically, with each of the main defence enterprises specialising in certain areas of expertise and taking charge of the whole life cycle of their products, from design, through production to after-sales care and maintenance. Nonetheless, even though Rafael became a producer, competing against other firms, it remained under the auspices of the MoD and therefore operated under the guidelines of a government department and not as a business entity.57

The combined effect of Rafael’s new status and a steep rise in government investment was a significant increase in industrial production capacity. The expenditure allocated for indigenous production in the metal and electronic sectors, especially within MoD-controlled facilities, increased by 40% year on year between 1967 and 1971.58 Consequently, the defence industry workforce soared from 14,000 in 1966 to 34,000 in 197259 – a rise particularly pronounced at IAI and IMI, which grew, respectively, from 4,461 in 1966 to 13,616 in 1972, and from 4,521 in 1967 to 9,465 in 1972.60

This injection of funding also facilitated the creation and expansion of several defence-related companies during this period, most of them privately owned. This was part of a deliberate attempt by the MoD to increase the overall capability of the defence industrial base to meet IDF operational demands that the state-controlled enterprises were struggling to meet on their own. At the same time, the MoD realised

57 Bonen, Rafael, pp. 43, 83–84, 198–199.
58 The MoD’s 1972 assessment on the defence industry, p. 5.
59 Yaniv, Politics and Strategy in Israel, p. 218.
60 Evron, Defence Industry in Israel, p. 486; Evron, Shield and Spear, p. 178.
that some defence firms, most notably IMI, had overcapacity problems, as the IDF no longer required certain types of munitions. It therefore decided to offer excess products to foreign customers through a dedicated export division, SIBAT, established in 1971. The new division had two roles: to find prospective clients for Israeli weapons and to connect them to Israeli producers.61

The defence firms continued to expand after the Arab–Israeli War of 1973, alongside the IDF’s accelerated process of weapons acquisition and personnel expansion. From 1975 the MoD instituted a new policy of competitive bidding for development projects, and this spelled a marked change in its attitude to local defence firms. An interventionist, central planning approach, in which the MoD directed and assigned projects and budgets to companies, gave way to the more commercially oriented practice of approaching more than one companies and encouraging competition among several bidders. As more companies offered the same expertise, the then MoD Director General, Prof. Pinhas Zussman, believed that by introducing a competitive bidding process the MoD would benefit from better and cheaper contracts.62

Despite a major slump in sales to Iran after the overthrow of the Shah in 1979,63 the number of employees in the defence industry was still rising and totalled 62,000 in 1984, most of them organised in strong labour organisations within the state-owned firms.64 These organisations secured generous wage packages for the employees, protected by rigid collective agreements that prevented unilateral or forced dismissal of workers and precluded new workers being hired, or existing ones

61 Barzilay, 'The weapon of the economy'.
62 Zussman interview; Bonen, Rafael, p. 39.
transferred, without explicit approval by the employees’ unions. These clauses granted them a significant influence over management decisions for years.\(^{65}\)

By the late 1980s, Israel’s defence-industrial sector included over 150 firms and organisations.\(^{66}\) Most were privately owned, but the state-owned industries were the biggest, comprising about 70% of workforce. In 1987 IAI had 22,000 workers, IMI employed 14,000 and Rafael had 6,000. The rest were in Tadiran (12,000), Elbit, El-Op, Soltam and other companies. The defence industrial base (excluding military depots and subcontractors) amounted to over 4% of the total workforce and 20% of the industrial labour force.\(^{67}\)

**Industrial Adjustments in the 1990s**

Significant events in the second half of the 1980s, namely the economic crisis in Israel and the end of the Cold War, had a long-lasting impact on the Israeli defence industry. Within a year, from 1989 to 1990, a 35% drop in foreign orders was recorded, and this trend continued until the mid-1990s (see Figure 3.1).\(^{68}\) Contracts with major clients, such as Germany and South Africa, finished while others did not arrive, leaving


\(^{68}\) Tishler and Rotem, ‘The Reasons for the International Success of the Israeli Defence Enterprises’, p. 471; the global defence spending declined from $1.2 trillion in 1985 to $868 billion in 1993 was the steepest since World War II, costing the US alone one million jobs. See *Defense News*, 11 April 1994; *The Economist*, quoted in the *Telegraph* (Israel), 16 January 1996.
Israeli defence firms struggling with significant excess capacity and a tenured workforce.

**Figure 3.1**

**Israel's Defence Exports**

![Graph showing Israel's Defence Exports from 1980 to 2000](image)

**Source:** Ministry of Defence.

**Note:** Figures relate to actual deliveries

As of 1985, local defence expenditure was significantly reduced as the government tried to rein in hyperinflation through a series of deep cuts in the defence budget to the tune of $700–800 million between 1987 and 1992.\(^6^9\) This translated into lower procurement from local defence industries, which fell some 50% between 1985 and 1992.\(^7^0\) Also cut were investments in defence R&D, reduced by two-thirds.\(^7^1\) Instead of buying from local firms, the IDF opted for American products paid for through the annual US military aid.\(^7^2\)

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\(^7^1\) Ibid.

\(^7^2\) IMI's sales to MoD fell by 45% from an average of $200 million a year between 1982 and 1984, to $109 million a year between 1985 and 1988. See *State Comptroller special report on IMI's incorporation*, p.17. During the same period, IAI sales to the MoD dropped by 22% from $641 million a year to $500 million. See *State Comptroller Annual Report no. 45*, p. 868.
Indeed, long-term US military assistance – part of the 1979 peace accords with Egypt and standing at around $2 billion a year\(^3\) – exposed deep anomalies in the relationship between the IDF, the Ministry of Defence and the defence industry.\(^4\) During the 1980s the IDF started exercising the principle of ‘consumer sovereignty’ in earnest, following the aforementioned 1975 decision of the then MoD Director General. Consequently, the IDF’s preferences came to take precedence over the long-term interests of the domestic industrial base. As the military favoured off-the-shelf equipment and objected to vast investments in costly and risky programmes funded through the defence budget,\(^5\) it gradually allocated less to R&D projects and more to the salaries and pension payments of IDF’s career officers (see Figure 3.2). In fact, the military R&D budget was cut by 43% between 1986 and 1994,\(^6\) while IDF pension payments grew by 57% between 1984 and 1994.\(^7\)

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\(^3\) Israel is required to use this grant for purchases in the US. Some observers have suggested that the US Government indirectly subsidises its arms-makers in this way. See Yaakov Toren, ‘The Impact of the US Aid on the Industrial Policy’, in Tov (ed.), *Defence and Israel’s National Economy*, p. 103. In addition to the geostrategic factors that influenced this arrangement, some senior officers argue that another American consideration was to ensure that Israel would be totally and permanently dependent on the US for supply of spare parts. Source: author’s interview with Yossi Snir, 23 June 1998 (hereafter: Snir interview, 1998). Brig. General (res.) Snir served before joining IMI as Deputy Commander of the IDF’s Logistics Branch.


\(^7\) Ministry of Finance – Budget Department, *State Budget 1998 – Main Parts* (Jerusalem: Government Printer, October 1997) and *State Budget 2000 – Main Parts* (Jerusalem: Government Printer, October 1999).
Figure 3.2

Defence R&D Investment in Israel

Source: Ministry of Defence.
Note: 1997 prices

The 1987 cancellation of the Lavi fighter project, under strong pressure from the Israeli Air Force – which had previously supported it – and the US administration, was another turning point in the relationship between the armed forces and the local defence industry. The IDF/Air Force preferred the US F-16 aircraft and advocated a shift towards developing ‘smart’ weaponry (e.g. precision-guided munitions, cruise missiles and stand-off weapons) in preparation for the future battlefield, even though senior officials in the Ministry of Defence supported the more expensive Lavi in order to boost the country’s defence industrial base and overall technological capabilities. Yitzhak Rabin, Defence Minister at the time, concluded that Israel could not meet the

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aircraft’s development costs – estimated at $2.5 billion at the time\textsuperscript{80} – without sacrificing essential military requirements (something he opposed) or asking for substantial financial support from the United States (which was not forthcoming for commercial reasons).\textsuperscript{81} In the absence of available resources and in view of the Air Force’s changed position, Rabin and his Labour party counterpart Shimon Peres (a prominent supporter of IAI and also the foreign minister in the Shamir-led National Unity Cabinet at the time) reluctantly supported the project’s termination. Another incentive for cancellation came from American agreement to support Israeli defence firms in several ways: the US allowed Israel to convert about 25\% of annual military aid – some $475 million – to Israeli currency for local uses,\textsuperscript{82} designated ‘to maintain the Israeli technological base and preserve its qualitative advantage,’\textsuperscript{83} and allowed US manufacturers to sign industrial buyback agreements with Israeli firms, totalling about $500 million a year, as part of the arms deals with Israel.\textsuperscript{84}

Despite forceful opposition from IAI workers, the government decided to terminate the \textit{Lavi} programme in 1987.\textsuperscript{85} About fifth of the company’s workforce at

\begin{flushleft}
\textsuperscript{80} Author’s interview with Amos Rubin (The Economic Adviser to Prime Minister Shamir, 1986–1991), 24 August 1998.
\textsuperscript{81} Zekheim interview; Meron interview; \textit{Yedioth Ahronoth}, 26 August 1997; \textit{Maariv}, 11 September 1987.
\textsuperscript{82} Arens interview.
\textsuperscript{83} Ivry interview, 1998.
\end{flushleft}
the time, more than 4,000 workers, were made redundant; the first major workforce contraction in the history of the local the defence base. It was also the first time that the MoF, and not the MoD, administered such a major move within the defence industrial base, which led to direct negotiations between representatives of the IAI workers and the Treasury. (Defence Minister Rabin became highly involved in this process as well. He lobbied for increased compensation packages for the IAI employees who were made redundant, hoping to minimise in this way the political fallout from the projects' demise. He knew that these costs would be covered by the state budget, and not through the defence budget.)

The upshot of the Lavi cancellation was that the defence establishment no longer saw the local defence industries as preferred suppliers to the IDF, as the US pledged to back Israel militarily and diplomatically during the peace negotiations in the Middle East. The local defence enterprises were merely required to guarantee the IDF's qualitative edge through 'force multipliers'—in other words, to supply small 'smart' weapon systems that would guarantee superiority on the battlefield and were

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89 Peretz interview, 1998b.

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not available from other sources. However, this revised role depended on sufficient funding being available in the defence budget, as became clear soon after the *Lavi*’s cancellation. Because immediate operational needs took precedence over long-term procurement, the high level of activity after the outbreak of the first Palestinian uprising (*Intifada*) in 1987 meant the IDF could not honour the Cabinet’s pledge to earmark $100 million per annum for alternative programmes at IAI and other firms. Consequently, local defence firms recorded a 36.5% drop in orders from the MoD between 1985 and 1989, which affected their employment (see Figure 3.3).

**Figure 3.3**

Employment through MoD’s orders in the local defence firms

Source: Ministry of Defence.
Note: 1989 prices

At the same time, privately owned defence companies in the electronics and software sector gained prominence and spearheaded the local industry. Some of these

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92 Israel Cabinet Decision no. 658, ‘The Lavi Project’, 30 August 1987, paragraph III.
94 Speech by David Ivry in the annual meeting of the Forum for Strategic Thinking with the Defence Establishment, March 1990 (transcript).
companies, which had started as subcontractors to the main state-owned enterprises, stepped into the latter’s traditional areas of expertise, such as unmanned aerial vehicles (UAV), upgrade packages and electronics, and showed they could challenge the dominance of the state-owned sector.\(^{95}\) (Over the years, private companies attracted a larger portion of Defence Ministry orders, from 12% in the late 1960s to 37.5% in the second half of the 1990s,\(^{96}\) a change facilitated in part by the Mandatory Tenders Law.)

The emergence of a viable private defence sector prompted the Likud government to accelerate the privatisation of state-owned firms. In July 1991 an MoD-appointed committee recommended that four companies – Elta (an IAI subsidiary), Ashot (an IMI subsidiary), the retail company Shekem and the jet engine maker Bet-Shemesh Engines – should be fully privatised.\(^{97}\)

However, by the beginning of 1992 the state-owned sector started to show growing signs of financial difficulties (see Table 3.3). Significant contracts were approaching their end, others were cancelled and new ones were not forthcoming.\(^{98}\) Attempts to branch out into the civilian market failed spectacularly, inflicting heavy losses on the firms involved.\(^{99}\)

\(^{95}\) Sela interview; see also interview with Emanuel Gil, President of Elbit, in: ‘The red flag of IAI’, \textit{Yedioth Ahronoth}, 12 November 1993.


\(^{99}\) IMI, for instance, incurred a loss of $40 million in 1991 due to diversification into civilian products, while IAI posted a gross loss of $64.7 million between 1990 and 1992, of which $46.6 million was accumulated in 1992. Meanwhile, only 1% of Rafael’s sales between 1989 and 1992 were to
Table 3.3: The state-owned defence enterprises in 1991

<table>
<thead>
<tr>
<th>Indicator</th>
<th>IMI</th>
<th>IAI</th>
<th>Rafael</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit (Loss)</td>
<td>($127 m)</td>
<td>$24 m</td>
<td>($89 m)</td>
</tr>
<tr>
<td>Sales</td>
<td>$523 m</td>
<td>$1,720 m</td>
<td>$376 m</td>
</tr>
<tr>
<td>Employment</td>
<td>9,115</td>
<td>17,213</td>
<td>6,500</td>
</tr>
<tr>
<td>Sales per worker</td>
<td>$51,621</td>
<td>$102,200</td>
<td>$57,850</td>
</tr>
</tbody>
</table>

Source: State Comptroller.

Note: figures in constant prices, $1 = ₪2.8 in 1993.

Meanwhile, foreign clients replaced the IDF as the main source of income for the domestic industry. Of IAI’s sales, for example, 80% was abroad; IMI exported 50% of its products, and about a third of Rafael’s sales went to foreign clients.100 Growing dependence on foreign sales increased the defence industries’ exposure to the cyclical nature of the global arms market and to fluctuations in currency exchange rates. The latter factor eroded the firms’ profitability. The dollar exchange rate in Israel remained devalued and frozen for several years as a result of the 1985 Emergency Stabilisation Programme; however, public-sector cost-of-living wage adjustments, to which the workers’ salaries were linked, increased in real terms by 22%, year on year. This significantly eroded export profits.101

While enterprises in the private sector handled their problems mostly internally and with little or no assistance from the Treasury, the state-owned ones sought the help of the government system. The Shamir government was facing the dilemma of whether to subsidize hidden unemployment and avoid further

customers in the civilian market, well below the 10% target. See State Comptroller Annual Report no. 45, pp. 821, 843, 875 and subsequent chapters in this dissertation.

100 Lifshitz, Defence Economics, p. 382; Maariv, 24 February 2004.
101 State Comptroller special report on IMI’s incorporation, p. 18.
confrontations with the workers, or to tackle these firms’ problems head on by streamlining their operations and workforce. However, the Prime Minister did not tackle the issue head on. According to then Defence Minister Arens, Shamir did not consider making reforms and structural changes in the defence industrial sector an essential policy goal.\textsuperscript{102} Facing general elections in mid-1992, he therefore left this matter unaddressed, effectively leaving it for the next government to handle.

\textbf{Putting the Defence Industry on the Government Agenda}

In June 1992 the Labour party narrowly beat Likud and returned to sole power for the first time in fifteen years (from 1984 to 1990 it had been part of national unity governments with Likud). Its victory owed as much to rising unemployment, a collapsing health system, a severe housing shortage and disintegrating pension funds as to deteriorating internal security and growing strains in relations with the US (which had viewed the previous government of Yitzhak Shamir as an obstacle to regional peace). Incoming Prime Minister Yitzhak Rabin, interpreting Labour’s success as his own personal victory, moved swiftly to assert his control\textsuperscript{103} and made it clear from the outset that he intended to be a strong leader, not merely ‘first among

\textsuperscript{102} Arens interview.

This intention was clear from his victory speech, in which he declared that he would assume greater powers. Furthermore, Rabin was determined to redefine Israel’s strategic goals and decisively tackle its lingering economic problems. He advocated a reordering of national priorities: more spending on education, transport infrastructure and fighting unemployment, and less investment in the West Bank and Gaza settlements. He assumed that by spearheading the peace process negotiations and improving Israel’s position in the world, both politically and economically, he would be able to reduce its defence spending and free more resources for other priorities.

In view of the Iraqi defeat in 1991 and, above all, unwavering American backing – viewed by the IDF as the most significant deterrence against possible Arab aggression – he believed Israel was enjoying a rare window of opportunity that


105 David Horovitz (ed.), *Yitzhak Rabin: Soldier of Peace* (London: Peter Halban, 1996), p. 111. After the poll on 23 June 1992, which showed a Labour victory forthcoming, Mr Rabin told his supporters there could be no responsibility without authority first being granted to those who assume such responsibility: ‘Therefore I will handle the coalition negotiations as soon as the final election results are known. And I will decide who will be ministers. There will be no horse trading’. See *Yedioth Ahronoth*, 24 June 1992.


allowed him to take some calculated risks. To Rabin, Israel’s security and economy were interdependent, and he decided to place economic reform at the top of his agenda.

On 13 July 1992, when he was officially sworn in as Prime Minister, he said his Cabinet would increase economic growth by ‘adapting our economy for “open” management, free of bureaucratic restrictions and excessive government intervention. There is too much paperwork and not enough productive work’. To that end, he endorsed a string of economic reforms and also headed the Ministerial Privatisation Committee. This Committee approved the most significant acts of privatisation in Israeli history and ultimately achieved a substantial reduction in the number of government-owned companies, selling approximately $1 billion worth of government assets, including banks and large companies in the first year of Rabin’s premiership alone.

These achievements were no mean feat, considering that his coalition consisted of only 62 members of Knesset (out of 120) and that his popularity

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110 Flato interview.


114 When it was first formed, Rabin’s government was supported by 62 coalition members (44 Labour, 12 Meretz and 6 Shas) and another five Members of Knesset from outside the coalition.
plummeted from 60% to 42% in his first 100 days in office.\textsuperscript{115} However, Rabin managed to maintain sufficient political cohesion, despite his small coalition, by constructing a Cabinet in which his Labour party played a dominant role: it held 13 of the 17 portfolios in 1992. (This was similar to Rabin’s 1974 government, in which Labour held 16 out of 19 portfolios in a coalition totalling 61 seats only.\textsuperscript{116})

Rabin’s drive to reduce government ownership stemmed from his belief that governments were not capable of running businesses\textsuperscript{117} and that state-owned industries were by definition inefficient and loss-making – and this included the state-owned defence enterprises: Israel Aircraft Industries (IAI), Israel Military Industries (IMI) and Rafael. Indeed, Rabin publicly asserted that the realisation of how successive IMI managements had ‘relied on government handouts instead of tackling their problems by themselves’ reaffirmed his contention that ‘all state-owned companies should to be privatised’.\textsuperscript{118} But Rabin also realised that, to make these organisations economically viable, the government needed to address some of their financial and labour deficiencies. ‘Rabin had this lingering feeling that we were lacking proper administrative tools for efficient management of the state-owned defence enterprises,’ noted David Ivry.\textsuperscript{119} Above all, these firms should become more business-oriented, accountable and responsible for their own actions, and should stop regarding government ownership as a safety net to soften the blow of failure.

\begin{itemize}
\item \textsuperscript{115} Ibid., P. 137.
\item \textsuperscript{116} Figures taken from Arian, Nachmias and Amir, \textit{Executive Governance in Israel}, p. 112.
\item \textsuperscript{117} See quote from Rabin, dated 18 September 1995, noted in special supplement on Rabin, \textit{Globes}, 10 November 1995, p. 14.
\item \textsuperscript{118} Rabin, speech at an Israeli Management Institute conference, quoted in \textit{Mabat}, 17 November 1992.
\item \textsuperscript{119} David Ivry, quoted in ‘Shalom, Haver’, a booklet in memory of Yitzhak Rabin, published by the workers’ union of the MoD, 5 December 1995, p. 5.
\end{itemize}
Government ownership should be a purely technical matter, and, just like any private shareholder, the state should demand and expect a profit.120

Rabin also believed that the defence firms' continuing losses were increasingly unsustainable and would jeopardise other long-term interests: for instance, the funding of arms for the IDF.121 Former US Under-Secretary of Defence Dov Zekheim, who negotiated with Rabin the termination of the Lavi project, said in an interview with the author that 'Rabin was very frustrated by the ability of the state-owned industry to dictate in effect what the state was going to do.' Rabin felt that military priorities had become secondary to those of the industries, which meant that the '[the firms'] trade unions were starting to distort decisions that actually were made on the basis of defence efficiency'. Rabin, he noted, 'opposed any kind of non-germane, exogenous matters in the decision-making of resource allocation', being acutely aware that resources were limited, while the military threat was ever-growing and changing in nature.122

The firms' ability to influence policy decisions was attributed partly to their sheer size. Rabin's Head of Prime Minister Bureau and one of his senior aides, Eitan Haber, noted that 'Rabin detested the bloated structure of the state-owned enterprises'123 and wanted 'to sort them out' without fear or favour. Former Defence Minister Moshe Arens, asserted that Rabin felt 'outright hostility' towards the state-controlled enterprises,124 and this attitude was reflected in his estranged and highly

120 Flato interview; author's interview with David Brodet (Director of Budget Department, Ministry of Finance, 1991-1994; Director General, Ministry of Finance 1994-1997), 2 July 1999 (hereafter: Brodet interview).
121 Komisar interview. See also Chapter 4.
122 Zekheim interview.
123 Haber interview.
124 Arens Interview.
critical approach towards them. Ivry offered a different perspective: ‘Rabin valued the output of the defence firms, their R&D output and the quality of their human resources … [but] he was also very frustrated at the innumerable administrative and legal difficulties that thwarted many of his attempts to resolve their problems and run them more efficiently’.125

Known for his straight talking, Rabin shared his frustration with the wider public. He remarked in 1992: ‘There is no escape other than restructuring and adjustment in the government defence firms. They must undergo a painful operation in order to cut them down in size.’126 In 1994 he said: ‘The defence firms should not exist at the expense of the IDF ... I am prepared to hand them over for free to anyone who would be willing to take and manage them’.127

As former chief of staff, ambassador to Washington and defence minister in the National Unity Governments between 1984 and 1990, Rabin had first-hand knowledge of the problems facing the state-owned defence firms.128 More than other Israeli leaders, he questioned the need to build a large local infrastructure to produce military equipment – in 1969, he objected to the development of the Kfir aircraft but was overruled129 – and on several occasions criticised the abilities of Israeli scientists.130 His preference was to buy completely developed arms and systems off

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125 David Ivry, quoted in ‘Shalom, Haver’, p. 5.
127 Rabin speech to Jewish activists in New York, quoted in Haaretz, 18 December 1994.
128 Defence Minister Rabin commented in 1988 that ‘the state of Rafael results from its structure, which combines a research institute and a production factory. This state of affairs cannot be dragged on for long.’ See State Comptroller Annual Report no. 45, p. 857.
129 Reiser, The Israeli Arms Industry, p. 103.
130 Such were his doubts that in 1965, during one of his first visits to Rafael after being appointed Chief of Staff, Rabin cancelled a project to develop an airborne warning system because he doubted that it
the shelf, preferably US-made. In the rare cases where he approved indigenous programmes he insisted on being convinced that they were within the Israel’s financial means. (He endorsed the Lavi project at the beginning of his tenure as Defence Minister in 1984 after receiving detailed assessments of its contribution and costs. He withdrew his support as soon as he realised that the end user, the Air Force, rejected the project, and that its costs were more than Israel could afford.)

Rabin also thought that maintaining a close military relationship with the US earned Israel security and diplomatic dividends far greater and more important than the contribution made by local defence firms. He therefore maintained that Israeli weapons manufacturers should specialise only in adapting imported weapons to the specific needs of the IDF, whereas the MoD had traditionally favoured indigenous weapons projects.

Despite clear indications of the defence firms’ deteriorating condition, no previous government (including governments in which Rabin had been Defence Minister) had formulated and executed concrete policies for improving the management of the state-owned defence industries. Now, as holder of the defence

could be successfully completed. See Efraim Inbar, Rabin and Israel’s National Security (Baltimore MD: Johns Hopkins University Press, 1999), p. 80.

131 Meron interview.

132 Komisar interview. Dr. Komisar argued that Rabin and other prime ministers insisted on keeping the US military aid, despite its negative consequences for local Israeli industry, because it ensured a steady supply of aircraft and battle tanks which was crucial for Israel’s operational readiness and strategic deterrence. For discussion on Rabin’s position vis-à-vis the US, see Rabin, The Rabin Memoirs, pp. 122–123; Henry Kissinger, Years of Renewal (New York: Simon and Schuster, 1999), pp. 374–382, 458–459; and Inbar, Rabin and Israel’s National Security, pp. 34–57, 168.

133 Inbar, Rabin and Israel’s National Security, pp. 79–81.

134 State Comptroller Annual Report no. 45, pp. 863, 918. In 1989, Rabin appointed a committee to resolve Rafael’s structural problems (the Yurtner committee) and endorsed its proposed solution, but did nothing to implement it. See Ibid., p. 855.
portfolio, as well as Prime Minister — he believed combining the two posts ensured
greater authority, cohesion and civil control in military affairs and fewer openings for
disagreement within the defence establishment — Rabin decided to put the state-
owned enterprises in order and gave the issue a high priority. He opted for a hands-
on approach — discussing their problems personally every Thursday and Friday —
and called for a major overhaul in the firms’ affairs, even at the cost of conflict with
their management and unions. He felt that this attitude would maintain his public
image as a ‘doer’, a politician who kept his promises to the voter. To that end,
Rabin spent many hours pondering ways to ensure that the defence enterprises
employed the best possible business practices.

However, Rabin was reluctant to confront all three defence firms head-on and
at the same time. A few months after the Labour party came to power Nir Gilad,
Deputy Head of the Budget Department at the Finance Ministry, suggested that the
government should deal with all three in one go by merging them into a single entity.
Rabin rejected the idea. ‘I have three problematic firms to handle,’ he said. ‘Why
should we turn them into a one big problem?’ His first major decision, therefore,
was to treat the defence enterprises individually and sequentially: IMI, IAI, and
finally Rafael. ‘The reason for that was simple: had he tried to alter their structure and
operations simultaneously, their strong unions would have joined forces to foil any

136 Eitan Haber, quoted in ‘Shalom, Haver’.
137 Deputy Defence Minister Mordechay Gur, answering opposition members’ questions in Knesset, 14
July 1993, *Records of the Knesset*, vol. 36, p. 6689. On the last Friday before his murder, Rabin spent
three hours debating Rafael. See interview with Haber in ‘Shalom, Haver’, p. 9.
138 Flato interview.
139 David Ivry, quoted in ‘Shalom, Haver’, p. 5.
141 Quoted in *Haaretz*, 17 January 1996.
meaningful step,' explained Rabin’s chief economic adviser, Ilan Flato. For this reason, a proposal to combine the three state-owned firms under a single holding company was dropped because it would have focused significant political influence in the hands of the employees’ organisations without producing meaningful and tangible business advantages.

Nevertheless, the Finance Ministry’s Budget Department kept raising suggestions for a complete overhaul in the defence sector, preparing internal papers for discussion with Prime Minister Rabin. The Department argued that the state-owned industry had become bloated and, thanks to government subsidies and protectionist practices, was characterized by waste and duplication. It pointed out that Israel, with its limited resources, had two companies upgrading jet fighters, three producing UAV, three producing missile and rocket engines, and four making avionics and electronic warfare equipment. By contrast, Britain had only one missile manufacturer, which was part of a joint venture with a French company. And lower efficiency in the state-owned industry meant that average sales per employee were around $40,000, well below the $100,000 level of comparable industries in the US and Europe.

142 Flato interview.
144 Ministry of Finance – Budget Department, Reorganisation of the State-owned Defence Industry, June 1994 (internal document); Gilad interview, 1997.
Influenced by major restructuring and merger plans in Europe and the US, the MoF explored various options, ranging from a ‘grand merger’ of the entire state-owned defence industrial base (including the IDF’s logistic centre) under a single holding company, to a smaller-scale plan involving the creation of a new company based on a merger of IMI and Rafael. A third proposal suggested that the government appoint a trustee to manage and privatise IAI and IMI with the help of a $2-billion budget; the idea was discussed by the Defence Minister Rabin and Finance Minister Avraham Shochat but was eventually shelved.

Bureaucratic Infighting

While the political echelon was pondering its options, a behind-the-scenes debate was raging. The growing losses of the three major state-owned firms posed a dilemma for both ministries involved, the MoD and the MoF: which of the two should assume responsibility and should shoulder these losses? Would they be covered in the defence budget (which might destabilise the structure and operations of the army) or the state budget (which might undermine the MoF’s macroeconomic objectives)?

The Ministry of Finance placed responsibility squarely on the defence establishment. It argued that the IDF had been the main beneficiary of the defence industries’ innovations, and the MoD was in charge of their growth and direction. However, over the years the defence establishment had behaved irresponsibly, the MoF’s Budget Department claimed, by encouraging duplicate infrastructure and

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147 Ministry of Finance – Budget Department, Reorganisation of the State-owned Defence Industry.
149 Note, for example, the warning by the financial adviser to the Chief of Staff: ‘The Rafael’s deficit, if imposed on the defence budget, will destroy the army’, Haaretz, 29 November 1995.
150 This section is based on Gilad interview, 1997.
funding identical centres of research, maintenance and production, internally as well as externally, in excess of Israel’s actual needs. This was done because, with a rigid cap placed on the defence budget, the defence establishment assumed it would get more for its money through competitive bidding.

Over the years, the MoF argued, as the defence budget’s share of government consumption expenditure remained stagnant, and even became smaller – in 1986 it amounted to ₪25.98 billion, and in 1995 it was down to ₪24.62 billion, in 1995 prices\textsuperscript{151} – the military also had to cope with internal changes which were beyond its control: on the one hand, the costs of locally made weapons, paid from the local-currency ingredient of the defence budget (also used to pay for salaries, defence imports and rehabilitation costs) increased; on the other hand, the labour cost of IDF personnel increased as well, due to general increases in the public sector to which it was linked. Other built-in costs, such as rehabilitation of disabled soldiers, grew as well. The military therefore had less money available for R&D and arms procurement from local sources, as it needed to allocate more funding for salaries and day-to-day tasks.\textsuperscript{152}


\textsuperscript{152} Gilad interview, 1997.
According to MoF officials, the defence establishment felt trapped: it was basically given the same budget, but the size and proportional weight of its internal ingredients changed (see Figures 3.4A and 3.4B). The solution it adopted came at the expense of the state-owned firms: the IDF diverted arms orders to the US (paid through US annual military aid) and reduced the budgets for R&D and procurement from domestic sources; in this way it could increase its budgetary leeway and free more money for internal needs, such as salaries and rehabilitation costs. The MoF therefore concluded that, because the defence establishment controlled the internal
distribution of its budget and was partially responsible for the decrease in the enterprises’ revenues, it was incumbent upon it to reprioritise its internal preferences: for example, reducing the number of in-house IDF logistic units – which in essence provided services that could be outsourced, at lesser cost, from external suppliers such as the state-owned firms.153

The Ministry of Defence rejected these claims, arguing that the MoF itself was chiefly responsible for the defence firms’ difficulties. Labour costs in these firms increased well beyond their financial means, senior officials argued, as a result of decisions taken by the MoF, and the MoD had no control or leverage over this. Determining labour costs in the public sector had rested solely in hands of the MoF’s Wage and Labour Accord Unit, which approved the sector’s salary raises as part of its annual wage negotiations with the Histadrut. These rises had a direct effect on the state-owned defence enterprises, whose collective labour agreements required management to increase the workers’ salaries on a par with the rises in the public sector, irrespective of their actual business performance. Consequently, they experienced a sharp rise in running costs, a phenomenon that was acutely felt in the MoD-funded Rafael. Indeed, over the years, Rafael’s labour costs reached 70% of its total revenues, at IMI the figure was approximately 65% and at IAI about 50%.154

The then MoD Director General, David Ivry, argued the problem of the firms in question stemmed from their inability to control labour costs. In interview with the author he noted that ‘because we [the MoD] did not have full control and authority across the full sphere of management [in those firms], we could not have, and should not have, been responsible for these firms’. Ivry noted that ‘the MoF expected us to

chip in and cover the costs of a problem which was not of our making and over which we had no control in the first place – all these pay rises in the public sector – so under no circumstances could we have accepted any responsibility’. He argued that the MoF was less concerned about the state-owned defence industrial base than about the accomplishment of two long-sought objectives: undermining exclusive military control over the defence budget, and forcing the MoD to make significant pay cuts in its salary base.155 As to the MoF suggestions about the defence establishment’s maintenance and logistic centres, the MoD maintained that it required these centres for operational reasons. Furthermore, the MoD mitigated the reduction in orders from local industries by granting them more export licences and promoting R&D agreements with foreign clients.156 Eventually, the MoD won the argument – Prime Minister Rabin insisted on keeping the defence budget intact during the peace negotiations157 – and the MoF was assigned to cover the enterprises’ expenses through the state budget.158

Conclusions

The main catalyst for the growth of the defence industrial base was the realisation that, despite the traumatic experience of the Holocaust, Israel was still subject to existential threats from the Arab world. This led to a psychological as well as a material institutionalisation of the ‘Centrality of Security’ concept, an approach then strengthened by arms embargoes and foreign suppliers breaking agreements.

156 Ibid.
157 Flato interview; Rabin’s quote of 12 September 1995, in Globes, 10 November 1995.
Consequently, Israel’s policymakers allowed rapid expansion of the state-owned arms industries and initiated production of indigenous state-of-the-art weapons systems in response to foreign embargoes. Significant government investments created a formidable state-controlled defence industrial base that grew well beyond the IDF’s operational needs. Even so, its production capabilities were supplemented by companies in the private sector, which were partially funded by the MoD – and thereby the MoD sowed the seeds of future rivalry between these two segments.

Further enlargement of the defence industrial base took place in the early 1970s. Rafael became the third arms-producer, after IAI and IMI, a change which also gave rise to increasing competition and duplication of expertise and infrastructure. Gradually the defence firms came to comprise the biggest manufacturing and technological segment of Israel’s industrial sector, employing tens of thousands, most of them organised in strong unions.

Just as the close relationship between government, military and defence firms reflected a confluence of interests, decisions and events, so too did the eventual crisis that splintered it. A series of policy events and geopolitical developments, unconnected to each other, gradually brought the relationship to a head, as it became clear that the Israeli economy was unable to sustain or maintain such a labour-intensive industrial base indefinitely.

The MoD’s 1975 decision to grant the military full control over the arms spending budget, and easier access to US weapons arsenal following the 1979 peace treaty with Egypt, gradually shifted the IDF’s procurement policy and effectively ended the industry’s raison d’être. It also deprived the Israeli firms of their most important client and sales promoter. The financial difficulties that hit Israel in the mid-1980s, which caused a massive reduction in MoD orders from local industries
and revamped Israel’s macroeconomic objectives, showed that the country could no longer afford to develop major combat platforms. This was further underlined when the government cancelled the *Lavi* fighter project in 1987, which signalled a transition to the development of niche systems, in the form of ‘force multipliers’, for the IDF.

The MoD did indeed temporarily alleviate the impact of the IDF’s shift of platform procurement by granting the defence firms more export permits, which led to a rapid rise in their revenues in the 1980s. This source of income partially subsidized the development of new weapons and compensated for further sharp cuts in the domestic R&D budget. No less important, the export revenues helped to maintain inflated employment levels in the government-owned defence firms, albeit not for long. The simultaneous drop in domestic and foreign orders at the beginning of the 1990s revealed the industry’s vulnerability. (See later chapters for further discussion, in the context of individual firms).

Financial gains obtained during the successful export years were quickly consumed by the firms’ bloated workforces and loss-making projects. Profitability plummeted, due to redundant production lines and exaggerated overheads. The sharp drop in sales and orders caused deep shortfalls in cash flow. At this point, it became clear that the MoD could no longer bear financial responsibility for this situation. Any attempt to shift funding from its shrinking defence budget to helping the ailing state firms would come at the expense of vital security tasks and could undermine the military’s operational capabilities. That was inconceivable and unacceptable. Further, the IDF’s General Staff had other pressing concerns, such as retaining quality career officers by means of pay increases, and this stressed its inward-looking approach.

Therefore, and in a marked departure from its historic role, the MoD no longer viewed itself as the sole ‘custodian’ responsible for the viability of these enterprises.
To do so might rob it of resources vitally needed for its ultimate and primary role: providing for the defence of Israel’s security by military means. The upshot was that, for the first time in their existence, the state-owned defence firms were left without Defence Ministry backing, entangled in inherent structural and managerial deficiencies that threatened their very existence. Meanwhile bureaucratic infighting between the Defence and Finance Ministries – each refusing, for its own reasons, to assume ultimate financial responsibility for the defence firms – created an ‘authority vacuum’ that compounded their problems. No one, it seemed, was willing to tackle these problems head on.

Enter Yitzhak Rabin, who for many years had observed and been in charge of the defence industrial base, both as Defence Minister and Prime Minister. Rabin was a significant strategist, and he realised that Israel’s economic future was closely tied up with his own peace-making: the more progress he made with the latter, the easier it would be to secure the former. Striving to change national investment priorities, Rabin assumed that the way to alleviate the security burden – which, in turn, would free much-needed resources for honouring his campaign promises – was to make significant progress on the Middle East peace process.

Tackling what Likud governments had neglected for years – reducing unemployment, reinvigorating the education system and modernising the transport and communication infrastructures – also required a bold departure from Labour’s Socialist origins, and particularly from the idea of a state-controlled economy. This last point was fundamental to the handling and recovery of the ailing defence industrial base, which was hampered by restrictive public-sector practices.

It was no easy task, but, by holding the dual role of Prime Minister and Defence Minister and by maintaining cohesion and political discipline in his Labour-
dominated Cabinet, Rabin stood the best chance yet of reforming the state-owned defence firms, despite their powerful unions. Rabin was no stranger to crossing swords with disgruntled workers. In 1987 he had personally sealed the fate of the Lavi project, de facto ending the era of combat platforms production in Israel and presiding over the transformation of the domestic defence firms into providers of niche systems and services – such as platform upgrading and developing specific sub-systems, like electronic warfare equipment and radars. Rabin realised that the investment required to develop niche systems was far lower and the risks less, and yet Israel could still maintain its technological qualitative edge. This approach was perfectly consistent with his wider intention of equipping the military with the technological solutions it needed within a given and much reduced budget. Rabin hoped to make the state-owned industries more efficient by reprioritising their objectives, by refocusing their product lines and by restructuring. Failing that, the firms would be unable to meet their primary goal: maintaining and facilitating national security.

In this sense, Rabin was a policy entrepreneur who identified a ‘policy window’ and seized the opportunity to initiate action. This particular window was opened by the coincidence of mounting losses by the three defence enterprises, including Rafael, with the advent of Rabin’s new administration, committed to deregulation and privatisation policies, and changes in the geopolitical arena, all against the backdrop of a post-Gulf-War Middle East, and the 1991 peace conference in Madrid. By combining a pressing problem, new policy priorities and political realities into a single stream, Rabin placed the three defence industries firmly on the government agenda for the first time.
CHAPTER 4
Policy Implementation in the IMI Crisis

A major provider of weapons and explosives to the IDF, Israel Military Industries (IMI) operated as a department within the Ministry of Defence until 1990, when it became a government company. But, as the newly elected Labour government discovered in mid-1992, despite the firm’s achievements and international reputation, IMI was actually on the verge of collapse. A series of plans was implemented aiming to stabilise the company and address its managerial weaknesses. In the event, almost half the workforce was made redundant between 1993 and 1995.

This chapter examines the policy process in the IMI affair, which became a major political and financial challenge for Prime Minister Rabin and the government bureaucracy. Starting with the background to IMI’s difficulties, and then focusing on the interplay between the main actors involved, it examines the considerations that guided ministers, state officials and labour representatives and pays close attention to the dynamics between the bargaining parties. The chapter ends with observations on the effects that major actors and past policy choices had on government policy capacities.

Passing the Buck to Rabin

In early July 1992, when the Rabin government was taking its first steps in power, IMI appealed to the Ministries of Defence and Finance for financial assistance. An earlier cash injection, made by the MoD at the beginning of 1992, helped the company to pay for salaries and meet its contractual commitments. However, it was
experiencing growing losses, and its resources were drying up fast. The two ministries agreed to provide IMI with additional funding of 80 million shekels.¹

Rabin, meanwhile, received detailed briefings about the firms under MoD control. News of IMI’s difficulties took him completely by surprise: just two years earlier, when as Defence Minister he had presided over its transformation from an MoD unit into a government-owned company, the management had presented a four-year business plan predicting continued growth in sales and profits (see Figure 4.1).²

**Figure 4.1**

![Graph of IMI Business Results: Projection vs. Actual](image)

**Sources:** Government Companies Authority, State Comptroller, IMI reports.

**Note:** IMI’s four-year business projection, suggesting a steady rise in sales and profits (block columns), was presented in 1989. External auditors, appointed a year later, examined IMI’s earlier accounts and discovered shortcomings in the calculations. In addition, adverse market conditions rendered the projection totally unrealistic. The details of IMI’s actual business results (continuous lines) led to a major row between the MoD, which was responsible for IMI until 1990, and the Ministry of Finance (see text for further discussion).


² For an account of IMI’s incorporation process, see: *State Comptroller special report on IMI’s incorporation*, pp. 9–62.
Further enquiries revealed that in June 1991, just seven months after IMI became a company, its board of directors had realised that the firm was at a crossroads. The end of the Cold War resulted in the rapid contraction of defence budgets worldwide, which was bad for IMI, 70% of whose turnover derived from export sales. Major clients, such as the West German army, terminated their contracts with the firm,\(^3\) while others, including the Swiss and American forces, did not renew existing orders.\(^4\) Worst hit was one of IMI’s most profitable product lines, munitions and explosives.\(^5\) At the same time, the company had to meet stringent financial obligations imposed as part of its incorporation process, including costly pension payments for thousands of former IMI workers (previously employed by the MoD); it was also charged a prohibitive interest rate – no less than 10% per annum – on its state-funded equity capital.\(^6\)

A strategic plan codenamed *Tafnit* (‘major turn’ in Hebrew), implemented shortly afterwards, did not stabilise the company’s cash flow; IMI was still losing money at an alarming rate, despite making almost 2,000 workers redundant, closing 14 factories and revamping the firm’s structure and commercial focus.\(^7\) Business indicators pointed to a continuous decline in performance, manifested by a $149-million drop in sales – down to $523 million in 1991 – and an unexpected loss of

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\(^3\) Letter from IMI’s internal auditor to the State Comptroller office, 4 October 1992.


\(^5\) *State Comptroller special report on IMI’s incorporation*, p. 33, footnote 40.

\(^6\) Draft decision on the Principles for turning IMI from a MoD unit to a government-owned company, as approved by the Ministerial Committee for Economic Affairs, pp. 4–5, 8. The draft was formally approved on 4 June 1989. (Hebrew).

\(^7\) As part of this plan, IMI was regrouped into six divisions and 18 factories, down from eleven divisions and 32 factories; each of the remaining factories operated as a profit centre. The company also decided to branch out from its traditional military activities into the civil market. See: *IMI Tafnit plan* (internal document), June 1991; *Haaretz*, 18 December 1992.
$240 million: more than the profit posted by all other state-owned companies combined.\textsuperscript{8} The sales forecast for 1992 was not encouraging either, suggesting a further drop of some $80 million.\textsuperscript{9} By now it was becoming clear that Tafnit's main assumptions – that IMI would reach break-even by 1993 and increase sales to $650–700 million a year by penetrating the civil market – were wide of the mark.\textsuperscript{10}

The company's chairman, former Chief of Staff Dan Shomron, was alarmed. 'I agreed to head the company at the request of Defence Minister Moshe Arens after he described it to me as “resilient and profitable”; however, it was not like that at all.'\textsuperscript{11} Shomron hired auditors and management consultants who advised him that the company was in fact lagging behind in almost every respect.\textsuperscript{12} Their reports suggested that IMI was heavily burdened by inflexible work rules, wage rates above the market average, under-funded pension plans and an outdated business strategy. Specifically, they highlighted major deficiencies in its operations, including an absence of attractive products, a defective audit system, and slow adoption of effective business

\textsuperscript{8} Maariv, 16 September 1992.
\textsuperscript{9} Hadashot, 2 August 1992.
\textsuperscript{10} IMI planned to branch out from its traditional military activities into the civil market, expecting this to account for up to 30% of total turnover. This shift, it assumed, would offset the decline in its military business, a view that was shared by the MoD. See IMI Tafnit plan (internal document), June 1991. This approach was called into question by Defence Minister Moshe Arens, who said shortly before his departure from the MoD that he 'never heard of an arms company that successfully diversified into the civil market', even though just two years earlier MoD Director General David Ivry had offered full support for this very notion. For Arens quote, see Hadashot, 2 August 1992, and for Ivry's position see Yedioth Ahronoth, 2 March 1990.
\textsuperscript{11} Affidavit by Lt Gen. (res.) Dan Shomron (IDF's Chief of Staff, 1987–1991; IMI Chairman, 1991–1995) at the Israeli High Court of Justice, case no. 991/96: The Movement for Quality Government in Israel (MQG) vs. The State Attorney, p. 2 (hereafter: Shomron's affidavit). See also Dan Shomron, 'I received a sick company', Haaretz, 9 February 1995. MQG claimed that the MoD and IMI were negligent in their handling of firm's incorporation process. The petition was dropped at the request of MQG in March 1996.
\textsuperscript{12} The main findings are discussed in State Comptroller Annual Report no. 45, pp. 821–824.
practices. These failings reflected IMI's previous incarnation as a unit within the MoD, whose main role was to serve as the 'national explosives warehouse' for the IDF, regardless of economic considerations.\textsuperscript{13} After the 1973 Yom Kippur War, IMI had been instructed to expand production capacity and stock up with significant amounts of raw materials for explosives manufacture.\textsuperscript{14} Over the years, however, IDF orders had declined, leaving IMI with significant production overcapacity. Its accumulated stocks of raw materials, valued at over $280 million, had become obsolete and had to be written off.\textsuperscript{15}

The external advisers' conclusions were harsh. A continued decline in orders (in January 1992 the IDF warned IMI it would terminate orders of key products,\textsuperscript{16} while the situation in the export market was unlikely to improve), combined with technological advances in automation and machinery, meant that almost half of the workforce was actually redundant.\textsuperscript{17} Furthermore, the management admitted that entering the civil market was a costly mistake, and it should have invested more in what IMI did best: producing arms and weapon systems.\textsuperscript{18}

\begin{itemize}
\item \textsuperscript{13} Affidavit by Michael Shor (IMI Director General, 1972–1990, IMI Chairman 1990–1991) submitted to the High Court of Justice, case no. 991/96, p. 15 (hereafter: Shor's affidavit).
\item \textsuperscript{14} These orders were given by the MoD and State Comptroller office as part of sweeping changes to the workings of the defence establishment after the Yom Kippur War. Source: Shor interview; Shor's affidavit, p.15; \textit{State Comptroller special report on IMI's incorporation}, p. 16.
\item \textsuperscript{15} \textit{State Comptroller Annual Report no. 45}, p. 823.
\item \textsuperscript{16} Letters from MoD Procurement Directorate (which handles weapons acquisition on behalf of the IDF) to IMI chief executive, headed 'IMI – Acquisition of 155mm artillery ammunition', and 'Acquisition of 5.56mm ammunition from IMI', both dated 30 January 1992.
\item \textsuperscript{18} Snir interview, 1998. According to Yossi Snir, who prepared the \textit{Tafnit} plan, the company was unfit to compete in the civil market and subsequently lost $40 million on civilian-related ventures; \textit{State...}
\end{itemize}

164
These findings shocked the MoD and MoF representatives on the company’s board, who had not realised the extent of IMI’s troubles.\textsuperscript{19} An interdepartmental feud erupted in February 1992, with a senior official at the MoF charging that ‘the IMI management and the MoD knew about the firm’s difficulties for a while but preferred to conceal them from us.’\textsuperscript{20} (The MoF suspected that the MoD wanted to ensure that IMI’s transformation into a government-owned company, underwritten by the state budget – and not that of the Defence Ministry – would go smoothly.\textsuperscript{21})

The MoD strenuously denied this. ‘Neither IMI nor the MoD concealed any information on the company; simply put, no reliable information was available on IMI’, asserted the MoD Director General, David Ivry, noting that ‘even IMI did not have a clear picture about its own operations’. He added that the MoF was fully involved in the transformation process and could have examined any aspect of the firm’s accounts it wanted, but preferred not to. According to Ivry, the extent of IMI’s losses was revealed only in August 1990, when external auditors examined its first balance sheet after it was registered as a company.\textsuperscript{22} (It later emerged that IMI’s previous management had failed to monitor its performance adequately and did not inform the board of its increasing difficulties; the Chairman, Michael Shor, accepted

\textsuperscript{19} Hadashot, 6 October 1992; Globes, 6 April 1995; Davar, 17 February 1995.

\textsuperscript{20} Letter from the Director of the Budget Department, Ministry of Finance to the MoF Director General, quoted in \textit{State Comptroller special report on IMI’s incorporation}, p. 33.

\textsuperscript{21} Author’s interviews with Shochat, Brodet and Shomron (2002).

\textsuperscript{22} Globes, 6 April 1995.
full responsibility\textsuperscript{23} and left the board shortly afterwards.\textsuperscript{24} Shomron replaced him, unaware of the full circumstances behind his predecessor’s departure.)

As the two ministries continued bickering, IMI – now kept afloat by advance payments from the MoD\textsuperscript{25} – started preparing a request for government assistance. In April 1992 it asked Prime Minister Shamir for a $150-million aid package\textsuperscript{26} and was informally notified that the government would be willing to endorse it.\textsuperscript{27} At that point, however, the political system was already absorbed by preparations for the June 1992 general elections, and Shamir eventually did not approve IMI’s appeal, leaving the matter for the next government. Nevertheless, three weeks before the elections he appointed a government Steering Committee, headed by the Director of the MoF’s Budget Department. Shamir instructed the committee ‘to determine the scope of the financial aid the state will provide IMI, to examine and approve the recovery plan, and to ensure that the company will meet the plan’s objectives.’\textsuperscript{28} The committee, which examined IMI’s requests, did not make up its mind on the matter, preferring instead to await further instructions from the incoming Labour government.

After they had digested these details, Yitzhak Rabin and his Finance Minister, Avraham Shochat realised that IMI would require substantial government help. ‘We could have dismantled IMI then and there, because the company was not economically viable; however, other considerations were at play,’ said Shochat.

\begin{thebibliography}{9}
\item Transcript of the IMI board meeting, 3 April 1991, p. 9.
\item State Comptroller special report on IMI’s incorporation, p. 40.
\item Haaretz, 18 December 1992.
\item Ibid.
\item Haaretz, 16 April 1992.
\item Letter of Appointment to the members of IMI’s Steering Committee by Prime Minister Shamir, 2 June 1992.
\end{thebibliography}
We had to bear in mind the wider employment implications, especially at that particularly difficult period [with unemployment reaching a record 11.2%\(^{29}\)]; we also had certain strategic considerations, as we wanted to maintain arms production capability in Israeli hands. Rabin decided to keep the company running, and the government looked for practical ways to achieve this.\(^{30}\)

MoF calculations suggested it was possible to secure long-term employment for only about 3,000–3,500 workers;\(^{31}\) at the time, IMI employed more than 8,200.

By the beginning of August 1992 the company was on the verge of collapse. An accidental blast in its explosives bunker, a few miles outside Tel Aviv, killed two workers, injured several civilians (including a Cabinet minister), damaged thousands of nearby homes and brought IMI to a virtual standstill.\(^{32}\) This was the second such fatal explosion in less than two months, and the company came under intense public pressure. While a committee of enquiry investigated its safety procedures, IMI handled thousands of insurance claims\(^{33}\) and considered relocating major production lines to the Negev desert. (However, such a major task was well beyond the firm’s financial means\(^{34}\) and aroused fierce objections from the workers.\(^{35}\) The relocation idea was subsequently dropped,\(^{36}\) despite Cabinet endorsement.\(^{37}\))


\(^{30}\) Shochat interview.

\(^{31}\) Ibid.


\(^{33}\) Author’s interview with Yossi Snir, 21 June 2005 (hereafter: Snir interview, 2005a).

\(^{34}\) *Hadashot*, 16 August 1992.

\(^{35}\) *Davar*, 7 August 1992.

\(^{36}\) Shochat interview.

\(^{37}\) A ministerial committee approved the plan to transfer IMI’s factories to the Negev in July 1992, see *Hadashot*, 2 July 1992. Several members of Knesset protested that the Labour government did not honour its pledges on this matter. The then Deputy Defence Minister replied that not every Cabinet decision is eventually implemented, adding that any relocation of IMI factories had to be judged on the basis of cost-effectiveness. See transcript of Knesset session no. 199 of 2 June 1993, available on http://www.knesset.gov.il (accessed 1 August 2005).
Shortly after the accident the firm submitted an appeal for an urgent aid package; its resources were drained and it could not pay its workers and suppliers. However, the new request, for $250 million, was almost double the one submitted to the Shamir government just four months earlier.\textsuperscript{38} The Director of the MoF's Budget Department, who headed the government's IMI Steering Committee, was furious. He criticised the new request and concluded that the firm was 'to all intents and purposes bankrupt'.\textsuperscript{39} Nonetheless, Rabin and Shochat instructed IMI to prepare a comprehensive plan for financial recovery; meanwhile they ordered the Treasury to transfer 250 million shekels (about $100 million) to give the company sufficient liquidity.\textsuperscript{40}

This was enough to sustain the company for two more months, allowing IMI's management to fend off pressure from workers and suppliers. In September 1992, after seven months of negotiations, it signed a new labour agreement with the workers' national organisation and the Histadrut (which officially represented the company's workers). The management promised to refrain from mass redundancies in exchange for a 16% pay cut and a minor reduction in the existing workforce, stabilising it at around 7,500. No specific provision was made for further redundancies, although — unknown to the workers' organisation — such redundancies were planned, as more details emerged of the company's increasing losses. In the following weeks, the company's external advisers completed their work and handed in recommendations for sweeping changes in structure and working practices.

\textsuperscript{38} \textit{Haaretz}, 10 September 1992.
\textsuperscript{39} The Director of the Budget Department at the Ministry of Finance, in \textit{Haaretz}, 24 September 1992.
\textsuperscript{40} \textit{Haaretz}, 18 December 1992.
Battling for Public Opinion

In November 1992, IMI (now trading under the name Taas\textsuperscript{41}) unveiled 'A Plan for Operational Recovery'. It stipulated that the company should match the size of its workforce to its sales and dramatically improve its output per employee. In the face of an unforeseen 30% drop in revenues over the previous two years, the company needed to lay off 3,000 more workers and close several factories, including a major plant in Jerusalem and two smaller ones in developing areas. Assuming a steady level of orders from the MoD, the company's sales target was set at around $475 million for 1994 and subsequent years (35% below the figure suggested in the defunct Tafnit plan of 1991), of which $217 million would go to the defence establishment\textsuperscript{42}.

The plan called on the Cabinet to assist the management financially, mainly by underwriting its labour costs and its pension obligations to present and former employees\textsuperscript{43}. However, the full scale of the aid required had still to be ascertained, the management insisted, because a comprehensive business strategy for the company was still in the making. In the interim the company asked for a $153-million increase of its equity capital, about $70 million towards the payment of other expenses, and another $139 million to fund the redundancy process, assuming that all 3,000 excess workers would depart within less than a year\textsuperscript{44}. (At that stage, the IMI management

\textsuperscript{41} The company changed its trading name in 1992 from IMI to its pre-state alias, Taas. The new name sounded more neutral and did not evoke military connotations. However, the company reverted to its original name in 1995. See Hadashot, 28 July 1992; Milo interview.

\textsuperscript{42} State Comptroller Annual Report no. 45, p. 826.

\textsuperscript{43} IMI's Operational Recovery Plan, pp. 11–12, 16–18.

\textsuperscript{44} IMI's Operational Recovery Plan, pp. 3–7, 11, 40–42; IMI Management, Taas Recovery Plan – An Executive Update, 20 December 1992, pp. 2–7 (internal document); State Comptroller Annual Report no. 45, p. 826.
already assumed that the total multi-year assistance required would be close to $1 billion.\(^4^5\) The main elements of the plan caused shock waves through the company, sparking widespread protests among IMI workers. The chairman of the IMI workers’ national organisation, Shalom Havshoosh, was particularly dismayed, for, despite his close working relations with the management, he had been kept completely in the dark.\(^4^6\) He rejected the recovery plan, arguing that it made a mockery of the September 1992 labour agreement.\(^4^7\)

In the following weeks the IMI workers’ organisation severed all contacts with management. With the backing of the Histadrut (the national labour federation), which was a signatory to IMI collective agreements, it declared a labour dispute for the first time in the company’s history.\(^4^8\) Havshoosh, vowing to do his utmost to prevent the plan’s approval by Cabinet, hired a public affairs specialist to help prepare a campaign strategy.\(^4^9\) The Histadrut, in the meantime, gave the IMI workers blanket approval for industrial action.\(^5^0\)

Hoping to win over public opinion and politicians by portraying themselves as victims of the management’s incompetence and lies,\(^5^1\) IMI workers initiated a twofold campaign. The overt campaign filled the national and local media with ads and

\(^{4^5}\) Author’s interview with Yossi Snir, 8 October 1997 (hereafter: Snir interview, 1997).
\(^{4^7}\) Hadashot, 4 November 1992.
\(^{4^8}\) Hadashot, 9 November 1992.
\(^{4^9}\) Author’s interview with Shalom Havshoosh (Chairman, the IMI workers’ national organisation, 1980–1993), 22 June 1998 (hereafter: Havshoosh interview, 1998); Maariv, 5 January 1993.
\(^{5^0}\) Hadashot, 26 October 1992.
\(^{5^1}\) Maariv, 5 January 1993.
revelations of alleged management and MoD wrongdoings, complemented by explicit denunciations of the IMI board and management. Similar messages were repeated in demonstrations and public protests near the compound of the Prime Minister's Office in Jerusalem, the Labour Party convention in Tel Aviv, and the IMI headquarters in Ramat Hasharon, near Tel Aviv. These received significant media attention, not least because of the huge gridlocks they caused in Tel Aviv and Jerusalem, and the quantity of police manpower assigned to disperse the demonstrations. On several occasions, Rabin himself confronted the protestors.

At the same time, behind the scenes, the IMI workers' organisation sought to form a lobbying alliance at parliamentary and local government levels. It approached Members of Knesset from all parties, targeting in particular those residing in key primary constituencies, such as the Jerusalem and Haifa districts, and those on influential Knesset committees. (During this lobbying effort, it turned out that a leading Likud MK was an ex-IMI employee.) It also contacted mayors and heads of municipalities in developing areas that had been, or were about to be, affected by the large-scale redundancies at IMI. Finally, the Histadrut leaders – past and present – and

54 Hadashot, 16 November 1992.
57 See, for example, Yedioth Ahronoth, 13 November 1992; Hadashot, 16 November and 20 December 1992.
58 See speech by Ron Nachman MK (Likud), Motions for the Knesset's Agenda, Session no. 38, Records of the Knesset, 16 December 1992, p. 1229. Mr Nachman, Mayor of Ariel, the biggest Israeli town in the West Bank, was employed by IMI for 13 years, becoming Deputy Director General of Research and Development. During that Knesset session he was also a member of the Knesset's Finance Committee.
regional labour councils of the Histadrut were also called on for help. This direct appeal triggered some local initiatives, such as a joint campaign by the Jerusalem Labour Council and the Maale Adumim municipality against the closure of IMI factories in their respective areas.

Havshoosh, chairman of the IMI workers’ national organisation since 1980, led the workers’ campaign. As a life-long Labour Party member, a member of the Histadrut’s Central Committee (the body’s supreme decision-making forum) and a close confidant of senior party figures, he could count on the support of leading politicians. One was Environment Minister Ora Namir, former chairman of the powerful cross-party Knesset committee for Labour and Welfare Affairs, and one of Rabin’s closest allies. Other ministers and politicians also pledged support for the IMI workers, including Economic Affairs Minister Shimon Sheetrit, who lived in Jerusalem.

While the employees were engaged in their PR campaign, IMI prepared a counter-offensive. It hired a leading public affairs agency, whose owner, Moshe Teoim, was a close friend of Shimon Peres, Rabin’s Foreign Minister, and well-

59 Author’s interview with Havshoosh, 16 June 2005 (hereafter: Havshoosh interview, 2005); Maariv, 3 January 1993.
60 Hadashot, 4 November 1992.
62 In her previous capacity, Ora Namir helped Havshoosh in campaigns against Shamir’s Likud government, and especially its construction minister Ariel Sharon, who shelved orders for prefab houses made by IMI. See Kol Hatzafon (regional newspaper in northern Israel), 17 January 1992.
connected among the political and business elite. The agency handled the management’s relations with the media and devised a communication and lobbying strategy; it also helped to formulate reassuring messages to the company’s clients. A second firm, specialising in decision-making and business strategy, helped the IMI management map out the political and bureaucratic actors involved in the policy process.

In contrast to the approach taken by the workers, the management focused primarily on few ‘quality targets’, whose consent and cooperation was essential for approval of the recovery plan within the government system. These included Prime Minister Rabin, Finance Minister Shochat and the officials advising them, and members of the Knesset’s Finance Committee (which had to approve the budget earmarked for the plan). IMI chief executive Komisar, meanwhile, cultivated personal relations with the Finance Minister and the chairman of the Knesset’s Finance Committee, visiting them and their families in their home towns. He did the same with Prime Minister Rabin, with whom he had worked closely when Rabin was Defence Minister.

A second management objective was to ensure that the budget required, or at least a substantial part of it, would be secured without delay. ‘We were running out of time,’ said a senior IMI executive. ‘We knew that the financial problems at Rafael had yet to be addressed [by the Rabin government]; had we failed to secure the funding we needed at that point in time, in all probability it would have gone toward solving

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63 Maariv, 3 January 1995; Snir interview, 1997.
64 Hadashot, 16 December 1992.
65 Snir interviews, 1997 and 2005a.
66 Komisar interview; Snir interviews, 1997, 2005a and 30 August 2005 (hereafter: Snir interview, 2005b). Komisar was responsible for major IMI export deals in Asia during Rabin’s tenure as Defence Minister in the 1980s.
Rafael’s financial problems, not ours.\footnote{Snir interview, 1997.} (In addition to the defence enterprises, other organisations had reached crisis point at the end of 1992 and were awaiting government assistance, among them the biggest health maintenance organisation, \textit{Kupat Holim Klalit}, and the Kibbutzim movement,\footnote{Interview with Shochat, in \textit{Yedioth Ahronoth}, 18 December 1992.} their debts amounted to more than $4 billion.\footnote{State Comptroller Annual Report no. 44, p. 142; State Comptroller Annual Report no. 43, pp. 88–89.})

With this in mind, the management initiated meetings with MKs identified as potential opponents of the recovery plan, inviting them for one-on-one talks with IMI’s chairman.\footnote{Snir interview, 1997.} At the same time, the IMI board and management met key journalists from newspapers known to be read by Rabin and the senior government bureaucracy. Leading figures in the business community, with whom Rabin kept close contact, were also briefed.\footnote{\textit{Maariv}, 5 January 1993.}

Over the next month, as the Cabinet decision drew near, both sides intensified their campaigns. IMI’s workers stepped up their rhetoric and protests, while management countered with a blitz of press briefings that emphasised IMI’s difficulties but also indicated to the company’s customers that the board and management were on top of the situation.\footnote{Komisar interview. The company’s briefings received wide attention. See, for example, a four-page cover feature on the IMI recovery plan in \textit{Yedioth Ahronoth’s} financial supplement, 17 November 1992, and the \textit{Haaretz} editorial, 13 November 1992. For a report on IMI’s difficulties, see \textit{Haaretz}, 10 December 1992; findings of a confidential report by the State Comptroller on the failings of the MoD and the former IMI management were published in \textit{Haaretz}, 3 December 1992.} After a while, violent outbursts by disgruntled employees marred the situation, which became so extreme that
management had to hire bodyguards and beef up security at the IMI headquarters after managers were physically intimidated and the chief executive’s chair set on fire.73

Nevertheless, despite the apparent havoc at IMI, a secret channel of communication was opened. While workers were protesting and management was lobbying, IMI chief executive Komisar and the workers’ leader Havshoosh (who was occasionally accompanied by the Secretary General of the Histadrut, Haim Haberfeld) met routinely at a Tel Aviv hotel late at night. Komisar and Havshoosh had similar views about the company, and they also feared there was a real risk that it was heading for self-destruction.74 ‘I berated Komisar for the management’s style of negotiations; broken promises and deceit were never the hallmark of the labour relations at IMI’, said Havshoosh.75 (IMI had been a model of stable labour relations for many decades, and even in the most turbulent times, such as when major layoffs were taking place, workers refrained from industrial action.76 Former Prime Minister Shimon Peres noted that during his many years at the helm of the MoD, labour relations at IMI were exemplary, in part due to the shared understanding that certain arms deals with regional powers like China and Iran were of strategic importance to Israel.77) After admitting his initial mistake of reneging on the September agreement, Komisar discussed ways to reach an understanding with Havshoosh. The two decided to keep their nightly negotiations under wraps while carrying on their rival lobbying campaigns as planned.

75 Ibid.
76 Author’s interviews with Shor, Havshoosh 1998; Shield and Spear, p. 241.
77 Peres interview.
Setting the Political Stage

At the beginning of December 1992, after overcoming last-minute Treasury reservations, IMI’s management compiled a final draft of the Operational Recovery Plan. By then, the workers’ campaign had gained significant momentum. Half a dozen cabinet members, including the Finance, Health and Transport Ministers, as well as leading figures from Labour (including the party’s Secretary General) and prominent Members of Knesset from other parties, had either met the workers’ representatives or visited factories in their constituencies slated for shutdown. Economic Affairs Minister Shimon Sheetrit expressed reservations about the recovery plan and called for it to be reconsidered, and the Knesset’s Labour Affairs Committee also expressed opposition, while the influential Defence and Foreign Affairs Committee held sessions behind closed doors on the plan’s implications.

In addition, several Motions for the Agenda were presented at the Knesset plenum and then discussed in the Finance and Labour Committees. Triggered mostly by direct appeals, demonstrations and press reports about the impending layoffs at IMI, the Motions tabled by Labour and other parties’ MKs focused on the fate of the workers, urging the Cabinet to refrain from closing factories in developing areas.

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79 Havshoosh interview, 2005; Hadashot, 18 November 1992 and 10 December 1992; Maariv, 5 January 1993. The ministers were Avraham Shochat (finance), Ora Namir (environment), Israel Keisar (transport), Shimon Sheetrit (economic affairs), Binyamin Ben-Eliezer (construction) and Haim Ramon (health).
80 Shimon Sheetrit, quoted in Davar, 4 December 1992.
82 Havshoosh interview, 1998.
83 Shlomo Buhbut MK (Labour), Motions for the Knesset’s Agenda, Records of the Knesset, session no. 17, 28 October 1992, p. 90; Gideon Sagi MK (Labour), Motion for the Knesset’s Agenda, Records of the Knesset, vol. 4, session no. 25, 17 November 1992, p. 490. Both Buhbut and Sagi
while those from Likud members served merely as pretexts to attack the Rabin government.\textsuperscript{84} Meanwhile, the Ministries of Defence and Finance, and the Prime Minister's Office, were deluged with letters and messages of support for the IMI workers. Havshoosh complemented these with grim assessments of the implications of the factory closures for developing towns.\textsuperscript{85}

While the workers' campaign was continuing, the management held intense meetings with the Defence and Finance Ministries. Rabin demanded to be apprised of every minute detail,\textsuperscript{86} insisting that his government 'did not have a bottomless supply of money for IMI', a view he also conveyed to IMI workers' representatives.\textsuperscript{87} In these discussions, the IMI Chairman and Chief Executive presented the main planks of the Operational Recovery Plan along with a comprehensive set of data, stressing that 'there is no other way for recovery other than taking a hard line.'\textsuperscript{88} The management took pains to explain why it needed to shed so many workers as quickly as possible, and why it would be worth the government paying the redundancy costs.

It calculated that the labour cost of the excess workforce was about $150 million a year, while the total cost of making them redundant was $300–350 million: in other words, the state would be able to write off the financial liabilities of these

\textsuperscript{84} Yaakov Shamai MK (Likud), Motion for the Knesset’s Agenda, \textit{Records of the Knesset}, vol. 4, session no. 25, 17 November 1992, p. 491; Yehoshua Matza MK (Likud), Oral Questions, \textit{Records of the Knesset}, vol. 4, session no. 26, 18 November 1992, p. 505

\textsuperscript{85} Havshoosh interview, 1998.

\textsuperscript{86} Snir interview, 2005a.

\textsuperscript{87} \textit{Hadashot}, 16 November 1992.

\textsuperscript{88} Author's interview with Dan Shomron, 16 February 1994 (hereafter: Shomron interview, 1994)
This argument appealed to the Ministry of Finance, which had long sought a reduction of IMI’s workforce at minimum possible cost as part of its long-held intention to restructure and privatise defence companies. (The Treasury also assumed that, with fewer workers on the payroll, the power of the IMI unions would be much diminished, as would their ability to muster the political backing to thwart such a plan in the future). The IMI management also highlighted the dramatic increase in its labour costs over the years, compared with other employers, arguing that the cost of keeping such an excessive and costly workforce had become prohibitive. The most notable example was the 12% unconditional pay raise given to all IMI’s employees in February 1990, with the approval of the MoD and the MoF, in return for turning IMI into a company when it was actually experiencing sharp reduction in orders and persistent losses. (At that point neither IMI nor the MoD had envisaged mass redundancies or a persistent and sharp drop in the company’s revenues.)

After extensive deliberations with senior officials, Rabin and Shochat agreed to endorse the Plan. However, the IMI management did not know whether this would be enough to win over the Cabinet and the Knesset Members’ Social Lobby. The Finance Minister, meanwhile, threatened that unless the IMI workers accepted the recovery plan, he would consider putting the company into administration. Such an action would entail automatic suspension of all labour agreements and the dissolution

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89 Komisar and Snir (2005a) interviews. Pension instalments were to be spread over 20 years or more, so the overall financial burden on the state budget was manageable. These payments were also taxable, so about half of this one-off expenditure was to be returned to the state coffers.
90 Ministry of Finance – Budget Department, Reorganisation of the State-owned Defence Industry.
91 State Comptroller special report on IMI’s incorporation, pp. 42–43; State Comptroller Annual Report no. 45, p. 819.
of the workers’ representative body, while a court-appointed receiver replaced the management and took charge of the company’s affairs. Rabin, who met members of the Knesset’s Social Lobby shortly afterwards, made a case for the IMI recovery and asked them to pledge their support for it, otherwise the company would face liquidation.93

With the backing of the MoF, the IMI management started preparing a plan to put the company into receivership. However, it was reluctant to take such a drastic step; rather, it intended to use the study of this option as a ploy, part of its psychological warfare with the workers. ‘We played the bankruptcy card to convey a message that IMI was in a severe crisis and that we would go all the way if necessary,’ said Yossi Snir, a senior executive.

However, we left the door open for negotiation. We trod carefully, because the last thing we wanted was to undermine the workers’ organisation to the point of it losing all authority. The organisation was a worthy interlocutor, truly capable of pushing through a painful agreement among the workers and the local workers’ committees at each plant. We had no intention of seeking the assistance of other bodies, such as the Histadrut, who might have complicated things. We had one point of contact, and we preferred to keep it that way.94

To make this brinkmanship strategy credible, the management announced that it would consider placing the company in administration and added a presentation by a leading lawyer, a specialist in bankruptcies and liquidations, to the agenda of the next board meeting.95

News of a possible receivership action spread quickly among worried workers, but Havshoosh and his colleagues remained sceptical. They made discreet enquiries and received assurances from highly placed figures that such an eventuality was

93 Shomron interview, 1994.
95 Ibid.
purely hypothetical; no one seriously considered placing IMI in receivership, they were told. However, these messages did little to calm rank-and-file workers, whose low morale badly affected output. Consequently, IMI was unable to meet contractual commitments to the MoD and other customers, missing delivery deadlines to the tune of $100 million.

In early December 1992, a couple of days before the Cabinet meeting, Rabin summoned Havshoosh for a face-to-face discussion. The worker’s leader reiterated his objections to the recovery plan, demanding that Rabin dismiss the IMI Chairman, Dan Shomron, and Chief Executive, Gabi Komisar. ‘They deceived us; we simply do not trust them any more,’ he said. However, Rabin refused to budge. Yielding to such a demand, his advisers warned him, might not only delay any recovery at IMI, because a new management would require some time to adjust, but would also set a dangerous precedent that other powerful workers’ organisations in state-owned companies – those at IAI and the national telecommunications provider, Bezeq, for instance – would be eager to take advantage of. (Other considerations were also involved. Rabin valued the judgement of the IMI’s Chief Executive, Gabi Komisar, who also became a close personal friend. As to the Chairman, Dan Shomron, Rabin was impressed by his military achievements, including overseeing the Entebbe Rescue Operation in 1976; like Rabin, Shomron was an ex-Chief of Staff and therefore had an open door to the Prime Minister at all times.) Rabin therefore explained that the

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96 Havshoosh interview, 1998. He refused to identify his sources for this.
100 Komisar interview. See also personal letter from Yitzhak Rabin to Komisar, [Prime Minister’s Office, Ref. 136–102], 27 August 1995.
101 Snir interviews, 2005a and 2005b.
situation of IMI had become untenable and he was left with no other option but to reduce its size and workforce. Havshoosh retorted:

I accept that the company is in a difficult situation, but in other companies that have experienced similar problems the management tried to find new markets and worked much harder at getting orders. At IMI, on the other hand, all the management did was to cut our salaries and make people redundant.102

Rabin remained adamant, saying he would nevertheless carry the recovery plan through.103

The IMI management, meanwhile, met the Finance Minister, his advisers, and the top officials at the MoD, including Director General Ivry, for a final round of discussions on the main points of the plan.104 At the same time, the IMI workers contacted members of Cabinet, briefing them on the failure of the previous recovery plan (Tafnit) and the apparent inconsistency in the management’s decisions, which had culminated in the dismissal of more than 6,000 employees in six years.105 These briefings, and pressure from other actors involved – the Histadrut, municipalities in developing areas and other trade unions – put Rabin and his political advisers under formidable pressure.

At the request of Havshoosh, Rabin reluctantly agreed to convene the Our Ministers forum – the group of Labour ministers in Cabinet – for a special meeting. Havshoosh demanded to be given an opportunity to outline the reservations of the IMI workers about the recovery plan, ahead of the Cabinet session on the matter. This was unprecedented: never had a union representative succeeded in securing an

103 Ibid.
104 Snir interview, 2005a.
unscheduled, exclusive gathering of ruling party ministers for the sole purpose of lobbying against the Prime Minister.\textsuperscript{106}

On 13 December 1992, a couple of hours before the decisive Cabinet meeting, Havshoosh met the Labour ministers. He presented documentary evidence illustrating the IMI management's apparent inconsistency over the years and criticised major aspects of its strategy. From the workers' perspective, the meeting ended successfully, as most ministers became convinced that the recovery plan was flawed and required more work. They expressed support for the workers' position and prepared to hurl tough questions at the board and management representatives.

Cabinet Showdown

The Cabinet session on IMI's recovery plan, which took place shortly afterwards, was tense. In his opening remarks Prime Minister Rabin noted that he 'had no idea' of the severity of IMI's difficulties when he entered office.\textsuperscript{107} He pointed out that the company's seemingly insurmountable problems -- mounting losses and the breakdown in trust between management and workers -- posed 'a serious dilemma' for the government.\textsuperscript{108}

IMI representatives, who were in attendance, had prepared a detailed presentation which outlined a series of events that, they argued, had eventually led to the company's downfall. These included the government's Economic Stabilisation Programme of 1985, which imposed a deep cut in government spending and a temporary freeze on the dollar exchange rate. This, the company representatives

\textsuperscript{106} Maariv, 5 January 1993.
\textsuperscript{107} Transcript of Cabinet meeting, 13 December 1992.
\textsuperscript{108} Ibid.
maintained, forced the MoD to cut its IMI orders by 46%. Export sales, which increased in subsequent years, offset this drop for a while, but nevertheless were not enough to keep up with the spiralling labour costs. These grew by 80% between 1985 and 1989, claiming almost half the company's revenues, despite a 12% reduction in workforce.109 Rising labour cost, they said, compounded by production overcapacity and loss-making contracts, created a persistent cash-flow deficit. In order to mitigate these effects, the previous management had started eating into IMI's savings, which had totalled some $350 million in 1985. (As a government unit at the time, IMI could not borrow from financial institutions and had to cover losses from its own resources.110) In 1991 these reserves had been completely consumed, by which time the global arms market had also fallen dramatically, after the end of the Cold War and of the US-led Gulf War. This resulted in a 30% drop in sales (see Figure 4.2).111

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109 IMI Presentation of the Operational Recovery Plan to the Israeli Cabinet, 13 December 1992 (internal document, hereafter: IMI Presentation to Cabinet). The implementation of the 1985 Economic Stabilisation plan may explain this anomaly: while IMI's shekel-paid wages rose in line with the cost-of-living increases and pay rises in the public sector, its dollar-paid export revenues were devalued by the exchange-rate freeze. The rise in labour costs outpaced the increase of export revenues. See State Comptroller special report on IMI's incorporation, pp. 18–20; see also Yair Aharoni, The Israeli Economy, pp. 83–91.

110 Shor interview.

111 Ibid.
Figure 4.2

IMI: Business Indicators

Sources: State Comptroller and IMI.

Note: This graph suggests that, despite a steady increase in sales and a slight reduction in workforce between 1987 and 1990, IMI posted losses and used up all its financial reserves in an effort to keep its workforce intact. In 1991, just as IMI became a company, it reached a crisis point, as sales dipped and losses mounted following the end of the Cold War.

IMI’s chairman, Dan Shomron, insisted that the core of the company’s problem was rooted in factors beyond its control. ‘Transformation of a government unit into a company requires mental and cultural metamorphosis (within the organisation); to do so while your business environment has just plunged into crisis is particularly traumatic,’ he said, noting that:

In 1990 IMI started operating [as a company] without financial resources of its own, overburdened by an inflexible, distorted wage structure that did not bear any relation to the company’s actual business results. [...] In fact, IMI performed not like a business but like a contractor, governed by non-commercial practices of a government department. It was an industrial enterprise with manufacturing units that had no concept whatsoever of profit and loss; they did not even care to know. At the same time, these units cross-
subsidised each other to the point where no one knew which unit was actually making money and which one was losing it.\textsuperscript{112}

Shomron confessed to complete ignorance about the true situation of IMI:

\begin{quote}
When I arrived in June 1991 I had no idea of the company's problems ... the chief executive had only a sketchy account and did not know much either. The way IMI operated was such that it was very hard to have a complete picture; only partial details were available.\textsuperscript{113}
\end{quote}

Once these were compiled, the IMI representatives said, they realised that the company suffered from several problems that needed to be addressed urgently, such as a production overcapacity of 100\% and underperforming factories with a low-output workforce (sales per worker were $50,000, compared to an average $100,000 in competing companies). Crucially, they stressed, the company lacked control of labour costs – due to past agreements with the workers and government guidelines – and was burdened further by pension commitments to more than 4,000 former employees, who had worked at IMI when it was a MoD unit but were paid by the company and not by the state Treasury.\textsuperscript{114} The company also needed to internalise more sophisticated working practices.

The IMI representatives went on to describe the steps the company had already taken to address its deficiencies. These included a series of cost-cutting measures and implementing the \textit{Tafnit} plan, which sought to revamp the company's organisational culture and reorient its business focus. Selling some of IMI's real estate had raised additional capital. Yet, they said, these efforts had not been enough, and the only way to halt the company's 'cash haemorrhage' was immediately to shut down six loss-making plants, including two in developing areas, and consider closing

\begin{footnotes}
\textsuperscript{112} Transcript of Cabinet meeting, 13 December 1992.
\textsuperscript{113} Ibid.
\textsuperscript{114} \textit{IMI Presentation to Cabinet; IMI's Operational Recovery Plan}, pp. 15–19.
\end{footnotes}
another four (see Figure 4.3). In the process, 3,000 employees would have to be made redundant, stabilising the payroll at under 5,000.\textsuperscript{115} (IMI's Chief Executive, Gabi Komisar, who presented this section, was interrupted by Environment Minister Ora Namir, who scolded him for saying he would 'release redundant employees'; she responded, 'these people are not slaves and you are no liberator.'\textsuperscript{116})

These drastic measures, the IMI representatives maintained, had to be paid for by the state in order to help the company achieve break-even by 1994. In addition, the Cabinet was asked to underwrite loans and other financial expenses, including pension plans of former and present workers, and to exempt the company from certain liabilities. All in all, the projected cost of the financial aid package throughout the recovery phase and in subsequent years stood at close to $1 billion. The IMI representatives asked the Cabinet to support this request, adding that a comprehensive strategic business plan would be presented later, probably within four months.\textsuperscript{117}

While Rabin and Shochat guided the discussion and offered helpful comments, helping IMI representatives to build a stronger case, many ministers remained sceptical. Transport Minister, Israel Keisar, previously the Histadrut's Secretary General from 1984 to 1992, and someone who was close to both Rabin and the IMI employees' leader Havshoosh, disputed the management's account:

> When IMI was in the process of turning into a company, there was a great show of profit and strength. I myself took part in that, both in 1987 and 1988.\textsuperscript{118}

\textsuperscript{115} Transcript of Cabinet meeting, 13 December 1992; IMI presentation to Cabinet.
\textsuperscript{116} Snir interview, 2005a.
\textsuperscript{117} Snir interviews 1997 and 2005c; IMI presentation to Cabinet; State Comptroller Annual Report no. 45, p. 835.
\textsuperscript{118} Transcript of Cabinet meeting, 13 December 1992.
Figure 4.3: Location of IMI's factories

Legend:
- Factory in a developing area
- Factory slated for closure in a developing area
- Factory
- Factory facing prospects of a shutdown
- Factory slated for closure
Some ministers asked the management to address discrepancies between the previous plan (*Tafnit*) and the new one: for example, the policy reversal over involvement in the civil market. Others focused on the breakdown in trust between management and employees and the apparently misleading behaviour of management over the defunct September 1992 labour agreement. (This was an accusation Shomron flatly denied. He insisted that ‘while there was a clause in the agreement which stipulated an end to future mass redundancies, we also told the workers that we would keep the situation under review. We approached them as soon as we finished that assessment. We deceived no one.’\(^{119}\))

As the meeting progressed, it turned out that most ministers remained unconvinced. Environment Minister Ora Namir unequivocally criticised the new plan and openly questioned the management’s ability to deliver it, based on its record to date: ‘This is the fourth recovery plan [at IMI]; all the previous ones resulted in mass redundancies and nothing else happened.’ She therefore demanded the immediate dismissal of the IMI management, arguing that, if it were to stay in post, this would spell ‘the beginning of the end’ for the company.\(^{120}\) Almost all ministers concurred, expressing their support for removing the management.\(^{121}\) Realising he would be unable to secure sufficient support for the plan, Rabin closed the meeting.\(^{122}\) He later notified the IMI management that a follow-up Cabinet meeting was scheduled for later that week.

In the next few days, Rabin considered whether he could accommodate the plan’s critics, discussing various options with the Ministries of Defence and Finance.

\(^{119}\) Ibid.

\(^{120}\) *Haaretz*, 13 December 1992.


\(^{122}\) Snir interview, 2005a. (Snir was among those presenting the recovery plan in Cabinet)
The IMI board of directors, meanwhile, held an emergency session at which it offered full backing to the management. In a statement to the press, board members – who included senior MoD and MoF officials – expressed anger at the workers' demands. The spectre of a workers' union dictating the replacement of a company management as a condition for any implementation of a plan by its owners, the government, is a dangerous precedent. The continuous service of the present management is a vital and essential part of the IMI recovery.123

The same day, workers' representatives led by Havshoosh arrived at the Knesset for a final round of lobbying, meeting MKs and Finance Minister Shochat. (Havshoosh collapsed during the meeting with Shochat and was admitted to hospital with a heart problem;124 the first person to visit his bedside was Chief Executive Komisar.)125

On Wednesday 16 December 1992 Cabinet reconvened. Rabin was adamant, threatening to relinquish any responsibility for the company and put it into administration at once unless Cabinet agreed to restructure IMI while keeping the management in place.126 However, after further discussion a compromise was reached. In return for accepting these initial demands, Rabin and Shochat agreed to water down the original plan and to address some key concerns raised by Cabinet members: chief among them the scope and pace of workforce downsizing. Rabin was reminded by his colleagues and advisers – and not least by IMI's Havshoosh – that such a large wave of redundancies would run contrary to the party's ethos and might well play into the hands of Labour's detractors. New clauses were therefore inserted, which deviated significantly from the original plan.

124 Noted by Finance Minister Shochat, in a speech to the Knesset, see *Records of the Knesset*, Vol. 8, Session 38, 'Motions for the Agenda', 16 December 1992, p. 1233.
First, the Cabinet ordered the IMI management not to shut down three of the six factories slated for closure (those in Jerusalem, the adjacent developing area of Mishor Adumim, and the northern town of Maalot – all strongholds of prominent Labour ministers and MKs\textsuperscript{127}) and to find alternative solutions instead. Second, the Cabinet called for a gradual, sequential reduction in the workforce, laying down several conditions that had to be met before moving on to the next wave of redundancies; it also asked for a comprehensive business plan to be submitted by March 1993.\textsuperscript{128} In response to ministers’ criticism of the IMI management’s behaviour, Rabin and Shochat added another clause instructing it to cooperate fully with the workers’ organisation on all aspects of the recovery plan and to refrain from unilateral actions.\textsuperscript{129}

The modified proposal was accepted by a majority of eight ministers to three (two of whom, Namir and Sheetrit, had already sided publicly with the IMI workers), with three abstentions. Two counter-proposals – one to delay redundancies by six months and spread the plan’s implementation over a longer period, the other to postpone the whole plan for two months and ask the IMI management to prepare a more complete one – were narrowly rejected.\textsuperscript{130}

Shortly after the vote Finance Minister Shochat declared that, while the Cabinet decision was a ‘life preserver’ for the company, the prospect of receivership was still on the table. ‘Should the workers and management fail to agree on

\textsuperscript{127} Three Labour ministers – Uzi Baraam, Shimon Sheetrit and Avraham Shochat – resided in Jerusalem; the Mayor of Maalot, a small town on the Israel–Lebanon border, was the Labour MK Shlomo Buhbut, who was also member of the powerful Knesset’s Finance Affairs committee.


\textsuperscript{129} See Ibid., clause XIII.

\textsuperscript{130} Haaretz, 17 December 1992.
implementation of the recovery plan ... the company might be liquidated or placed in administration'. To the Members of Knesset, he said that the Cabinet decision 'was not taken light-heartedly,' describing the chain of events that had led to the crisis at IMI and the efforts to preserve as many factories as possible. He then attacked the Shamir government for failing to address IMI's problems earlier, claiming that it had known of the company's problems as early as 1991 'but preferred - I presume for political reasons - to wait long enough so they could pass on this hot potato straight to us'. (Prime Minister Shamir rejected this charge: 'We looked for solutions [for IMI] which did not involve mass redundancies; we saw nothing positive in that.' He added that 'no one predicted the sudden collapse in IMI's exports. ... I remember its management bragging about its success, presenting long lists of orders; these orders disappeared virtually overnight'.

Away from the political bickering, the reactions of the IMI management were mixed. On the one hand, the Cabinet approved a two-year aid package to the company worth $292 million as well as the immediate laying off of 1,500 workers, with an option of a further 1,000 to follow. On the other, the compromises and concessions outlined in that decision were at odds with the premises of the original recovery plan, rendering it more expensive, if not outright impossible. Yet, the Cabinet did not allocate any additional funding or set provisions for potential untoward eventualities, such as a lengthy negotiation with the workers' organisation and the Histadrut, even though the company management clearly outlined the financial implications of any

131 Ibid.

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such delay in its recovery plan. The workers, meanwhile, announced that they would do their utmost to foil the ‘implementation of the IMI destruction plan’.

Unravelling the Recovery Plan

Once the Cabinet decision had been taken, implementation of the IMI recovery plan was handed over to the company’s management and the Ministries of Finance and Defence. However, key assumptions in the plan began crumbling almost immediately, either because changing preferences by IMI’s main customer, the MoD, influenced the company’s sales projection, or because political constraints delayed, or in some cases prevented, timely reductions in its workforce. The following sections – on labour, restructuring and sales – examine key developments in these areas, which affected IMI throughout the implementation of the plan in 1993 and 1994.

Labour Reduction: Delays and Cost Overruns

The Cabinet decision, with its conditions and restrictions, posed a major challenge to the IMI management. Immediately afterwards, and while the Ministry of Finance continued pouring large sums of money into the company, the management unsuccessfully tried to resume communication with the workers. The standoff lasted for several weeks, during which hundreds of workers demonstrated against Rabin in front of his MoD office in Tel Aviv.

The Prime Minister, who witnessed some of the protests and even haggled with demonstrators, was furious. He publicly denounced the IMI workers’ refusal to

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135 See IMI Presentation to Cabinet; IMI Operational Recovery Plan, pp. 42–44.
cooperate, asserting that it 'would be cheaper to accommodate them in Hilton hotels than on the factory floor'. And, while criticising the 'inaction' of the previous government, he argued that the money to be spent on IMI 'could have created new workplaces for more than 10,000 unemployed people' or 'done wonders for the education system'.

Rabin's attacks fuelled much anger and resentment among the IMI workers, but also left them despondent. Havshoosh noted,

for me and for my fellow workers, to hear these disparaging remarks uttered by the highest authority of all – Prime Minister Rabin himself – was like witnessing the destruction of the Tables of the Covenant. We believed that by risking our lives working on capricious production lines we actually performed a major national security function; now we felt as if a knife was piercing our body. The result was hatred: of the workplace, of the defence establishment. Under such circumstances, all that was left for me was to get the best redundancy packages possible, and that was exactly my intention. I told Rabin as much.

Realising they had lost the battle in the public arena, and with the Prime Minister turning against them as well, the workers agreed to negotiate with management. Havshoosh says his main interest was not to reduce the number of redundant workers – he did not challenge the figures given in the Cabinet decision – but to improve their severance terms; he was less concerned with the fate of the remaining workers. The discussions lasted more than three months, during which the workers realised that 'everyone wanted to see the back of this process', so they

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139 Rabin, speech to union leaders from the Haifa district, quoted in Haaretz, 24 December 1992.
140 Ibid.
141 Rabin, speech at the national conference of mayors and heads of municipal authorities, quoted in Yedioth Ahronoth, 13 January 1993.
142 Havshoosh interview, 1998.
143 Ibid.
deliberately stalled it. Another factor in their favour was the Cabinet’s instruction to the management that it must win the workers’ approval for the operational recovery plan. Most of their initial demands were therefore accepted, including career retraining packages at government expense. However, the workers’ most significant achievement related to compensation and retirement arrangements. Laid-off workers were awarded one-off compensation of over $100,000 each (equal to three years’ work on full pay), more than twice the statutory rate; others were allowed to retire early on full pension – which, in net terms, was almost double the cost of the one-off compensation payment.

The 5,000 employees not laid off had to forgo pay rises and agree to certain conditions, including the outsourcing of services and the hiring of contract workers on lower pay. They also accepted, with the consent of the Histadrut, that IMI’s future survival was contingent on the profitability and performance of each of the factories, and that each would be assessed and dealt with individually (to avoid the phenomenon of cross-subsidy between factories).

The terms of the new agreement were approved in March 1993 by the government’s IMI Steering Committee, even though the cost of the redundancy package was almost 50% higher than estimated: up from the $139 million in the recovery plan to $192 million. A few weeks later the Cabinet also endorsed the agreement, noting that it ‘met the government guidelines’. However, it allocated no additional funding, even though the company had already missed key recovery

144 Ibid.
145 Transcript of IMI board meeting, 10 March 1994, p. 2; Haaretz, 23 June 1998.
146 State Comptroller Annual Report no. 45, pp. 831–832.
147 Ibid., p. 833.
148 Clause I, Cabinet Decision No. 1118 on IMI’s Operational Recovery Plan, 4 April 1993 (hereafter: Cabinet Decision No. 1118).
objectives due to the preconditions stipulated in the Cabinet’s December 1992 decision.

Over and above the increase in the direct compensation cost, the Cabinet’s preconditions also slowed workforce reduction. According to IMI’s figures, instead of the 1,500 employees the company planned to lay off by the end of March 1993, only 831 actually departed (a delay management blamed on the protracted negotiations with the workers). In other words, only 55.4% of target layoffs was achieved, which meant higher than expected running costs. In June 1993 the IMI Steering Committee examined the company’s business results and authorised a management request to lay off 1,500 extra workers, bringing the total number of redundancies close to 3,000.149

**Political Opposition to the IMI Restructuring**

The decision of the Steering Committee – which also noted that it would expect to see the company back in profit within eighteen months – signalled to the remaining workers that the management was adamant about carrying through the recovery plan in its entirety, including factory closures. Indeed, in the course of 1993 IMI shut down three of the six factories it planned to close – a prefab production plant in IMI’s northern factories complex in Haifa, a munitions plant in its Ramat Hasharon complex, and a metal-working plant for the civil market in Maalot. While the plant in Haifa was closed on time, that in Ramat Hasharon was shut after a six-month delay, and the factory in Maalot was sold to an Israeli firm after it gave financial guarantees to the workers. (The workers at the Maalot plant agreed to the deal only after the Finance Minister visited them in person and persuaded them to accept it.150)

149 *State Comptroller Annual Report no. 45*, p. 831.
150 Shochat interview.
A few months into the first wave of redundancies and plant shutdowns, the management found itself exposed to a new wave of criticism. A series of scathing investigative reports in a national daily,151 which were based on information and documentary evidence from ex-IMI workers, prompted some Members of Knesset to call for a public enquiry into the company’s alleged ‘incompetence and corruption’.152 Two MKs filed a joint complaint with the police, asking for a criminal investigation into the newspaper’s claims.153 However, the Defence and Finance Ministries dismissed the calls and gave the company full backing. (Four months later, the police told IMI management it had decided not to press charges and closed the case.154)

While the management was fending off its critics, the workers’ national organisation – now headed by Havshoosh’s successor, Haim Zweig, also a Labour Party member – sought to prevent closure of the two remaining factories in the Jerusalem area. In contrast to Havshoosh, who had favoured dialogue and compromise, the new workers’ leadership took a stance as unyielding as it was forceful. The first hints of possible closure of IMI’s factories in Jerusalem and Mishor Adumim started circulating in January 1994, a few weeks after the management finished a comprehensive feasibility study that suggested these factories should be closed because they had accumulated an operational loss of $11 million in 1993.155 The local workers’ committee at the Jerusalem factory decided to handle their fight for survival on their own terms. With the backing of the IMI workers’ national

organisation, they broke off all relations with management and warned senior executives not to attempt to enter the factory. (Indeed, none of these executives dared to set foot there for two years, and the factory was practically run by its line managers, who received occasional instructions telephoned and faxed from IMI headquarters.\(^\text{156}\) Remarkably, the MoD and the company kept this situation under wraps and did not initiate legal proceedings against the workers).

Meanwhile, in April 1994 the IMI board passed a resolution to close the Jerusalem factory and relocate its infrastructure to another IMI factory in Haifa. IMI’s Finance Director estimated the costs of closure, including redundancy of the factory’s 357 workers, at $50 million but noted that IMI would be spared significant expenses associated with the loss-making plant and could streamline its aviation activities on one site instead of two. All in all, he predicted the company would cover this one-off cost ‘within two to three years’.\(^\text{157}\) Even though the company lacked the resources for such an undertaking, a point made clear by the MoF representative on the board, the company’s Chairman was confident that state funding would be forthcoming and declared that he ‘would personally take care of this’.\(^\text{158}\)

However, the IMI workers’ organisation opposed the board’s decision from the outset. It sought to reverse it by direct appeals at political level – to the Knesset and the Defence and Finance Ministers. This proved highly effective, given the strong support the workers received from Jerusalem-based politicians, including ministers (the Finance and Tourism Ministers among them) and influential Members of Knesset, from both Labour and Likud,\(^\text{159}\) such as Dalia Itzik, chairman of the Knesset

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\(^{157}\) Transcript of IMI Board of Directors meeting, 10 March 1994, p. 4.

\(^{158}\) Ibid.

\(^{159}\) Snir interview, 1998.
Education Committee, and opposition leader and head of Likud Binyamin Netanyahu. The latter even visited the Mishor Adumim factory and promised to keep it open; the message relayed to the Jerusalem employees was unequivocal – under no circumstances would the politicians allow a major factory in the capital to close. To make their case yet more persuasive, the workers’ organisation hired management consultants to examine the Jerusalem factory’s performance and long-term viability. Soon afterwards, when a workers delegation met Finance Minister Shochat to advise him of this initiative, he backed the idea and asked to see the report’s findings.

IMI management refused to assist the workers’ advisers or give them unfettered access to information, so the advisers relied on line managers and rank-and-file workers, who supplied them with internal assessments and documents. These sources helped to produce a telling account that alleged IMI management had rushed to close the factory without examining alternative solutions for its revival. An interim report by the consultants, released in May 1994, warned of dire consequences and a potential loss of revenues to the tune of $197 million (including $47 million in firm orders). The report pointed out that over the years IMI Jerusalem had acquired unique expertise in aerospace systems and had been awarded non-transferable qualifications from leading foreign manufacturers; it also suggested some cost-cutting

160 Member of Knesset Dalia Itzik was instrumental in the workers’ lobbying efforts within the Labour party. See, for example, her Motion for the Knesset’s Agenda protesting against the imminent closure of IMI Jerusalem, in Records of the Knesset, session 224, 1 June 1994, vol. 32, pp. 7762–7763.
161 Zweig interview, 1998a.
162 Snir interview, 2005a.
163 Maagar Mohot Ltd, IMI Jerusalem – Economic Analysis: Interim Report, May 1994, p. 2. The study was commissioned by the IMI workers’ national organisation.
164 Ibid.
measures and relocating the factory rather than closing it down.\textsuperscript{165} Copies of the report were sent to the Prime Minister’s Office, the Ministries of Defence and Finance, selected Knesset committees, and news organisations. The workers also presented them to Rabin and Shochat in person.

On receiving these findings, the Knesset’s Finance Committee convened for a special session in June 1994, at which it instructed IMI management to refrain from any deliberate attempt to close the factory or lay off its workers.\textsuperscript{166} However, after discussions with Prime Minister Rabin and Finance Minister Shochat, the Committee chairman, Labour MK Gdalia Gal, asked an independent expert from Tel Aviv University to look into the workers’ claims. IMI management commissioned a leading economist (who had once been a Labour candidate for the finance portfolio\textsuperscript{167}) to produce a report of its own, which was based on the management’s assessments.\textsuperscript{168} The two reports did indeed call into question many of the workers’ assertions but did little to change the politicians’ mind. The pressures that Prime Minister Rabin was under – at the time he was intensely involved in the Middle East peace process, while also negotiating a recovery plan for IAI (see Chapter 5) – made him disinclined to take a bold stand on the matter. He therefore dodged the issue for months, ignoring recurrent calls by IMI’s board and management to close the factory, which, in the meantime, continued to incur significant losses.\textsuperscript{169} In the summer of 1994, however, the IMI started implementing the closure. A senior executive was assigned to prepare


\textsuperscript{167} News First Class, 13 May 2001 (www.nfc.co.il, visited 30 August 2005). Prof. Haim Ben-Shakhar also served as special advisor to Prime Minister Barak.

\textsuperscript{168} Snir interviews, 1998a, 2005b; Haaretz, 4 August 1994.

\textsuperscript{169} State Comptroller Annual Report no. 45, p. 837.
the complex shutdown of the Jerusalem factory, discreetly transferring its know-how and infrastructure to the Haifa factory.\textsuperscript{170}

While this was going on, an internal dispute erupted between Chief Executive Komisar and Chairman Shomron over an opportunity that arose for the Jerusalem factory. An IMI consultant, who was also working on a restructuring project for the other state-owned company, Israel Aircraft Industries, suggested that company might be a prospective buyer for the Jerusalem factory. Komisar endorsed the idea and negotiated a deal with his counterpart at IAI; the two sides even drafted a tentative agreement.\textsuperscript{171} However, Shomron opposed the initiative, insisting that the relocation of Jerusalem factory to Haifa should go ahead as planned; he also persuaded the board to veto the Chief Executive's deal with IAI.\textsuperscript{172}

The rift caused a split among senior management and board members, who were presented with conflicting expert assessments commissioned by each side.\textsuperscript{173} The employees, too, were divided. On the one hand, the workers' local committee of the Haifa plant and the Histadrut's regional labour council in Haifa sided with the Chairman and called for the dismissal of the Chief Executive\textsuperscript{174} (the Chairman of the Histadrut's branch in Haifa asked the Knesset to intervene\textsuperscript{175}). The workers' national organisation, by contrast, initially agreed to support Komisar's idea on condition that IAI offered immediate and permanent employment to all the workers at the Jerusalem factory.\textsuperscript{176} Once that demand was rejected, it decided to oppose both proposals --

\textsuperscript{170} Snir interview, 1998. Snir was in charge of the Jerusalem factory relocation project.
\textsuperscript{171} Komisar interview.
\textsuperscript{172} Ibid.
\textsuperscript{173} Snir interviews, 1998 and 2005b.
\textsuperscript{174} Haaretz, 14 December 1994.
\textsuperscript{175} Haaretz, 20 December 1994.
\textsuperscript{176} Author's interview with Haim Zweig, 2 July 1998 (hereafter: Zweig interview, 1998b)
relocation to Haifa and IAI's purchase offer – and demanded the replacement of the
Chairman, claiming he was unable to lead the company to recovery. However, the
chairman of the IMI workers' organisation was presented with internal management
assessments suggesting that the Haifa factory faced possible shutdown as well, if the
transfer of IMI Jerusalem were not completed. Apparently, the IMI munitions factory
in Haifa could not cover its operating costs on its own and needed the additional
production lines of the Jerusalem factory to remain in business.

The fate of the Jerusalem and Mishor Adumim factories was not the only thing
in doubt. A third factory, in Tel Aviv, was slated for shutdown by June 1993 but
remained open more than a year later, due to differences with the workers over their
terms of departure; some unforeseen technical problems also contributed to the delay.
The factory posted an operational loss of more than $20 million in 1993 and 1994,
which had to be absorbed by IMI. Also in 1994, the IMI board decided to relocate
two other factories, a step contingent upon government funding. On the other hand,
a plan to close the loss-making factory in Kiryat Shmona, a struggling town on the
Israel–Lebanon border, was scrapped after the IMI board concluded the Cabinet
would not endorse it for political reasons. The State Comptroller censured the IMI
board for this, stating that it failed to uphold its responsibility for following profit-
driven considerations, as laid down in the Government Companies Law.

177 Interview with Haim Zweig in Haaretz, 10 November 1994.
178 Zweig interview, 1998b.
180 Ibid., pp. 838–839.
181 Ibid. p. 838.
Sales: Diminishing MoD Orders

The closure of loss-making factories was not all that failed to materialise. IMI’s domestic sales forecast, whose accuracy was critical for the success of its recovery plan, also proved over-optimistic.

During discussions with the MoD the company was informed that its predictions were ‘unrealistic and not based on the actual [acquisition] plans of the MoD,’ contrary to the Cabinet decision of April 1993, which stipulated that ‘IMI’s recovery plan ... should be compatible with the IDF’s long term work plan’. On the basis of the IDF work plan the MoD placed orders from IMI, and, according to the MoD Director General, he was ‘unable to dictate to the military what to buy.’ Against this background, the MoD maintained, IMI’s expectation that the military would place orders to the tune of $200 million a year was ‘well beyond the MoD’s budgetary means’ and also ‘outside the scope of its immediate priorities’. In fact, actual IDF orders from IMI fell well below company estimates (see Figure 4.4).

The MoD also insisted it could not commit itself to long-term acquisition from any single source, IMI included. Such an undertaking, it argued, ran contrary to the Mandatory Tenders Law of 1992, which stipulated that a government ministry could only enter into a contractual arrangement with a supplier after a competitive bidding process. Moreover, the MoD had other sources for weapons and explosives in the form of American manufacturers; their products could be contracted and paid for as part of the US annual military aid to Israel (which meant that the IDF would receive these products free, whereas purchases from IMI were paid for from the local-

182 Clause IV, in Cabinet Decision No. 1118.
183 Interview with David Ivry, in Davar, 17 February 1995, p. 16.
185 State Comptroller Annual Report no. 45, p. 829.
currency portion of the defence budget, which had to accommodate other pressing needs).

Figure 4.4

![IMI Sales Distribution: Projection vs. Actual](image)

Sources: IMI reports; State Comptroller.

Note: IMI's actual sales to the MoD in 1993 and 1994 – the years covered in the Recovery Plan – fell below the Company's predictions by $41 million and $37 million, respectively. Elsewhere, the company performed well and even better than expected.

The IDF’s position was unexpected, perhaps – it had not objected to any of the sales projections IMI had presented to the Steering Committee and to the Cabinet\(^{186}\) – but hardly surprising, since it had full autonomy to determine its operational needs and purchases (under the ‘consumer sovereignty’ directive, discussed earlier). In addition, the IDF tended to reduce its orders from local contractors in response to budget cuts; this was also useful means of protest by proxy – some affected suppliers

\(^{186}\) Ibid., p. 830.
would usually lobby the Cabinet and Knesset against defence cuts proposed by the Ministry of Finance.\(^{187}\)

IMI’s management was aware of this, as well as of the fluctuations in overseas markets, and therefore decided to hedge against future shortfalls in military orders. To this end, the company’s board – which included four ex-Generals, in addition to an ex-Chief of Staff as chairman – put considerable pressure on the defence establishment and Prime Minister Rabin, asking for a complete rethink of the IDF’s position vis-à-vis IMI. ‘Governments all over the world subsidise their domestic arms producers,’ noted the Chairman, Dan Shomron. ‘The Israeli government should do the same by keeping a steady stream of purchases from IMI at the level that was set in the Operational Recovery Plan\(^{188}\) – i.e. $200 million a year.

Matters of particular concern were the artillery munitions and rocket engines production lines, which involved particularly high fixed costs but operated in an unsteady business environment. IMI concluded that keeping these lines open would require a minimum level of orders; below that level, it argued, they would cease to be viable. To ensure that this would not happen, the company asked for an indefinite subsidy from the government, about $10–15 million a year, if the company failed to reach predefined annual sales targets.\(^{189}\) (IMI studied subsidy arrangements in other countries and followed the one that existed between a British arms manufacturer and the UK’s MoD.\(^{190}\))

Shomron himself spearheaded the efforts to secure that commitment. Over the following weeks and months he threw his weight into promoting the subsidy proposal,

\(^{187}\) Snir interview, 2005b.
\(^{188}\) State Comptroller Annual Report no. 45, p. 829.
\(^{189}\) Snir interview, 2005b.
\(^{190}\) Ibid.
enlisting at times the help of Chief of Staff Ehud Barak, who succeeded him in that role. Together they approached Prime Minister Rabin and persuaded him that maintaining the artillery munitions and rocket propulsion lines at IMI was of strategic importance to the military — especially in war — and that such an undertaking should be funded outside the defence budget. The MoF, which opposed this initiative from the outset, was furious; from its point of view, the defence establishment had simply found another way to increase its budget beyond the agreed ceiling. However, in December 1994 Rabin instructed Finance Minister Shochat to accept the arrangement, notwithstanding the MoF officials’ reservations.191

Credibility Crisis at IMI

Around the final weeks of 1994 it became clear that the Operational Recovery Plan had failed in some key objectives. Relations with the workers had not been stabilised; indeed, mistrust and resentment reached new heights, as witness the struggle over the Jerusalem factory. Occasional industrial action initiated by the employees’ national organisation disrupted deliveries and threatened to damage the company’s reputation.192 (This was narrowly averted thanks to management marketing initiatives, which generated larger-than-expected export revenues; the MoD also helped by forwarding advanced payments and supporting IMI’s export efforts abroad.193)

The company’s financial situation was hampered by continued excess production capacity at some factories — such as those in Jerusalem and Tel Aviv — which the management tried unsuccessfully to close. It was also exacerbated by the

191 Snir interviews 2005a and 2005b.
delay in the departure of redundant employees, which meant more people on the payroll than originally budgeted for. Consequently, IMI did not reach break-even by the end of 1994, but posted a $47-million loss instead (see Figure 4.5).

Figure 4.5

Sources: State Comptroller, IMI Reports, Government Companies Authority.

Notes: The chart compares projected (p) with actual (a) sales, operating profit and workforce. Sales projections for 1993 and 1994 were not met; at the same time factory closures were delayed. The combination led to higher than expected operating losses: $85 million and $47 million in 1993 and 1994, respectively (an operating profit of $1 million had been forecast for 1994).

The MoF, meanwhile, became increasingly worried. The Comprehensive Strategic Plan, expected to be submitted by March 1993, was not presented until August 1994, amid increasing signs of disagreement between the management and the board over the future structure of the company's military operations. The government's IMI Steering Committee, which examined the 184-page plan, asserted that it was not consistent with the multi-year work plan of the IDF, as it contained

194 Haaretz, 6 February 1995.
unrealistic estimates of procurement by the MoD.\textsuperscript{195} This was disputed by IMI, which argued that the projections were based on assessments and working assumptions that formed the basis of the Operational Recovery Plan, endorsed by Cabinet in December 1992.\textsuperscript{196} Nevertheless, the Strategic Plan was rejected by the Steering Committee, which asked the company to present a modified version consistent with the military’s future needs.\textsuperscript{197} In the meantime, IMI requested and was granted an additional $87-million cash injection, on top of the $292 million already given, towards the additional expenses it incurred as a result of the preconditions set in the Cabinet’s December 1992 decision.\textsuperscript{198}

The request for additional support, along with the company’s financial results, suggested that it would still be several months, if not more, before IMI reached its recovery targets. Realising it was heading towards another round of redundancies, in September 1994 Finance Minister Shochat instructed IMI management to renegotiate the terms of the collective agreement it had with the remaining workers. Specifically, he asked it to reduce the costs of future redundancies (which meant that the MoF wanted cutbacks in the generous pension and compensation packages previously offered to departing workers).\textsuperscript{199} The MoF also insisted that it should take part in the discussions with the workers about their terms of departure, because it was the state treasury, not IMI, that was actually paying for the workforce reduction.

IMI management was baffled. Further enquiries revealed that the MoF’s top bureaucracy had persuaded both Rabin and Shochat that IMI had negotiated excessive

\textsuperscript{195} State Comptroller Annual Report no. 45, p. 839.
\textsuperscript{196} Taas – Israel Industries, Strategic Business Plan, August 1994, pp. 6–8, 11–12.
\textsuperscript{197} State Comptroller Annual Report no. 45, p. 839.
\textsuperscript{198} Ibid.
\textsuperscript{199} Haaretz, 29 September 1994.
severance packages, setting a bad precedent for future redundancy negotiations in other workplaces, including the private sector.\textsuperscript{200} The management rejected this claim, arguing that the terms of the severance packages were based on those the MoF itself had awarded to former state employees. According to Shmuel Kaufman, the executive who represented IMI \textit{vis-à-vis} the MoF:

Finance Minister Shochat claimed repeatedly that IMI had set an unacceptable ceiling, and that the workers were practically given a lottery win. The truth was that the terms IMI offered to its departing workers were exactly those proposed by the MoF in 1985, when the government reduced 3\% of the workforce in ministerial offices [one of the measures taken under the Economic Stabilisation Programme]. IMI was part of the government machinery and could not go below these terms. I told Shochat he could check this for himself and would most certainly discover that these were exactly the same terms as those offered in 1985; the MoF made them public in a memo it circulated back then.\textsuperscript{201}

IMI management also rejected the MoF’s request to participate in the negotiations with the workers. Chief executive Komisar insisted that he alone was ‘best suited to lead these discussions’ and threatened to resign if the MoF intervened. Rabin and Shochat yielded, and the MoF backed down.\textsuperscript{202} Rabin also gave Komisar permission to start preparing a bankruptcy filing for IMI, should the employees refuse to compromise.

Bolstered by the Prime Minister’s backing, Komisar started negotiating with the workers on a new collective agreement according to the terms laid down by the Finance Ministry. Initially, the workers refused to deviate from the terms they had received in the past, but Komisar told them the company was facing possible break-up if the negotiations failed. ‘I told them simply: either we reach a deal or the company

\textsuperscript{201} Ibid.
\textsuperscript{202} Komisar interview.
will instantly be placed in administration. Now, you can try me,' said Komisar. The workers refused to believe the receivership option was on the cards and asked to meet Rabin, but the Prime Minister backed Komisar's position.203 (Some weeks later, Rabin said in a speech that he would 'give away IAI and IMI if only someone could manage them properly.'204 Asked by Komisar exactly what he meant, Rabin replied that he 'did not want to pay for the industries any more, because he had better uses for the money spent on them.'205)

Then, in December 1994, the IMI board presented a revised strategic plan to the government's Steering Committee. This called for comprehensive restructuring of the company – something the IMI management opposed – underwritten by multi-year government assistance totalling some $800 million to meet one-off and recurring expenses such as redundancy and pension payments, maintaining production lines, relocating factories and R&D investments.206 Separately, IMI presented a draft memorandum of a new collective agreement in which the employees' representatives agreed to additional layoffs of some 1,500 workers on less generous terms than those offered in previous redundancy waves, while the management promised the remaining workers that they would receive favourable severance packages.

The Steering Committee was not impressed. It rejected the draft agreement, suggesting instead that 1,000 workers should leave immediately but on even less generous terms, which were closer to the statutory rate.207 Crucially, it questioned the feasibility of the strategic plan, given the tension between the board and the

203 Ibid.
204 Rabin's speech to Israel Bonds in New York, quoted in Haaretz, 21 November 1994.
205 Komisar interview.
207 Haaretz, 2 January 1995.
management and the company’s continuing losses. It concluded that IMI ‘was beyond repair’ and therefore recommended calling in the receivers.208

Prime Minister Rabin, presented with this a stark option for the second time in two years, did not rule it out. At a meeting on 1 January 1995 in his Tel Aviv office he received up-to-date briefings on the company and was also notified that IMI and the government ministries had completed preparations for putting the company into receivership. In the presence of Finance Minister Shochat and senior Defence and Finance Ministry officials, Rabin sided with the Steering Committee and rejected the deal reached between workers and management. He told Komisar the proposed collective agreement ‘was not good enough’ and advised him that he had ‘one week to come up with a new agreement on much reduced terms’; otherwise, IMI would be put into receivership.209

Rabin’s ultimatum prompted a fresh round of negotiations with the workers, which also involved the Histadrut and the Finance Minister.210 In fact, this was a two-way negotiation, with the IMI management – acting both as a broker and sounding board – shuttling between the workers and the MoF’s Budget Department and Wage and Labour Accord Unit.211 Even though they threatened to declare a general strike with the backing of the Histadrut,212 the employees’ representatives realised that the stakes were too high. Unlike the previous crisis in 1992, this time the threat of receivership was real. That could have dire consequences for the company and spell the end of the employees’ organisation itself, so the workers agreed to a series of far-
reaching concessions. Those laid-off, for example, received reduced severance packages (16% less costly, on average, than awarded previously), while remaining employees had to forgo long-held practices such as automatic salary increases in line with public-sector pay rises. They also agreed to a differential pay scale, including the introduction of performance-related bonuses for individual workers. Significantly, the employees' organisation consented to the hiring of senior employees on personal contracts, the terms of which were set beyond its control or influence.²¹³ Four days later, Komisar presented the draft of a new collective agreement, which was approved within a week by the Steering Committee, the Ministries of Finance and Defence and the Histadrut.²¹⁴

Meanwhile, the row between Komisar and Shomron over the future structure of the company's military operations reached boiling point. The board decided to go ahead with its unauthorised Strategic Plan to turn IMI as soon as possible into a holding company whose main divisions would operate as independent subsidiaries. It instructed the management to come up with a plan to that effect within a few months.²¹⁵ Komisar, however, objected. He thought that the plan was patently wrong, especially at that time, and suggested a different structure for the company. Either way, he urged the board to halt any restructuring effort for at least a couple of years, and until then to keep IMI running as a single entity whose units operated as separate profit centres.²¹⁶

The board refused, and so Komisar decided to leave the company. On 13 January 1995 he approached Rabin and Shochat directly with a request to discharge

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²¹⁴ Haaretz, 6 February 1995.
²¹⁵ Ibid.
him from his post, claiming that the Defence and Finance Ministers had decided his appointment, not the board, and therefore they should terminate his appointment.\(^{217}\) (By that stage, the relationship between Shomron and Komisar had deteriorated to the point where they stopped communicating with each other; Komisar reported directly to the Ministers instead.) However, the legal advisers at the Ministries of Defence and Finance pointed out that under the Government Companies Law, only the company’s board was authorised to deal with this matter; there were also some doubts as to the legal validity of the resignation letter itself.\(^{218}\) At that point, Finance Minister Shochat called on IMI’s Chairman and asked him to halt any discussion on Komisar’s departure. A board meeting was therefore scheduled for 29 January, until when the situation remained undecided.\(^{219}\)

Behind the scenes, however, pressure to dismiss Shomron himself began mounting. Top officials at the MoF and the Histadrut expressed their discontent with the performance of IMI’s board. The Histadrut sent a letter to Rabin openly questioning Shomron’s capacity to lead the company and calling for his dismissal,\(^{220}\) and senior officials of the MoF’s Budget Department (frustrated, some said, at Shomron’s ability to influence Rabin against their interests) convinced Shochat that Shomron was unfit to continue as IMI Chairman.\(^{221}\) This view was also reinforced by Komisar, who was quietly lobbying against Shomron and suggesting potential


\(^{218}\) Komisar interview.


\(^{221}\) Snir interviews 2005a and 2005b.
successors, and by senior MoD officials, including the Ministry’s Director General, David Ivry, who had clashed with Shomron in the past.222

Prime Minister Rabin, meanwhile, busy fending off criticism over a separate policy issue (a controversial proposal to tax capital gains on stock market profits), was unaware of the move to replace Shomron. Over the weekend, he was persuaded to shelve the decision on the new tax – he was inundated with phone calls about it from investors and leading business figures223 – much to the dismay of the MoF, which had hoped for a new source of income, having initially secured the support of the Cabinet and Knesset, including Rabin’s, for the move.224 Shochat met Shomron and asked him not to let Komisar leave the company, ‘because the Prime Minister and I did not want this to happen,’ adding that if the board met to discuss this, ‘all options were open.’225 Shomron, however, told the Finance Minister that he was under pressure to convene the board and to discuss the implications of Komisar’s letter.226

Fearing that the board would vote for Komisar’s departure, Shochat and one of his top officials decided to act pre-emptively. The next day, just hours before the IMI board was to convene, they approached Rabin and convinced him to sack Shomron – asking him to hand back his mandate, even though just six months earlier his appointment had been extended by three years.227 Shortly before the board meeting

222 Ivry had openly clashed with Shomron over the Lavi aircraft project. Ivry supported the programme; Shomron fiercely opposed it and persuaded Rabin and other ministers to shelve it. In an interview for this study, Ivry maintained that Shomron landed the chairmanship of IMI not on merit but because of a prior commitment to offer him a ‘suitable job placement’ on his retirement as Chief of Staff (Ivry interview, 1997).
223 See quotes by Rabin, in Globes, 10 November 1995.
225 Interview with Shochat in Globes, 22 September 1995; Komisar interview.
226 Komisar interview.
started, Shochat phoned Shomron and told him that the Ministers wished to keep Komisar in his job and so objected to any discussion on this in the meeting. Therefore, Shomron was told, the Ministers had no choice but to ask him to leave his job and to dissolve the entire board. He asked to have this request in writing, and a formal letter, signed by Shochat and Rabin, was faxed to his office.228 ‘In order to have free hand in implementing the recovery plan,’ they wrote, ‘the ministers responsible cordially ask the board members and management to discharge themselves from their duties’. Rabin and Shochat did not elaborate further.229

The inexplicable haste with which Shomron and the entire board of IMI were asked to leave – by fax – caused a public furore. Never before had a board of a government company – let alone one with five ex-IDF generals on it – been so unceremoniously dismissed. Shomron himself was hurt and baffled (he had had a meeting with Rabin just weeks earlier, and the Prime Minister had not hinted at dissatisfaction with Shomron230) but nevertheless refused to appeal against the decision. ‘The commander in chief asked me to leave, and I will obey,’ he told a senior executive who suggested fighting back.231 The other board members agreed and tendered their resignations there and then, noting that they were willing to act as caretakers for a few days until a new board was appointed.232

228 Interview with Shochat in Globes.
229 Letter by Prime Minister Yitzhak Rabin and Finance Minister Avraham Shochat addressed to IMI Chairman Dan Shomron, IMI Board members and IMI Chief Executive Komisar, 29 January 1995.
231 Snir interviews, 2005a and 2005b.
232 Letter from IMI Chairman Dan Shomron to Prime Minister Rabin and Finance Minister Shochat, 29 January 1995.
New Constraints on IMI

Shomron’s successor, Yaakov Lifshitz, asked for and was granted three months ‘time out’ to study the company’s situation.233 A former senior official and a respected figure in the Israeli business community – Lifshitz had served as economic adviser to the MoD and the Director General of the MoF and also headed major companies in the banking, energy and electronics sectors – he quickly realised that IMI was not ready for a major restructuring as proposed by the previous board. His first decision, therefore, was to shelve his predecessor’s proposal to convert IMI into a holding company and to resubmit a new plan. He also contacted the outgoing chief executive and asked him to retract his resignation;234 Komisar agreed to stay for six more months until he had completed five years in the job.235 Thereafter, their first decision was to go ahead with the agreement reached with the workers in January 1995.

Next, Lifshitz approached the Finance Ministry for clarification of its commitments to the IMI recovery process. In particular, he asked the Ministry to increase the company’s equity capital significantly, to give it financial latitude, and to outline the financial aid it proposed to allocate.236 In the process he emphasised IMI would strive to reduce reliance on state handouts to a minimum, opting for more commercially viable ways to raise money (like bank loans and strategic partnerships).

Whereas his predecessor had had a fractious relationship with the MoF, Lifshitz’s appointment was warmly endorsed by Ministry officials, who were more forthcoming in response to his requests. In a highly detailed letter, Finance Minister

233 Interview with Lifshitz, in Business supplement, Maariv, 9 July 1996, pp. 20–21 (hereafter Lifshitz interview in Maariv).
234 Haaretz, 14 February 1995.
235 Komisar interview.
236 Lifshitz interview in Maariv.
Shochat specified the amounts and assurances the state was willing to grant IMI and its ailing subsidiary, Ashot Ashkelon. Shochat promised to pay $120 million for the severance packages of 1,350 employees slated to leave from February 1995 onwards, to give another $63 million for the severance packages of workers who had left the company before that date, and to add $6.5 million towards Ashot's recovery costs. He also noted that ultimate responsibility for the redundancy costs would lie with the state Treasury, not with IMI.  

(In a subsequent letter, the MoF Director General qualified some of Shochat's commitments.)

IMI management, meanwhile, started a new attempt to win the support of the political echelon for the closure of the Jerusalem factory. All the actors previously involved – the IMI board, management and workers' representatives, the Histadrut, the Jerusalem politicians and the Ministries of Defence and Finance – were once more embroiled in a heated debate. Senior officials at the MoD and IMI favoured the option of merging the factory with IAI; the Histadrut regional branch in Jerusalem and the workers' committee at IMI Jerusalem, on the other hand, opposed any relocation attempt. Inside the Labour party, two camps formed – each comprising politicians prominent at national and municipal level. One, led by the Haifa Mayor and several ministers and MKs who resided in the city, put the case for relocating the Jerusalem factory to Haifa; the other, led by Jerusalem-based politicians, favoured a reversal of the decision to move the Jerusalem factory to Haifa. This time Finance Minister Shochat – who had previously opposed the Jerusalem factory's closure – tipped the

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238 Letter by MoF Director General, David Brodet, to IMI Chief Executive Komisar, 8 March 1995.
239 Snir interview, 1998; Globes, 1 February 1995.
240 Globes, 1 February 1995; Globes, 16 March 1995.
241 Zweig interview, 1998a.
scale, when he informed IMI in February 1995 that he would rather see the Jerusalem factory merge with IMI’s factory in Haifa.\textsuperscript{242} A month later, he also enlisted the support of Prime Minister Rabin, and the two formally approved the move,\textsuperscript{243} almost a year after the IMI board’s decision on the issue. (By then, IMI management had finished the discreet transfer of know-how and infrastructure from Jerusalem to the Haifa plant, begun six months earlier, and the Jerusalem plant had completed a major order for the US firm McDonnell Douglas, which had threatened legal proceedings if IMI failed to deliver on time.\textsuperscript{244})

A week later, on 14 March 1995, Shochat and two senior officials from the MoF Budget Department met the IMI Chairman and senior management representatives for an update briefing. Shochat was told that a last-minute hurdle delayed the signing of the new collective agreement. IMI’s management had discovered a gap of 91 million shekels between the figures promised by the Treasury and the actual cost of redundancies, and it had been haggling over this and other issues with Treasury officials for months. This debate, he was told, adversely affected IMI’s condition, as well as making the final settlement with the workers more expensive.\textsuperscript{245} The Finance Minister was having none of it: he instructed management to ‘sign the agreement immediately’ and, notwithstanding Treasury officials’

\textsuperscript{242} \textit{Globes}, 1 February 1995.
\textsuperscript{243} \textit{Haaretz}, 15 March 1995.
\textsuperscript{244} Snir interviews, 1998a, 2005a and 2005b. IMI was an accredited supplier of McDonnell Douglas for the F-15 aircraft and sole supplier of its fuel tanks. The management came under heavy pressure to comply with the terms of a major order being handled by the Jerusalem plant during its transfer to Haifa. Facing possible major disruption to its F-15 production line, McDonnell Douglas warned that, if IMI failed to deliver on time, it would initiate immediate punitive action, including daily interest charges for each $50-million aircraft not delivered on time to its intended customer. IMI then allocated significant resources to ensure successful completion of the order.
\textsuperscript{245} Kaufman interview.
reservations, gave his consent to 'covering the financial gap as part of the financial aid given to IMI'.\textsuperscript{246} After this, IMI management signed the agreement with the workers, and the Cabinet approved the necessary funding, totalling some $155 million, all in the same week.\textsuperscript{247}

With relocation of the Jerusalem factory and the new collective agreement both concluded, the IMI board and the management focused on preparing a modified strategic plan. After wide-ranging consultations, the IMI Chairman concluded that to secure the company's long-term viability it must implement additional cost-cutting measures and bring in external partners. Lifshitz identified the light and heavy munitions product lines as ideal candidates for restructuring and partial privatisation, a finding warmly welcomed by Prime Minister Rabin and top officials in the Defence and Finance Ministries. However, his proposal to transform secret IMI production and manufacturing lines into MoD-owned ones that IMI would be contracted to manage (an arrangement also known as GOCO – government-owned, contractor-operated) was turned down.\textsuperscript{248}

Two months later, on 15 May 1995, the IMI board presented the Steering Committee with a revised strategic plan, which called for a major change in the company's structure and organisational culture. It proposed that IMI should consist of three organisational divisions and should focus on eight areas of technological...
expertise in the military sphere – a move underlined by the suggestion to ditch the trading name ‘Taas’ and rename the company ‘IMI’. The plan placed significant emphasis on forming strategic partnerships with global and local companies in each core business area; this way, Lifshitz asserted, the company would keep the flexibility to cope with any future restructuring of the state-owned industries while maximising its business potential and hedging against untoward fluctuations in the arms market. However, certain production lines that served strategic purposes would remain classified and non-commercial; the MoF and MoD would maintain these through subsidies and annual orders. In addition, the Treasury was asked to finance in full IMI’s redundancy packages and factory relocation, provide export guarantees, and increase its equity capital. The total cost of the plan was estimated at $800 million, similar to the amount specified by the previous board.

IMI’s board and the Steering Committee tentatively accepted the plan, and the sides began detailed negotiations on its terms and conditions. In the meantime, IMI closed several of its factories (in Tel Aviv, Jerusalem, Mishor Adumim, Herzliya and Mitzpe Ramon), sold off sites and shut down internal units that were not part of the company’s core business, outsourcing services from external suppliers instead. The gradual reduction in workforce and fixed costs helped to stabilise the company’s finances. However, once again, the company was experiencing delays in deliveries to the IDF, which threatened to respond by reducing its future orders. IMI’s new chief executive, Shlomo Milo, who had succeeded Komisar in August 1995, realised the

250 Ibid., p. 8.
251 Ibid., pp. 1 and 9; see also Lifshitz interview, and Lifshitz interview in *Maariv*.
252 *Report on IMI*, pp. 9–11 and appendix III.
253 Lifshitz interview; Komisar interview.
needed to implement a series of urgent steps to restore the trust of its most important customer.\textsuperscript{254} He also noted the degree of intimacy between some senior politicians and workers' leaders (Finance Minister Shocat, and at least two other Cabinet ministers, for example, had taken part in a private function organised by the workers' leader of the IMI Haifa plant).\textsuperscript{255}

During the intense negotiations with IMI's board and management over the terms of strategic plan the MoF imposed various requirements, as also did the MoD. Lifshitz, frustrated by these new preconditions, lambasted Rabin in one of their meetings.

The way we were treated means one thing. You want to close us down but without making an explicit decision to do so; you do not have the courage to make such a decision; I certainly have no intention to initiate that myself. If you think that somehow the company's figures would work out fine by themselves, think again. After a year or two, the whole business called IMI would just fall apart.\textsuperscript{256}

Despite this, the MoF's Budget Department demanded that the company accept several preconditions and restrictions: for example, a cap on the subsidies IMI would receive for maintaining its artillery and rocket lines – in effect reversing an understanding between Rabin and previous IMI Chairman Shomron. Against the advice of his senior executives, Lifshitz yielded to the MoF's demand and agreed to a time limit of five years.\textsuperscript{257} However, on other issues, the Treasury was willing to accept Lifshitz's requests, for example by substantially increasing the company's equity capital (achieved \textit{inter alia} by letting the company retain the proceeds from the sale of land it had previously leased from the state). Lifshitz also received qualified

\textsuperscript{254} Milo interview.
\textsuperscript{255} Ibid.
\textsuperscript{256} Lifshitz interview.
\textsuperscript{257} Snir interview, 2005b.
approval from both MoD and MoF to pursue part-privatisation initiatives that would enable the company to raise additional capital from other sources.  

Six months later, on 2 October 1995, the Cabinet accepted IMI’s strategic plan and approved a comprehensive package of assistance totalling $545 million, resulting from the discussions between the company and the Treasury. It also disbanded the MoF-led Steering Committee. The decision, which was pre-vetted by the Treasury, outlined a comprehensive financial package that covered many of the company’s running and one-off expenses, including those of relocating and closing factories, and an increase in IMI’s equity capital.

Approval of IMI’s Strategic Plan was warmly welcomed at the Ministry of Finance, whose series of upbeat press releases highlighted the continuous improvement in the company’s situation and predicted it would reach ‘break-even point within a year’. The ministry also hailed the collective agreement signed seven months earlier as a ‘breakthrough in the labour relations of the state-owned defence firms’.

Cabinet approval paved the way for the company to proceed with the board’s reorganisation plan for the company. Top of Lifshitz’s agenda was partial privatisation of the artillery munitions line (he realised ‘we simply could not maintain the line without external partners’), which was to be turned into a subsidiary that would then be partially sold. To underline the seriousness of its intention, IMI prepared a prospectus for potential buyers with the assistance of external accountants. Two of the biggest companies in the field, Olin and Lockheed Martin’s armament

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258 Lifshitz interview; Lifshitz interview in Maariv.
261 Lifshitz interview.
subsidiary, were contacted and agreed to study IMI’s proposals; they hired solicitors and consultants to assess IMI’s suggestions. Representatives of Olin, who had previously met Rabin, asked Lifshitz whether Rabin’s proposal to give away IMI for free still stood. Lifshitz replied that Rabin’s November 1994 remarks had been misunderstood; IMI was certainly not to be given away free of charge, and the offer applied only to the artillery munitions line. The American firm, which had taken Rabin’s assertions at face value, nevertheless decided to continue with its enquiries, as did Lockheed Martin. The latter was particularly interested in IMI’s proposition, seeing possible synergy between IMI’s research capabilities in artillery munitions and its armament subsidiary.

The Undoing of IMI’s Partnership Strategy

The murder of Prime Minister Rabin on 4 November 1995 delayed the IMI management’s privatisation efforts for a while. They were resumed once the go-ahead was received from Rabin’s successor, Shimon Peres. (IMI’s Chairman had served as Ministry of Finance Director General under Peres in the 1980s, and the two knew each other well). Peres even met Dan Tellep, the chief executive of Lockheed Martin, the world’s biggest defence contractor at the time and one of the biggest weapon suppliers to the IDF, in March 1996. Tellep reiterated his firm’s serious intentions regarding IMI, and Peres encouraged him to continue with his negotiations. ‘I supported the deal with the American firm wholeheartedly,’ he said,

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262 Haaretz, 11 February 1996.
263 Lifshitz interview.
265 Ibid.
266 Haaretz, 8 March 1996.
'because it could have given IMI a far wider leverage, marketing-wise.'\(^{267}\) Lockheed Martin would greatly benefit from the deal because its armament and munitions subsidiary, IMI's potential partner, lacked the Israeli firm's research capabilities.\(^{268}\) In April 1996 both companies began formal talks on the purchase of 40% of IMI's heavy munitions division. However, if the Israeli company had hoped the Prime Minister's backing would clinch a quick deal, the hope was short-lived.

Soon after IMI and Lockheed Martin began their discussions, both the MoD and the MoF started to question the proposed deal. At the MoD, Maj.-Gen. (res.) Israel Tal, a senior assistant to the Defence Minister and the head of the Merkava battle tank programme, raised serious doubts over the merits of the proposed deal. In a harshly worded letter to Prime Minister Peres and the MoD's Director General David Ivry, he branded it 'highly dangerous', claiming that by applying strict commercial considerations to manufacturing of artillery munitions, Israel risked 'a real debilitating impact on existing capabilities', which in turn might hamper IMI's ability to meet the IDF's future needs. Furthermore, 'Israel might lose its independence in these areas if the American firm decided to increase its controlling stake. Israel was also risking an untoward exposure of unique IDF capabilities in the highly sensitive areas of armour and shell penetration'.\(^{269}\) Tal was particularly dismayed by the manner in which the negotiation was handled, demanding that 'a strategic issue of the first order such as this should not be left at the hands of the IMI management'. He implied that 'the whole decision process was not controlled and monitored properly' and proposed that only the MoD should be the prime negotiator. Other MoD officials, like Assistant

\(^{267}\) Peres interview.

\(^{268}\) Yedioth Ahronoth, 18 June 1996.

\(^{269}\) From partial letter by Assistant Defence Minister Israel Tal to MoD Director General, David Ivry [undated copy]; see also Tal interview.
Defence Minister Moshe Peled, also objected to the proposed deal. He argued that IMI might be required to follow the US law in addition to Israeli law if an American firm was to acquire a stake in it. Such situation, he said, might lead to serious diplomatic complications in the event of sales to countries under an international embargo that Israel was not a party to. He noted that IMI had major export deals with countries that were subject to UN or US sanctions.270

The MoF was unhappy with the deal too, fearing that Lockheed Martin wanted, in fact, to take advantage of IMI’s contracts with the MoD. ‘IMI wanted to sell the Americans the MoD’s commitment of long-term orders, which was not theirs to negotiate to begin with,’ argued MoD Director General, David Ivry.271 The MoF asked him to issue a letter ordering a freeze on further negotiations. IMI’s Chairman had meanwhile suggested excluding IMI’s central research laboratory from the deal, thus meeting most of the security concerns raised by Assistant Defence Minister Tal; nevertheless, the MoD forbade IMI to negotiate or disclose information on its divisions to foreign companies.272

IMI Chairman Yaakov Lifshitz was perplexed.

We received mixed signals. On the one hand, the MoD told us that it did not mind if we closed our [artillery and heavy munitions] lines because it did not view them as essential any more, and that it was reluctant to subsidise them;273 on the other hand, when we told them that we would bring in an outside partner to help us maintain these production lines,

272 Globes, 11 July 1996.
273 The MoD advised IMI in January 1992 that the IDF would cease buying artillery munitions from the company and it therefore had ‘no objection to close the line’. See: Letter from the MoD Procurement Directorate (which handles weapons acquisition on behalf of the IDF) to IMI’s chief executive, headed ‘IMI – acquisition of 155mm artillery munition’, 30 January 1992.
all of a sudden we were told that this option would compromise national security. So which of these positions was true? Did the MoD need these lines or not? It simply did not make up its mind.274

Peres, too, regretted this chain of events, saying that it ‘was possible to arrange a clearance agreement with the American firm’.275 At this point, though, he was deeply involved in campaigning for the election due in June 1996 (which he lost).

Lockheed Martin, meanwhile, reconsidered its position and, in the light of the MoD objections, concluded that the likelihood of a concrete deal with IMI was slim. It therefore withdrew its offer and decided that artillery production was no longer part of its core business activities. In November 1996 it sold off its munitions and armament subsidiary to another American firm, General Dynamics. Shortly afterwards IMI abandoned the idea of strategic partnerships and opted for straightforward strategic alliances instead.276

Conclusions

IMI started operating as a government company in 1990, heavily burdened by restrictive collective agreements, too large a workforce and unsustainable financial commitments. Its structure and operations were outdated and oversized, and its financial performance was well below par. The global arms slowdown of the early 1990s hit the firm’s earnings and showed that IMI was spread too thinly across too many businesses, sites and product lines.

From 1991 to 1995 IMI sold or shut down dozens of underperforming or non-strategic factories, businesses and product lines. It also turned its organisational

274 Lifshitz interview.
275 Peres interview.
276 Milo interview.
culture on its head: moving from a government contractor to a profit-oriented business. Rather than addressing the needs of the state, IMI focused more and more on its own interests. This change was manifested in many ways, not least by the management’s approach to new contracts. Rather than pursuing them at all costs, and often signing them at a loss, post-incorporation IMI realised the damage they could do to its profit-and-loss account, and so became more selective, signing only contracts that could yield significant profit (see Figure 4.6 for the steady improvement in IMI’s sales, output and net profit between 1992 and 1996). Yet this turn-round was largely obscured by the lingering global recessionary environment and the company’s continuing losses (it reached break-even after 1996).

**Figure 4.6**

![IMI: Business Results under Rabin-Peres Government](image)

**Sources**: IMI, Ministry of Finance, Government Companies Authority

The policy process at work in the IMI crisis highlights the contrasting considerations applied by various actors in the decision-making chain. It also suggests that the government policy-making process, characterised by a series of interactions
between several participants taking place at several locations simultaneously, brought
to light built-in policy preferences and biases that, in turn, influenced the pace, costs
and effectiveness of the policy implementation phase.

But before we focus on the respective actors' policy preferences, we should
note the glaring failures of the regulatory bodies (the Ministries of Finance and
Defence) during IMI's transformation and incorporation process, which preceded the
IMI crisis. The inadequacies of that process – unrealistic commercial expectations for
IMI and under-funded corporate and financial structure – became apparent only when
the market conditions in which IMI operated became adverse. Until then, none of the
main actors responsible for the company – neither the Defence Minister (first, Moshe
Arens, then Yitzhak Rabin), nor the Ministries of Defence and Finance, let alone IMI
itself – had reliable knowledge of the company's actual plight; that was discovered
only when external auditors and management consultants analysed the firm's business
performance. This speaks volumes about the incapacity of the state's regulatory
bodies effectively to control and supervise state-funded bodies.

One factor affecting this capacity, though, was defective reporting by IMI
itself, which conveyed to its political masters a soothing message of 'business as
usual' (note, for example, the comments by Prime Ministers Shamir and Rabin). Apart
from its internal inefficiencies, the company started off with significant financial
commitments, including prohibitive pension payments for thousands of former
workers, and flawed financial foundations blighted by insufficient equity capital and
lack of control over labour costs. Only when losses rose rapidly did the IMI
management realise, in June 1991, that it was ill prepared – operationally, financially
and organisationally – to face the commercial and business challenges of the post-
Cold-War era. And only at that point, when IMI was close to bankruptcy, did the
government bureaucracy leap into action.

However, even when all the relevant actors – the Cabinet, IMI management
and employees, the Ministries of Defence and Finance and the Histadrut –
acknowledged and understood the situation the company was in, new setbacks
hampered the efforts to turn its fortune. Some were obvious, others more subtle and
hidden. At the company level, both management and board were deeply divided
during the implementation of the Operational Recovery Plan in 1993 and 1994.
Neither the Chairman nor the Chief Executive could agree on issues of strategic
importance, differing over the future of the Jerusalem plant and over the preferred
corporate and financial structure for IMI’s military operations. A breakdown in
communication while the company was struggling to meet its recovery targets was
inevitable, and later led to the departure of the IMI board in early 1995.

The dilemmas that divided the two responsible ministries, the MoD and the
MoF, were of a different order. The MoD sought to extricate itself from any financial
responsibility for IMI, and indeed fulfilled a secondary role in the company’s
recovery process from the outset. The MoF, for its part, at first tried to pass the buck
to the MoD, and when this failed it sought to limit the state’s financial commitments
to the company as much as possible (to the point where the Finance Minister himself
felt compelled to override his officials, as happened in March 1995). Indeed, these
positions, which were conveyed in both word and deed, delayed IMI’s recovery, made
it more expensive and hampered management’s efforts to reach its objectives.

Underlying the inter-departmental turf wars and personal rivalries well-
entrenched interests were evident. These, the long-lasting and deep-seated after-
effects of separate policy events that had taken place many years before the crisis at
IMI was detected, influenced the responses and preferences of three key actors – the MoD, the IDF and the MoF.

The defence establishment approach to arms production and purchasing, largely formed in the traumatic shadow of the 1973 Yom Kippur War, focused almost exclusively on addressing the IDF’s pressing military needs, but from a shrinking defence budget. So the MoD sought to slough off completely any financial burdens or long-term obligations associated with IMI. The IDF, for example, paid no heed at all to the company’s financial difficulties during its most fragile phase, the implementation of its recovery plan in 1993 and 1994. IDF orders from IMI were cut just when the company needed them most – a move that only served to manifest the armed forces’ insular, inward-looking modus operandi following the 1975 ‘consumer sovereign’ directive and the division of responsibilities between the IDF and the MoD (see Chapter 2). In the same vein, the MoD rejected IMI’s demand for long-term acquisition commitments, not only because this might have limited the military’s budgetary freedom, but also because the MoD had to meet statutory requirements, such as the 1992 Mandatory Tenders Law that normally forbade sole-supplier arrangements of this kind. Indeed, save for sporadic cash injections and occasional lobbying of potential clients abroad on behalf of IMI, the MoD did little financially to alleviate the company’s situation from its own resources. Even when the IDF intervened on behalf of the company, as in the case of the joint lobbying by the IMI chairman and the IDF Chief of Staff, the bulk of the subsidy for maintaining strategic production lines was to come from the state’s central budget, not the MoD’s.

The MoF, for its part, employed a different set of considerations in dealing with IMI. These reflected its macro-economic objectives in the aftermath of the 1985 battle against hyperinflation. The Ministry’s Budget Department became familiar with
the firm's troubles only at the beginning of 1992, when other major organisations within the defence establishment and outside it were about to mount, or already were mounting, urgent appeals for state funding. To the Budget Department this was just another ailing enterprise waiting for state assistance, and it sought to limit as much as possible any costs associated with IMI's contraction and streamlining plans. It got mixed results. On the one hand, specific instructions from the Cabinet and the Finance Minister meant the MoF had to commit to meeting from the state budget costly pension payments it had previously hoped would be borne by IMI. On the other hand, it achieved two important breakthroughs in the 1995 negotiation round: for the first time in the annals of the defence industrial base it reduced the costs of future pension and severance packages for IMI workers, and it set a five-year time limit on the state subsidies granted to the company.

The significance of these achievements was twofold. The MoF succeeded in curtailing possible indefinite financial reliance on the state by IMI, forcing it to take concrete steps to find alternative sources of capital and to implement a series of cost-cutting measures. Crucially, the MoF managed to end the costly tradition of voluntary redundancies in the state-owned defence enterprises, with excess workers receiving ever-improving severance packages in return for consenting to early retirement.

The MoF thus sent a strong message to other companies that state ownership does not necessarily mean a blank cheque and an automatic bail-out; public money was no longer readily available for failing companies. Indeed, the MoF's insistence on considering putting IMI into receivership if the workers had refused to accept smaller wages and reduced severance packages - a demand backed by Prime Minister Rabin himself, not once but twice - conveyed that message quite effectively. Yet, even though the MoF took a critical attitude towards IMI throughout the crisis, it opted for
a negotiated settlement rather than taking unilateral action that might have sparked widespread protest by other unions – its interest was in keeping the situation under control and to keeping channels open as much as possible.

For all the MoF’s cost cutting achievements, though, the total earmarked for IMI’s recovery plans was significant: more than $800 million spread over several years. This highlights the generous pay terms offered to workers in the defence sector and also the influence that IMI, and especially its workers, exerted within the political system. In fact, politicisation of the decision phase – for example, before Cabinet decisions – grew so blatant that straightforward business or economic considerations became of only secondary importance or none at all. Furthermore, it seems that pressure from the IMI’s workers organisation (whose involvement in the bargaining phase was enshrined in the company’s collective labour agreements) and its pervasive reach within the political system influenced, and at times dictated, the pace and course of action preferred by Prime Minister Rabin (resulting, for example, in the watered-down Cabinet decision of December 1992) and the state bureaucracy, mainly the Ministry of Finance.

In the case of IMI, opportunities to disrupt policy implementation existed at several points on the institutional map – in the inner Cabinet, at the parliamentary level (through the Knesset’s committees) and within the Labour Party itself (via its representation on local authorities and regional labour councils) – and the workers’ organisation exploited them to the full. Although in theory apolitical, the workers’ organisation was in fact a major bastion of Labour hegemony: the two workers’ leaders at the time were Party members and high-ranking functionaries in the Histadrut, and hence well connected to senior figures in the political system. The effectiveness of the workers’ resistance to the management’s restructuring plan
(manifested, among other things, in the unprecedented presentation by the IMI workers’ leader to Labour ministers, and the year-long delay in closing the Jerusalem plant) was due to the success of their tactics of astutely exploiting developments in the Israeli political arena – including, for example, the advent of primaries. At all levels – Cabinet, parliamentary and local-government – the workers devoted significant time and effort to targeted lobbying. It was no accident, for example, that IMI workers put so much effort into influencing MKs from the Jerusalem and Haifa districts, two key strongholds of the Labour party at the time, where IMI operated several factories.

The political backing given to the workers – after all it was a Labour government – and the timing of the crisis, with both Rabin and his ministers facing mounting diplomatic and economic crises, led to a protracted negotiation process, which became costlier as it became longer. In fact, the workers’ unions managed to twist the arms of both the government bureaucracy and the IMI management, which succumbed to many of their demands, thereby arguably gaining far more advantage than their actual political clout warranted (by 1992 IMI was less than half the size it had been in its heyday). This indicates that it was not the sheer size of IMI’s workforce that brought it benefits, so much as the willingness of politicians to meet its demands. And these demands were also backed, to a large degree by the management – in fact, some evidence suggests the two sides acted to advance each other’s interests (see the secret meetings between the Chief Executive and the workers’ leader), to the point where the Prime Minister himself intervened to put an end to this cosy relationship with his landmark ultimatum in early 1995.

Interestingly, the IMI workers’ organisation managed to achieve its objectives without calling on other trade unions or sister organisations from other companies to help in putting pressure on the management or Cabinet; nor did it appeal to the Labour
Courts or threaten protracted legal proceedings. However, the employees' leaders did ask the Histadrut to join in the crucial phases of the negotiations, not only to make use of its vast experience of dealing with the MoF, but also for tactical/internal reasons: it helped persuade the employees to accept uneasy compromises with management.

In net terms, only a state could afford to provide such significant aid to a single company as IMI received, and yet during the tenure of the Rabin-Peres government it was still far from achieving full recovery. In fact, for all its marked improvements in output and overall financial performance, IMI struggled to devise and implement a practical business strategy that would guarantee its long-term viability. The company had to contend with significant obstacles during the implementation of the operational recovery plan. The first round of discussions, in December 1992, resulted in the Cabinet ordering IMI management to conduct any planned redundancies only after reaching consensus with the workers on their terms of departure (which delayed this phase by at least four months and made it more costly) and to refrain from closing down several factories, arguably for political rather than economic reasons. At a later stage, in June 1994, the Knesset's Finance Committee intervened as well, on the basis of flimsy evidence, instructing the management to refrain from closing the loss-making Jerusalem factory: this delayed its inevitable closure by seven costly months.

So intrusive did political intervention become that the IMI board started to act against the company's interests — in complete disregard of the Government Companies Law itself — for fear of additional political vetoes. This approach was evident in its reluctance to consider closing another troubled factory, in the northern town of Kiryat Shmona, in the belief that it would not get political and financial backing for this. In addition, the company was unable to secure long-term orders from
its most important customer, the MoD, and even those that were offered fell well below its projections, for reasons discussed earlier. The end result was a much more expensive recovery plan, and the gap between the initial estimates and the actual costs (for example, the redundancy costs almost doubled as a result of the Cabinet decision) was grudgingly covered by the state Treasury. Much later, in early 1996, when the IMI board was striving to execute its Cabinet-approved strategic plan, it encountered unforeseen objections from within the defence establishment that caused the collapse of the plan’s most important objective: the creation of strategic partnerships with local and foreign companies. Bizarrely, the MoD overruled proposed strategic cooperation with the US firm Lockheed Martin, one of the IDF’s biggest suppliers, even though the initiative was backed by Prime Minister Peres and was seen by the company’s board as essential to IMI’s long term survival.

The contrasting and inconsistent positions of the relevant government ministries (evident in the saga of the defunct Lockheed Martin deal), coupled with agenda congestion in the Cabinet, especially at a time of intense Middle East peace negotiations, all contributed in one way or another to make IMI’s recovery process costly and extremely lengthy. Add to that the institutional opportunities for disruption that were available to astute and determined union representatives, and one could conclude that any meaningful attempt to achieve a desired policy goal in such a highly politicised environment required steely determination and Herculean strength.

In at least two separate cases, and notwithstanding the significant power vested in Israeli Prime Ministers, both Rabin and Peres faced considerable opposition to their preferred policy choice. In December 1992 Rabin needed all his personal political clout to prevail over the workers’ challenge and force IMI’s recovery plan through Cabinet, where it was narrowly approved after a second round of discussions.
and acceptance of many costly concessions. The case of the botched IMI–Lockheed
negotiations in May 1996 was instructive as well, because it showed that even though
both Rabin and Peres supported the deal, that was not enough to seal it. The result of
their failure to reach consensus among all the actors involved in a policy event – to
deal with the objections of the Labour party ministers in the first example, and the
MoD’s and the MoF’s reservations in the second – may be that political cost
calculations dictated their final positions, once they realised that other policy issues
were more pressing, and that IMI was not worth risking their political careers for. Add
the built-in delays in government decision-making – approval for financial assistance
can take months to pass through Cabinet and the political and regulatory bodies in the
Knesset and the government bureaucracy – plus the effects of past policy choices –
such as the public-sector pay increases to which IMI workers were linked, and the
1985 Economic Stabilisation Programme, which deeply affected the company and the
preferences of the MoD and the MoF – and it is no surprise that the costs of helping
an ailing government company like IMI usually balloon. And, inevitably, the taxpayer
shoulders these extra costs.

Could the sort of mistakes and costly errors apparent in the IMI affair have
been avoided? Apparently not. The evidence presented here suggests that IMI
underwent a unique transition that was beyond the experience of the government
bureaucracy, the defence establishment and IMI itself – hence their many mistakes. In
other words, both the government bureaucracy and the firm were on a costly learning
curve. However, it was the firm that adjusted quicker to the changing circumstances –
for example, by ditching its ill-fated attempt to reverse its fortunes by entering the
civilian market – while the government bureaucracy was at times indecisive and
inconsistent, as vividly shown in the IMI–Lockheed Martin episode.
In conclusion, the policy process at IMI suggests that any attempt by government to impose financial losses on an organised interest group depends upon achieving consensus in favour of the proposed policy within the government bureaucracy, and wall-to-wall backing within the political institutions (Knesset, party forums), before it is implemented. Otherwise, the attempt is likely to run into serious and costly delays because of institutional openings for disruption (in Cabinet and party), the knock-on effects of past policy choices, and legal barriers of various kinds (such as legislation or court decisions).
CHAPTER 5
Policy Implementation in the IAI Crisis

Israel Aircraft Industries, Israel's largest industrial enterprise, encountered a financial
crisis in 1992 and 1993 that brought it near bankruptcy. A sharp decline in orders
prompted it to initiate two readjustment plans. However, the employees' organisation
rejected the second plan, which called for the dismissal of 3,000 workers and vast pay
cuts. Its demands and its power, which at one point led to the temporary closure of
Israel's main international airport, posed a political and financial challenge to the
Rabin government. In November 1993, a few hours before the Prime Minister decided
to put the company into administration, a last-minute compromise was reached.

This chapter sets out the chain of events that led Prime Minister Rabin to
intervene personally in the mediation of the IAI crisis. After outlining the background
to the company's financial difficulties, it charts the formulation and implementation
of the recovery plans, focusing on the considerations and opportunities that influenced
the choices made by key actors. Finally, it assesses the constraints that shaped the
outcome and affected the policy-making capabilities of the government system.

First Signs of Difficulties

In May 1992, shortly before the general elections, the IAI Finance Directorate
discovered that the company was facing a severe cash-flow problem. Until then, this
wholly owned government company, with 17,200 workers in 17 factories and two
subsidiaries,1 had been enjoying steady growth in contracts and revenues, and had

1 State Comptroller Annual Report no. 45, pp. 865, 867.
successfully recovered from the termination of the *Lavi* fighter, its flagship programme, in August 1987.\(^2\) However, contrary to the management’s forecast for 1992, which predicted a further 2% rise in revenues and a net profit of $39 million,\(^3\) initial indications pointed to an unforeseen drop in income and an overall cash-flow deficit totalling some $133 million.\(^4\)

A further investigation suggested that IAI had been hit by a sudden change in the business environment in two key target markets: the defence sector (foreign armies and governments) and civil aviation. Highly profitable export deals, which made the company the biggest Israeli exporter,\(^5\) were fast approaching their end, and it was struggling to refill its order book. Existing clients cancelled or cut their original orders (in some cases by up to 75%), others insisted on renegotiating their contract terms and demanded discounts.\(^6\)

As markets conditions moved against IAI, so did the terms attached to new contracts; in some cases these involved sales on credit or included a late payment option, while in others payments were spread over a long period, which meant that IAI needed to raise loans to bridge a period of low income or none. At the same time, the company was haemorrhaging money on costly projects like developing a new corporate jet (which between 1990 and 1992 generated a $41.6-million loss on a


\(^3\) *State Comptroller Annual Report no. 45*, p. 882.

\(^4\) *State Comptroller Report on Elta’s privatisation efforts*, p. 12.

\(^5\) IAI’s share in Israel’s industrial exports (excluding diamonds) stood on 17% in 1991 – $1.3 billion out of $7.8 billion. See: IAI Chairman briefing, April 1992, p. 1.

\(^6\) Internal IAI briefing document to the Board of Directors (undated), pp. 4–6; *State comptroller Annual Report no. 45*, p. 872; *Yedioth Ahronoth*, 13 August 1993; *Haaretz*, 23 September 1992.
$359-million investment\(^7\) and a programme for converting cargo airliners ($16.7 million lost from 1990 to 1992\(^8\)), while investing heavily in developing advanced projects such as combat UAV and satellites.

On top of all this, IAI had fixed labour costs of about $750 million a year,\(^9\) including $10 million a year for 'inter-factory employment balance':\(^10\) a euphemism for pockets of surplus workers who were paid but, due to lack of orders, did not actually work. (After the closure of the Lavi project, which led to the departure of more than 5,000 workers, IAI was left with about 400 tenured workers who were slated for dismissal but refused to leave the company.\(^11\) Under the terms of IAI's Collective Agreement and the Lavi termination arrangements, leaving the company was voluntary, and the management could not lay off any workers without their explicit consent and the approval of their legally recognised representatives, the Histadrut and the National Organisation of the IAI Employees, a Histadrut-affiliated labour union.\(^12\))

Hitherto IAI had been able to meet its contractual commitments, thanks to highly profitable export deals signed during the second half of the 1980s. These contracts – some requiring special Cabinet approval, granted on the recommendation

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\(^7\) *State Comptroller Annual Report no. 45*, pp. 876, 901. The IAI management was severely criticised by the State Comptroller for its handling of this project; see 'IAI's Astra Project – follow-up findings,' *State Comptroller Annual Report no. 45*, pp. 900–908.

\(^8\) Ibid., p. 876


\(^10\) *State Comptroller Annual Report no. 45*, p. 879;


\(^12\) IAI Ltd and the Trade Union Division of the Histadrut – the General Federation of Labour in Israel, *IAI Special Collective Agreement* (April 1979), p. 56 (hereafter: *IAI Collective Agreement*).
of then Defence Minister Rabin, who also ensured that the US would not veto them\textsuperscript{13} – brought a gross profit of $800 million between 1988 and 1992.\textsuperscript{14} This profit enabled IAI to absorb heavy losses on projects for the civilian market, accommodate its hidden unemployment and overcome a gradual decline in orders from the MoD (see Figure 5.1). However, these gains were dwindling quickly, not least because of adverse movements of the dollar exchange rate (which affected the value of IAI’s export contracts) in relation to Israel’s consumer price index (which affected its labour costs). Between 1988 and 1992 the CPI increased by 52%, but the dollar/shekel exchange rate by only 29%, which significantly eroded company export revenues.\textsuperscript{15}

Another burden on the cash flow was IAI’s wage structure, which entitled its workers to receive the public-sector pay rises irrespective of the firm’s financial performance. In mid-1992 IAI was notified by the MoF that it would have to pay its workers a 4% increase in accordance with a recent agreement between the Histadrut and the Ministry of Finance. Hence, the company would have to make additional provisions that went well beyond its earlier expense estimates.

IAI Corporate Vice President for Finance, Shmuel Peretz, met President and Chief Executive Moshe Keret and briefed him. IAI, he said, would run out of cash by

\textsuperscript{13} Sheves interview; The Shamir Cabinet approved several state-guaranteed export contracts in order to ease the impact of the \textit{Lavi} cancellation on IAI and other firms. Chief among them was a $1.5 billion 1988 deal, which earned IAI a net profit of $450 million; the contract, which lasted seven years, led to the direct employment of about 1,000 workers at IAI and 1,000 more in other firms, including Rafael, Tadiran and Elbit. See: \textit{State Comptroller Report no. 45}, p. 873; author’s interviews with Moshe Keret (IAI President and Chief Executive, 1985–2006), 7 and 9 October 1997 (hereafter: Keret interview) and Shmuel Peretz, IAI’s Corporate Vice President for Finance (1991–1996) and President, IAI Europe (1996–2002), 21 July 1998 (hereafter: Peretz interview, 1998d).

\textsuperscript{14} \textit{State Comptroller Annual Report no. 45}, p. 877.

\textsuperscript{15} Ibid., p. 879; see also interview with Shmuel Peretz in \textit{Haaretz}, 4 April 1995.
October 1992, and, failing urgent action, 'we would not be able to pay our employees'. Keret, unconvinced, brushed off his concerns.\textsuperscript{16}

![Image of Figure 5.1: IAI Sales Distribution](image)

**Figure 5.1**

**IAI: Sales Distribution**

<table>
<thead>
<tr>
<th>Year</th>
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<td>1992</td>
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</table>

**Source:** State Comptroller

**Note:** Until 1985, the MoD was IAI’s primary client but this changed following the Economic Stabilisation Programme of the same year. Between 1988 and 1991, IAI posted a 32% rise in revenues, owing to a 52% increase in exports. IAI’s sales to the MoD, however, dropped by more than 20% in this period (all figures shown are in constant 1993 prices).

However, IAI’s financial situation became worse by the day, and a contingency plan was prepared. Keret and the senior management at IAI viewed the situation as a temporary lapse,\textsuperscript{17} though, and were busy debating proposals to privatise the company and its profitable subsidiary, Elta, after earlier discussions with the Government Companies Authority (GCA). In July 1992 – while IAI’s management

\textsuperscript{16} Author’s interview with Shmuel Peretz, 19 February 1998 (hereafter: Peretz interview, 1998a).

\textsuperscript{17} *State Comptroller Annual Report no. 45*, p. 889
was preparing a redundancy plan for hundreds of workers\textsuperscript{18} – its Board of Directors, which included senior representatives from the Ministries of Defence and Finance, decided that IAI should be privatised as a whole and without delay.\textsuperscript{19} (At the same time, the management was engaged in protracted negotiation with the IAI Employees’ Organisation over the decision to sell one of the company’s subsidiaries, Ramta in Beer Sheba, which made military patrol boats. The Histadrut and the Employees’ Organisation challenged this through the courts;\textsuperscript{20} successive injunctions and long deliberations effectively shelved this privatisation initiative.)

The Board’s decision, however, never materialised. IAI’s situation rapidly deteriorated, and in the summer of 1992 internal consultations confirmed a persistent and growing gap between the company’s sales projections and actual financial results. There were several reasons for this, including the cancellation of multi-million-dollar military and civil contracts; underbudgeting and overrun costs on classified programmes for the MoD; and a sharp reduction in orders from existing civil aviation customers. In addition, the MoD remained non-committal about the level of future orders from the company, because of a proposed 300 million shekel cut in the defence budget which was being discussed at the time.\textsuperscript{21}

\textsuperscript{18} \textit{Yedioth Ahronoth}, 15 July 1992

\textsuperscript{19} \textit{State Comptroller Report on Elta's privatisation efforts}, pp. 10–11.

\textsuperscript{20} The legal battle on Ramta’s privatisation lasted 12 years and ended in a partial victory for the workers’ representatives at the High Court of Justice, after they had initially lost their case in the labour courts. See Ruling by the Labour Court – Tel Aviv District, \textit{The Histadrut vs. IAI Ltd. and Ramta Ltd.}, 25 August 1993; Ruling by the National Labour Court, \textit{The Histadrut vs. IAI Ltd. and Ramta Ltd.}, 22 April 1996; Ruling by the High Court of Justice, \textit{The Histadrut vs. IAI Ltd. and Ramta Ltd.}, cases no. 8111/96 and 922/97, 2 June 2004 (available at \url{www.court.gov.il}, accessed 12 December 2005).

\textsuperscript{21} \textit{Maariv}, 30 October 1992.

242
The conclusion reached by the company’s Finance Directorate was grave: IAI had failed to meet its business targets and was fast heading towards insolvency. Its new contracts figure was $100 million lower than expected, the backlog of orders had dipped by $157 million, and sales were $67 million below target. Payments from existing customers were $145 million less than the company had budgeted for, and it could not borrow enough to ensure sufficient liquidity, a failure that resulted in a $112 million cash-flow deficit.

The management’s main concern was the reaction of the banking sector, which at that point, in view of the company’s rapidly deteriorating situation, was reluctant to lend it still more money. IAI management therefore appointed six external teams to examine organisational and managerial aspects of its activities, including the labour force structure and the profitability of projects. The report on the order backlog revealed that IAI would generate a negligible operational profit of about 1% or less from its contracts, and also concluded that most of the contracts signed by IAI would end in losses, due to hidden unemployment and flawed resource allocation practices. These findings prompted the company to prepare an emergency plan, which was discussed during the summer of 1992.

**Negotiations with the Workforce**

In September 1992 IAI management presented to the board a draft of its emergency plan, codenamed *Rotem* (the word is a Hebrew acronym for ‘profit and cash flow’).

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22 State Comptroller Report on Elta’s privatisation efforts, p. 12
26 Ibid., p. 874.
Its goals included reaching $50 million net profit by 1994, ensuring sufficient cash flow for day-to-day expenses and investments, and further efforts to diversify into the civil market. It also suggested preparing the company for privatisation.\textsuperscript{27}

In a briefing to the board, management representatives explained that these targets were to be achieved by swiftly cutting overhead and running costs, laying off 1,500 workers (1,100 of them tenured), a 10\% reduction in labour cost, and a concerted effort to increase revenues towards $1.6 billion.\textsuperscript{28} Further investments were required for new products in the civilian market. The management also predicted that the market downturn was temporary, and that the company would recover.\textsuperscript{29}

From the outset, IAI management sought to secure the close cooperation from the workers in executing the \textit{Rotem} plan. The IAI Employees' Organisation was known as a disciplined, highly motivated organisation that exercised significant influence over rank-and-file workers.\textsuperscript{30} The company's management therefore saw it as an essential partner in facilitating structural changes, not only because of a contractual obligation (IAI's collective agreement required participation by employees' representatives in such matters) but also because of its track record.\textsuperscript{31} The Employees' Organisation, in effect, became extension of the management.

Another reason to seek close cooperation with the employees was their influence over, and access to, politicians. The Employees' Organisation maintained direct and independent channels of communication with officials at the Finance Ministry and the Prime Minister Office that had been cultivated since the negotiations

\textsuperscript{27} \textit{State Comptroller Annual Report no. 45}, p. 888
\textsuperscript{28} \textit{Haaretz}, 23 September 1992
\textsuperscript{29} \textit{State Comptroller Annual Report no. 45}, pp. 888--889.
\textsuperscript{30} Keret interview.
\textsuperscript{31} Ibid.
on the redundancy packages for workers laid off during the run-down of the *Lavi* programme. Haim Katz, then Undersecretary General of the IAI Employees’ Organisation, for example, maintained direct and close contacts with key politicians and officials, including Ora Namir, Rabin’s Labour Affairs Minister, Haim Ramon, the Health Minister, and Shimon Sheves, the Prime Minister Office Director General.

In addition, the IAI Employees’ Organisation was one of the first organised interests to recognise the opportunities presented by the introduction of constituency primaries in the main parties. Shortly before the June 1992 general elections, its Secretary General, Yaakov Sheffi, campaigned among IAI workers, urging them to join the Labour Party regardless of their political leanings and vote in the party primaries. The objective was to insert an IAI representative into the Labour party’s Knesset delegation. Sheffi, who openly stated that looking after the interests of the IAI employees would top his Knesset agenda, won the 35th place on Labour’s list, and his success underlined the fact that the Employees’ Organisation was capable of mobilising large groups of voters in concentrated geographic areas. It enhanced its political clout by actively assisting the primaries campaigns of such leading Labour party figures as Shimon Peres, Israel Keisar and Ora Namir.

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32 Sheffi interview.
33 Shoves interview; Shochat interview; Katz interview.
34 Sheffi interview; See also Sheffi’s comments in *Records of the Knesset, Motion for the Agenda*, Session 117, Vol. 36, 14 July 1993, pp. 6686–6687; Sheffi interview in *Yedioth Ahronoth*, 13 November 1992.
35 Haber interview; Shochat interview; Gilad interview, 2001; Yaakov Sheffi, the Secretary General of the IAI Employees’ Organisation, was a campaign manager for Israel Keisar, the former Histadrut’s Secretary General, in the 1992 Labour party primaries. See *Yedioth Ahronoth*, 7 February 1992.
It was against this background that the IAI Chief Executive and senior managers approached the Employees’ Organisation and briefed them about the company’s impending crisis. Its leaders were told that the company would have to reduce its workforce and forgo pay raises in the foreseeable future (including those agreed in the public sector), as the company did not have sufficient income. Similar messages were reiterated in a wider forum, when Chief Executive Keret later met the 75-strong Council of IAI Workers (the body that elected the Employees’ Organisation), which included workers’ representatives from each of the company’s factories. Keret did not mince words:

We have 1,500 redundant employees in the company, among them several hundred workers that have made zero contribution; their salaries came at our expense.

In addition to forced redundancies, he asked that the remaining workers accept a 10% cut in wages by the end of 1993. He warned that the company was in a fragile state, and that protests by the workers, in the form of deliberate delays in the delivery of finished systems or any disruption to the normal course of work, might damage its reputation irreversibly. Keret also promised that the management would contribute to the recovery effort by cutting 30% of managers’ salaries, halting promotions and shelving all non-essential renovations and trips. The employees, however, rejected his call.

Shortly afterwards, delegations from both the IAI management and the Employees’ Organisation met, separately, with Prime Minister Rabin and Finance Minister Shochat. The employees insisted that the management should honour the

36 Minutes of a meeting between IAI Chief Executive and the National Organisation of IAI Employees, 22 September 1992.
38 Shochat interview; Haaretz, 23 September 1992
company’s collective agreement and pay the workers the public sector’s 4% pay increase. (According to the union representatives, Prime Minister Rabin also backed this position, although urging them to accept some concessions.39)

The management rejected this demand, maintaining it could not accommodate any further salary increases. Another of the Organisation’s requests was that the 1,500 redundancy quota be made up of temporary workers instead of tenured ones, as IAI employed about 2,000 of them;40 the management, though, insisted that some temporary workers possessed specialist skills, and so the list would include both tenured and temporary workers. It also appealed for the workers’ cooperation: ‘The crisis is here and our reserves are eaten up; we need to perform the essential surgical operations very soon’.41

The IAI management, meanwhile, held meetings with the Ministries of Finance and Defence. Briefing Rabin and Shochat on IAI’s deepening crisis and the objectives of the Rotem emergency plan, Chief Executive Keret requested one-off assistance of about $455 million in total over three years. He said IAI needed the money for investing in future civilian projects, paying redundancy packages (which would cost about $50 million) and increasing the company’s equity capital.42 The issue of pensions was a particular worry, IAI management maintained, because it could not pay the severance packages of workers who would be made redundant. (Like those of other companies, IAI’s pension scheme was not connected to, or underwritten by, the state Treasury. It was based on contributions by employer and employee and the assumption that the latter would retire at the statutory age of 65; but

40 Interview with Sheffi in Yedioth Ahronoth, 13 November 1992
42 State Comptroller Annual Report no. 45, p. 888.
the proposed readjustment plan stipulated that hundreds of workers would leave on early retirement or on increased compensation packages, for which the company had not made sufficient provision; it therefore had to rely on supplementary state aid. Keret insisted that IAI's future resilience depended on the government's financial support, and that further redundancies were likely, due to the proposed cuts in the defence budget (which would most certainly lead to a further drop in orders for IAI).

In the interim, he added, the management had implemented a series of cost-cutting measures, such as not allowing workers to leave the company on early retirement.

Both Ministries asked for time to assess Keret's requests. However, it soon emerged that the defence establishment was unwilling to contribute towards the IAI recovery plan, due to its own pressing budgetary needs. MoD Director General David Ivry also blamed the MoF for exacerbating the company's difficulties unnecessarily. In an interview with the author he argued that IAI was a victim of MoF inaction: the MoF agreed with the Histadrut on a public sector pay rise, which also applied to IAI because of its collective agreement; the upshot was that the company needed additional income to cover this unexpected expense, but adverse market conditions abroad rendered this impossible. IAI was thus left without enough revenue to meet its increased labour costs, yet could not reduce its workforce without the consent of the

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43 IAI's expectation of a state bailout was based on a precedent set after the closure of the Lavi project in 1987. IAI was awarded $250 million by the MoD and the MoF to cover its post-termination expenses, $100 million of which was special assistance to help it meet the costs of redundancies. However, both Ministries insisted that this aid was a one-off arrangement and did not bind them in respect of future redundancies at IAI or other government-owned companies. The MoF, in particular, was wary of possible 'lateral effects' of the Lavi precedent; indeed, other companies such as IMI later requested state aid. See: Peretz interview, 1998d; State Comptroller Report no. 40, pp. 915–916, 922–924.


unions. According to Ivry, 'instead of exempting IAI from this pay rise, the MoF simply did nothing; IAI was therefore forced to initiate the Rotem plan'.

The MoF also voiced reluctance to help IAI on the ground that it was not required to do. MoF officials explained to the author that, because IAI was a business entity and not part of the civil service, the Treasury was not compelled by law to underwrite or otherwise cover its losses or share its pension payments burden. It was the responsibility of the company, as laid out in the Government Companies Law and the company's own regulations, to shoulder its financial obligations through its own resources. The MoF also feared that yielding to IAI's demands might undermine fiscal discipline. And, in any event, it insisted that any government support be given on condition that IAI should undergo significant structural changes.

Back at IAI, workers' and management representatives were exchanging draft proposals for a new, interim Collective Agreement based on the objectives of the Rotem emergency plan. The Histadrut was consulted also, as the formal signatory to all IAI's collective agreements. At the same time, the other unions at Rafael and IMI were preparing protests against redundancy plans in their respective workplaces that the IAI Employees' Organisation refused to join. Instead it completed the negotiations on a Special Collective Agreement to temporarily replace the collective agreement in force at the time. Whereas the existing agreement rigidly regulated all aspects of labour relations, including promotions, work schedules and layoffs – and

48 Fogel interview.
50 IAI Collective Agreement, pp. I-IV and as an illustration see clauses 7 (settlement of disputes), 18 (order of promotion) and 61 (dismissals).
therefore prevented management from making adjustments to salaries and personnel in response to market conditions – the new agreement contained several opt-out clauses and minor concessions. These included a gross reduction of 7% in the salary base and the number of paid holidays. In return, the IAI management agreed to back down on several key demands. It agreed that the agreement should be applied for a fixed period of 13 months, rather than 16, until the end of December 1993. It also agreed to reduce the working week by 1½ hours, from 42 to 40½ hours.

The main concession related to the number of departing workers: instead of 1,100 tenured workers, the management agreed to the early retirement of less than 700. These were granted preferential terms, guaranteed and paid for by the state Treasury. The new agreement also forbade the management from making further redundancies without the consent of the Employees’ Organisation and provided that, in disputed cases, individual redundancies would be settled by special tribunals.51

The final draft of the Rotem plan, approved by the management and the Employees’ Organisation in November 1992, was predicated on the condition that the MoF would underwrite IAI’s financial needs; the MoF, however, rejected the plan’s premises outright. Said Finance Minister Shochat:

The recovery plan, as presented to me and the IAI board, is unacceptable. Its proposers behave as if nothing had happened, as if IAI was not in trouble at all. I will recommend the Cabinet to reject this proposal, even if this leads to mass demonstrations. Any concession on this issue will haunt us in a year or two years time, as we would face far graver problems then.52

Shochat and the MoF officials told Prime Minister Rabin that the plan did not address some of IAI’s core problems, given its current and future losses, and that any

51 State Comptroller Report no. 45, p. 888
concession to the IAI management would have severe implications for the company and the wider economy, as it would send the wrong signal to other ailing companies.\textsuperscript{53} According to the then MoF Director General, Aharon Fogel, the Ministry insisted on pressing IAI on this matter because it realised that its management had glossed over the company’s deep structural deficiencies for too long, implementing minimal cosmetic changes instead.\textsuperscript{54} In an interview with the author he maintained that

\begin{quote}
IAI management co-opted the employees and has grown accustomed to easy, quick fixes … this happened not because it did not know what to do … [but because] it had a certain management style which focused on ensuring a steady cash flow and assuming the rest would take care of itself.
\end{quote}

Fogel branded this approach ‘life by the cash flow’: as long as IAI had sufficient cash, it believed it was in the clear, but, once it experienced difficulties, the management turned to the Treasury for financial help instead of solving its problems internally by initiating organisational changes and forced redundancies. ‘This frame of mind, we insisted, had to be changed,’ as Fogel noted.\textsuperscript{55}

Rabin accepted the MoF’s position and rejected the Rotem plan, but not for long. Four days after he had initially dismissed it, a delegation of IAI workers headed by Haim Katz persuaded him to change his mind. Katz presented the salary structure of IAI and argued in favour of the plan, supporting his arguments with internal documents provided by the management.\textsuperscript{56} Rabin agreed to reverse his position and back the plan after extracting more concessions from the workers, including further postponement of the public-sector pay rise (the 4% increase the workers expected in April 1992 was to be paid only in October 1993), a concession which eased the

\textsuperscript{54} Fogel interview
\textsuperscript{55} Ibid.
\textsuperscript{56} Katz interview.
pressure on IAI’s cash flow. The workers’ representatives also promised to ensure that a further 300 to 500 employees, whose contribution to IAI was low, would ‘quietly’ leave the company.57

Following this, both Rabin and Shochat instructed the management to prepare a final draft that would reflect these additional provisions and submit it for the approval of the IAI board. According to press reports, Rabin wanted to stabilise labour relations across the state-owned defence firms, which had become highly charged since the presentation of a major redundancy plan at IMI few weeks earlier. A compromise at IAI, he hoped, would head off a possible confrontation with its employees, at least for a while.58 (Senior officials also believed that IAI stood better chance of recovery than IMI, because of its superior technology and capable workforce.59)

However, the draft agreement was strongly criticised by members of the board, who at a special meeting on 6 December 1992 demanded several changes. In particular, they insisted on clearly defining the number of redundancies, maintaining that ‘it was unacceptable to leave such matter unspecified, as if we were dealing here in a sort of a gentleman’s agreement’. Some criticised Rabin’s unforeseen volte face, arguing that the agreement needed to include additional clauses about the commitments given by the Employees’ Organisation to the Prime Minister. One board member even resigned in protest over the proposed agreement.60

 Nonetheless, the IAI management insisted on pushing the draft agreement through, noting that the new, revised version – the board had rejected an earlier

58 Ibid.
59 Tov interview, 1997; Granit interview, 1998.
60 Haaretz, 7 December 1992.
version based on the workers' proposal, after branding it 'inadequate'\textsuperscript{61} – was approved by the ministers themselves and by the Ministries of Finance and Defence, as well as the Histadrut and IAI's workers.\textsuperscript{62} Reluctantly the IAI board gave its consent, and the agreement was finally signed on 29 December 1992, without detailing the extent of workforce reduction or its composition.\textsuperscript{63} Four weeks later the Knesset’s Finance Committee issued a $100-million state guarantee to the company, and on 31 January 1993 a Cabinet resolution granted IAI a comprehensive assistance package, including $50 million towards redundancy packages for 400 tenured workers, a $15-million increase in its equity capital and other forms of assistance. In addition, the MoD agreed to temporarily forgo export royalties owed by IAI.\textsuperscript{64}

**Further Signs of Decline**

Within a few months, however, the IAI management noticed the premises underlying the *Rotem* plan beginning to unravel. Struggling to stabilise its orders portfolio, the company was dismayed when in April 1993 the MoD awarded its main rival, Elbit, a $140-million contract to develop a classified weapon system.\textsuperscript{65} The Ministry rejected IAI's protests, arguing that, notwithstanding the state ownership of IAI, it was required by law to consider the proposal from the privately-owned Elbit and to hold

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\textsuperscript{61} Ibid.

\textsuperscript{62} *State Comptroller Report no. 45*, p. 888.

\textsuperscript{63} See IAI, the Histadrut and the IAI Employees' Committee, *Special Collective Agreement*, 29 December 1992.

\textsuperscript{64} *State Comptroller Report no. 45*, p. 888.

\textsuperscript{65} *Yedioth Ahronoth*, 15 April 1993. Several MoD officials who served on the board of IAI, such as the Ministry's Economic Adviser, were physically and verbally intimidated by members of IAI's unions during the competition process and afterwards. Source: Author's interview with Imri Tov, 18 November 2001 (hereafter: Tov interview, 2001).

253
competitive bidding for this contract in accordance with the Mandatory Tenders Law. Any attempt to circumvent this procedure – for example, by exercising an opt-out clause in the law\textsuperscript{66} – would have been legally contested and, most probably, reversed by the courts.\textsuperscript{67} The Ministry noted that Elbit had won after careful consideration of its proposal, which was also cheaper than IAI’s.\textsuperscript{68} IAI appealed to the Tel Aviv District Court but lost.\textsuperscript{69} In a separate move, the IAI Employees’ Organisation demanded the replacement of five board members (four of them representing the MoD and the MoF) on the grounds of conflict of interest;\textsuperscript{70} the Defence and Finance Ministers ignored the call.

IAI’s situation continued to deteriorate, as initial results for the first two quarters of 1993 suggested that the company would face another difficult year. Most, if not all, of its initial assumptions – IAI would return to profitability by keeping annual revenue steady at $1.6 billion and reducing labour costs\textsuperscript{71} – proved inaccurate. In fact, the company posted a $17-million loss in the first six months, and, as the year progressed, management realised that the sales figure would be under $1.5 billion. The new contracts figure was $1.3 billion instead of a projected $1.5 billion, and the


\textsuperscript{67} Ivry interviews, 1997 and 1998.

\textsuperscript{68} Ibid. See also Eilam interview, 1999. The MoD has consistently opted for suppliers which met its requirements at a lower cost. For example, in February 1995 it awarded Elisra, an emerging competitor of IAI subsidiary Elta, a major contract to supply electronic warfare systems after concluding that its proposal was cheaper and technologically superior. See State Comptroller, ‘Report on Elta’ in \textit{Reports on Organisations Connected to the Defence Establishment} (Jerusalem: Government Printer, March 1998), pp. 27–28 (hereafter \textit{State Comptroller Report on Elta}).

\textsuperscript{69} \textit{Haaretz}, 2 July 1993. Shortly after the ruling Elbit hired IAI as a secondary principal contractor for this project, awarding it about 85% of the total work. Tov interview, 1998.

\textsuperscript{70} Circular by the IAI Employees’ Organisation, 12 July 1993.

\textsuperscript{71} \textit{State Comptroller Report no. 45}, p. 889.
orders backlog stood at $2.6 billion (equivalent to a year-and-a-half’s work) against IAI’s normal backlog of two years and more (see Figure 5.2).72

**Figure 5.2**

![IAI: Contracts and Backlog](image)

**Sources:** IAI, State Comptroller, Haaretz.

**Notes:** The graph shows that IAI encountered a 15% drop in new contracts between 1991 and 1993, and its backlog shrank by 10% during that period (all figures are in current prices; end of year results).

These disappointing results were compounded by the management’s failure to reduce the number of excess workers, because the Employees’ Organisation had backtracked on its earlier commitment to Rabin.73 As a result, the company’s workforce was reduced by only some 1,100 employees, and 400 tenured but unneeded workers were left on the payroll.74 In addition, the Chief Scientist Office at the Ministry of Trade and Industry withdrew a $35-million grant awarded to IAI for...

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72 Davar, 7 July 1993.
73 State Comptroller Annual Report no. 45, p. 889.
74 Hadashot, 1 April 1993 and 27 April 1993.
activities in the civil market, because the company failed to submit detailed project proposals.\textsuperscript{75}

Only at this late stage, in mid-1993, did the management finally realise the enormity of the company’s situation, as attested by Chief Executive Keret:

When the Israel Cabinet cancelled the \textit{Lavi} project [in 1987] it was a clear-cut situation: there was no doubt that the company could not afford to retain the 5,000 workers assigned for it ... this time, sensing the coming crisis was much harder: our financial results for 1991 were some of the best in the company’s history, and the early signs of a possible slowdown in our key markets were inconclusive. It took a while, almost a year, until we felt a rapid decline in business. Until then everything went as planned, so it was hard for everyone — the management, the employees, even the ministers in charge — to accept that we were actually facing an imminent problem. When we finally did, it was just too late; we should have begun preparing ourselves for this situation a year before.\textsuperscript{76}

This late recognition stemmed, to a large degree, from \textit{ad hoc} cash injections (either from foreign clients or the MoD) which helped to alleviate IAI’s deteriorating finances but also obscured the severity of its problems (as noted earlier by the MoF Director General).

Early signs of trouble had begun to show as early as February 1993, just few months after the \textit{Rotem} agreement was signed. IAI experienced a persistent cash-flow problem, struggling to raise sufficient funds to pay for salaries and services. However, its cash shortages were quickly mitigated through sporadic cash injections, including advance down payments from the MoD, received after vigorous lobbying by senior

\textsuperscript{75} \textit{State Comptroller Annual Report no. 45}, p. 891.
\textsuperscript{76} Keret interview. Not only was IAI oblivious to the rapidly changing circumstances in the world’s arms markets; the press was unaware of the situation as well. A leading Israeli paper published an editorial praising IAI for its 1991 financial results and its overall strategy. See ‘IAI is in the right direction’, \textit{Globes}, 15 April 1992.
representatives of the IAI Employees' Organisation. They appealed directly to
Cabinet ministers and the Histadrut chiefs in a ritual that was repeated every month.\textsuperscript{77}

In July 1993, however, the IAI management realised that it could no longer
afford to keep the entire workforce, and it informed the employees’ representatives
that 1,500 jobs needed to go with immediate effect.\textsuperscript{78} This figure was in fact much
lower than was really needed -- at the end of 1992 it had already been realised that the
workforce should be reduced by at least 2,500 employees\textsuperscript{79} -- but this was not the most
pressing issue the management faced. The main challenge was to adapt the Collective
Agreement to its changing circumstances. The sticking point of the Rotem
negotiations -- that IAI's Collective Agreement did not permit forced redundancies
without explicit consent of the Employees’ Committee -- resurfaced again, but, given
IAI’s lack of orders and capital, this time far more acutely.

Amid growing signs of difficulties, the IAI management approached the
Employees’ Committee and asked to renegotiate terms of the original Collective
Agreement, which was about to be reinstated once the Rotem agreement lapsed. In
particular, the management was concerned about the rigid dismissal procedure and the
linkage to the public-sector pay rises, which severely curtailed its financial and
commercial flexibility. It informed the employees’ representatives that it was adamant
about taking decisive action (including unilateral suspension of the Collective
Agreement), until the company’s situation stabilised. IAI did not want to break the

\textsuperscript{77} Katz interview. In the course of their lobbying efforts, the workers' representatives met the
Histadrut’s Secretary-General Haberfeld and approached both Shochat and Rabin. Health Minister
Haim Ramon was also instrumental in facilitating the workers' efforts.

\textsuperscript{78} \textit{Haaretz}, 9 July 1993.

\textsuperscript{79} Penso interview.
Collective Agreement, a senior executive said, but was left with no choice, 'because keeping it had become prohibitive'.

The MoF, meanwhile, publicly criticised the situation at IAI for the first time. 'The company was no longer commercially viable,' said Nir Gilad, the Deputy Director of the Budget Department, to the Knesset’s Finance Committee, and in a later appearance before the Knesset’s Labour Committee he alluded to the possibility of shutting down IAI if its losses continued. The Budget Department examined IAI assets and argued that it needed a fundamental reorganisation, including the sale of profitable units and a complete overhaul of its Collective Agreement and corporate strategy. It demanded that IAI employees should agree to major changes in the agreement, similar to those implemented six months earlier at IMI: sharp workforce and wage reductions; workforce mobility and severance of all wage linkages to the public-sector pay raises. In addition, the MoF insisted that the IAI management should cease the practice of cross-subsidy between factories, which 'perpetuated inefficiency and waste'. Behind the scenes, the MoF's Budget Department started exploring drastic steps, including putting IAI into receivership or outright liquidation – the strongest of the measures prescribed by the Government Companies Law – should the employees refuse to yield.

For IAI’s workers, the management’s threat and the pressure from the MoF were nothing short of a casus belli. They launched a PR offensive with a statement from the IAI Employees’ Organisation that any attempt to undermine the company’s

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80 Shmuel Peretz interview, 9 June 1998 (hereafter: Peretz interview, 1998c)
81 Globes, 24 June 1993.
82 Globes, 30 July 1993.
84 See Government Companies Law, clause 14.
Collective Agreement would be met with fierce resistance.\(^8\) A press briefing maintained that any breach of the employees' statutory rights 'would lead to a third world war', and also rejected any attempt to compare the situation at IAI to that of IMI. Accusing the MoF of 'deliberately spreading lies,' it argued that 'the IMI workers were previously civil servants whose pension schemes were already budgeted by the state; this was not the case with IAI, whose employees were relying on the company's resources for their retirement'.\(^9\) (This last claim was not accurate: before IMI became a company in 1990 it had operated as a unit within the MoD, and its workers were therefore part of the civil service; however, once it became a company, IMI took upon itself the future pension and salary obligations of its employees.\(^10\))

Having exhausted all other options, and following a breakdown in negotiations with the employees' representatives, the management approached Prime Minister Rabin and Finance Minister Shochat in July 1993 and presented an updated assessment of its situation. It asked for an urgent aid package totalling $400 million and ministerial backing for taking a drastic line with the employees. As to the latter, the management suggested either unilateral suspension of the Collective Agreement by the management, with the backing of the ministers in charge, until the company's situation has stabilised; or else placing IAI in the hands of a receiver through the

\(^8\) *Haaretz*, 15 July 1993.

\(^9\) The IAI Employees' Organisation Press release, 14 July 1993, p. 3; open letter to the IAI workers by the Histadrut, the IAI Employees' Organisation and the IAI Workers' Council, 12 July 1993.

\(^10\) See Dan Shomron, 'IMI: Present and Future', in *The Israeli Economy at the Threshold of the Year 2000 – Conference Proceedings* (Jerusalem: Jerusalem Centre for Public Affairs and Old City Press, 1993), pp. 199–200 (Hebrew); comments by IMI Acting Chief Executive in a session titled 'the crisis at IMI' held by the Labour, Welfare and Health Affairs Committee of the Knesset, 7 June 2005 (protocol held by author, also available on www.knesset.gov.il, accessed 20 December 2005).
courts. (The employees already rejected the possibility of a consensual suspension of the Collective Agreement.)

Of the two, the IAI chief executive preferred the first option, arguing that a labour dispute as a result of temporarily suspending the Collective Agreement would cause less harm to the company’s reputation. ‘IAI’s customer base was mainly abroad, with over fifty clients’, explained a senior IAI executive who took part in the meeting with Rabin. ‘If we were placed in receivership, our clients would dump us and go to the next competitor. No one would risk doing business with us.’ If, on the other hand, ‘IAI were engaged in a labour dispute, the clients would most probably accept that this was only temporary phase that would last no more than a month or two’.90

Prime Minister Rabin, however, rejected the management’s position:

Under no circumstances would I sanction a unilateral suspension of a collective agreement. If I do that, the Electric Company would shut down the electric supply, Bezeq [then the state-owned telecommunication company] would bring down the telephone network, and Maaz [the government-owned road works department] would close the highways. I would be left with a paralysed country.91

He also argued that IAI’s proposal was not decisive enough and could not guarantee the massive reduction in workforce and salaries the company so urgently needed.92 (In an interview with the author, Mr Shochat explained that ‘breaking collective agreements with the [IAI] unions might have led to a colossal confrontation. The Cabinet did not want to face a crisis of such magnitude at that point in time’.93)

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88 Globs, 8 July 1993.
89 Peretz interview, 1998c.
90 Ibid.
91 Ibid.
93 Shochat interview.
Instead, and to the great dismay of IAI management, the two ministers instructed it to negotiate an agreement with the employees along the lines of the IMI agreement, and to bring it over for approval within a month. If the management failed to do this in time, ministers would recommend placing the company in receivership – so it should prepare for that possibility as well.  

The ministers’ decision was influenced by secret discussions held with senior MoF officials and IAI’s board Chairman few weeks earlier. Anticipating the employees’ defiance, the MoF’s Budget Department (whose Director had previously been a senior executive at IAI) maintained that only a decisive, unequivocal measure would convince the IAI employees to accept significant concessions. It suggested presenting them with an ultimatum: unless they complied, the ministers in charge would ask Cabinet to authorise putting IAI in receivership and file a request to the courts to that effect. Such step would undermine the very existence of the IAI unions themselves – a receiver was entitled to suspend IAI’s Collective Agreement, including fringe benefits and pay raises, and to make employees redundant at the statutory rate – and this threat alone might persuade them to accept the management’s demands. The Budget Department therefore recommended a brinkmanship strategy, which was risky and potentially damaging (there was no guarantee that the court would agree to appoint a receiver for IAI, and in any event the company’s reputation would be harmed) but nevertheless the only way to achieve the required structural changes in the company. According to the then Director of the Budget Department:

The MoF viewed the crisis at IAI as a major test case, similar in its magnitude to the watershed crisis of ATA, a private textile company which appealed in 1985 for government aid. ATA was located in a developing area with high unemployment rate,

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and its business was export-oriented; nevertheless, in a marked departure from previous
conventions, the Cabinet refused to help the company; ATA subsequently collapsed.
Since then, no other private company had appealed for government assistance, realising
that it needed to sort out its problems on its own. We tried to institutionalise the same
approach *vis-à-vis* the state-owned enterprises by forcing a receiver on IAI. Through this
action we wanted to convey a clear message: “Do not think that, just because you are
owned by the government, it means that we will automatically leap to your assistance.
You must be more business-minded and take responsibility for your actions.” We no
longer accepted a situation where the management and the employees colluded to extract
state funding.96

Indeed, the MoF believed that its decisiveness in the IAI crisis would serve it
well in other labour disputes. The MoF Director General noted that a decisive move
*vis-à-vis* IAI’s employees sent a stern, deterrent message to other ailing organisations
in the public sector — such as the General Sickness Fund (*Kupat Holim Klalit*), which
also required substantial state aid — to the effect that the Cabinet would do not hesitate
to enforce painful structural changes through the courts.97 (Shochat indeed noted that
the crisis at *Kupat Holim* was more significant than IAI’s, because ‘it affected 70% of
the Israeli population’.98)

In separate discussions, exactly the same recommendation was relayed to
Prime Minister Rabin by the IAI Chairman, former Chief of Staff Zvi Zur, one of his
most valued and respected friends,99 and by the Economic Adviser to the Prime
Minister, Ilan Flato, a former MoF official.100 Unknown to the IAI management, Zur
met Rabin in private and told him that a firm course of action against the employees
was inevitable:

96 Brodet interview.
97 Fogel interview.
98 Shochat interview.
99 Haber interview.
100 Flato interview.
A softly-softly approach would lead us to nowhere. We must place IAI in the hands of a court-appointed receiver, and by this means dismantle the stifling, formal structures of decision-making inside the company [IAI's Collective Agreement and the Employees' Organisation]; only thus would we manage to turn the company round.\(^\text{101}\)

Rabin accepted this recommendation.

Ministerial endorsement of a receivership option for IAI took management by surprise. The ministers' outright rejection of its suggestion prompted several executives to suggest that the IAI management should collectively hand in its resignation; Keret dismissed this idea outright.\(^\text{102}\) The Employees’ Organisation, meanwhile, held an emergency session in which it declared Finance Minister Shochat ‘the No. 1 enemy of IAI’ and promised to ‘destroy him politically’.\(^\text{103}\) At the behest of several IAI employees,\(^\text{104}\) the Histadrut also became involved in the crisis, promising to back IAI's workers through industrial action across the public sector if the company were put into administration.\(^\text{105}\)

IAI's financial situation, meanwhile, reached a crisis point. The costs of maintaining 2,500 excess workers ‘became unsustainable’,\(^\text{106}\) as clients continued to cancel or defer contracts. Banks refused IAI further loans – it already owed them more than $600 million\(^\text{107}\) – and within days the company’s reserves came close to depletion. It was unable to pay the employees’ full salaries (a clear breach of the Collective Agreement) and could afford only partial down payments. On 9 August

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\(^\text{101}\) Zur interview.

\(^\text{102}\) Peretz interview, 1 January 2006 (Hereafter: Peretz interview, 2006)

\(^\text{103}\) Jerusalem Post, 27 July 1993; Globes, 25 July 1993.

\(^\text{104}\) Letter from Eli Holtzman, a union representative at IAI’s MBT factory and member of the Histadrut’s Central Committee to the Histadrut’s Secretary General, Haim Haberfeld, 14 July 1993.

\(^\text{105}\) Yedioth Ahronoth, 28 July 1993.

\(^\text{106}\) Penso interview.

\(^\text{107}\) Maariv, 9 August 1993.
1993, when the management informed the employees of its situation and told them that the previous month’s salary was temporarily withheld, the work across IAI factories was brought to an abrupt halt. Several thousand employees at IAI’s main complex near Ben-Gurion Airport stormed the management building, causing damage and havoc on their way; order was restored after police intervention.\textsuperscript{108}

The IAI crisis caught the attention of the political system. Representatives from the main parties, including a large group from the ruling Labour party, visited the company and met the employees and management. The opposition Likud party, in particular, saw an opportunity to embarrass the Labour government. A ten-member delegation, headed by party leader Binyamin Netanyahu, arrived at the invitation of the Employees’ Organisation for a tour at IAI just a day before the salary crisis broke out, on 8 August 1993; however, the management did not allow it in. Before leaving, Mr Netanyahu and his colleagues promised the workers they would ‘intervene on their behalf’.\textsuperscript{109} Other Members of Knesset presented in the media makeshift proposals ‘to alleviate IAI’s situation and restore its finances’, but none was followed up.\textsuperscript{110}

**Negotiations**

The clashes at IAI captured headlines and featured prominently in news bulletins. A few days later a fresh round of negotiations started in earnest. Up against a tight deadline, IAI management and workers’ representatives met daily, trying to find a compromise that satisfied the conditions presented by the Defence and Finance

\textsuperscript{108} Hadashot, 10 August 1993.
\textsuperscript{109} Maariv, 9 August 1993,
\textsuperscript{110} Ibid.

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Ministers. The Israeli President, who visited IAI in September 1993, expressed concern and urged the parties to reach a compromise.\textsuperscript{111}

Both sides came well prepared for the negotiations on a new Special Collective Agreement, called \textit{Rotem 2}. The IAI management presented similar demands, which were based on the previous \textit{Rotem} agreement, but insisted that the situation required far harder concessions by the employees. The management’s team was accompanied by professional consultants, including lawyers and labour affairs specialists. With the help a former union leader (once head of the Workers’ Committee at IAI’s subsidiary Elta) it conducted ‘war games’ to simulate likely moves by the employees’ representatives.\textsuperscript{112} The Employees’ Organisation, for its part, appointed a team of negotiators led by the Under Secretary of the Employees Organisation, Haim Katz, and assisted by lawyers, accountants and pension plan specialists.\textsuperscript{113}

The workers divided their efforts: while Katz negotiated with the IAI management, Secretary General Sheffi lobbied on behalf of the employees in the Knesset, winning support for the IAI workers from other MKs, both on the left and the right.\textsuperscript{114} According to Sheffi, he intended to exercise his parliamentarian privileges to the fullest, and if necessary to apply direct pressure on his own party. A veteran Histadrut apparatchik, Sheffi did not get along at all with Prime Minister Rabin – they were on such bad terms that they did not speak for more than eighteen

\textsuperscript{111} IAI press release, ‘Visit of the President’, 9 September 1993.
\textsuperscript{112} Penso.
\textsuperscript{113} Sheffi interview.
months, until the beginning of 1994, even though Sheffi was the party whip\textsuperscript{115} -- and gradually established himself as a distinctive, critical voice, differing from the line taken by Prime Minister Rabin on defence spending, organised labour and the handling of the IAI crisis. He soon realised that the fragile make-up of the governing coalition -- just 62 seats out of 120, (and later only 58\textsuperscript{116}) -- enhanced his influence, and put him in a powerful position to overthrow the Rabin government almost at will. ‘A majority of one was enough to topple the prime minister, and therefore every vote mattered. The party leadership was under great pressure because of this,’ he said.\textsuperscript{117}

As the crisis at IAI deepened, so did his efforts on the employees’ behalf.

\textbf{The Premier’s Involvement}

Despite long, round-the-clock discussions usually finishing in the early hours of each morning -- the workers prolonged the discussions to grind the management down by attrition\textsuperscript{118} -- a compromise turned out to be beyond reach. The employees also discovered that whatever offer the management representatives made, it needed to be approved by the IAI Chief Executive, the IAI Board, the Government Companies Authority and two separate departments at the MoF;\textsuperscript{119} many of the proposals were rejected or changed along this decision chain. The employees consequently hardened their position, and this prompted a senior management official to conclude that they

\begin{flushright}
\textsuperscript{115} Sheffi interview.
\textsuperscript{116} After Shas left the Labour-led coalition in September 1993 and another party -- Yi’ud -- joined it, the number of MKs supporting the government fell to 58 coalition members and five more from outside the coalition. See Knesset website (www.knesset.gov.il, accessed 20 December 2005).
\textsuperscript{117} Ibid.
\textsuperscript{118} Penso interview.
\textsuperscript{119} Penso and Katz interviews.
\end{flushright}
‘either did not understand or simply refused to accept how severe IAI’s situation really was’.120

At the same time, preparations for the IAI receivership application continued apace. The MoF formed a task force of representatives from three departments and the Ministry’s legal adviser to deal exclusively with this issue. Its work was coordinated by the Deputy Head of the Budget Department, who liaised with teams at the Government Companies Authority, the Ministry of Defence and IAI.121 At IAI, the Chairman of the Board presided over an internal team that assessed the legal and operational implications of a receivership application, including the financial requirements for the completion of projects.122 In addition, the company’s legal adviser and the heads of key departments prepared detailed affidavits in support of the receivership application.123 The MoF, meanwhile, issued performance guarantees for the company’s customers;124 IAI’s Chief Executive then went on a worldwide tour, meeting the company’s key clients in a bid to keep their business.125

The situation at IAI was closely monitored by the political advisers of Prime Minister Rabin, including the Director General of the Prime Minister Office, Shimon Sheves, who was regularly briefed by IAI’s Employees Organisation. In the meantime, the management hired management consultants to examine and

120 Author’s interview with Doron Suslik, (IAI Head of Communications Directorate, 1986–1999, Deputy Vice President for Communications 2000–present), 7 October 1997.
122 Zur interview; Peretz interview, 1998c.
123 Peretz interview, 2006
124 Fogel interview
recommend a new structure for the company. However, there was little or no progress in the negotiations with the employees, and they reached a dead end.

Seeking a solution to this impasse, the employees' chief negotiator Katz contacted Rabin's Chief of Staff Sheves in September 1993 and asked to meet the Prime Minister. This was a seemingly unusual request, given Rabin's disparaging comments on the IAI crisis ('spending $400 million dollars on the company would be a waste of money and would compromise vital security needs') and his known dislike for its unions and the Histadrut. It also circumvented the official channel of communication and authority, since the formal interlocutor for the IAI workers was the management, not Cabinet. Nevertheless, appreciating the delicate situation at IAI and its potential political ramifications, Sheves arranged for the Prime Minister to meet Katz.

Rabin knew Katz from previous informal meetings the two had held in private, although these had been kept secret from the IAI management. Rabin, an introverted, cerebral person, gradually grew fond of the IAI workers' representative, whom he viewed as an authentic, trustworthy union leader who also shared his deep contempt for the Histadrut's policies. However, at this meeting the

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126 Hadashot, 10 September 1993.
127 Sheves interview.
128 Hadashot, 5 August 1993
129 Granit (1998 interview), Haber and Fogel interviews; Galnoor, No, Mr Commissioner, p. 211. Rabin disliked the IAI unions in particular because he viewed them as an electoral pool base of his political rival, Shimon Peres.
130 Katz interview.
131 For reflections on Rabin's personality, see: the CIA's biographical account of Prime Minister Rabin, in Yossi Melman, The CIA Report on the Israeli Intelligence Community (Tel Aviv: Erez/Zmora-Bitan-Modan, 1982), p. 104; Kissinger, Years of Renewal, pp. 374–376
132 Granit interview, 1998 and Penso interview.
two hardly saw eye to eye, and engaged in a ‘long, tense discussion,’ as Katz recalled.\textsuperscript{133}

Rabin blamed the IAI employees for presenting unacceptable demands and warned Katz that they would have themselves to blame for IAI’s downfall, a message he had also given some weeks earlier to the labour affairs minister, Ora Namir, one of Katz’s confidants and a staunch supporter of the IAI unions.\textsuperscript{134} Katz told Rabin that IAI’s employees wanted to reach a compromise, but the management was incapable of making a credible offer. ‘We simply stopped taking them seriously,’ he said, asking the Prime Minister to intervene.\textsuperscript{135}

Rabin spoke with Finance Minister Shochat and they summoned a senior MoF official, Shalom Granit, then Director of the Wage and Labour Accord Unit, for a meeting at the end of September 1993. By this time the two ministers had increasing doubts about whether the receivership plan was indeed the right course of action for IAI, given the political and commercial risks involved and the relative inexperience of the courts and the government bureaucracy in dealing with such matters.\textsuperscript{136} (At the time, the only other big company run by a receiver was El Al, but it served a different type of client and operated in a market markedly different from IAI’s). Granit shared their concerns, arguing that receivership should be kept as a last resort. Granit disagreed with the brinkmanship advocated by his colleagues at the MoF’s Budget Department and believed that only direct dialogue with the IAI employees would defuse the stalemate and eventually solve the crisis. He felt that the MoF should

\textsuperscript{133} Katz interview.
\textsuperscript{134} Yedioth Ahronoth, 5 August 1993.
\textsuperscript{135} Katz interview.
\textsuperscript{136} Author’s interview with Israel Oz (Chief of Staff, Office of the Finance Minister, 1993–1995) 2 January 2006; Gilad interview, 2001.
actively pursue compromise with IAI’s employees on all relevant matters, including issues from IAI management’s agenda, such as the future privatisation of the company. This view was objectionable to other MoF officials, who opposed giving the employees any say in management decisions.137

The two ministers, accepting that the risks of a possible receivership outweighed its benefits, then asked Granit to take charge of direct, personal negotiations with Katz. Instructing him ‘to conceal his meetings from all other officials’, including those of IAI and the Ministries of Defence and Finance, they outlined the main concessions he needed to extract from the IAI employees, such as the unlinking of their salaries from public-sector wages and agreement to a reduction of about 3,000 employees.138 He was also given a set budget for the negotiations by Finance Minister Shochat, totalling around $500 million (five times the amount the MoF’s Budget Department publicly pledged for accommodating the employees’ demands139). This amount allowed Granit to offer the IAI employees high severance packages – averaging some $166,000 per head – in exchange for their concessions.140

With this mandate, Granit met Katz during the small hours of every night, after the formal round of negotiations between IAI management and employees had ended. At times, the two met in the Finance Minister’s house or at secret locations in or near Jerusalem.141

Explaining why Granit was appointed, Avraham Shochat told the author that ‘the costs associated with the IAI recovery plan were such that we had to take the lead

138 Ibid.
139 Hadashot, 28 September 1993 and 4 October 1993.
140 Granit interview, 2 January 2006 (hereafter: Granit interview, 2006).
on this matter'. He added that ‘we felt that the IAI management was incapable of reaching a satisfactory solution, and in any event it was simply wrong to let them deal with this issue on their own while the recovery costs were to be borne by the state Treasury.’\textsuperscript{142} (This last point alluded to the unease of senior MoF officials, who claimed it was patently wrong to let the IAI management negotiate the terms of redundancy packages that were to be paid by the state, not the company.)

\textbf{Rabin's Brinkmanship}

While the preparations for a putting IAI into receivership and the secret negotiations over a compromise continued in two separate, parallel tracks, the Prime Minister Rabin’s closest political advisers were feeling growing concern. As elections for local authorities – slated for 2 November 1993 – drew nearer, internal assessments suggested that the Labour party might be defeated in several key municipalities. The Prime Minister was worried, because he viewed the result of these elections as an important indication of the public support for the Israeli–Palestinian Oslo accords, signed just weeks earlier.\textsuperscript{143} He warned that ‘a victory of a Likud candidate in one of the three big cities would have far-reaching consequences, well beyond the municipal level; it might derail the peace process altogether’.\textsuperscript{144} Rabin’s concerns played straight into the hands of the IAI employees, who started campaigning against Labour candidates.

Indeed, Rabin’s political advisers, mainly Sheves, saw the IAI’s workers machinations as a political threat that was not to be taken lightly, especially before

\textsuperscript{142} Shochat interview.

\textsuperscript{143} \textit{Haaretz}, 12 November 1998.

\textsuperscript{144} Rabin quoted in \textit{Yedioth Ahronoth}, 24 October 1993.
elections. With its network of activists and track record in public campaigns, the IAI Employees' Organisation appeared to be having an influence on the make-up of several municipalities and local authorities in central Israel, especially near the company's main industrial complex (see Figure 5.3), and it was presumed to be capable of mustering up to 50,000 votes (equalled to 3–4 seats in the Knesset). In addition, it maintained close cross-sector cooperation with other powerful unions, such as the National Organisation of Airlines and Airport Employees and the National Organisation of Electric Company Employees (which, at the time, had its own grudges against the Rabin government) and according to Shochat was indeed capable of disrupting key operations in the country. However, he did not believe that the Employees' Organisation possessed the electoral influence it claimed to have.

However, senior officials at the MoF and the Prime Minister Office argued to the contrary, and indeed the IAI employees had gone to great lengths to show Rabin and Shochat their political strength. In several meetings, the employees' chief negotiator Katz warned the Prime Minister that the IAI employees were capable of inflicting a major blow to him and his party. 'We will bury you if the company is dismantled,' he told Rabin time and again. To prove this point, the employees gradually escalated their protests.

145 Granit interview, 1998; Sheves and Zur interviews.
146 Zur and Flato interviews; Makor Rishon, 28 November 2003. The IAI Employees' Organisation was politically active in as much as twenty municipalities.
147 At that time, the Electricity Company employees Organisation resisted a proposal to break the company into smaller producing units and to appoint independent regulator for energy prices. See: Shochat interview; Haaretz, 5 September 1994, and 9 July 2004.
148 Shochat interview.
149 Granit interview, 1998.
Figure 5.3: Location of IAI's factories

Legend:
- Profitable factory in a developing area
- Loss making factory in a developing area
- Profitable factory / subsidiary
- Loss making factory (number denotes several factories in the same industrial complex)
- Factory slated for reorganisation or sale

Sources: State Comptroller, IAI, Hadashot, Haaretz
After the September holidays, in response to Shochat’s announcement that he would withhold all funding for IAI until it set an immediate deadline for its recovery plan, IAI personnel took to the streets and blocked major highways. When shortly afterwards IAI’s management started compiling redundancy lists, the Employees’ Organisation coordinated a demonstration that closed down Ben-Gurion International Airport. On 21 October 1993, in scenes reminiscent of the protests against the cancellation of the Lavi project, thousands of IAI employees stormed the airport runways and prevented flights landing or taking off for several hours. During the demonstration, Katz mounted a podium and threatened political retribution in the imminent local elections ‘unless the Labour party meets our demands’. The employees’ leader, Member of Knesset Yaakov Sheffi, also promised to act: ‘If the [Rabin] government will not yield, I will oppose the state budget bill, even though I am a Labour party member’.

And Sheffi carried out his threat. A week before the local elections, he voted against the state budget bill during its first reading, which was embarrassing to the Labour leadership because it signalled that he would not hesitate to bring Rabin’s government down. The vote took place just weeks after Shas, a major party, had left Rabin’s coalition in protest at the Oslo Accords, bringing the coalition’s seats in the Knesset below the 60-seat threshold. Opposition members quickly seized the moment and congratulated Sheffi for ‘his courageous vote’, which was akin to a vote of no-
However, his vote was actually a tactical move aimed at warning the Labour leadership to tread carefully in its negotiations with the IAI employees. However, the Prime Minister refused to budge. Maintaining a façade of ‘business as usual’, and as preparations for the receivership action neared completion, he was presented with reports and assessments by the IAI chairman and management, the MoF’s Budget Department and the MoD legal adviser (who was assigned to prepare a detailed application to the courts). The Ministry of Finance’s Budget Department suggested approaching the courts a day after the Cabinet meeting, or as soon as Prime Minister agreed to do so, as it assumed that by that point the employees would back down.

Shortly afterwards, Rabin met the IAI chairman Zvi Zur in private. The two agreed to bring the IAI receivership plan before the Cabinet for approval at the beginning of November, shortly after the local elections, and to approach the courts immediately afterwards. However, Rabin — who did not divulge to Zur the secret negotiations between Katz and Granit — wanted to review the legal aspects of the plan for the last time with the most senior MoD, MoF and IAI officials. He and Zur therefore scheduled a major meeting on 3 November, at which Rabin asked to be presented the complete paperwork. Rabin then made another, and quite unexpected, request: ahead of the Cabinet discussion on the IAI receivership, he — Rabin — wanted to ensure the backing of Peres for this move. According to Zur,

154 Sheffi interview.
156 Gilad interview, 2001 and Brodet interview.
Rabin told me: ‘Shimon Peres is a friend of yours, so before we convene Cabinet to
discuss the receivership plan for IAI, sort this out with him first’. Now, Peres felt close
affinity to IAI because, more than anyone else, he was the one who built it up from
scratch. Many of his friends and voters came from there, and they comprised a very large
base of support for him. I sat down with Peres and told him about the situation of the
company. He said to me: ‘You are probably 100% right but I will never hand IAI to a
receiver. I simply cannot do it.’ Once Rabin heard that Peres objected to the receivership
plan, he became much less enthusiastic about it.157

Shimon Peres was not the only cabinet minister who refused to confront the
IAI employees. Labour affairs minister Namir also approached Rabin and pressed for
a negotiated compromise with them (a position she also voiced in Cabinet meetings
and through opinion articles written by her senior adviser.158)

While Zur was struggling to come to terms with Peres’ refusal, the secret
negotiations between Granit and Katz reached a critical impasse. Katz then met
Finance Minister Shochat, who stated his support for recommending placing IAI in
receivership to Rabin.159 This last development set in motion a rapid chain of events.
Katz called Sheves and updated him on the collapsed negotiations with Shochat.
Sheves approached Rabin ahead of the weekly ‘Our Ministers’ meeting and cautioned
him that matters were about to get out of hand. Putting IAI into receivership, he said,
would bring the party in a collision course ‘not just with the IAI employees, but with
all the others as well. It would have some catastrophic consequences.’ He urged Rabin

157 Zur interview. According to Shimon Sheves, Rabin tricked Zur into believing that Peres’ position
mattered to him; in truth, ‘he did not really care whether Peres would support or oppose a
receivership plan for IAI … he simply wanted Zur to challenge Peres with the idea, and to see his
reaction, just to know whether he would entertain it or not’ (Sheves interview).
158 Haaretz, 8 August 1993; Esther Alexander, ‘we buried the Lavi and we shall also bury IAI’,
Ha’olam Haze, 18 August 1993; Esther Alexander, ‘Sickening recovery at IAI, Globes, 2 November
1993. Dr Alexander was economic adviser to Labour Affairs minister Namir.
159 Sheves interview.
to ‘take charge of the situation, personally’ and find a solution to this problem.\textsuperscript{160}

According to Sheves, Rabin

had very good political instincts ... he dreaded the thought of a failure with the IAI employees. He was afraid of the political repercussions of such an outcome. ... What he wanted was to ease the pressure, at least temporarily, so that he could focus on the peace process. For him, at that point in time, the peace talks were the most important issue.

Rabin therefore strove to ensure that IAI was stabilised and not forced to pay excessively, and to do so ‘without clashing with its employees’.\textsuperscript{161}

At that point, and as the elections were just days away, Rabin decided to confront the Finance Minister. In a closed session of the ‘Our Ministers’ forum, the senior gathering of the Labour party ministers, he asked Shochat to present the situation at IAI and its implications. The Finance Minister described the background to the company’s crisis and the failure of the negotiations with the employees, noting that the MoF recommended putting IAI into receivership. ‘All avenues have been exhausted, and we reached a dead end; I was left with no other choice,’ he said. This conclusion angered Rabin, who slammed his hand down on the table and said:

I simply cannot accept this. You [Shochat] do not have a clue how to handle these things ... from now on, I am in charge ... I suggest that you learn how we laid off 6,000 IAI workers after the Lavi [was cancelled] and stayed alive. If you do that, you will learn how not to break IAI into pieces.\textsuperscript{162}

Rabin’s outburst surprised those present, Shochat included, but in statements to the media the Finance Minister continued to appear firm, and in Cabinet few days later he declared that ‘the government would appoint a receiver to IAI unless the negotiations with the employees achieve some progress.’\textsuperscript{163}

\textsuperscript{160} Ibid.

\textsuperscript{161} Ibid.

\textsuperscript{162} Ibid.

\textsuperscript{163} Hadashot, 1 November 1993
Few days later, Katz met Rabin once again, at the Prime Minister’s home. By this time Sheves had told him that the Prime Minister was his last hope of sparing IAI from receivership, so Katz came to the meeting less defiant and ‘with lots of good will’ to strike a deal with Rabin. The two discussed the matter and agreed on broad guidelines for a compromise. Nevertheless, Rabin told Katz that unless he reached an agreement by Wednesday, 3 November, IAI would be put in receivership as planned. After the meeting, Rabin phoned Shochat and informed him of the results of his discussion with Katz, instructing him to secure these understandings in writing.

As Katz resumed his negotiations with Granit – who by now had received new guidelines from Shochat – the IAI Board and management, as well as the legal teams at the MoD and the MoF, completed a final presentation for Rabin on IAI’s receivership. While the attention of the media and political system was focused on the local elections, Katz held a series of round-the-clock discussions with Granit and the Finance Minister’s chief of staff, Israel Oz. In the early hours of 3 November 1993 the three reached a compromise. They went to Shochat’s home and received his approval. The Finance Minister then called Rabin, the two discussed the draft’s main points, and the Prime Minister then accepted it as well. Shochat now phoned the IAI Chief Executive, Keret, at 3 a.m. and informed him, to his great surprise, that a settlement had been reached with the employees. He instructed him to go to the IAI headquarters and meet the two MoF officials, Granit and Oz, as well as Katz.

By the early hours of the morning, a draft memorandum was prepared: Katz agreed to the dismissal of up to 2,900 tenured employees and the unlinking of the remaining workers from the public-sector pay rises for two years – equivalent to a pay

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164 Sheves interview.
165 This section is based on the author’s interviews with Shochat, Katz, Granit (1998) and Sheves.
cut of at least 20% – with an option of extension.¹⁶⁶ In return, the Treasury representatives waived the threat of receivership action against IAI and promised that the state would pay for the severance packages of the departing workers.

Katz, who was about to replace Sheffi at the helm of the Employees’ Organisation, had some conditions of his own. He asserted that his organisation would not be involved in the redundancy selection process – he feared that handling this sensitive issue might prove to be too risky for his position and image – and therefore insisted that the management should deal with it exclusively.¹⁶⁷ He also demanded that the memorandum should recognise in a separate paragraph the ‘special standing’ of the Employees’ Organisation with respect to future privatisation plans for IAI, giving it a de facto veto power over any such process.¹⁶⁸ Later known as Clause 80, this stated that ‘the parties acknowledge the company’s need for strategic alliances, joint ventures and raising equity capital through privatisation; however, these actions will take place only after ensuring that the employees’ rights are secured (by the state)’.¹⁶⁹ Finally, Katz insisted that the memorandum should be applicable to the entire workforce of the company, including IAI’s most profitable subsidiary, Elta (a decision which was unsuccessfully challenged by Elta’s management and employees, and later led to a mass departure of key employees and managers¹⁷⁰). These requests were also granted.

¹⁶⁶ Gilad interview, 2001, and Fogel and Zur interviews; IAI Ltd and Elta Ltd., the Histadrut and the National Organisation of the IAI Employees, Special Collective Agreement, 8 December 1993, clauses 1, 78 and 81.
¹⁶⁷ Granit interview, 2006.
¹⁶⁹ IAI Ltd and Elta Ltd., the Histadrut and the National Organisation of the IAI Employees, Special Collective Agreement, 8 December 1993, Clause 80.
No one within the senior bureaucracy was aware of the night’s developments. Dozens of senior officials, including the Directors General of the MoF and MoD, made their way to the Prime Minister Office in Jerusalem, presumably to discuss the final details of the receivership plan, when they were told that the meeting was called off and the plan shelved. Just minutes before his arrival the IAI Chairman received a phone call from Shochat, who told him about the breakthrough with the employees. When Zur entered the Prime Minister Office he learnt for the first time about the secret negotiations channel. The Finance Minister then presented him and Rabin the main points of the memorandum with the IAI employees, during which the Prime Minister kept asking whether they agreed to be de facto separated from the public sector.¹⁷¹ Shochat replied in the affirmative, and Rabin then turned to the IAI chairman and asked him for his opinion. (In accordance with the Government Companies Law, the IAI chairman held an independent position with respect to the company’s affairs, which the ministers could not override).

Zur accepted that the draft memorandum ‘was indeed an impressive achievement’. However, he noted, that ‘the company’s structure remained unchanged, and it will therefore be left with the same basic problems as before.’¹⁷² Rabin responded:

If there is a compromise, then it is a compromise! What do you want me to do? To decide here and now to appoint a receiver for IAI? A move never before taken and which was likely to be rejected by Cabinet? Let’s wait a while and see what will happen.¹⁷³

Faced with this position, Zur decided to endorse the draft memorandum as well, to the great relief of Rabin’s advisers. (In an interview with the author, Zur said that he later

¹⁷¹ Flato interview.
¹⁷² Zur interview.
¹⁷³ Ibid.
enquired and found that the Cabinet had indeed been unlikely to approve the IAI receivership plan.\textsuperscript{174}

The memorandum was signed on the same day by the management and employees representatives and later approved by the IAI board, even though senior MoF officials severely criticised its terms – in particular, the clause on the company’s future privatisation, which, they argued, had given the employees undue influence.\textsuperscript{175} The MoF Director General argued that the agreement did nothing to ensure better managerial performance by IAI and noted that it contained ‘some absurd clauses’. The decision to enforce it on the Elta employees, for example, ‘compelled them to accept a 20% pay cut, even though this particular subsidiary of IAI was very successful. We approached Elta’s management and employees directly and suggested exempting them from the agreement; not only that, we also offered them stock options if Elta were to be privatised. They rejected both offers’.\textsuperscript{176}

On 8 December 1993 the IAI management signed the revised version of the memorandum, which by now became to be known as the \textit{Rotem 2} Agreement. Even though the IAI Employees’ Organisation forfeited some of its most cherished privileges, it nevertheless stood by the agreement. In an interview, Katz said,

\begin{quote}
We reluctantly accepted the \textit{Rotem 2} agreement because we were forced to choose between the bad and the worse ... some people here did not realise that, had we not signed it, the Employees’ Organisation would have ceased to exist. And our strength stemmed from our existence.\textsuperscript{177}
\end{quote}

IAI and the MoF then entered into a detailed negotiation in which the MoF’s Budget Department agreed to pay the redundancy costs of two-thirds of the departing

\begin{flushright}
\textsuperscript{\textit{174} Ibid.}
\textsuperscript{\textit{175} Flato interview; Brodet interview; Gilad interview, 2001.}
\textsuperscript{\textit{176} Fogel interview.}
\textsuperscript{\textit{177} Katz interview.}
\end{flushright}
employees, while the management undertook the costs of the remaining third, if its financial condition permitted it to do so.\textsuperscript{178} At the same time the Histadrut was asked to formally endorse the memorandum, but, it raised last-minute objections, forcing a further round of negotiations on the final terms that lasted two more months. The trade union federation, which had deliberately been kept out of the negotiations phase by Rabin and Katz, refused to ratify the Rotem 2 agreement until certain financial conditions were met by the MoF. According to the Chairman of the Histadrut, Amir Peretz, Rabin was entitled to conduct the negotiations with the IAI employees as he saw fit, but it was then the duty of the Histadrut ‘to examine the agreement and ensure that it did not undermine existing agreements with other unions’.\textsuperscript{179} Only after the MoF agreed to provide additional guarantees concerning IAI employees’ pension payments, did the Histadrut chiefs formally endorse the Rotem 2 agreement.\textsuperscript{180} (During this period Finance Minister Shochat threatened once again to recommend putting IAI in receivership, but this was an empty gesture in view of the significant opposition to it in Cabinet.\textsuperscript{181})

After the Histadrut’s endorsement, on 23 January 1994 Cabinet approved a comprehensive financial package for IAI. It included $338 million in direct funding and a supplementary budget of $70 million for the development of civil products. IAI, in turn, agreed to contribute $28 million from its own resources towards the funding of the Rotem 2 agreement.\textsuperscript{182} At the behest of the MoF’s Budget Department, Rabin and Shochat appointed a Steering Committee for IAI, headed by the MoF’s Director

\textsuperscript{178} Interview with David Brodet in Hadashot, 9 November 1993; Peretz interview, 2006.
\textsuperscript{180} Davar, 20 January 1994.
\textsuperscript{181} Telegraph (Israel), 1 December 1993
\textsuperscript{182} State Comptroller Annual Report no. 45, p. 892.

282
General. A letter signed by the two ministers assigned the Committee’s members – who included the MoD Director General, the Director of the GCA and the Economic Adviser to the Prime Minister – to monitor the progress of the implementation of the recovery programme; examine and approve a comprehensive recovery plan for IAI which will include organisational changes and privatisation of business units.¹⁸³

According to MoF officials, the Steering Committee in effect outgunned the IAI Board, and became – for the duration of the Rotem 2 agreement – the de facto IAI Board. In other words, without an accompanying legislative framework, ministers suspended some of the powers vested in the IAI Board by the Government Companies Law.¹⁸⁴ The need for close supervision stemmed from IAI’s significant debt – $766 million in January 1994¹⁸⁵ – and the significant public investment in its recovery.

The MoF’s Budget Department, meanwhile, discovered that Finance Minister Shochat did not qualify the controversial Clause 80 before he approved the Rotem 2 agreement. The clause, which empowered the IAI unions with respect to future privatisation plans of the company, was viewed as a major obstacle on the way of future structural changes at IAI. This oversight by the MoF was apparently due to a communication failure between the Labour Accord Unit (responsible for drafting the Rotem 2 agreement) and the Budget Department (which oversaw its implementation) – the two kept a sort of ‘Chinese wall’ between them, and were careful not to intervene in each other’s internal affairs¹⁸⁶ – and to Shochat’s own inattention.¹⁸⁷


¹⁸⁶ Flato interview.

¹⁸⁷
Clause 80 underpinned the position of the IAI Employees Organisation for years to come, and neither IAI nor any of its subsidiaries, including Elta, was subsequently privatised. (In 1994, the IAI management approached the Government Companies Authority with a proposal to privatisé the company. The offer was rejected by the then GCA Director on economic grounds; no further attempts were pursued after that.\textsuperscript{188})

IAI, meanwhile, began implementing the \textit{Rotem 2} agreement. After initial internal unrest, as the redundancy phase was carried out,\textsuperscript{189} the company’s finances gradually improved (see Figure 5.4), and there was no further Cabinet intervention in its financial affairs throughout the remaining years of the Rabin/Peres government.

\textbf{Figure 5.4}

\begin{center}
\includegraphics[width=\textwidth]{iai_business_indicators.png}
\end{center}

\textit{Sources:} IAI, State Comptroller, Haaretz

\textit{Note:} The \textit{Rotem 2} agreement, which led to a gradual decrease in IAI’s costly workforce, improved the company’s output and reduced its losses.

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\textsuperscript{187} Shochat interview.

\textsuperscript{188} Peretz interviews, 1998b and 2006.

\textsuperscript{189} Penso interview; \textit{Haaretz}, 27 December 1993
Conclusions

Policy implementation in the IAI crisis illustrated how a labour dispute involving a large special interest with a geographically concentrated membership could threaten the political survival of a prime minister. Indeed, the handling of this crisis - against the backdrop of fragile coalition on the verge of collapse, and a highly charged public atmosphere after the signing of controversial peace accords - played into the hands of an astute special interest, the IAI Employees’ Organisation, which took advantage of the potential that the constituency primaries presented, and thereby managed to manipulate both the government bureaucracy and the elected governing party.

As in the case of IMI, there was no pre-emptive intervention by Cabinet or the Ministry of Finance in IAI's affairs until the end of 1992, when the company was already deep in financial trouble. Its cash-flow crisis was inevitable, given its fixed labour costs and inflexible collective agreement, which had remained unchanged despite a marked decline in its key export markets after the end of the Cold War. The impact of this drop on IAI finances was not felt immediately, as the company still had sufficient orders from existing customers, but when it did happen IAI was unable to respond. Indeed, the high turnover and lucrative export deals had a numbing effect on the company: they enabled it to meet its contractual commitments, and, as long as the revenues kept coming, the company did not feel compelled to address its internal deficiencies.

Initially, the financial crisis at IAI did not require the active and personal intervention of the Prime Minister. Labour disputes were governed by the company's collective agreement, which, although restrictive and stifling from the management's point of view (especially with respect to layoffs and labour costs), was still negotiable. This was evident when both the management and employees discussed the first
recovery plan for IAI, signed in late 1992. At that point, the parties concerned assumed that IAI was experiencing a temporary setback from which it would recover with the help of limited government funding.

The ministers in charge – then embroiled in an uphill struggle with IMI employees over their company’s reorganisation plan – and the Ministries of Defence and Finance presumed the same, but were soon proved wrong. IAI’s export markets remained depressed, and the company accumulated a significant cash-flow deficit. Unable to meet its financial commitments to employees and suppliers, it was soon heading for insolvency.

Only at that point, at the beginning of 1993, did IAI’s management realise the severity of its problems and the shortcomings of the first recovery plan. Confronted with mounting debt and dwindling resources, the management sought ministerial backing for drastic, unilateral measures against the powerful IAI Employees’ Organisation, and generous state aid to address its financial shortfall.

The role played by the two principal ministries, the MoD and MoF, in mitigating IAI’s difficulties repeated a pattern already observed at IMI. Faced with growing pressures on its budget, and with the IDF applying the ‘consumer sovereignty’ directive, the MoD ceased to be IAI’s principal customer in the mid-1980s; a further shift away from the company happened after the introduction of the Mandatory Tenders Law in 1992. Recognising its diminishing contribution to the company’s order backlog and the IAI management’s restricted leeway in respect of labour costs, the MoD – and Defence Minister Rabin in particular – played an important role in facilitating IAI’s export endeavours. But when the export market crashed and the company appealed for government help, the MoD quickly shifted
responsibility onto the MoF, citing its own budgetary constraints and holding the
Treasury partially responsible for IAI’s plight.

The MoF, for its part, was pursuing a different set of objectives and interests.
Unwilling to accommodate IAI’s appeal, the MoF’s Budget Department presented the
company with a series of stringent preconditions. The Department saw this situation as
a golden opportunity to advance a strategic objective of its own: ending the cosy
reliance of public enterprises on state bail-out. Facing similar appeals from other debt-
ridden organisations, such as the General Sickness Fund (Kupat Holim Klalit) and the
Kibbutzim movement, the MoF championed a tough stance against IAI, up to and
including the appointment of a receiver for the company; this, it assumed, would serve
as a deterrent to the other organisations.

The political echelon – both the Defence Minister and Finance Minister – was
willing to back the position of the MoF until the IAI crisis cut across separate and
unrelated developments in the political arena, namely the public battle over the
legitimacy of the Oslo Accords. At that point, the firm stance advocated by the MoF
bureaucrats was judged too risky by the ministers in charge. For them, the issue of IAI
moved past the point of being a mere economic issue and became a political problem
that needed solving. Fearing a political backlash and serious social consequences could
result from liquidating Israel’s biggest industrial enterprise, Prime Minister Rabin
changed tack, forcing Finance Minister Shochat to follow suit; they both sought a way
to avoid putting IAI into receivership, accepting that the risks of doing so outweighed
the benefits. For Rabin, above and beyond the maxims he had advocated all along (that
the state should not run businesses, and government-owned companies should yield
profits and dividends like those in the private sector), there lay at this moment a more
important strategic objective: facilitating the reconciliation process between Israel and
its neighbours – which, in turn would reduce the nation’s defence spending and ensure the availability of greater investments for other policy sectors in need. In this context, the prolonged struggle with the IAI employees became an obstacle in the way of his grand plan, because it risked consuming the Cabinet’s attention and energy and undermining its political standing.

The case suggests that the executive branch had significant powers with respect to state-owned entities, but using those powers involved political cost calculations. Indeed, placing IAI in the hands of the courts, through a receivership action, did not look appealing from a narrow political perspective. The independent judiciary had a separate agenda and considerations on which the executive had no influence. Such move would have amounted to an admission of failure by the Labour government – something the opposition would no doubt have capitalised on – and would also have removed it from a position of control over the company’s affairs (with all the concomitant side benefits, such as political appointments to the board of IAI and its subsidiaries). Faced with the visible inability of IAI’s management to rein in its employees – culminating in the embarrassing closure of Ben-Gurion Airport – Prime Minister Rabin concluded that, unless he intervened personally to diffuse the situation, matters would get out of hand just when he needed to devote most of his time and attention to what he saw as a more important policy objective.

He therefore decided to bring this matter to a close via a brinkmanship strategy, which enabled him to extract significant concessions from the IAI employees and spared him involvement in the micromanagement of a politically damaging labour dispute. The government bureaucracy and the IAI board received ministerial backing for the plan to put the company into receivership so long as this did not interfere with other Labour government policy objectives. But once several policy issues started to
cut across one another, Prime Minister Rabin prioritised: by deferring the completion of IAI’s reorganisation to a later stage, he and his Cabinet could focus on what they perceived as the more important task of peace negotiations.

Rabin therefore agreed to a compromise that came at a very high price – almost $500 million in total – but did at least remove this issue from his congested agenda. It also put IAI on the path to financial recovery by imposing financial losses on its employees and streamlining its operations. To ensure this, he appointed a Steering Committee for the company. But, far from being a tactical move aimed at ensuring the implementation of the recovery plan, this in fact made the state’s involvement in the company’s affairs more entrenched, in complete contradiction to the objectives of the Government Companies Law and indeed of Rabin’s himself.

The case outcome also suggests that once special interests have the chance to access institutional actors (like the courts) or claim a stake within one (the legislature), they stand a better chance of thwarting a policy that runs contrary to their interests. The employees appealed in the courts against the attempt to sell one of IAI’s subsidiaries, and the move effectively shelved that process. The strategic choice by IAI employees to insert their own representative into the Knesset worked well in capturing the attention of legislature and influencing the executive, especially when the Rabin government no longer had a majority coalition in the Knesset. IAI’s Knesset representative therefore held a position of strength and to all intents and purposes acted as a faction of one on matters pertaining IAI.

This, combined with their organisational competence and influence over Cabinet ministers, meant that IAI employees were viewed as a formidable force that could not be ignored – something that was also evidenced by the time the Prime Minister spent with their representative in private. The crisis ended when the two
reached common ground on which they based a compromise; at that point neither the
government bureaucracy nor the IAI management, nor the Histadrut were in any way
involved. Even though the IAI employees were forced to sacrifice some of their
privileges, this was for a few years only. Their organisational structure and
involvement in the management of IAI’s affairs remained intact and was even
strengthened (with respect to future restructuring and privatisation of IAI, through
Clause 80). Not only did the IAI Employees’ Organisation survive the crisis virtually
unscathed, it also retained as much political clout as before.
CHAPTER 6
Policy Implementation in the Rafael Crisis

Rafael was established in 1958 as an organisation operating within the Israeli Ministry of Defence (MoD), responsible for developing advanced weapon systems. At the beginning of the 1990s its growing losses and hidden unemployment precipitated a financial crisis that turned into one of the most contentious issues Yitzhak Rabin’s government had to deal with. In 1994 the government decided to address Rafael’s problems by ordering a substantial reduction of the workforce and changing Rafael’s structure and legal status. The main plank of this transformation, deemed crucial to its recovery, was to turn Rafael into a state-owned company. However, the government plan was fiercely resisted by Rafael’s workers and by segments within the senior bureaucracy, and therefore was not implemented during Rabin’s period in office or that of his successor, Shimon Peres.

This chapter discusses policy formation and implementation in the Rafael case. Starting with the background to Rafael’s financial and labour problems, it then presents the debates within the bureaucracy and the attempts by the management and Prime Minister Rabin to weather the political and legal challenges the workers’ unions posed. It ends with observations on the considerations influencing policymakers and the impact of institutional features on government policy capabilities.

Government Conflict Management

Deteriorating labour relations within Rafael, coupled with its growing losses and lack of coherent managerial guidance, forced Rabin’s government to pay close attention to the organisation’s problems. Rafael’s Director General, Maj.-Gen. (res.) Moshe Peled,
had resigned in June 1992 due to ill health. His successor, Brig.-Gen. (res.) Yitzhak Gat, was not appointed until December 1992 and then requested, and was granted, 'time out' to study Rafael's problems. ('I wanted to start afresh, without any bias towards a particular solution,' he explained. 'Rabin gave me a free hand to come up with whatever I thought was appropriate'.

In the meantime, the MoD appointed an inter-ministerial committee to examine Rafael's situation, headed by the Ministry's economic adviser. In July 1992 it recommended that Rafael should be incorporated as a business entity, whose joint owners would be the state, the employees and an Israeli group from the private sector. However, when the committee's chairman, Imri Tov, told Rabin that he did not have 'any idea how to take this recommendation forward', the Prime Minister decided to put this issue on hold. He and Finance Minister Avraham Shochat agreed that Rafael's status would remain unchanged over the next two years – during which its restructuring plan would be prepared – and meanwhile the status quo would be maintained. Another consideration was the looming crisis at IMI and IAI, which the Prime Minister decided to handle first. Rabin's apparent rejection of the MoD recommendation was greeted with scepticism by Rafael's unions, which demanded to be part of any future discussion on the firm's structure. They argued that any unilateral move by the MoD was bound to fail.

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1 Interview with Moshe Peled in Maariv, 17 July 1992; Jerusalem Post, 18 April 2000.
2 Gat interview.
**Inter-ministerial Tension**

Around the time of Gat’s appointment – and while he was assessing Rafael’s condition – the MoD and the Finance Ministry were involved in a heated debate about Rafael and public-sector collective agreements. Rafael workers were grouped in two categories – collective agreement workers (about 30%), whose labour terms were agreed between the Histadrut and the MoD, and state employees (including a large group of research staff), who were part of the civil service. The salaries of both were linked to public-sector pay rises, but research staff benefited from additional perks, such as fully paid sabbaticals and study funds. The differences in academic background and professional affiliation within Rafael meant that its workers were represented by five separate committees, each corresponding to a different rank and remuneration scale and led to prolonged in-fighting and inter-group rivalry.

Amid signs of further deterioration in Rafael’s finances, MoD Director General David Ivry recommended that the Cabinet endorse a bill unlinking Rafael workers’ salaries from frequent public-sector pay rises. His reasoning was that these rises were agreed by the Finance Ministry for reasons that had no relevance to the MoD, but they nonetheless affected the MoD’s ability to manage appropriately the budget allocated to it. They had a devastating effect on Rafael’s financial performance, and hence on the defence budget, which had to underwrite the

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8 Bonen, Rafael, p. 43. The committees represented: Research Workers, Technicians and Practical Engineers, Engineers and Social Sciences Workers, Uniformed Pay Scale Workers, and Technical Workers/Agreement (the first four representing state employees, the fifth affiliated to the Histadrut).
9 Flato interview; Galnoor, No, Mr Commissioner, p. 168. Prof. Galnoor was the Civil Service Commissioner (1994–1996).
organisation’s losses. Dissociating Rafael from the public sector would give its management better control over spending.\textsuperscript{10}

The Finance Ministry’s legal advisers objected. The proposed legislation would contravene two of Israel’s Basic Laws – one on human dignity and freedom, and the other on freedom of employment – and, if challenged by Rafael’s workers in the High Court of Justice, could not be defended. They pointed out that the state could not break a signed agreement or change its terms unilaterally, because this would undermine the fabric of labour relations in Israel. (According to a senior MoF official, ‘implementing this proposal would have been like using a nuclear bomb to settle labour disputes. It was unheard of.’\textsuperscript{11} A signed labour agreement could be changed only with the approval of the workers concerned, not through legislation; otherwise the Cabinet could lose its ethical and moral standing and forfeit trust. Finance Ministry officials – the Director-General, the Director of the Wage and Labour Accord Unit and the legal adviser – concluded that such a bill would never be passed in the Knesset.\textsuperscript{12} Finance Minister Shochat accepted his officials’ view and rejected Ivry’s proposal.

The MoD was disappointed, because it felt that this would unnecessarily increase the cost of any restructuring plan for Rafael that its new Director General might formulate in the meantime. Consequently, the MoD decided to shift sole responsibility for Rafael’s restructuring costs to the Finance Ministry and refused to allocate the majority of funding for this purpose from its own budget, even though Rafael was part of the MoD.\textsuperscript{13} Gat, therefore, had to work out his plan with the MoF.

\textsuperscript{10} Ivry interview, 1997.
\textsuperscript{11} Brodet interview.
\textsuperscript{12} Brodet, Flato and Granit (1998) interviews.
\textsuperscript{13} Ivry interview, 1998; Brodet interview.
Rafael’s Restructuring Plan

In July 1993, Director General Gat presented Rabin with a plan that called for Rafael’s immediate incorporation. Prompt action was needed, he argued, because Rafael’s financial crisis was deepening (see Figure 6.1), and 1994 losses were projected to increase by 20% to 256 million shekels.14 Gat had concluded that only a radical shake-up, including a new business and remuneration structure, would save Rafael from complete disintegration.15

Figure 6.1

This dire warning was based on the findings of a comprehensive background analysis presented to Rabin along with the recommendation for a restructuring plan. The analysis pointed to a combination of internal and external factors, some of them completely beyond Rafael’s control, that had led to its financial difficulties. First, the

15 Ibid., p. 860; Tov interview, 1997; Gat interview; author’s interview with Yigal Sarbero (Rafael Vice President for Strategic Planning, 1997-present), 18 January 1998 (hereafter: Sarbero interview).
domestic arms market had undergone fundamental changes that put Rafael under increasing strain. The Ministry of Defence reduced its orders from Rafael by almost a third between 1991 and 1993 (see Figure 6.2), returning to the same spending level as in the mid-1980s (which in itself reflected a 26% drop in MoD orders compared to earlier years, following the 1985 Economic Stabilisation emergency programme). The Ministry then reprioritised its appropriations, shifting more funding to two other weapon programmes not handled by Rafael. In addition, other companies entered Rafael’s fields of expertise, and its products were relatively more expensive.

At the same time, the global arms market had also taken an unfavourable turn. In 1993 Rafael noted a 19.3% decline in its foreign sales compared to 1992, a downturn that the management predicted would continue until 1997. Rafael management observed ‘a noticeable drop’ in global defence budgets, including those in the third world, as clients became more selective and demanding, putting greater emphasis on broader economic considerations. The result was that foreign clients started preconditioning deals with a technology transfer element in order to facilitate indigenous production, a development which ultimately reduced even further the demand for arms imports. Finally, the competition in the arms market became fiercer, as mergers and acquisitions created a small number of big firms and multinational alliances; in addition, competing foreign industries benefited from protectionist policies and subsidies offered by their respective governments.

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16 Bonen, Rafael, p. 189.
17 Rafael management, Rafael’s Crisis Analysis (internal presentation), July 1993, p. 13; State Comptroller Annual Report no. 45, p. 849.
19 Rafael’s Crisis Analysis, p. 12.
Figure 6.2

Rafael: Sales distribution

1,400 1,200 1,000 800 600 400 200 0


Source: State Comptroller. 1993 constant prices

Note: In the early 1990s Rafael’s sales to the MoD dropped to their mid-1980s level, a decline cushioned by export deals. However, starting in 1993, Rafael noted a fall in its foreign sales as well.

**Effects of Unplanned Growth**

Rafael also found itself in an increasingly untenable position because its original mission and structure did not match its actual development. It had been formed as a small research and design unit, working for the MoD on a handful of projects and employing few hundred workers, most of them scientists. Within two decades, however, it had turned into a full-scale manufacturer, engaged in state-of-the-art weapons programmes and export activities and employing several thousands – and yet it was still operating as a government department within the public sector. The adverse managerial implications of this status had been known since the early 1970s. Even so, in 1978, when the then Director General, Zeev Bonen, proposed turning Rafael into a state-owned company, which would have given it greater financial flexibility, the MoD endorsed the idea but then retracted its support; later attempts, in
1984 and 1987, were rejected as well.\textsuperscript{20} The managerial limits in Rafael were well known also to Defence Minister Rabin, who had commented in 1988 (while serving in Yitzhak Shamir’s government) that ‘the state of Rafael … which combines a research institute and a production factory under one roof … cannot be dragged on for long’.\textsuperscript{21}

Indeed Gat, in a July 1993 assessment, asserted that ‘Rafael was in an impossible situation’. While the MoD expected Rafael to stick to its budgetary limits and employ business considerations (which was also necessary on account of the competitive environment in which it was operating), it was still governed by inflexible labour agreements. Benefits and bonuses granted to the public sector were also given to Rafael’s workers, irrespective of the organisation’s actual revenues and financial condition. This ran counter to customary business practices and hampered Rafael’s commercial efforts in the domestic and international markets. Gat concluded that Rafael ‘could no longer continue operating under these contradictory operational perceptions’.\textsuperscript{22} In a later interview with the author he added that ‘Rafael was still treated as a research unit within the MoD, while 90\% of its activities actually evolved around arms sales; this was an anomaly and was patently wrong. It should have become either a scientific centre or a company’.\textsuperscript{23}

\textsuperscript{20} Bonen interview; Gat interview. See also Bonen, Rafael, pp. 43, 46. In February 1978 the then Defence Minister, Ezer Weitzman, approved outgoing MoD Director General Prof. Pinhas Zussman’s recommendation to transform Rafael into a company; however, the new MoD Director General, Yosef Maayan, appointed in August 1978, shelved the idea. Maayan favoured a centralised style of management and preferred to retain full MoD control over Rafael.

\textsuperscript{21} State Comptroller Annual Report no. 45, p. 857

\textsuperscript{22} Rafael’s Crisis Analysis, p. 15.

\textsuperscript{23} Gat interview.
In the management’s view, the labour agreements at Rafael perpetuated the organisation’s public-sector characteristics and considerably restricted its powers.24 It could not adjust its payroll and workforce to its financial condition. Moreover, the management could not dismiss workers without the permission of the relevant employee unions or the approval of the Service Committee of the Civil Service Commission (which was authorised to override the unions’ objection). The workers, on the other hand, were allowed to challenge any decision regarding their status or terms of employment – including decisions by the Commission – through Labour Courts; also, they could legally protest by means of temporary work sanctions, picketing and strikes, provided the Histadrut backed these actions.

This state of affairs affected both Rafael’s competitiveness and its profitability. The cost of Rafael’s average salary and social benefits package exceeded that of similar companies in the private sector, and between 1987 and 1992 Rafael’s average hourly cost had been 14% higher than that in similar firms.25 Its overall costs were estimated to be 30% higher than its competitors’, in part owing to the 40% pay rise granted in 1992–1993 to academic staff in the higher education system, to which Rafael research staff pay was linked.26

Such organisational rigidity led to hidden unemployment and low productivity, even when judged by the MoD’s lenient standards. Between 1989 and 1991 there were between 300 and 400 excess workers, in 1992 at least 230, and in 1993 Rafael estimated that there were around 380 surplus workers on its payroll. Maintaining these workers cost on average 113 million shekels in each of these years.

24 Sarbero and Gat interviews.
26 Ibid.; Sarbero interview.
years. The combined effect of the pay rise to research staff and the hidden unemployment, the management claimed, was that the total cost of salaries stayed at the same level between 1989 and 1993, although the number of employees fell by 20%. In other words, the salaries of the remaining workforce grew by 23%, in real terms, over a period of four years (see Figure 6.3).

**Figure 6.3**

<table>
<thead>
<tr>
<th>Year</th>
<th>Sales (in mil.)</th>
<th>Salary Cost (in mil.)</th>
<th>Employment (in thousands)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989</td>
<td>6,120</td>
<td></td>
<td>6,500</td>
</tr>
<tr>
<td>1990</td>
<td>5,763</td>
<td></td>
<td>6,000</td>
</tr>
<tr>
<td>1991</td>
<td>5,673</td>
<td></td>
<td>5,763</td>
</tr>
<tr>
<td>1992</td>
<td>5,349</td>
<td></td>
<td>5,500</td>
</tr>
<tr>
<td>1993</td>
<td>5,072</td>
<td></td>
<td>5,000</td>
</tr>
</tbody>
</table>

**Sources:** State Comptroller, Rafael.

**Note:** Rafael's workforce was reduced by 1,000 employees (about 20%) between 1989 and 1993, yet its salary cost stayed the same throughout this period. Figures are in constant 1993 prices.

Gat's explanation of why this organisational structure prevailed for so long – despite the changes in Rafael's activities – was inertia: 'The workers have always perceived Rafael as the “national laboratory or national weapons systems house”, a perception underpinned by Rafael’s historic assignment and background.' This deeply embedded philosophy 'prevented the development of the business orientation and

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28 Ibid., p. 853.
29 Ministry of Finance – Budget Department, Reorganisation of the State-owned Defence Industry.
internalisation of business practices which were more appropriate and compatible to
the competitive business environment in which Rafael had been operating in recent
years. In addition, Rafael’s labour structure and agreements, ‘befitted government
offices and universities, not business organisations’.30

According to Gat, the only feasible way to recover was to transform Rafael
into a business entity whose shares would be owned by the state. The secret non-
commercial production lines (also known as ‘the national laboratory’) would be
managed by the new company but funded by the state through the MoD. This
configuration, Gat said, was based in part on the recommendations of an internal MoD
committee, which examined Rafael’s structure in 1989.31

The proposed plan was designed to provide Rafael with a flexible structure
and a salary mechanism that promised reduced labour costs. The workers would be
transferred to the new entity; their salaries would be performance-related and free
from any link to collective agreements in the public sector. (This proposal was based
on lessons learned from the crises in IMI and IAI, which had been exacerbated by
expensive and rigid collective labour agreements inherited from their pre-
incorporation days.32) The state was to allocate funding sufficient to cover the costs of
the transition and those of early retirement and compensation for redundant workers,
estimated at 1 billion shekels (the plan concluded that a further 1,000–1,500 workers
needed to be made redundant in the immediate future).33 The main challenge
remained convincing the employees to accept Gat’s proposal, but the chances of that

31 Gat interview.
32 Sarbero interview.
33 State Comptroller Annual Report no. 45, p. 859.
were slim: for the employees, staying within the MoD meant job security and permanent salaries, which could not have been guaranteed outside the public sector.34

**Government Reaction**

Rabin agreed to the plan in principle, but decided in July 1993 to postpone its implementation: ‘I accept the general approach as presented. But, as there are already impending decisions concerning the [other] state-owned defence firms, and in order to avoid immediate confrontations, we need to ponder carefully the right timing of implementing this plan in its entirety,’ he said.35 Rabin then instructed the MoD and Rafael to present him with the financial implications of starting the plan either by the beginning of 1994 or later that year.

This deferment – which increased Rafael’s losses by at least 108 million shekels, according to its management36 – was consistent with Rabin’s initial decision to deal with Rafael after concluding the crises in IMI and IAI (in 1992 and 1993, respectively). According to Gat, Rabin told him that he preferred to address the problems of these two companies first and ‘to leave the issue of Rafael to last’.37

Other factors were also at work, such as the regional effects of mass redundancies in Rafael’s plants, which were located in northern Israel and employed hundreds of sub-contract employees in adjacent companies (see Figure 6.5).38 In an earlier Knesset discussion, Deputy Defence Minister Mordechay Gur had remarked that ‘the Prime Minister delved into the minute details of every project in each of the

34 Sarbero interview.
36 Ibid.
37 Gat interview.
[state-owned] defence industries to ascertain exactly which of these projects was essential to the national security and what would be the economic and social implications [in case of their termination], as a significant part of these enterprises is located in developing areas where unemployment rate is much higher than average.\footnote{Records of the Knesset, Motions for the Knesset’s Agenda, session 17, vol. 1, 28 October 1992, p. 93.}

Indeed, according to official statistics, the unemployment rate in the Haifa district was consistently higher, by as much as 38%, than the average national unemployment rate (see Figure 6.4). It peaked in 1992 at 15.5%, compared to the national average of 11.2%; in 1993 the figures were 12% and 10%, respectively.\footnote{Bank of Israel, Annual Report for 1994 (Jerusalem: Bank of Israel, 1995), p. 189.}

\textbf{Figure 6.4}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{unemployment_rate_northern_districts_vs_national}
\caption{Unemployment rate: Northern districts vs. national}
\end{figure}

\textbf{Sources:} Central Bureau of Statistics, Bank of Israel
Figure 6.5: Location of Rafael's plants

Legend:

Factory(s) in a developing area
Subsidiary(s)
Unit(s)
Headquarters and main complex of factories
Weapon Test and Evaluation Centre
Rabin was reluctant to initiate mass redundancies for another reason. According to his head of bureau, Eitan Haber, 'whenever possible, Rabin preferred to postpone tough decisions as much as he could, especially those which might have led to mass redundancies. He considered the families of those affected.'

The Defence and Finance Ministries’ bureaucracies welcomed Rabin’s support for Rafael’s restructuring, but closer examination revealed internal frictions over the proposed plan, especially within the MoD. The MoD R&D Directorate was concerned that, in its new form as a profit-driven business entity, Rafael might be tempted to abolish or cut sensitive research activities for the sake of a better balance sheet. On the other hand, the MoD’s economic adviser Imri Tov – who had headed the inter-ministerial committee on Rafael, whose 1992 recommendation of incorporation Rabin had shelved – said that Gat’s proposal was ultimately the preferred solution, notwithstanding the organisational shock such move might have entailed, because ‘Rafael’s burden on the MoD’s budget became simply intolerable’. For him, leaving Rafael within the MoD meant that it would siphon off essential resources from the defence budget whenever a financial crisis loomed.

Finance Ministry officials who belonged to the Budget Department had different concerns. Feeling that over-zealous government commitment to Rafael’s transition programme would set an expensive precedent for incorporation or privatisation of other state-funded organisations, they secretly agreed to delay the plan’s implementation as long as possible, in the hope that a future breakthrough with

41 Haber interview.
42 Author’s interview with Maj.-General Itzik Ben-Israel (Head of R&D Directorate, MoD 1997–2002), 15 March 1998 (hereafter: Ben-Israel interview).
43 Tov interview, 1997.
Rafael’s workers would reduce the transition’s final costs. They also believed that, in the interim, Rafael’s increasing losses would force the MoD (which, until the plan’s completion, was legally required to fund Rafael in full) to cut unnecessary operations and expenses and manage its budget more efficiently. Their chosen delaying tactic was to raise reservations and objections to different clauses during the anticipated negotiations with the MoD and Rafael’s employees. For as long as the process was delayed, the Ministry would not have to make provisions or appropriations for Rafael’s transition, thus keeping the state budget and public expenditure within the target range.

The Unions’ Challenge: Lobbying and Legal Action

Rafael’s unions objected to any attempt to make organisational changes, and in October 1993 they were alarmed to learn that the Ministries of Defence and Finance had appointed a steering committee to oversee teams examining and outlining the requirements for Rafael’s incorporation. In response, they orchestrated a concentrated campaign that targeted members of the Knesset (especially members of the inner political cabinet of the Labour party, the ‘Our Ministers’ forum), past and present Defence Ministers, MoD and state comptroller officials and journalists.

44 Tov interview, 1997; Flato interview; Horev interview.
46 Haaretz, 3 October 1999; Sarbero interview.
49 See Rafael unions’ letter and enclosures to the State Comptroller Miriam Ben-Porat, Prime Minister Yitzhak Rabin and three Members of Knesset, dated 11 November 1993, asking for the appointment
Members of Knesset – especially those from northern districts, where most Rafael workers were based (one of these, Yossi Katz, was the legal adviser to the Histadrut in the Haifa district and known for his pro-union stance50) – were urged to table questions to the Cabinet, while journalists, particularly military and labour affairs correspondents, were invited for briefings.51

At the same time, the unions’ legal advisers devised their legal strategy and subpoenaed the MoD, Rafael’s management and the Civil Service Commission to court hearings. (The workers were entitled to dispute restructuring and dismissal decisions in Labour Courts.) Over the next seven months, they appealed five times against different administrative and managerial decisions taken by Rafael management, winning several injunctions in the process.52 The aim of these actions was to further a counter-narrative of the background to the Rafael crisis aimed at refuting the management’s claims that Rafael needed to be transformed into an independent, business-oriented entity. The United Struggle Headquarters, an umbrella forum consisting of representatives from all five of Rafael’s worker unions, claimed that the blame for the organisation’s poor condition lay solely with the government, the MoD and Rafael’s management. In letters to politicians and state officials, they detailed a catalogue of mistakes and obscure decisions, errors of judgement and
careless assumptions that had contributed in their mind to the organisation's financial downfall over the years.

Their main arguments were summarised in a pamphlet, *Rafael's Incorporation Endangers the National Security*, circulated in March 1994.\(^{53}\) The writers warned against measuring and treating Rafael as a business, and flatly rejected the idea of turning it into a state-owned company 'in preparation for its future privatisation'. The planned reorganisation of the firm, they claimed, was decided on the basis of recommendations by a private consultancy, 'which examined Rafael's business potential while ignoring its contribution to national security'.\(^{54}\)

The writers went on to stress the contribution of the military scientific research to Israel's deterrence, which was now being threatened because 'the MoD and the Finance Ministry are laying the foundations for privatising the government-owned defence firms by turning public opinion against them'. They claimed that both Ministries 'were making scathing remarks against Rafael, which is a state-funded unit, and its workers, who are government employees. They present them as bunch of parasites that work at the taxpayer's expense in an unworthy organisation that fails to meet business expectations. ... We, Rafael workers, view the recent years' events as a damaging blow to the organisation's future and as a serious mistake, which puts Israel’s security at risk in the years to come'.\(^{55}\)

In briefings with journalists, the unions stepped up their rhetoric by pointing specifically to three issues that, according to official documents and management

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\(^{54}\) Ibid., p. 2.

\(^{55}\) Ibid., p. 3.
reports, had exacerbated Rafael's problems no end. First, the building of a new production and testing complex in northern Galilee – a project initiated to give Rafael further industrial space and to help in mobilising Jewish population into that region, but one that had cost Rafael dearly, due to management miscalculations and also because it was approved in 1983, before the organisation's worsening condition was fully known. Secondly, the IDF's frequent objections to Rafael's export licenses meant that only 20% of its requests were approved. Third, the growing dependence on American-made weaponry – the IDF received most of its weapons from the US, a preference openly endorsed by Rabin and previous defence ministers – deprived Rafael of its most important client and sales promoter. It was forced to rely on foreign customers to ensure sufficient revenue, but this also exposed it to the cyclical nature of the arms export market and to fluctuations in the official rate of exchange which affected its profitability.

56 Haaretz, 10 May 1994.
57 Yedioth Ahronoth, 24 September 1995; Zeev Bonen, Rafael, pp. 152–153. The project in Northern Galilee was at a centre of a scathing State Comptroller report that pointed to flawed decision-making and cost-assessment processes; see State Comptroller Annual Report no. 40, pp. 891–900.
58 When Rafael's previous Director General, Moshe Peled, took office in 1987, he was surprised to discover that the organisation had not hitherto produced a balance sheet. A few days later he discovered that Rafael had a $50-million deficit, contrary to previous reports submitted to the MoD and Peled himself; see Hadashot, 1 May 1992. Furthermore, Rafael started repaying the state-guaranteed loan that funded the construction of the complex in the northern Galilee in 1989 – the year in which it also posted a loss of 129 million shekels. See State Comptroller Annual Report no. 45, p. 858.
59 Interview with Moshe Peled, Rafael's Director General in Hadashot, 1 May 1992.
60 Arens interview.
Government Decisions

In January 1994, having now concluded the major adjustment plans for IMI and IAI, Rabin seconded Gat's recommendation for an interim work plan for Rafael (for six months only) and the immediate dismissal of 250 workers. He also instructed Gat to complete a comprehensive transition plan; if approved by the Cabinet, Rabin said, this would be implemented in the second half of 1994. Rabin also emphasised: 'Rafael is in a difficult and unsustainable condition, and we should do everything possible in order to execute a recovery plan as soon as possible.'\(^{61}\) Shortly afterwards, in April 1994, Gat met the Civil Service Commissioner, Prof. Yitzhak Galnoor, and presented his plan and potential difficulties. The Commissioner was persuaded that Rafael's deteriorating situation called for a thorough reorganisation, including a limited number of redundancies.\(^{62}\) This view was also endorsed by the Regional Labour Court in Haifa, which ruled on 25 April 1994 that the incorporation plan was lawful (and also rejected the Rafael unions' other four petitions to overrule administrative decisions by the management).\(^{63}\) Rafael's unions, in response, announced that they would initiate immediate steps to prevent the management from implementing its plans, calling all the workers to refrain from cooperating with it.\(^{64}\)

Rafael's management, meanwhile, sought ways to reduce its labour costs, which by that point reached more than 60% of its revenues.\(^{65}\) In discreet discussions with the MoF, Gat asked that Rafael should be exempt from further pay rises in the forthcoming Public Sector Wage Agreement for the years 1993 to 1996, which at the

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\(^{62}\) Galnoor, No, Mr Commissioner, p. 168.

\(^{63}\) Haifa District Labour Court, Case No. 4/15, 25 April 1994, pp. 45–46.

\(^{64}\) Circular by the Rafael Workers' Unions, 25 April 1994.

\(^{65}\) State Comptroller Annual Report no. 45, p. 853.
time was being negotiated by the MoF’s Director of the Wage and Labour Accord Unit, Shalom Granit, and the Secretary General of the Histadrut, Haim Haberfeld. Granit promised Gat that, although Rafael was a government department and therefore bound by all public-sector agreements, the MoF would ensure that the new agreement would not apply to it. Granit was confident that the Histadrut would agree to such a request, given Rafael’s financial state and a precedent that had excluded Rafael from a similar agreement in 1988.66

The Histadrut’s Secretary General, however, refused. Haberfeld told Finance Minister Shochat and Granit that he lacked the powers and influence he had had some years earlier, and that any attempt to keep Rafael out of this agreement would bring the entire economy to an immediate halt. ‘Rafael workers are state employees, and the entire public sector would strike at once if they are to be excluded,’ he said. ‘Would the Cabinet be able to withstand such a protest?’67 Haberfeld, who was fighting for his political life at the time – elections to the Histadrut Convention were to be held just few weeks later, on 10 May 1994 – was adamant. Finance Minister Shochat reluctantly backed down and agreed to include Rafael in the Wage Agreement, which granted a 19.2% pay rise to various sectors,68 despite its growing losses. The stakes were just too high: not only was he risking a head-on confrontation with 700,000 public-sector workers at a crucial time, he might also have caused irreparable damage to the campaign of Haberfeld, who represented Labour (Shochat’s party) in the Histadrut. (Haberfeld subsequently lost the elections to a faction led by former Labour Party politicians, Haim Ramon and Amir Peretz.)

67 Ibid.
The Prime Minister Office deferred further Cabinet discussion on the future of Rafael until after the elections to the Histadrut, scheduling it for 25 May 1994. Before then, the Defence and Finance ministries reviewed the proposed structure for Rafael and other some alternative scenarios. The Rafael unions, meanwhile, prepared to hold a demonstration outside the Prime Minister Office on the same day.

At its 25 May meeting the Cabinet heard briefings on Rafael’s difficulties, in line with the management and MoD arguments. It learned that Rafael’s cash-flow deficit would reach 1 billion shekels by 1998, and this would have to be covered by the defence budget. ‘In light of this situation, Rafael should cease operating as a budgeted unit within the MoD – the need for its incorporation is self-evident,’ the MoD, MoF and Rafael representatives concluded. The proposed solution was to turn Rafael into a government-owned company handling both secret and commercial activities, as per Gat’s proposal; this would lead to the reduction of the workforce by 1,200 employees and cost an estimated 2.6 billion shekels.

The Cabinet decided unanimously to:

- start initial steps towards transforming Rafael into a government-owned company, which would combine business operations and state-funded activities. [Rafael’s incorporation] is to be decided by the Cabinet at a later stage … based on a proposal of the Defence and Finance Ministers.

It instructed the Ministries to finish their preparatory work and forward a draft proposal on Rafael’s incorporation. It also authorised Rafael management to enter negotiations with its workers and the Histadrut in order to reach a flexible labour agreement, which would include performance-related incentives and a new

69 Quoted in State Comptroller Annual Report no. 45, p. 861.
70 Haaretz, 1 August 1995.
71 Cabinet secretariat, Cabinet decision no. 3178: a preparation for the incorporation of Rafael, 25 May 1994, article 1.
remuneration scale. These negotiations were unsuccessful, as the workers made it clear from the outset that they would actively oppose any attempt to incorporate Rafael. This attitude was soon manifested in a highly confrontational strategy: the unions hindered day-to-day work in various parts of the organisation, held picket lines near the management building and harshly criticised Gat in leaflets and posters that were delivered near his home; they also initiated threatening calls to his office.

At the same time, the workers’ unions appealed at the National Labour Court against the earlier decision of the Haifa District Labour Court, which allowed the management to continue its restructuring process, and sought a judicial review of the Cabinet decision at the High Court of Justice; both attempts were unsuccessful. The management, in the meantime, continued its internal restructuring programme and started the formal redundancy process for 250 tenured workers.

Despite deteriorating labour relations at Rafael – which was to be expected, judging by the militant, violent attitude of the unions in previous disputes – the Prime Minister offered Gat his full backing. Indeed, the few contacts between Rabin and workers’ representatives that did take place in 1994 were acrimonious. Rabin had long argued that Rafael had become a financial burden that robbed the IDF of

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73 Press release by the joint forum of Rafael’s workers unions, 25 May 1994.
74 Circular by Rafael workers’ unions, 14 July 1994.
75 Internal memo of the Rafael workers’ protest forum, 21 July 1994.
76 Circular by Rafael workers’ unions, 10 July 1994.
77 Globes, 29 September 1994.
79 Bonen interview; Trop interview 2001. In 1986 union representatives’ destroyed the office of the Director General in protest over a delay in payment of salaries. See Bonen, Rafael, p. 45.
essential resources,\textsuperscript{80} and he wholeheartedly supported the plan to incorporate it and cut its size.\textsuperscript{81} Whenever Gat approached him to support a step related to the restructuring process – the two met regularly, at least once a month, for in-depth discussions\textsuperscript{82} – Rabin vented his anger at the workers’ unions’ obstructiveness.\textsuperscript{83} Nevertheless, he insisted on meeting the workers personally, especially during the most hostile clashes, because he wanted ‘to look them in the eye’ and ‘challenge their grievances directly’, according to a senior aide.\textsuperscript{84} That said, Gat was careful not to permit direct, non-brokered meetings between the workers’ representatives and the Prime Minister and insisted on being present at all times.\textsuperscript{85}

\textbf{In Search of Winning Strategies}

While it had long been clear that the Prime Minister had aligned himself with the Rafael management, the workers’ representatives received strong support from the Histadrut. The new chairman of the Trade Unions division, Amir Peretz, promised a more determined approach to guarding workers’ rights than his predecessor’s.\textsuperscript{86} At a meeting with Gat and other Rafael and MoD representatives in August 1994 he strongly criticised the management ‘for rushing to dismiss 250 employees through the

\textsuperscript{80} Rabin was highly critical of Rafael unions and the organisation itself, which he described as a ‘paradise of waste’ in which ‘money flows like there is no tomorrow’. During a meeting in 1991 he charged that, because of earlier financial commitments to Rafael, the IDF was forced to cut down its military units. See \textit{Davar}, 15 July 1991. A year later, after he became Prime Minister and Defence Minister, Rabin repeated the last claim in a radio broadcast. See \textit{Haaretz}, 24 September 1992.


\textsuperscript{82} Sarbero interview.

\textsuperscript{83} Gat interview.

\textsuperscript{84} Haber interview.

\textsuperscript{85} Gat interview.

\textsuperscript{86} \textit{Haaretz}, 19 July 1994.

314
Civil Service Commission' rather than negotiating their departure with the unions.87 His discussion with Gat, during which the Director General complained about the behaviour of Rafael's unions and the damage they caused, revealed deep divisions between the two. Whereas Gat insisted that 'the ultimate responsibility for Rafael' rested on him, Peretz countered that he and the Histadrut also had a say in the fate of enterprise. Peretz asked for more time to study the situation – it was the first major labour dispute he had to handle since his appointment – and requested Gat to refrain from unilateral actions in the meantime. The Director General refused, insisting on a set deadline and asserting that he would go ahead and force the redundancies on the unions through the Commission, with or without the Histadrut's consent.88

Also in August 1994, senior MoF officials convened to discuss the Cabinet's decision and the ways to take it forward. The Deputy Director of the Budget Department presented a proposal, never devised or implemented in Israel before,89 that was secretly discussed at the time with the Rafael management. The core of the plan, which Gat labelled 'the Closure–Opening model', involved legally closing Rafael as a fully budgeted unit in the Ministry of Defence and reopening it as a government-owned company with a special pension and salary scheme, which would replace the existing pay scales. This plan, in essence, aimed at easing the concerns of the workers while freeing Rafael, in its company format, from all debt that stemmed from its historic past as a MoD unit, a direct lesson from the IMI incorporation plan.90

87 Handwritten protocol of a meeting between the chairman of the Trade Union Division at the Histadrut, Rafael Director General and the workers' unions, 4 August 1994.
88 Ibid.
89 Haaretz, 5 November 1996.
90 Sarbero interview; Author's interview with (Deputy Director of Wage and Labour Accord Unit, Ministry of Finance 1993–1994; Chief of Staff, Finance Minister Office, 1995; Director of Wage and
The participants, who included the MoF Director General and the Civil Service Commissioner, expressed interest. They agreed to explore the model further with the MoD and Rafael’s management and to present it to the Histadrut and the employees only after reaching a common position.91 A consensus on this matter was necessary as senior officials, including the Director of the Wage and Labour Accord Unit, Shalom Granit, strongly objected to the model, claiming that it would lead to unacceptable financial demands across the public sector in the event of future restructuring in other government units.92

In the interim, the MoD and MoF discussed the guidelines and the practical issues concerning the creation of a new government company. Rafael’s management insisted that the structure of the proposed company should avoid, as far as possible, the managerial and financial pitfalls that had blighted sister companies IAI and IMI, as revealed during their recent crises. In particular, Rafael management was wary of a prohibitive collective agreement, like IAI’s, which prevented the management from executing redundancies without the consent of the unions, and of undue ‘sweeteners’ in the form of pay rises to employees in exchange for their consenting to join a government company, as had happened with IMI’s botched incorporation of 1990.93

To that end, joint teams from Rafael and the two ministries prepared a thorough audit of Rafael’s structure, assets and business performance, and a detailed examination of the new company’s present and future financial liabilities. Rafael management also insisted – another lesson from IMI’s flawed incorporation – on being provided with

91 Galnoor, No, Mr Commissioner, p. 172
93 Sarbero interview.
sufficient equity capital without any financial burden stemming from the firm’s pre-incorporation past. At the same time, it negotiated a detailed agreement for the voluntary retirement of 120 tenured workers, which the Histadrut was inclined to support; however, representatives of the research staff union raised last-minute objections to the deal.

The unions, meanwhile, discussed a new strategy for challenging Rabin’s leadership through the Labour party’s primaries. In a bid to put a stop to the incorporation plan, and taking account of recommendations from political consultants and media experts, in October 1994 the unions drafted a series of leaflets and circulars that called for a mass enrolment of Rafael’s employees and their families to the Labour party, ahead of its primaries. Such step, they noted, was indeed extreme and extraordinary, as ‘Rafael has striven, since its inception, to keep itself outside the filth of the Israeli political system. … [However] we must now act inside it for the sake of saving our Rafael’. Likening Rafael to ‘a precious diamond-studded gold watch which fell into the gutter’, the unions claimed that they ‘were left with no other choice but to enter inside, in order to save and clean it’. In another circular, the unions admitted that all their indirect efforts – briefings with the media, lobbying politicians and demonstrations – had hitherto been in vain. ‘Because the Cabinet decision [of 25 May 1994] was political, fighting it requires political means. We therefore would like to exert influence through direct political pressure’.

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94 Ibid.; see also, in this context, comments by the Acting President of IMI in a session of the Knesset’s Labour and Welfare Affairs Committee, 7 June 2005 (www.knesset.gov.il, accessed 6 December 2005)
95 Letter from the Chairman of the Histadrut in the Haifa district to the Histadrut’s Chairman of the Trade Union Division, headed ‘Voluntary retirement agreement in Rafael’, 10 August 1994.
96 Circular by Rafael unions, 1 October 1994.
97 Circular by Rafael unions [undated].
The unions hoped that, by installing a power base of 15,000 members or more within the ruling party, they would be able to mobilise sufficient votes against the nomination of Rabin as the Labour candidate for prime minister at the next elections. They also promised to actively promote the nomination of any candidate who would agree to include in the party’s manifesto a proposal for a new Basic Law which, like the ‘Basic Law: IDF’ would ensure that Rafael was recognised as unique institution and kept as the national weapons laboratory of Israel.98

The unions launched their recruitment campaign through a proxy organisation called ‘Citizens for Rafael,’ circulating membership application forms for the Labour party to all Rafael workers, pensioners and family members.99 The timing of the campaign’s launch – 1 November 1994 – was chosen to ensure maximum exposure in the media and local press ahead of a Cabinet discussion on Rafael, which was to take place few days later.

While their political campaign was taking shape, the unions continued to apply pressure on both the MoD and Rafael management. They disrupted the normal course of work across Rafael with the full backing of the Histadrut,100 and filed a complaint with the police, asking for Gat to be investigated on suspicion of bribery and corruption.101 The complaint was prominently covered in the local press.102

98 Circular by Rafael unions, 1 October 1994.
100 Letter by the Chairman of the Histadrut in the Haifa district to Rafael’s Director General, headed ‘Work disruptions in Rafael’, 2 October 1994.
101 Letter from Rafael unions’ lawyer to the Israel Police Commissioner and the Head of Investigations and Crime Fighting Department, headed ‘Complaint against Rafael’s Director General’, 26 September 1994.
102 See ‘Rafael’s unions filed a complaint with the Police Commissioner: the management allegedly conspired to accept bribes’, Arei Hamifratz (a Haifa regional paper, part of Yedioth Ahronoth), 30 September 1994, p. 1.
prompting a Member of Knesset to table a parliamentary question to Rabin on the matter\(^{103}\) (the police dismissed it for lack of evidence\(^{104}\)). At the same time, they approached the MoD Director General, David Ivry, and asked him to stop the incorporation plan, or at least to convey their concerns to the Prime Minister and Cabinet ministers. He agreed to pass on their message to Rabin but refused to back down on the plan. A few days before the Cabinet meeting, Ivry informed them that the MoD ‘will continue the [incorporation] process while giving the utmost respect to [the rulings of] the High Court of Justice and to the workers, and with the full understanding that, while the latter would like to stall the process, we have no choice but to press ahead due to Rafael’s situation’\(^{105}\).

As soon as the MoD and the MoF concluded their internal discussions, Cabinet convened on 6 November 1994 to chart the terms under which Rafael was to be incorporated. Based on a joint proposal drafted by the two Ministries, it decided that:

Rafael will become a company, wholly owned by the government. ... In the light of financial indicators presented to us, it cannot continue operating as a unit in the Defence Ministry. The company, Rafael Ltd., will combine commercial activity with funded activity of national defence infrastructure. While transferring to the company, the workers are to retain their previous entitlements accumulated during their service as state employees in Rafael.\(^{106}\)

The parties to the negotiations – management and workers – were urged to bridge their differences, with the proviso that:

\(^{103}\) Haaretz, 10 November 1994.
\(^{104}\) Letter from the Investigations and Prosecutions Branch of the Israel Police to the lawyer of Rafael’s unions, 15 November 1994.
\(^{105}\) Letter from the MoD Director General to Rafael’s Director General, headed ‘The letter from Rafael’s workers unions of 27 October 1994’, 1 November 1994.
\(^{106}\) MoD Press release of Cabinet decision, 6 November 1994.
If the agreements pertinent to this decision are not signed within six months, or within any other timeframe set by the Defence and Finance Ministers, all Rafael’s activities will be shut down for economic reasons, apart from those activities that belong to the 'national infrastructure and technological research centres'.

The Cabinet’s decision was carefully worded. By stressing the importance of a negotiated settlement and emphasising that workers’ rights were to be preserved throughout the transition process, it acknowledged their contribution to the nation’s security and showed that the government was acting as a responsible employer. (This also addressed a scenario much feared by security chiefs: if a decision was forced upon them, frustrated workers holding high security clearance might, in desperation, decide to sabotage operations – note the case of Mordechay Vanunu, who revealed Israel’s nuclear secrets, shortly after he was made redundant.) The Cabinet also agreed to allocate an additional $55 million a year to fund specific R&D projects handled by Rafael; this was to ease concerns in the MoD’s R&D directorate, that some programmes might be adversely affected by a profit-driven approach (even though the directorate remained unconvinced that this would solve the problem).

At the same time, the Cabinet made it clear that Rafael’s current structure was obsolete, costly and unacceptably burdensome to the entire MoD budget. And it put psychological pressure on the workers by laying down a firm timetable for change, coupled with an explicit threat of closure (though giving itself some leeway by stipulating that the deadline was not confirmed and could be extended at the Defence and Finance Ministers’ discretion).

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107 Cabinet decision of 6 November 1994, quoted in State Comptroller Annual Report no. 45, p. 862; see also a final draft proposal for the Cabinet decision on Rafael, circulated by the MoD’s general counsel, 18 October.


109 Ben-Israel interview.
Implementation: Protests and Litigation

Immediately after the Cabinet’s decision, the Rafael management, with the backing of the Defence and Finance Ministries, invited the Rafael union representatives and the Histadrut for detailed negotiations on the labour and wage agreements of the new company. Rafael’s unions, however, refused to cooperate. Some union activists, who belonged to Rafael’s research staff, formed a policy team that sought ways to block the proposed incorporation. Other unions held emergency meetings at which they expressed their utter objection to the plan. Their anger reached a peak on 24 November 1994, after a general gathering of union activists, when dozens of disgruntled workers stormed the management building, smashing and breaking walls, intercom and telephone systems and flooding the building’s floors with water. The police were called in and several complaints were lodged by the MoD. Rafael management expressed its shock and disgust in an open letter to the workers in which it detailed the day’s events – the third violent outburst of this kind in as many months – and promised to bring all the perpetrators to justice. The Histadrut, meanwhile, endorsed the workers’ position and declared a collective labour dispute in Rafael: a call which allowed the workers to intensify their protest in accordance with existing laws. The regional labour council of Haifa also expressed solidarity with their stand and offered assistance.

As the situation in Rafael continued escalating, Prime Minister Rabin ordered a review of the MoD’s relationship with Rafael with a view to separating the two.

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10 Letter from Rafael’s Director General to the Chairman of the Histadrut in the Haifa district, headed ‘The Cabinet’s decision on turning Rafael’s into a government-owned company’, 7 November 1994.
11 Open letter by Rafael’s Director General, 4 December 1994.
12 Circulars by Rafael’s Workers’ Unions, 8 December 1994 and 29 January 1995.
13 Ibid.
Following the earlier unsuccessful attempt to unlink Rafael from the public sector, Rabin decided to explore another possibility: a government-sponsored bill separating Rafael from the MoD, and turning it into a company. Justice Minister David Libai rejected the idea, explaining that the Cabinet was not permitted to propose or endorse a law which ran contrary to a signed agreement between the State and its employees. Rabin discreetly turned to the Chairman of the Knesset’s Finance Committee, the Labour MK Gdalia Gal, who agreed to initiate a private bill on this matter – and by so doing to circumvent the Justice Ministry’s objection.114

Rabin’s request came at a time when the Finance Committee discussed the proposed incorporation of Rafael. (In accordance with the Government Companies Law, the Committee was required to approve the inclusion and maintenance of non-commercial activities in Rafael, once it became a company.115) The understanding between Gal and Rabin remained unknown to the other committee members, who in the meantime became embroiled in a heated debate on the pros and cons of the new company’s structure, fuelled by the contradictory arguments the management and unions’ representatives presented to them. So when Gal suggested deferring the decision on this matter for few months, and in the meantime continuing to assess the situation, they willingly obliged.116

Against this backdrop, and while the labour relations at Rafael remained tense, Gat summoned the unions and the Histadrut representatives in March 1995 for a discussion on his proposed Closure–Opening plan. He explained that all workers would be made redundant and leave on early retirement, paid or underwritten by the

114 Interview with Ilan Flato in Yedioth Ahronoth, 10 November 1995.
116 Globes, 14 February 1995.

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State, and would then be rehired by Rafael the company, which would then pay them a progressive salary without special benefits or a linkage to the public sector, similar to the pay in other hi-tech companies;\textsuperscript{117} not all the workers would be invited back -- only those required by the management -- and in any event they would be represented by a single Committee, and not five as before.\textsuperscript{118} While accepting that 'the proposed model is unconventional' and might therefore cause concern, Gat stressed that 'it would be based on negotiated agreement and acceptance by all parties concerned,' and therefore the management would not attempt to impose it on the unions.\textsuperscript{119} He also promised to refrain from unilateral actions. The unions, however, were not convinced: 'We would not enter into any negotiations ... until the issues concerning retirement and pension matters are solved ... judging by our past experiences with the management, we could no longer count on its promises and therefore have taken all the necessary precautions, both legally and organisationally, to deal with any eventuality.'\textsuperscript{120} In a later circular they threatened to 'bring Rafael down', and to 'conduct a repeat of the Masada episode' should the management continue with its plan.\textsuperscript{121} The Histadrut, too, dismissed what it branded as a 'one-sided' proposal and

\textsuperscript{117} Details of the proposed model were included in \textit{Letter to Rafael Employees from the Director General's Office}, 15 January 1996.
\textsuperscript{118} See table comparing the current and proposed new structure of Rafael, prepared by the management (undated); \textit{Haaretz}, 5 November 1996 and 1 December 2000.
\textsuperscript{119} Letter from Rafael's Deputy Director General for Human Resources to the Chairman of the Histadrut in the Haifa district, headed 'The retirement-recruitment model' [the initial name of the model, later changed to Closure-Opening model], 20 March 1995.
\textsuperscript{120} Rafael's Unions' circular to the Rafael workers, 21 March 1995.
\textsuperscript{121} Rafael's Unions' circular to Rafael workers, 3 April 1995.
demanded that ‘any future plan regarding Rafael should not be accepted without the consent of the unions and the Histadrut’. 122

The workers’ unequivocal rejection of the plan prompted the management and government bureaucracy to consider their next moves. However, it was soon apparent that they were struggling to forge a common position. Senior officials were divided on how best to handle Rafael’s transition, and they could not even agree on a single estimate of the costs involved: the gap between the Finance Ministry’s figure and that of Rafael’s management was more than one billion dollars.123

In March 1995, therefore, when Prime Minister Rabin met Finance Minister Shochat and senior officials from the MoD and the MoF to discuss the crisis in Rafael, he was confronted with a wide array of views. Whereas the MoF and Rafael management advocated the Closure–Opening model, MoD Director General Ivry expressed his utter objection to the idea, labelling it ‘a fiction’ that would not withstand any legal challenge; worse still, he claimed, the government might be accused of acting in bad faith (as such model might be viewed as a unilateral departure from previous conventions and understandings with state employees). He also held the MoF responsible for exacerbating Rafael’s losses, due to the May 1994 Public Sector Wage Agreement, which forced the MoD to increase its employees’ salaries – an increase he found totally unwarranted.124 Rafael’s Director General disputed Ivry’s reservations on the proposed model and suggested that for the time being, the MoD should take a drastic step – shutting Rafael down for few months (another proposal to which Ivry strongly objected) – so as to convey an unequivocal

122 Letter from the Rafael Affairs Administrator at the Haifa district of the Histadrut to the Prime Minister and the Finance Minister, headed ‘Rafael – negotiation’, 2 April 1995.
123 Galnoor, No, Mr Commissioner, p. 174.
124 Ibid., p. 174; see also Haaretz, 7 January 1996.
message to the workers. He said that some union leaders expressed support for such step, and noted that the workers would cooperate only when they realised that the State was determined to bring the situation to a head. His suggestion therefore was to convene the Civil Service Commission and ask it to issue redundancy letters to 650 state employees. The representatives of the MoF, on the other hand, proposed to implement the Closure–Opening model without delay.

Rabin informed the participants that a proposal to present a bill on Rafael had been dropped, as it was unlikely to pass in the Knesset, and there was no other choice but to find an administrative solution that could stand judicial scrutiny, because ‘none of the Cabinet’s decisions were immune from [being overruled by] the courts’. He therefore rejected a proposal to that the Cabinet should unilaterally announce that Rafael was to become a government company with immediate effect; on the other hand, the Closure–Opening model was an administrative option he wanted to explore further. It soon turned out, though, that it posed some legal and labour dilemmas. Would the new business entity be exempted from past labour agreements signed by Rafael, and therefore free to recruit new employees on lesser terms? What kind of severance packages would apply? Was it lawful and technically feasible to close down a legal entity and superimpose on it a new one that would employ the same labour force?

A legal opinion presented to Rabin at the meeting by the Deputy Legal Adviser to the MoD was inconclusive, pointing to potential weaknesses in the model but not ruling it out completely. Finance Minister Shochat said in response that he did not want to reach a solution ‘with burnt tyres near the gates of Rafael’, and Rabin

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125 Galnoor, *No, Mr Commissioner*, p. 175.
noted that the unions were 'politically savvy' and were striving to slow the process for another year, inching it closer towards the elections (expected to be held in 1996). The Prime Minister closed the meeting, concluding that Rafael’s situation was worsening and could no longer be tolerated – its losses increased from 215 million shekels in 1993 to 287 million shekels in 1994 – and he would therefore not rule out the most drastic measures. He asked the officials for practical suggestions which he would re-examine a month later.\textsuperscript{127}

At the Knesset, meanwhile, a concerted lobbying effort by Rafael’s workers led on 19 June 1995 to the lodging of a Knesset Motion of No Confidence in the Labour government for its handling of the Rafael crisis,\textsuperscript{128} followed by parliamentary questions from right-wing opposition parties which opposed the incorporation process.\textsuperscript{129} The Motion was eventually defeated – by 40 votes to 53\textsuperscript{130} – but from the unions’ point of view it was a successful effort, as they managed to bring their struggle on to the national agenda, enlisting the support of dozens of Knesset Members.

Despite the parliamentarians’ protests, in July 1995 the registration of Rafael as a company came into force, but this was merely a symbolic, nominal act, for Rafael was still being managed and budgeted as a government department. However, the Ministries of Finance and Defence, and especially Rafael’s management, were determined to push this process forward. The negotiations were led by a senior

\textsuperscript{127} Galnoor, \textit{No, Mr Commissioner}, p. 176.
\textsuperscript{128} See ‘Proposal of the Zomet party for a Motion of No Confidence in the Government’s policy on Rafael and the future of the defence industries’, 19 June 1995, (transcript). The former Chief of Staff, Rafael Eitan (Zomet), presented the Motion, which was also seconded by Meir Shitrit MK of Likud.
\textsuperscript{129} See, for example, a parliamentary question by Likud MK Moshe Katzav on ‘Military R&D cuts and redundancies in Rafael’, tabled on 24 July 1995.
\textsuperscript{130} \textit{Haaretz}, 20 June 1995.
Finance Ministry official and Rafael's Director General, who acted under strict instructions from the Finance Minister regarding the cost of the transition plan and the redundancy payments. The actual figure – about $1 billion\textsuperscript{131} – was actually closer to a revised cost estimate of $1.1 billion presented by Rafael management which, was $300 million higher than the MoF Budget Department's calculation.\textsuperscript{132} (However, the MoF made provision for even a costlier transition process at Rafael, putting its total cost at closer to $1.5 billion.\textsuperscript{133}) Yet, while these negotiations were taking place, it was unclear whether, in view of its novelty, the Closure-Opening model would withstand a future legal challenge. The Ministries of Defence and Finance therefore referred the matter to the Attorney General, Michael Ben-Yair, for evaluation and approval. This move was not without risk, however. Gat and the MoF's Budget department viewed this model as an indispensable prerequisite for a successful incorporation; if the Attorney General vetoed it because he found the model unlawful or otherwise indefensible in the courts, then the entire transformation of Rafael could have been thwarted.\textsuperscript{134}

While the government administration weighed its options, Rafael's unions stepped up their public pressure. They arranged press conferences which received wide coverage;\textsuperscript{135} the management countered by giving revealing interviews to the

\textsuperscript{131} Rachlevsky interview; see also Gat interview.
\textsuperscript{132} Galnoor, \textit{No, Mr Commissioner}, p. 180.
\textsuperscript{133} Ministry of Finance – Budget Department, \textit{State Budget 1996 – Main Parts} (Jerusalem: Government Printer, October 1995), p. 77
\textsuperscript{134} Tov interview, 2001; Rachlevsky interview.
local media.136 The workers also extended their lobbying operations by appealing directly to local residents137 and enlisting the support of two mayors who agreed to suspend their municipalities’ work for one day in a show of sympathy with their struggle.138 They were also aided by the Histadrut, which offered legal assistance and orchestrated solidarity strikes in various factories across northern Israel;139 Histadrut spokespersons also briefed the media during the legal proceedings.

Back at Rafael, the unions prepared themselves for a phase of protracted negotiation with the management. They joined forces and organised themselves into a single negotiating team including members of all five unions – putting aside their fractious relations and disagreements – on the assumption that a combined position would strengthen their hand. However, it became clear that this show of unity was cosmetic, and each union was seeking to advance its own interests behind the scenes.140 This was quickly exploited by Gat, who employed a divide-and-rule negotiating style. While negotiating with the main union team, he also secretly met representatives of each sector separately, hoping thus to undermine the bargaining strategy of each sector and to weaken the workers’ united front. Without the

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136 Since his appointment in December 1992, Gat had refused to give press interviews. He agreed to conduct his first interview in May 1995 with Haaretz’s local papers in the Haifa area, See Hed Hakrayot/Esek Mekomi, 16 May 1995.

137 See, for example, the Unions’ circular to the residents of municipalities near Rafael’s main complex in Haifa, 24 May 1995.


140 Rachlevsky interview; for an illustration of the tension between the different workers committees in Rafael, see: letter from the Technical Workers Committee of Rafael to the Director General, headed ‘Letter of Deputy Director General 9 January 1995.
knowledge or consent of the Ministry of Finance, he even offered certain benefits which apparently breached payout guidelines issued by its Wage and Labour Accord Unit and the Budget Department; the MoF therefore refused to endorse an agreement Gat reached with the Histadrut and one of Rafael’s unions, the Technical Workers/Agreement Committee, and suggested an immediate halt to the transition process.\textsuperscript{141} The disclosure of Gat’s tactics in the national press created a credibility crisis among the main participants; some members of Rafael’s management and the other workers’ committees felt betrayed and misled.\textsuperscript{142}

Gat’s firm and uncompromising approach provoked the unions to occasional outbursts of fury towards him – including the demolition of his office, walkouts and sudden suspensions of work.\textsuperscript{143} During 1995 the workers went on strike for a total of 30 days, leading to losses of millions of dollars,\textsuperscript{144} as well as halting the supply of raw material, staging frequent walkouts and preventing temporary employees and subcontractors entering plants – all of which badly affected deliveries to foreign customers and the IDF. They also hired a public-relations firm to give them strategic advice regarding the media (most workers were officially barred from talking to journalists). They distributed leaflets and communiqués and sought to exercise political influence within the Labour party through the 1,500 Rafael workers who joined the party’s northern constituency and promoted their views via Labour members of Knesset, a vociferous lobby that sought to delay the restructuring plan in every legal way possible.\textsuperscript{145}

\textsuperscript{141} Globes, 20 February 1996.
\textsuperscript{142} Haaretz, 20 December 1995.
\textsuperscript{143} Haaretz, 9 January 1994.
\textsuperscript{144} Haaretz, 22 May 1994, 6 June 1995.
\textsuperscript{145} Haaretz, 11 February 1996, 20 February 1996
The workers’ preferred weapon, though, was legal action. Frequent objections about the management’s actions were made to the Civil Service Commission, and requests for injunctions and judicial reviews from regional and national Labour Courts severely delayed Rafael’s incorporation process. The Chief Justice of the Regional Labour Court in Haifa, Doron Meiblum, who presided over many of these hearings, expressed his disapproval of such practices. One of his rulings against Rafael’s unions noted: ‘We [the court] suspect that the workers are deliberately prolonging the legal process. They believe that dragging out the process indefinitely would serve their purposes, but … we think they should have acted more responsibly.’

To add insult to injury, the poor performance of the State Attorney lawyers representing Rafael management exacerbated the sluggishness of court proceedings. In 1995, after protests and appeals from Gat, Rabin authorised the hiring of a leading solicitor specialising in labour laws from the private sector, and thereafter Rafael hardly lost a case. This reinforcement, however, did not discourage the workers’, who insisted on frustrating the management’s restructuring plans through the courts. This strategy proved highly effective, as it kept delaying further attempts at workforce reduction.

The attempt to make 650 of Rafael’s workers redundant was a case in point. Union representatives challenged as unlawful the May 1995 approval by the Service Committee of the Civil Service Commission of Rafael’s decision to dismiss 322 state employees, in addition to 300 workers from the collective-agreement sector. The Commission’s decision came after long deliberations, during which it heard the views of the workers, the Histadrut, Rafael’s management and the Ministry of Finance. It

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146 Haifa District Labour Court, Case No. 41/20, 26 November 1995, pp. 75–76.
147 Gat interview.
also found itself under pressure from the MoF (which lobbied in favour of the
decision), the Haifa mayor (who opposed it) and several Members of Knesset, (who
objected to it as well) just prior to the Commission final discussion on the matter.\textsuperscript{148}

The decision itself was greeted with dismay by Rafael’s unions. They
threatened to initiate industrial action encompassing the two other state-owned
defence firms, while denouncing Rabin in demonstrations and through press briefings,
and warning him of dire consequences to his political career.\textsuperscript{149} In addition, they
attacked the Civil Service Commissioner in the press and staged a protest rally in
front of his office.\textsuperscript{150} The Histadrut’s Trade Union chief was highly critical as well,
promising the Commissioner he would do his utmost to reverse the decision.\textsuperscript{151} After
few days, however, both the MoF and the Histadrut decided to consider a compromise
in which the Commission’s decision would be suspended for a period, during which
the sides would negotiate the terms of departure for the workers and agree on turning
Rafael into a government-owned company.\textsuperscript{152}

At that point, while the MoF and Rafael management were discussing the
severance packages, Rafael’s unions appealed against the Commission’s decision. In
August 1995 the Haifa Labour Court issued a temporary injunction against this move,
ordering Rafael management and the Commission to revisit the decision. A further
discussion took place two months later, in October 1995, and the Commission re-

\textsuperscript{148} Galnoor, \textit{No, Mr Commissioner}, p. 177.
\textsuperscript{149} Ibid., p. 179.
\textsuperscript{150} \textit{Maariv}, 1 June 1995.
\textsuperscript{151} Galnoor, \textit{No, Mr Commissioner}, p. 178.
\textsuperscript{152} Memorandum headed ‘Negotiating a solution for the crisis in Rafael’, issued by the Office of the
Finance Minister and co-signed by the Finance Minister’s Chief of Staff, the Histadrut’s Head of the
Trade Unions Division and the MoF’s Director of Wage and Labour Accord Unit, 13 June 1995.
approved its earlier decision; the workers and the Histadrut rejected the decision and promptly filed an appeal in the Haifa Labour Court.

At that point, the Ministry of Finance persuaded Rabin that in the face of yet another impasse in the negotiations, the time had come for a tougher stance towards the workers. On 25 October 1995 Rabin met a small number of senior MoF and MoD officials in the Knesset. He was presented with updated figures which suggested that Rafael’s losses were mounting. The officials recommended declaring an emergency lockout for several months, during which all work would be suspended, bar essential projects of national importance; this was also consistent with the Cabinet decision of November 1994. Rabin agreed and asked to examine the legal implications of such measure, despite a strong objection by the MoD’s Director General, David Ivry, who (consistent with his earlier objection of March 1995) argued that a lockout was the wrong approach because it might jeopardise national interests. ‘It was the first time [since the Rafael crisis had begun] that Rabin was willing to go all the way,’ said a senior MoF official, Yuval Rachlevsky, who attended the meeting. ‘Such a step was not without risks: it had never been enforced before [in Rafael], and there was a possibility that the courts would overturn it.’

By that point the Closure–Opening model, which was at the heart of the restructuring plan, was also approved by the Attorney General, Michael Ben-Yair. However, he attached several conditions as a hedge against potential legal challenges, and stipulated that its use was restricted to the case of Rafael only. (The Treasury wanted to prevent a situation in which other segments of the public sector – for

153 See: Decision by the Service Committee of the Civil Service Commission, 18 October 1995.
154 Rachlevsky interview.
155 Ibid.
156 Sarbero interview.
example, hospital employees — would condition restructuring and privatisation of their workplace by demanding a safety net similar to Rafael’s Closure–Opening model, which was more expensive than normal state-backed pension plans. Now having the backing of the Attorney General, the Treasury and Rafael management were ready to confront the workers in a final showdown.

At that point, however, a new row erupted between the MoF’s Budget Department and the MoD over the transition costs. Each side insisted that the other should shoulder the lion’s share of these costs — a debate that lasted for years (and was in fact decided only in 1999). According to the MoD’s economic adviser, who represented the defence establishment in these negotiations, ‘we simply did not know how to reach an agreed position on this point’.

The Impact of Rabin’s Assassination

In November 1995 Rabin was assassinated, and this set back the transition process significantly. Shimon Peres, previously Rabin’s Minister of Foreign Affairs, now became Prime Minister and Defence Minister. The losses of Rafael featured prominently on his agenda, and he addressed them in a series of meetings with Finance Minister Shochat as part of a wider discussion on the defence budget. At this time the Haifa Labour Court upheld the latest Civil Service Commission decision on the dismissal of 650 Rafael workers, to which the unions responded by filing another appeal, this time to the National Labour Court, which halted the dismissal process.

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157 Rachlevsky interview.
That decision alarmed the defence establishment, which sought to minimise any untoward liabilities on the defence budget. The IDF, one of the parties affected by this delay, refrained from publicly interfering in this conflict until it realised that Rafael’s mounting losses (1 million shekels a day, equal to the price of a brand new guided missile$^{161}$) might have serious effects on its operations.$^{162}$ During 1995 senior officers expressed their concerns in closed forums (Cabinet, Knesset committees) besides frequently complaining to Rafael. In November 1995, however, while Prime Minister Peres was discussing the defence budget with Shochat, the military stepped up the pressure with a direct, public attack on Rafael: the financial adviser to the IDF’s Chief-of-Staff gave a rare interview in which he charged that ‘covering Rafael deficits through the defence budget might destroy the Army’.$^{163}$ This harsh statement, unprecedented in the history of IDF–Rafael relations, echoed the late Prime Minister Rabin, who had asserted two months earlier that ‘Rafael’s persistent deficits undermine the IDF and the state’s security’.$^{164}$

Against this background, Prime Minister Peres was presented with several options. The Ministry of Finance proposed deferring the transition until after the general election (expected in a few months) and restarting the process in 1997,$^{165}$ while Labour members of Knesset recommended postponing the transition for three years.$^{166}$ A senior aide to the Minister of Defence suggested closing Rafael as a unit in the MoD, discharging its employees and then rehiring some of them through the

$^{161}$ Gat interview; see also Haaretz, 26 December 1995.
$^{162}$ Haaretz, 28 November 1995.
$^{163}$ Haaretz, 29 November 1995.
$^{165}$ ‘Letter to Rafael employees from the Director General’s office’, 8 January 1996.
$^{166}$ Haaretz, 19 December 1995.
private sector. Another option was to continue the process as planned, in accordance with the decision of November 1994.

During his previous career in the MoD, Peres had favoured a more co-operative, conciliatory approach to labour disputes. 'In labour negotiations, one should not assume that only the owner is right; maybe the employees also have a point. We have always found a way to reach a common ground with the workers,' he told the author. He also believed that stable labour relations in the state-owned defence enterprises were crucial for successfully implementing export deals. Peres therefore chose a less confrontational approach to the Rafael problem than Rabin. Noting that it is hard to make painful decisions on industrial relations in an election year, he initially decided to continue the transition process, but insisted 'that all redundancies should be handled by the Service Committee (of the Civil Service Commission)' and that the Histadrut be consulted on ways to reduce Rafael's losses, these reached 330 million shekels in 1995 and were expected to grow to 512 million in 1996. He also sought to avoid confrontation with the unions as far as possible, so he rejected Gat's request to dismiss several workers' leaders (the Defence Minister had to authorise this) because of the Histadrut's fierce objections. This so angered Rafael's Director General that he threatened immediate resignation.

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167 *Haaretz*, 1 January 1996.
168 Peres interview. Peres noted that during his career in the defence ministry (he served as defence minister between 1973 and 1977) the relationship between the government system and the entire defence industrial base was 'exemplary' and 'there were no labour disputes'.
170 Prime Minister Office – Economic Advisor to the Prime Minister, 'Minutes of a discussion held by Prime Minister Peres on Rafael, 1 January 1996', dated 3 January 1996.
173 Gat interview.
event, Gat was persuaded to stay, and the union representatives quietly resigned a few months later.

However, while the management was preparing for another round of layoffs and clashes – the National Labour Court dismissed the unions’ appeal and in January 1996 upheld the Commission’s decision to lay off 650 workers\textsuperscript{174} – the MoF reassessed the situation at Rafael. Its senior officials felt Gat’s insistence on pushing ahead with the Closure-Opening model was completely futile and counterproductive, given the prevailing political climate and the recent decision on early elections (scheduled for May 1996). The workers, meanwhile, escalated their actions, which culminated in violent demonstrations and hunger strikes in response to a management decision to make 90 surplus workers redundant.\textsuperscript{175} In addition, they invited senior politicians, including the opposition leader, Binyamin Netanyahu, for election rallies inside Rafael’s compound,\textsuperscript{176} and at the same time nominated two union leaders to stand for the Labour party primaries.\textsuperscript{177}

Realising that the political echelon wanted to keep Rafael off the agenda until after the elections, the MoF decided to act. ‘Both Peres and Shochat indicated that they had no desire to confront the workers,’ said Yuval Rachlevsky, then Deputy Director of the Wage and Labour Accord Unit, ‘so we were facing a dilemma: should we try minimising Rafael’s increasing losses or should we simply wait’.\textsuperscript{178} The MoF’s Budget Department chose the second course – from its point view, as long as Rafael

\textsuperscript{174} Haaretz, 22 January 1996
\textsuperscript{175} Maariv, 13 February 1996, Yedioth Ahronoth, 14 February 1996.
\textsuperscript{176} Haaretz, 26 January 1996; Maariv, 26 January 1996.
\textsuperscript{177} Letter from Rafael’s Deputy Director General for Human Resources to two Rafael workers (Nachum Blatman and David Zookman) headed ‘Your participation in the primaries for the Labour party’, 13 February 1996.
\textsuperscript{178} Rachlevsky interview.
was kept inside the MoD, it was the MoD’s problem – but the Wage and Labour Accord Unit rejected this because it wanted to keep Rafael labour costs to a minimum, as did the MoD and Rafael’s management. In February 1996 it therefore negotiated a secret interim agreement with the Histadrut: the transition process would be postponed for two years, though negotiations between management and workers would continue, and the workers agreed to minor pay cuts and 750 redundancies.

Gat, who joined the negotiations at their last stage, accepted the deal on the condition that it should clearly state that deferral of the incorporation process was only temporary. ‘Otherwise,’ he told the MoF, ‘the agreement would put the entire process on hold, indefinitely.’ Rachlevsky, who led the negotiations with the Histadrut, met Gat on 19 February 1996 and told him that he was unwilling to accept any changes. He argued that the agreement was clear enough, and he therefore recommended signing it; this prompted a second resignation threat from Gat.

Finance Minister Shochat, informed about the crisis with Gat on same night, asked for an emergency meeting with Prime Minister and Defence Minister Peres the following morning, before the Cabinet meeting. Rachlevsky, meanwhile, met the Finance Minister and the senior MoF bureaucracy, briefed them on the agreement with the Histadrut and received their backing. Shortly afterwards he and Shochat went to see Mr Peres. They explained the situation and asked him whether he preferred to go ahead with the incorporation plan or to postpone it. Peres opted for postponement and endorsed the proposed agreement, noting that he ‘simply did not have enough time to complete the task (of incorporation) before the elections’. Gat, who went to

179 Ibid.
180 Globes, 20 February 1996.
181 Rachlevsky interview.
182 Ibid.
see the Prime Minister just after they left, tendered his resignation. A few days later, following an ad hoc compromise with the Histadrut, the Prime Minister issued a letter promising to complete Rafael's transformation into a company as soon as the management concluded labour arrangements with the unions. He also reiterated that his policy had not changed and expressed full support for Gat and his plans.\(^{183}\) Gat again reconsidered and remained in his job.

Peres subsequently explained in an interview with the author that he had not found the time to address Rafael's problems because of his tight agenda and the severe complications of the peace process (during his last months in power, Israel experienced a series of terror attacks in Tel Aviv and Jerusalem). He also noted that in the Rafael situation he had 'inherited an ongoing and bitter crisis' in which he had not previously been involved. His main concern was to ease the tensions as much as possible and to enable Rafael to operate smoothly, ‘without souring the relations with the employees’. He maintained that the right way forward was only through a mutually accepted agreement with the workers, and that a forced solution would have been ‘undemocratic’.\(^{184}\)

In the event, Peres lost the May 1996 general election, and a Likud government was elected. During the course of deliberations in the Rafael episode – from the May 1994 decision to start turning Rafael into a government-owned company until 1996 – the total cost of the incorporation had doubled: from the 2 billion shekels estimated in 1994\(^{185}\) to 4.8 billion shekels (about $1.1 billion) in

\(^{183}\) MoD press release, 26 February 1996; Sarbero interview.
\(^{184}\) Peres interview.
\(^{185}\) State Comptroller Annual Report no. 45, p. 862.
This increase reflected pension cost capitalisation, pay rises under public-sector labour agreements (to which most Rafael workers’ salaries were linked) and higher mandatory redundancy payments terms agreed by the state. It was not until 2002 that Rafael began operating as a government-owned company.

Conclusions

In the case of Rafael, the policy-making process was a complicated one involving two parallel tracks: a continuous effort to reduce Rafael’s spiralling losses and, simultaneously, a search for ways to turn it into a government-owned company. Fourteen different actors – drawn from the political echelon (ministers/Cabinet), the bureaucracy (two departments, the Ministry of Finance and the Ministry of Defence, and Rafael management), and the judiciary (Labour Court and the High Court of Justice) as well as Rafael’s five workers’ unions, the Histadrut, and the Civil Service Commission – actively participated at different stages. Knesset Members, the Attorney General Office, the Justice Ministry, and the IDF were also involved, albeit briefly. Consequently, the sheer number of parties concerned, each with its own set of considerations, goals and agenda congestion, contributed to the length of the deliberations. All the same, this in itself was not what determined the outcome, as will be explained later.

The evidence presented here suggests that the agendas of the main actors – the executive (both elected representatives and bureaucrats) and the organised interest

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186 Letter from Defence Minister Yitzhak Mordechay to Member of Knesset Yona Yahav (Labour), headed 'Your Parliamentary Question on Rafael', 18 November 1996; see also Haaretz, 5 November 1996 and 6 November 1996.

187 The total cost of Rafael’s incorporation, which was concluded in January 2002, was higher, but no official figures were released at the time of writing this thesis.
group (Rafael's workers) – were each driven by a strategic calculus. Rafael management wanted to make the unit more efficient and economically viable by turning it into a company, and to make use of all possible administrative and legal avenues to this end. The MoD, under pressure from the IDF (exercising the 'consumer sovereignty principle' the military viewed Rafael as a financial burden that was preemptively restricting its room for manoeuvre in using the defence budget) sought to pass financial responsibility for Rafael on to the Treasury, and therefore wholeheartedly supported the incorporation effort. The unions and, at times, the Ministry of Finance's Budget Department sought to block this. And each actor selected the course of action best calculated to achieve its goal.

The political echelon was motivated by political cost calculations. Prime Minister Rabin and Finance Minister Shochat, for example, postponed the recovery process in Rafael for two years while handling the crises at IMI and IAI (in addition to the other pressing issues, like the Middle East peace process and the financial crises of the Kibbutzim, Kupat Holim and other organisations); Shochat, on the eve of the Histadrut elections, waived his attempt to temporarily unlink Rafael from the Public Sector Wage Agreement. The upshot of these decisions was mainly financial: Rafael's losses mounted, and its transition became ever costlier.

And yet, evident throughout this episode was the way in which the actors' choices were played out underlined the interdependence between policy-makers (whether politicians or officials) and various constraining factors: non-institutional effects like past policy choices, as well as institutional ones like judicial intervention, decision autonomy by the bureaucracy and attributes of decision-making.

Past policy choices – in the form of the labour structure of Rafael, which had been formed and agreed upon in the 1950s – meant it was all but impossible to lay off
employees without statutory (Civil Service Commission) or judicial (Labour Courts) intervention. In practical terms, it took the MoD and Rafael management as long as a year to make workers redundant. Take, for example, the decision to lay off 650 Rafael workers: the decision, first taken in March 1995, was challenged by the unions, and was finally given the go-ahead by the court only in January 1996.

Attempts to change this situation, either by legislation or via administrative measures such as a defensive lockout, were resisted by different segments of the bureaucracy, each time for different reasons, and each time revealing the existence of deep-seated interests. The Ministry of Finance and the Ministry of Justice opposed the legislative option (the former fearing it could destabilise national labour relations, the latter that it might destabilise the constitutional framework and possibly breach Basic Laws), while the MoD resisted the administrative one (on safety and national security grounds). Prime Minister Rabin’s attempt to change this situation – including his landmark decision to close Rafael for few months, while secretly discussing a private bill to detach it from the MoD – was curtailed by his assassination and therefore never materialised. In his absence, disunity and interdepartmental in-fighting within the government bureaucracy continued, prolonging the policy-implementation process and at times even derailing it.

By providing different opportunities for vetoing policies, the institutional structure affected the relative weights of the actors involved, as well as the strategies they deemed best suited to promoting their interests. Some actors, like the unions, formulated their goals and strategies independently of the institutional structure within which their actions were to take place, but then sought to use institutional mechanisms to accomplish those goals. In this context, the veto points offered important ‘strategic
openings' that actors could exploit to achieve their aims within and during the policy process.

The actors’ strategic calculations and choices were also influenced by their expectations of how others would be likely to act in response to, or simultaneously with, their own actions. The ability of Rafael’s workers to force issues out of the executive arena and into that of the independent judiciary gave them a great deal of leverage over government policy-making, because politicians were forced to consider carefully the workers’ views, and likely actions or responses, before making the next move. For example, in 1993 the Finance Ministry rejected the MoD proposal for unlinking Rafael from the public sector by means of legislation, because it assumed that the workers could challenge that legislation in the High Court of Justice and win. A similar concern resurfaced in 1995, when Prime Minister Rabin rejected a suggestion that the Cabinet unilaterally declare Rafael a government company for fear of such a decision being overturned by the courts; he opted for a consensual solution instead – the Rafael Closure-Opening model – which was subsequently vetted by the Attorney General. And the Cabinet waited to see if a Labour Court would uphold the unions’ claim that a plan to incorporate Rafael was unlawful; not until a month after the court had rejected the claim in April 1994 did the Cabinet decide that Rafael was to be incorporated.

Indeed, veto points played a major part in determining the outcome of the Rafael episode. The effective veto power of Finance Ministry officials was manifested in the way they could delay negotiations – on the grounds that this would serve other vital national interests, like keeping the state budget on target – without the knowledge or consent of the political echelon. (That this practice was possible reflected a lack of ministerial control and authority over the bureaucracy.) The unions
used the courts as a means to prevent (or at least stall as long as possible) the implementation of redundancies and Rafael’s restructuring plan. Nor was legal action the only veto opportunity open to them. They also sought to influence policy-making by accumulating political power – following the example set by the IAI employees – via mass membership of the Labour party, as well as by targeting members of the inner political Cabinet of the Labour party (who were more sympathetic to the defence industry than Rabin), and by applying pressure through the municipal and local government level.

Together, veto opportunities severely delayed the implementation of the restructuring plan. Indeed, after Rabin’s murder, they prevented it de facto. Rabin’s successor Shimon Peres (a defence industry sympathiser and a man struggling for political survival) was preoccupied with other more pressing issues – such as the Middle East peace process and preparations for early elections – which took precedence. At the same time, and despite the long-term financial implications, Finance and Defence Ministry officials (each for their own reasons) did not push for the process of incorporating Rafael to be completed. Thus the Peres government, foreseeing no penalty for postponing the decisive action (a political showdown with the workers), eventually felt free to ‘leave the field’.

In sum, the case of Rafael shows how specific institutional mechanisms structure the decision process, and how, in so doing, they give interest groups and bureaucrats opportunities to influence political decisions and policy outcomes. The Labour government’s ability to implement its decision to restructure Rafael was affected by the use (or potential use) of veto opportunities. Those open to Rafael workers could be found both inside and outside the executive; others were internal and latent within the bureaucracy. In practical terms, these veto points constrained the
CHAPTER 7
Cross-case Comparison

The financial crises at IMI, IAI and Rafael, took place while the Rabin-led government was engaged in ground-breaking peace negotiations and financial crises in other key sectors (most notably health, with the struggling general sickness fund, Kupat Holim Klalit). As the losses of the three state-owned enterprises mounted, Prime Minister Rabin and Finance Minister Shochat initiated a series of restructuring plans aimed at increasing the productivity and international competitiveness of these firms, reducing their running costs and providing their managements with increased leverage vis-à-vis the unionised labour force.

The results of this effort were mixed, at best: in the case of IMI, most targets were achieved; in the case of IAI, the state backtracked on major parts of its plan, and in the case of Rafael, it failed to meet its main objective (turning the unit into a company). This Chapter discusses the similarities and differences in the way Cabinet and the government bureaucracy approached each of these enterprises, and the methods used by organised interests to counter and thwart the restructuring efforts.

The View from the Top

Production overcapacity, excess labour and insufficient equity capital were hallmarks of all three enterprises in the early 1990s. Successive governments had not addressed these deficiencies beforehand, and, as we saw in previous chapters, the Rabin government faced many challenges throughout the implementation phase. Then Finance Minister Shochat suggested that agenda congestion was a major factor hindering the government’s efforts:
The Rabin government focused primarily on finding solutions for the crises at hand [in these firms] and easing their financial pressure, rather than aiming for a comprehensive restructuring of all three. We started discussing this issue at a later stage, but it did not top our agenda. We had other priorities at the time, and there was only so much we could do in one term. We simply did not find time for that as well.

Pointing to the inaction of previous administrations, he noted that Israeli governments tend to pass the buck to their successors when faced with financial crises that do not require emergency intervention. According to Shochat, ‘I think we would have acted exactly the same, had [the crisis in the defence industry] not occurred on our watch; once it did, we were compelled to act.’

Rabin’s successor as Prime Minister, Shimon Peres, was also convinced that urgent corrective measures were required, but he was unable to implement them:

It had been clear for some time that we needed to revamp and restructure the defence industrial base. Any bureaucratic organisation that does not change becomes inefficient and bloated, sooner or later, and I did not consider the defence industry so sacred ... I had some ideas, while serving as a defence minister [after Rabin] of consolidating the defence enterprises into a single entity and privatising some of their units. But then we had terror attacks and other burning issues which simply consumed all our attention and energy, and sadly nothing happened.

Agenda congestion on its own, however, could not account for the different outcomes of these three episodes. A host of factors and intermediate mechanisms were at play, and therefore no single factor could account for any particular outcome. Each recovery plan triggered different protest and appeal mechanisms, which stemmed from the particular organisational structure, legal privileges and composition of the organised interests in question (see Table 7.1).

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1 Shochat interview.
2 Peres interview.
Table 7.1: Outcome and policy implementation (June 1992–May 1996)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>IMI</th>
<th>IAI</th>
<th>Rafael</th>
</tr>
</thead>
<tbody>
<tr>
<td>Workforce reduction</td>
<td>-43%</td>
<td>-23%</td>
<td>-15%</td>
</tr>
<tr>
<td>Factories shut down/reorganised</td>
<td>6</td>
<td>1</td>
<td>None</td>
</tr>
<tr>
<td>Attainment of policy objectives</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Severance from public sector’s pay rises</td>
<td>Yes</td>
<td>Temporary</td>
<td>No</td>
</tr>
<tr>
<td>Profit centres</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Pay cuts</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Unqualified consent for privatisation</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Consent for redundancies</td>
<td>Yes</td>
<td>Yes</td>
<td>Partial</td>
</tr>
<tr>
<td>Reduced terms in severance packages</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Consent for outsourcing of activities</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Consent for incorporation (in Rafael)</td>
<td>-</td>
<td>-</td>
<td>No</td>
</tr>
<tr>
<td>Government’s pressure tactics</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Withholding of cash injection/loan support</td>
<td>Yes</td>
<td>Yes</td>
<td>-</td>
</tr>
<tr>
<td>Brinkmanship threat</td>
<td>Receivership</td>
<td>Receivership</td>
<td>Closure</td>
</tr>
<tr>
<td>Threat carried out?</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Was management circumvented?</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>If Yes, by whom?</td>
<td>-</td>
<td>Ministers</td>
<td>MoF</td>
</tr>
<tr>
<td>Organised interests’ pressure tactics</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Appeals to courts</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Appeals via inner Cabinet</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Pressure via Knesset and its committees</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Demonstrations, cross-union collaborations</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Intimidation of management</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Use of Histadrut in the critical negotiations</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Political support inside government system</td>
<td>Knesset, Cabinet, local authorities</td>
<td>Own MK, Cabinet, local authorities</td>
<td>Knesset, local authorities</td>
</tr>
<tr>
<td>Pressure on the back of elections?</td>
<td>-</td>
<td>Local</td>
<td>General</td>
</tr>
</tbody>
</table>
Effects of institutional veto points

In each case, a confluence of factors – institutional constraints, political cost calculations, agenda congestion – all affected the policy-making simultaneously, thus leading to a different outcome. Yet, it is argued that the institutional configuration was the most influential determinant, because it set the parameters within which interests were defined, ideas propagated and issues addressed.

The institutional landscape was complex, as discussed earlier. No single state authority was exclusively handling the state-owned defence industry, and the responsibility for oversight and guidance was spread among different bodies within the executive and the bureaucracy. The main actors represented different interests and were bound by internal considerations and legal requirements:

- The MoD abided by strict resource allocation practices that had been established in the mid-1970s after the 1973 Yom Kippur War. Due to internal considerations, it was unwilling to afford any financial assistance to the ailing defence enterprises, and it was also legally barred from contracting them on an exclusive basis (under the Mandatory Tenders Law passed in 1992, before the recovery plans were initiated). In exercising its oversight and regulatory powers, the MoD effectively blocked the partnership strategy of IMI on national security and economic grounds, even though this strategy was deemed essential for ensuring the company’s long term financial viability and was already endorsed by the IMI board.

- The MoF, empowered by the 1985 legislation following the Economic Emergency Programme, adhered to fiscal discipline, but its departments adopted disparate approaches in their dealings with the defence enterprises. The Budget Department was wary of principal-agent problems.
such as ‘moral hazard’ and ‘rent-seeking’ which were likely to arise as a result of a dependency on state bail out. It therefore objected in principle to aid requests from failing enterprises that were not accompanied by corrective measure in the form of structural changes (see the cases of IAI and IMI). The MoF’s Wage and Labour Accord Unit, on the other hand, was primarily interested in stable labour relations with the public sector, and therefore sought to reach compromises with the employees’ organisations, even if these ran contrary to the interests and guidelines of the Budget Department (as was evident in the cases of Rafael and IAI).

- Following the enactment of Basic Laws and the gradual empowerment of the Supreme Court – which became an effective policy veto point – Cabinet decisions were increasingly subject to judicial scrutiny. This development prompted the Prime Minister and MoF to ask for legal clearance for the Rafael and IAI recovery plans.

Confronting the government machinery were organised interests – employees’ organisations – whose relationships with management and the public bureaucracy were based on labour legislation and on legally binding but highly restrictive collective agreements. As Table 7.1 shows, during the negotiations with the IMI and IAI employees’ organisations, the MoF’s Budget Department made frequent use of two measures: suspending cash injections (in the case of cash-flow deficits) and withholding state guarantees (against which the company could raise loans). A third measure – receivership or liquidation proceedings (which might have rendered labour agreements null and void) – was initiated with the backing of the ministerial level but eventually dropped (in both cases, the ministers in charge retracted the threat after the employees yielded).
In contrast with the competing and often contradictory aims of the government machinery, the employees’ organisations pursued cohesive and straightforward goals: the continuation of tenured and organised labour arrangements. They consistently refused to renegotiate the terms of the collective agreements, whose special status was further recognised and protected by law. In practice, these collective agreements linked the three enterprises’ workforces to salary rises in the public sector and stipulated their automatic payment, irrespective of the enterprises’ actual financial situation. This rendered all three managements rather powerless, because the only domain over which they retained full control was marketing and orders backlog; every other management domain – corporate strategy, internal restructuring, and the composition, size and costs of human resources – was affected and governed by the terms of the collective agreement. Yet, even when the three enterprises came near financial collapse, the MoF insisted on maintaining as far as possible the status quo and consensus in dealing with trade unions, rather than seeking to impose a solution.

Fearing that a unilateral approach might destabilise labour relations across the economy and put at risk its long-standing arrangements with the Histadrut and the public sector, the MoF preferred to retain these arrangements intact – which de facto galvanised and institutionalised its own dominant role in the policy-making process. It therefore dismissed suggestions that might have countenanced a more forceful stance vis-à-vis the organised interests to be taken via other routes (like the legislature). In the case of Rafael it rejected the MoD’s idea of disassociating Rafael from the public sector by legislation, and in that of IAI it turned down a management proposal to unilaterally suspend the company’s stifling collective agreement.

The organised interests’ influence was further boosted by their growing involvement in the political arena. This began shortly after the termination of the Lavi
project in 1987, when the IAI Employees' Organisation realised that the support of the Defence Minister – on which it had counted – could not be taken for granted, and anyway would not guarantee its organisational existence. It therefore sought new ways to sustain its political and electoral clout. One approach was to cultivate close relations with cabinet ministers, members of Knesset, and leaders of local municipalities. Close links were also formed with regional labour councils and other trade unions across the country, which helped to build a formidable coalition of political players which offset the steady decline in the Histadrut's influence. Another effective route to power, direct participation in party politics, was made possible by the introduction of the primaries system in 1992. Mass enrolment of employees as party members – noted in the cases of IAI and Rafael – enabled organised interests to form a formidable support base within the parties, and this could serve as a potential retaliatory weapon against politicians seeking re-election via the party's candidates list. At least in the case of IAI, the employees' organisation successfully inserted its own representative into the Knesset, which enabled it to openly promote its interests.

In all three cases, the employees' representatives were at pains to demonstrate their political and organisational clout, making use of all the legal and political avenues opened to them:

- **Rafael**: By frequently appeals to the labour court, the Rafael unions effectively shelved implementation of the government's incorporation plan by pushing it closer to a general elections year (during which the political echelon tends to postpone potentially politically costly plans, as Shochat noted). Then, to enhance their political influence, Rafael employees emulated IAI's and embarked on mass enrolment to the Labour party ahead of the 1996 elections. The unions' position was further helped by the
disorganised and conflicting handling of the negotiations by the bureaucracy.

- **IAI**: Taking advantage of the Labour government’s tenuous coalition majority and looming local elections (perceived by Prime Minister Rabin as an important indicator of public support of the peace process) IAI employees’ successfully fended off a receivership action against the company. They employed a pincer strategy: the IAI workers’ representative in Knesset voted against the state budget, thus undermining the very existence of the Labour coalition, while the employees’ organisation caused great inconvenience to the wider public by closing Israel’s main international airport and major highways. IAI employees’ also vowed to lobby against the Labour party in local elections, a threat the party leadership did not take lightly.

- **IMI**: Here the employees’ organisation took a conciliatory, cooperative approach, after a period of brinkmanship and confrontation with management culminating in a direct appeal against the management’s plan to the inner Cabinet, and later on to the Knesset’s Finance Committee. However, in both cases it realised that, given IMI’s relative weaknesses (in technology and quality of workforce, compared to the other two enterprises) and the other financial crises facing the government at the time, the company’s long-term survival was at stake unless it was downsized and restructured. It therefore opted for a negotiated but costly settlement. IMI employees benefited from the open and close relations between their union leadership and the Labour cabinet, which instructed management and the MoF to accommodate most of the employees’
demands. In turn, the IMI union agreed to the most comprehensive concessions among the three defence enterprises (see Table 7.1).

It was evident in the cases of IAI and Rafael that the political influence accumulated by organised interests in the defence sector and the unions’ ability to delay and thwart policy initiative by appeals to the courts or the inner cabinet – effective policy veto points – influenced the government’s negotiating tactics. So much so, that the IAI and Rafael managements were effectively pushed out of the negotiations with the employees, and replaced by politicians whose leverage and bargaining power were ostensibly weaker than those of the bureaucracy. This was due to political cost calculations and the short parliamentary cycle. Furthermore, in the course of the negotiations over recovery plans, some organised interests managed to secure explicit clauses that gave them influence over management decisions.
GENERAL CONCLUSIONS
Policy Capacities in the Israeli Defence Industry

The preceding chapters discussed the government system’s handling of the financial crisis in the Israeli state-owned defence industry, unearthing many underemphasised aspects of the relationship between the state and interest groups. The detailed narration of the three episodes on IAI, IMI and Rafael allowed us to delve into the critical junctures of policy-making and try to understand what happened and why. In each case similar policy objectives were pursued: restructuring and downsizing the enterprise in question, which involved imposing significant financial losses on the organised interests involved – the employees’ committees and organisations in each enterprise. However, the outcomes varied widely, and in each case various factors accounted for the different result.

To explain what may account for such variation, it was hypothesised in the introductory chapter that institutional rules and procedures set the terms for political conflicts, by providing opportunities and risks for both politicians and interest groups. Central to new-institutionalist accounts is the notion that political struggles are structured, and the outcome shaped, by the characteristics of the institutional settings within which they occur. Institutional factors can therefore shape both the objectives of political actors and the distribution of power among them in a given polity. Thus, the institutional framework not only structures political conflicts but also affects government capabilities; this, in turn, may explain divergence in policy outcomes. It was further argued that intermediate institutional features – policy veto points inside and outside the executive, as well as the influence of the judiciary and the bureaucracy – greatly influence government capacity to implement policy and impose loss on
powerful groups. In the course of the case studies discussed here, it has been demonstrated that the use, or likely use, of veto points affected the considerations applying to different actors and, ultimately, the policy outcome.

Yet, based on the evidence presented thus far, one can argue that, while the structure of political institutions *per se* had an impact, this was but one of several factors that constrained the policy-makers' choices. Non-institutional determinants, namely past policy choices, played an important part in presenting openings for and impediments to the imposition of financial losses on organised interests. These determinants guided and influenced the choices made by politicians as well. Consider, for example, the insistence of Prime Minister Rabin and the MoF's Budget Department – throughout the three episodes – on negotiated compromise with the unions, and their adherence to consensual arrangements (which ultimately increased the recovery costs of all three enterprises). Or the MoD resource allocation policy of 1975 and the emergency economic legislation of 1985 which, each in its own way, determined the scope of the public bureaucracy's autonomy, and, in turn, inculcated certain preferences and attitudes that surfaced years later.

The three episodes show how specific institutional mechanisms structure the decision process, and how, in so doing, they provide interest groups and bureaucrats with opportunities to influence political decisions. The author therefore proposes the following inferences about certain capabilities of the Israeli governmental system, as drawn from the evidence presented in the case studies:

- Institutional arrangements may present impediments to and opportunities for specific governmental capabilities, but they are contingent upon political and social conditions. Therefore, a government that is supported by a minimum coalition, with a small or insufficient parliamentary
majority, is likely to encounter difficulties in effectively implementing policies and imposing losses. Indeed, the loss-imposition capability of the Labour government under Rabin (and later Peres) varied over time, under the influence of changing political circumstances: its capability to impose losses was high when it had a majority coalition in its first year in office (as in the case of IMI), but weakened later when it became a minority government with a reduced coalition and faced an election in the near future (as in the cases of IAI and Rafael).

- The institutional structure of the Israeli government, with its multiple veto points, interest groups' access and short parliamentary cycles, is susceptible to a high level of political contestability. Constraints on the government’s specific policy capabilities of implementation and imposing financial losses built up gradually, as different institutional components (judiciary, bureaucracy) were granted more powers at different stages.

- The prevailing institutional setting puts the Israeli government at a political disadvantage when it comes to executing policies that affect large, organised interests in the public sector. Policy implementation is composed of sequences of actions undertaken at different institutional locations, and agreement is required at several points along this chain. The fate of policy implementation, then, rests on the opportunities for veto in these locations. As transpired from the cases of IAI and Rafael, interest groups sought judicial intervention at different stages of the policy implementation. Use of the judiciary as a veto point was particularly potent – as the Rafael case showed – because the state would have no alternative veto point at which to override the judiciary’s rulings (save for
enactment of new legislation, which is a lengthy process). Furthermore, Israel’s independent judiciary can deliberate on a case for as long as it wishes, irrespective of the country’s relatively short parliamentary cycle. Hence, a verdict may become irrelevant if delivered in the next session of Knesset; by that time a new government with a different agenda may have been elected, and previous policies could be altered or abandoned altogether. (Interest groups used the judiciary as a veto point in two instances. In the first, if the Rafael workers’ attempts had succeeded, the government would have had no alternative veto point at which to override that success. In the second, IAI employees challenged an attempt to privatised one of IAI’s subsidiaries, using prolonged legal deliberations that effectively derailed this initiative.)

The ability of organised interest groups to influence the policy outcome stemmed from their access to both the judiciary and the political system. Introducing electoral reforms (namely, party primaries) and the gradual empowerment of other veto arenas (namely, the public bureaucracy and the judiciary) effectively ended state hegemony over the policy-making process. No longer were those in the national government sufficiently autonomous to make decisions; they were seriously challenged by contending organised interests who made use of all the veto opportunities opened to them.

Theoretically, the executive could restrict organised interests’ access to and influence on the policy-making process, by removing veto points, or by outlawing some or all of the interest groups’ practices. However, that might lead to an institutional framework that was not democratic. It can be inferred from the key
decisions throughout the restructuring process in the defence industry that policy-makers preferred to maintain dialogue with organised interests – so as to allow the implementation of policy objectives in other domains – rather than jeopardise stable labour relations. Keeping the current institutional arrangements intact, despite the impediments they posed to the government, was more important than forcing a particular policy on a reluctant constituency, whatever dividends that might have yielded.

The implication of the policy-makers’ preference was that some government capabilities – imposing losses and implementing policy – remained impaired. If the institutional arrangements in Israel – and this could be established only with the help of additional studies – do indeed lead to some capabilities that are less effective than others, when dealings with similar problems in different policy areas, then institutional reform needs to be considered.

A Broader Research Agenda

The inferences concerning Israeli governmental capabilities, as outlined here, are tentative and by no means to be treated definitive, being based on a limited number of case studies. Supplementary evidence is therefore required, and the objective of this section is to suggest some ideas for further research which may shed light on other institutional and non-institutional determinants of policy-making in the Israeli context. For example, the role and influence of the media on the course and the decisions of the actors involved in policy-making, and also the possible effect of bureaucratic structural differences between and within ministries on policy output and coordination.
Institutional analysis of policy outcomes in other sectors (like education, health, etc.) may allow for a cross-case comparison between several policy domains, highlighting the factors that constrain the same government actors (for example, the Ministry of Finance). Another relevant subject might be the relevance and applicability of the Government Companies Law to the government's handling of state-owned enterprises experiencing financial difficulties, and in particular the practical interpretation of the law by the state actors involved.

In order to stimulate and guide such research, the author would like to suggest a tentative illustration of Israeli policy determinants, presented overleaf. It is based on the evidence gathered and is by no means exhaustive or definitive. It should be treated as a tentative framework that requires further corroboration through additional research.
Determinants of Government Policy Capabilities in Israel: Suggested Illustration

**Institutional Constraints**

**Parliamentary System**

- Electoral Rules: PR with a low threshold
- Rules, Norms and Procedures of Government Formation

**Type of Government:**
- two or more parties

**Government Formation:**
- multiparty coalition

**Attributes of Decision-making Processes**

- Level of party discipline in legislature: strong
- Recruitment of ministers from legislature: yes
- Degree of centralisation (cabinet vs. legislature and public): strong

- Cohesion of government elites: weak
- Policy veto points within government: inner cabinet, Knesset committees
- Autonomy of elites: weak (tenuous coalition and short parliamentary cycles)
- Interest group access and influence: strong

**Policy-making Capabilities**

- Policy Choices
- Policy Outcomes

**Broad Framework Institutions**

- Judiciary: judicial review of statutes and laws
- Bureaucracy: decision autonomy

**Additional Non-institutional Influences**

- Corporatist-style arrangements
- Geo-political conditions
- Policymakers' goals
- Socio-economic and demographic conditions
- Past policy choices

Source: Adapted from Weaver and Rockman, *Do Institutions Matter?*
Interviews

[Note: The author conducted interviews with the following figures. At the end of each entry is given the short form by which the interview is referred to in the text.]


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372


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Appendix A: Glossary of Financial Terms

**Annual report**: A report a company publishes for its stockholders at the end of each fiscal year. Includes required elements, such as an auditors' report and the company's statement of earnings, statement of financial position and statement of cash flows. Also includes elements such as letters and articles by company executives, information on its financial condition, and significant events.

**Assets**: Anything companies own. These might be physical assets - such as buildings, trucks, inventories of products, equipment and cash - or intangible assets, such as goodwill, trademarks, and patents. ‘Assets’ is listed as a category on the balance sheet.

**Balance sheet**: A financial statement reporting a company's assets and the claims against them - liabilities and stockholders' equity - at a set date noted on the statement. The term can also mean a company's overall financial position.

**Backlog**: The amount of a company’s unfilled or unprocessed sales orders at the end of the year. When the company fills the orders the following year (or years), it records the revenue on the earnings report. For purposes of transparency and accountability, some companies (like IAI, see Chapter 5) distinguish between ‘external backlog’ – that is, orders from external clients – and ‘internal backlog’: orders from units within the company contracting work to sister units.

**Cash flow**: A measure of a company's financial health, noting the flow of cash into and out of the company. Equals cash receipts minus cash payments over a given period of time; or equivalently, net profit plus amounts charged off for depreciation, depletion, and amortisation.

**Contract**: A binding agreement between two or more parties for performing, or refraining from performing, some specified act(s) in exchange for lawful consideration. A ‘new contracts’ figure represents the total value of agreements signed by a company in a given period or fiscal year.

**Earnings report**: A financial statement that reports the results of a company's business operations (revenue and expenses) for a set period, usually one year. The term can also mean an income statement, statement of earnings, statement of operations, and statement of profit and loss.
Equity: The part of a company’s assets belonging to the stockholders – i.e. what would remain if a company sold all its assets and paid off all its liabilities.

Expenses: Costs such as salaries, rent, office supplies, advertising, and taxes.
‘Expenses’ is listed in the operating expenses category on the earnings report.

Gross profit: The difference between a company’s total sales and its cost of sales.
‘Gross profit’ is listed as a category on the statement of earnings; also called gross income.

Loss: The reduction in the value of an investment; a condition in which a company's expenses exceed its revenues.

Net profit: A company's total revenue less total expenses, showing what a company earned (or lost, called net loss) for a set period, usually one year. ‘Net profit’ is listed often literally as the ‘bottom line’ on the statement of earnings; also called net earnings and net income.

Profit: The positive gain from an investment or business operation after subtracting all expenses.

Revenues: The total flow of funds into a company, mostly for sales of its goods or services.

Sales: Total amount collected for goods and services provided. While payment is not necessary for recognition of sales on company financial statements, there are strict accounting guidelines stating when sales can be recognised. The basic principle is that a sale can only be recognised when the transaction is already realised, or can be quite easily realised. This means that the company should have already received a payment, or the chances of receiving a payment are high. In addition, delivery of the good or service should have taken place for the sale to be recognised.

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