Economic Challenges 2025-2035

Security and Political Scenarios

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Economic Implications of Defense–Political Scenarios

- Main scenarios for Gaza:

01 War Ending With an Arrangement	02 War Ending Without an Arrangement	03 Gaza Occupation

- Economic analysis: short term (2025–2027) and long term (2028–2035)
- Based on estimated defense costs and their effects on growth, deficit, and debt-to-GDP ratio
- Focus on: sanctions risk under occupation, fiscal adjustment needs, and growth-enhancing reforms in all scenarios

Occupation of Gaza blocks growth-enhancing reforms, weakens employment and output, and poses risks to financial stability – resembling the "lost decade"

Arrangement, restored security, and reforms will return the economy to a growth trajectory, as after the Second Intifada

Security Context – Fall 2025

North

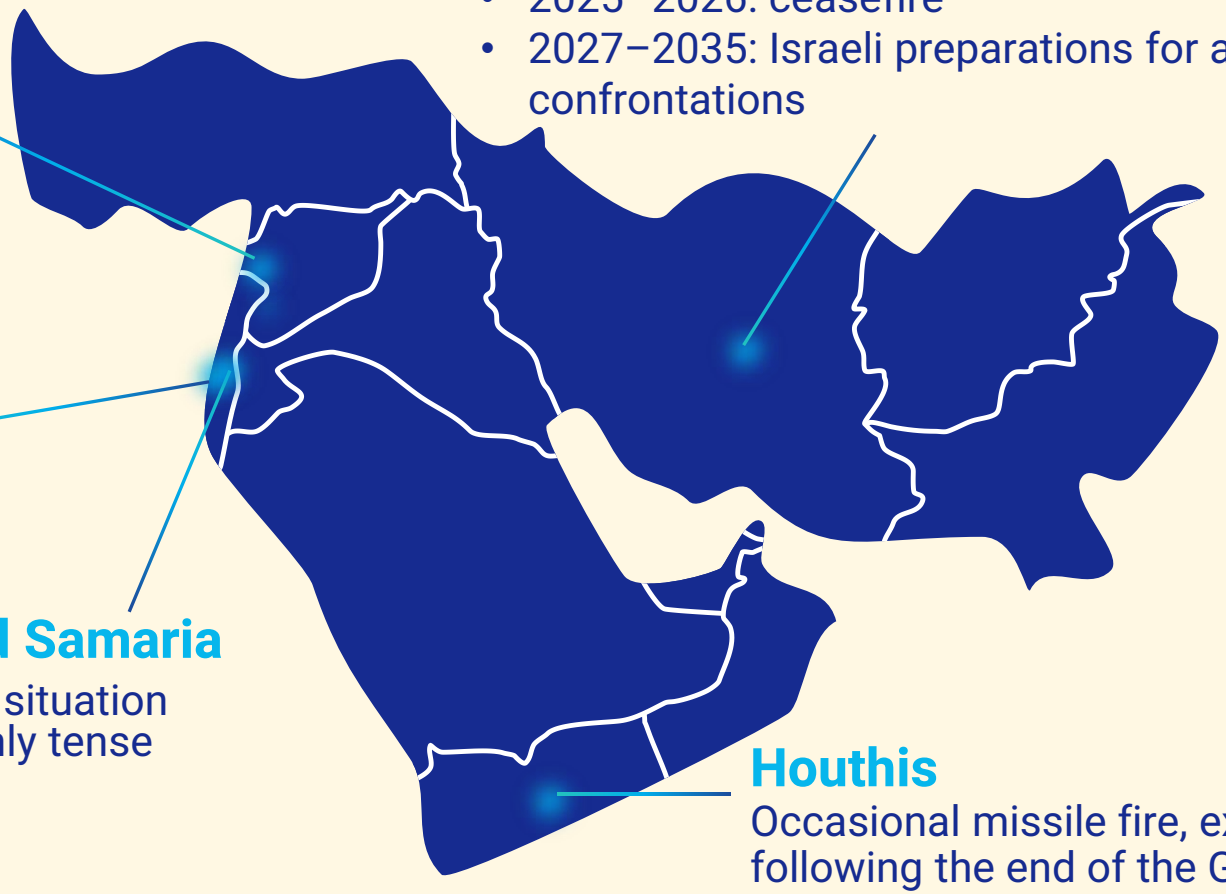
Arrangement under current conditions with Lebanon

- Return to near-normal economic activity by Q4 2025
- **Syria**: continuation of the existing situation

Iran

"Twelve-Day War": significant damage to Iranian nuclear and missile capabilities

- 2025–2026: ceasefire
- 2027–2035: Israeli preparations for additional confrontations



Gaza

Details ahead

Judea and Samaria

The security situation remains highly tense

Houthis

Occasional missile fire, expected to cease following the end of the Gaza war

The scenario was constructed in consultation with security Experts.

Gaza: Security and Political Scenarios

End of the War in Gaza		Full Occupation of Gaza
Arrangement by end-2025	**No Arrangement**	**Military and Civilian Control from 2026**
Military activity declines in late 2025	Continuation of current hostilities	Intensive military operations through Q1 2026 Sustained military activity during 2026
Civil administration by Egypt/international actors (2026)	Israeli responsibility for food distribution	Israeli responsibility for food distribution and civilian services, in accordance with international law
Return to political-military status of late 2024	Economic sanctions, international pressure	Sanctions from European companies and countries Social polarization, emigration from high-tech

Macroeconomic Model for the Short Term, 2025–2027 – Output-Based Framework

01

Output equals the product of employment and labor productivity

Output =

Employment **X** Labor productivity

02

Economic activity is divided to three sectors

1. High-tech sector
2. Business sector (excluding high-tech)
3. Public sector

03

2025–2027: Focus on employment and labor productivity (output per worker)

Additional assumptions

- Tax revenues exhibit unitary elasticity
- Civilian government expenditures, defined by the fiscal numerator
- Defense expenditures, based on Aaron Institute estimates (to follow)

Employment levels are estimated according to the defense scenario, accounting for reservists and employees temporarily absent from work

Estimated Defense Expenditures by Scenarios[1]

	Actual Expenditures		Aaron Institute Estimate[2]	Aaron Institute Estimate[3]						
	2023	2024	2025	2026	2027	2028	2029	2030	...	2035
Budget	**86**	**104**	110	110	100	103	104	107	...	103
War + Deferred Expenditures	**17**	**81**	53	20						
Total Expenditures With an Arragnement	**103**	**185**	**163**	130	100	103	104	107	...	103
Total Expenditures without an Arrangement			**163**	140	110	113	114	117	...	113
Occupation of Gaza			179	180	133	134	135	138	...	134
U.S. Aid[4]	**16**	**33**	**28**	**13**	**13**	**13**	10	7	...	0

1. NIS billions, constant 2023 prices.
2. Based on 2025 defense budget, including approved additions, and Q4 assessments adjusted to the scenarios.
3. 2026 onward are based on the Mind Israel security framework, in consultation with Dr. Sasson Hadad, adjusted to the scenarios.
4. Until 2028: according to the U.S. agreement; 2029 onward: Aaron Institute estimate, in consultation, under a declining framework.

Economic Forecast for 2025–2027: Gaza: War Ends under Arrangement

	2023 (Actual)	2024 (Actual)	2025 (Projection)	2026 (Projection)	2027 (Projection)
Employment Growth	3.3%	1.1%	1.9%	1.5%	1.7%
Productivity Growth	1.5%-	0.4%-	1.0%	1.8%	1.6%
Interest Rate (Nominal)	**4.75%**	**4.75%**	**4.50%**	**4.50%**	**4.50%**
Output Growth* (Real)	**1.7%**	**0.7%**	**2.2%**	**3.7%**	**3.6%**
Defense Expenditure (% GDP)	5.3%	8.6%	8.2%	6.3%	4.7%
Civilian Expenditure (% GDP)	34.4%	34.7%	33.7%	33.7%	33.7%
Deficit (% GDP)	6.9%	9.4%	5.3%	4.2%	2.5%
Debt-to-GDP Ratio	**61.5%**	**67.8%**	**69.1%**	**69.3%**	**68.1%**

Output growth accounts for the loss associated with temporarily absent workers. In line with 2025 policy, fiscal adjustments of 2% GDP are assumed for 2026–2027.

Economic Forecast for 2025–2027: Gaza War Ends Without an Arrangement

	2023 (Actual)	2024 (Actual)	2025 (Projection)	2026 (Projection)	2027 (Projection)
Employment Growth	3.3%	1.1%	1.9%	1.3%	1.2%
Productivity Growth	-1.5%	-0.4%	0.2%	0.2%	0.2%
Interest Rate (Nominal)	**4.75%**	**4.75%**	**4.50%**	**4.50%**	**4.50%**
Output Growth* (Real)	**1.7%**	**0.7%**	**1.3%**	**1.7%**	**1.9%**
Defense Expenditure (% GDP)	5.3%	8.6%	8.3%	7.0%	5.4%
Civilian Expenditure (% GDP)	34.4%	34.7%	33.7%	33.7%	33.7%
Deficit (% GDP)	6.9%	9.4%	6.7%	5.5%	3.9%
Debt-to-GDP Ratio	**61.5%**	**67.8%**	**69.7%**	**71.9%**	**72.5%**

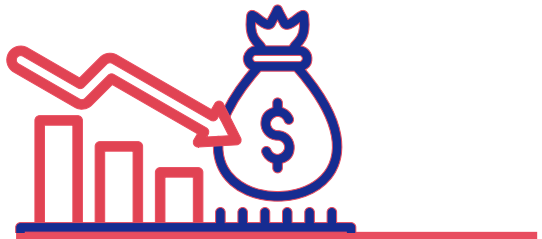
Output growth accounts for the loss from workers temporarily absent. In line with 2025 policy, fiscal adjustments of 2% GDP are assumed for 2026–2027.

Economic Forecast for 2025–2027: Gaza Occupation and Civilian Administration

	2023 (Actual)	2024 (Actual)	2025 (Projection)	2026 (Projection)	2027 (Projection)
Employment Growth	3.3%	1.1%	1.7%	1.3%	1.0%
Productivity Growth	-1.5%	-0.4%	-0.1%	-0.4%	-0.4%
Interest Rate (Nominal)	**4.75%**	**4.75%**	**4.50%**	**4.80%**	**4.80%**
Output Growth* (Real)	**1.7%**	**0.7%**	**0.7%**	**1.1%**	**0.9%**
Defense Expenditure (% GDP)	5.3%	8.6%	9.2%	9.1%	6.7%
Civilian Expenditure (% GDP)	34.4%	34.7%	33.7%	33.7%	33.7%
Deficit (% GDP)	6.9%	9.4%	7.6%	7.9%	5.6%
Debt-to-GDP Ratio	**61.5%**	**67.8%**	**70.9%**	**75.9%**	**78.8%**

Output growth accounts for the loss from workers temporarily absent. In line with 2025 policy, fiscal adjustments of 2% GDP are assumed for 2026–2027.

Economic Risks for Israel from 2026 Onward



Failing to meet defense budget needs and reduction in civilian services

Driven by large deficits, high interest rates, and low growth

Risk of a "lost decade"

Diplomatic isolation

Security instability
Multiple conflict arenas

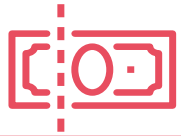
Financial Instability
Diverging Debt-to-GDP ratio
Decline in credit rating

Social Polarization

Intensifying tension between the executive and the judicial authorities

Growing disputes between the political and professional levels

Intensifying conflict over the military service law



Risk of economic sanctions

Decline in trade

Negative impact on employment and output

Negative impact on the high-tech sector

Slowdown in foreign investment and boycotts

Rising risk of emigration of young people with high-quality human capital (brain drain)

Growth Estimates for 2028–2035

Under 2026 Security and Policy Scenarios

Arrangement, Growth-Enhancing Reforms – Annual Growth: 3.7%

Investment in human capital, employment, infrastructure, and digitalization
High-tech sector share in output and employment remains high

Arrangement, no Growth-enhancing Reforms – Annual Growth: 2.5%

High-tech's share in output increases, while its share in employment remains stable

No arrangement, no Growth-Supporting Reforms – Annual Growth: 2.5%

High-tech's share in output and in employment declines
Partial economic sanctions

Occupation of Gaza without Reforms – Annual Growth: 1.0%

High-tech's share in output and in employment declines sharply
Severe economic sanctions – growth reduced by 1.5 percentage points

Arrangement with Growth-Enhancing Reforms

Raising employment rates
in Arab and ultra-Orthodox populations

Closing education gaps
In Arab and ultra-Orthodox populations

Digitalization of the public sector

Investment in transportation infrastructure
Improving accessibility

Sustaining the high-tech sector
fostering industrial integration and expansion

Reducing the cost of living
Promoting competition

Annual Growth: 3.7%

Scenario details

Arrangement, no Growth-Enhancing Reforms

No increase in employment rates among ultra-Orthodox and Arabs

Limited infrastructure investment in transportation

Education distribution remains unchanged
Gaps persist

High-tech expands only moderately
Stable share in employment

Annual Growth: 2.5%

Scenario details

No arrangement, no Growth-Enhancing Reforms, High-tech Sector in Decline, Limited International sanctions

Decline in high-tech employment share

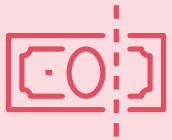
Due to brain drain and reduced R&D attractiveness

- High-tech sector contraction: share of output declines by 2.8 pp to 17.0%, employment share by 1.4 pp to 8.5%

Outflow of skilled human capital (brain drain)

Driven by economic and security uncertainty

- Annual outflow of 6,000 employees



Decline in foreign and multinational investment

Annual Growth: 2.0%

Scenario details

Occupation of Gaza and Civilian Administration, No Growth-Enhancing, High-tech Sector in Decline, International Sanctions

Sharp fall in exports

Primarily high-tech, from sanctions

Disruption of input imports

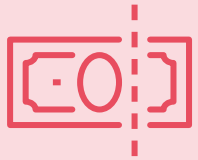
Reduces output

- Export share of GDP falls from 35% to 32% by 2037, driven mainly by high-tech services

Falling high-tech employment and output

Accompanied by emigration abroad

- Employment down by 94K compared to 2024
- High-tech share drops 4.4 pp to 15.5% of output and 2.2 pp to 7.7% of employment



Decline in foreign and multinational investment

Annual Growth: 1.5%

Scenario details

Absent Growth-Enhancing Reforms – Debt-to-GDP Ratio Diverges

Forecast to 2035, based on economic-security scenarios

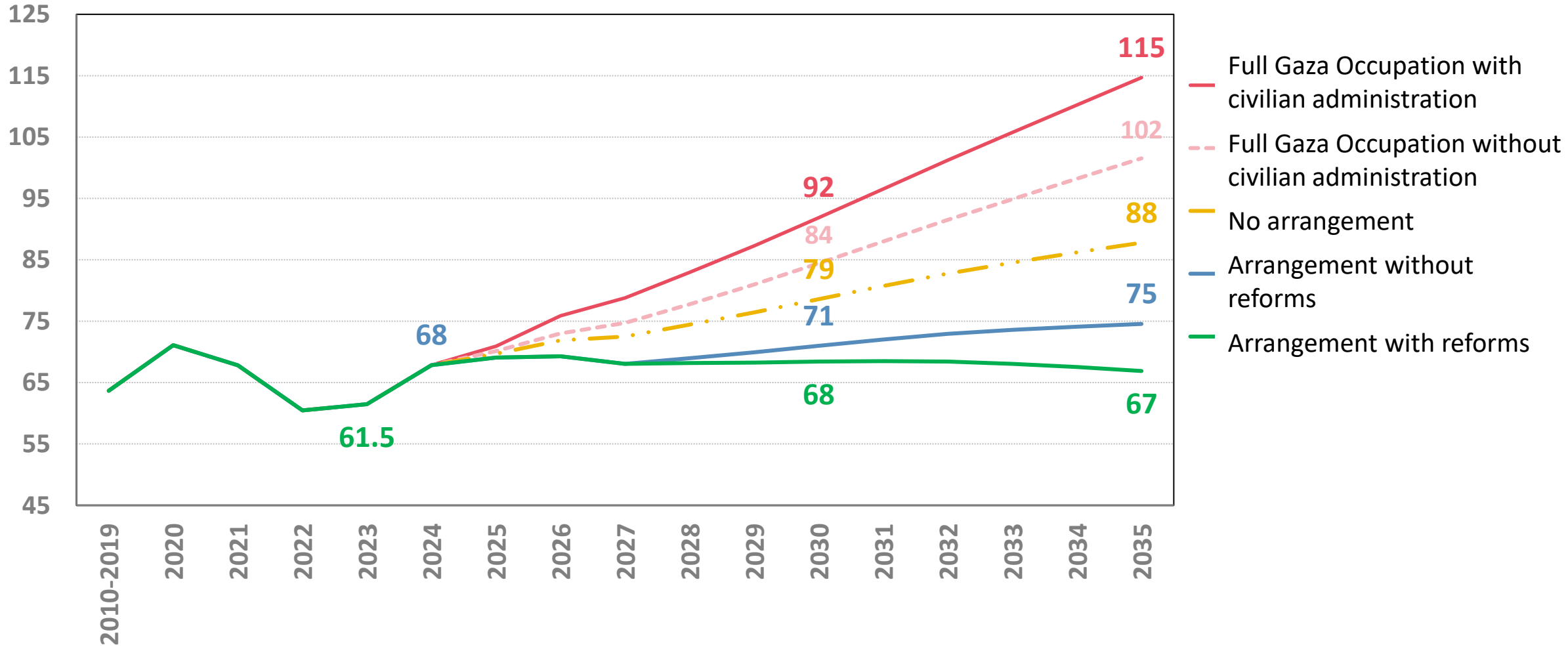
Scenario	Deficit	Interest Rate–Growth Gap	Convergence/ Divergence
Arrangement and growth-enhancing reforms	Low, declining	Negative	Stabilization
Arrangement without growth-enhancing reforms	Low, declining	Near zero	Slow divergence
No arrangement, no growth-enhancing reforms	High and widening	High and widening	Rapid divergence
Gaza Occupation and continuous civilian governance	High and prolonged	High over time	Very rapid divergence

Source: Aaron Institute

Absent growth-enhancing reforms, a full Gaza Occupation threatens fiscal sustainability and obstructs defense funding

Debt-to-GDP Trajectory, 2027–2035

Based on economic-security scenarios



Source: Aaron Institute.

Gaza Occupation: Risk of Financial Crisis

Pre-War

- Rapid sustained real growth of ~4% annually
- Real interest rate held at ~2% annually
- Government maintained responsible fiscal policy with a primary deficit of 1–1.5% of GDP
- Result: **Debt-to-GDP ratio declined** from 90% at the early 2000s to 60% at the eve of the war

2027-2023

- Debt-to-GDP trajectory reverses
- **Growth slows below the real interest rate**
- **Significant rise in the primary deficit**
- **Debt-to-GDP rises to 79% by 2027**

Outcome – Risk of Financial Crisis

- Diverging debt-to-GDP trajectory
- Financial markets aware of rising risks
- Possible raising in interest further widen the growth-interest gap
- Risk of state unable to raise funds
- Loss of public confidence, deposit withdrawals
- Heightened risk of capital market collapse

Arrangement: Economic stability achievable through fiscal adjustment and growth-oriented reforms

Pre-War

- Rapid sustained real growth of ~4% annually
- Real interest rate held at ~2% annually
- Government maintained responsible fiscal policy with a primary deficit of 1–1.5% of GDP
- Result: **Debt-to-GDP ratio declined** from 90% at the start of the 2000s to 60% on the eve of the war

2027-2023

- Stabilization of the debt-to-GDP ratio by 2027
- **Growth resumes above the interest rate from 2026**

Outcome – Economy back on a growth trajectory

- Defense spending remains financeable
- Growth-oriented reforms can be implemented and funded

⇨ Requires only moderate fiscal adjustment

Thank you

Appendix

*Employment Estimates – Including Reservists and Temporarily Absent Workers**

(thousands)

			Actual data				Projection			
			Q4 23	Q4 24	Q1 25	Q2 25	Q3 25	Q4 25	2026	2027
	**War Ending With an Arrangement**	**Reserve duty**	220	90	70	100	**80**	**70**	**50**	**50**
		**Temporarily absent from work ****	310	40	30	50	**40**	**30**	**30**	**10**
	**War Ending Without an Arrangement**	**Reserve duty**	220	90	70	100	**80**	**50**	**40**	**30**
		**Temporarily absent from work ****	310	40	30	50	**40**	**20**	**20**	**10**
	**Gaza Occupation**	**Reserve duty**	220	90	70	100	**80**	**100**	**100**	**100**
		**Temporarily absent from work ****	310	40	30	50	**50**	**50**	**30**	**30**

- Based on CBS Labor Force Survey data and estimates of the population exposed to fire in the North.
- ** Excluding workers temporarily absent from work due to reserve duty.
- The macroeconomic forecast was constructed using the data in the table, according to sectoral distribution and sector-specific productivity.

Breakdown of the Defense Budget*

War Ending Without an Arrangement

		2025	2026	2027
		110	**110**	**100**
Deferred Expenditures	**Iron Swords**	25	6	
	Gideon's Chariots + Rising Lion	28	14	
Routine Security			5-15	5-15
Total Budget		**163**	**135-145**	**104-114**

Gaza Occupation

	2025	2026	2027
Budget + Deferred	**163**	**130**	**100**
Gaza Occupation	16	16	
Routine Security**		5-15	5-15
Military Administration***		9-19	9-19
Civil Administration + Food Supply		10	10
Total Addition to Gaza Occupation	**16**	**50**	**34**
Budget inc. Civil Administration	**179**	**180**	**133**

* In NIS billions, constant 2023 prices

** For Gaza Occupation: routine security and military administration total in 24 billion NIS in 2025.

*** 2025–2027 Civilian and military administration costs estimated in consultation with Dr. Sasson Haddad based on Mind Israel strategy and Aaron Institute assessments.

Economic Assumptions for 2025–2027:

War Ending with an Arrangement

Assumptions on employment growth, labor productivity, output, and overall GDP, 2025–2027

	Employment			GDP per Worker			GDP		
2027-2025	2025	2026	2027	2025	2026	2027	2025	2026	2027
High-Tech Sector	1.5%	2.5%	3.5%	6.0%	6.0%	4.0%	7.5%	8.5%	7.5%
Non-High-Tech Sector	0.5%	0.7%	1.0%	0.5%	1.0%	1.0%	1.0%	1.7%	2.0%
Business Sector	0.7%	1.0%	1.5%	2.0%	2.7%	2.3%	2.8%	3.7%	3.8%
Public Sector	3.5%	2.0%	2.0%	0.0%	0.0%	0.0%	3.5%	2.0%	2.0%
Total* (result)*	1.9%	1.5%	1.7%	1.0%	1.8%	1.6%	**3.0%**	**3.3%**	**3.3%**

Source: Aaron Institute

Employment: Based on past trends. For the high-tech sector, employment growth is assumed to be half of the rate in 2017–2022.
Output per worker: Based on past trends. For high-tech, GDP per worker growth assumed at the 2017–2022 rate.
* The gap between output growth and employment growth reflects expected productivity gains (measured as GDP per hour worked).

Economic Assumptions for 2025–2027:
War Ending without an Arrangement

Assumptions on employment growth, labor productivity, output, and overall GDP, 2025–2027

	Employment			GDP per Worker			GDP		
2027-2025	2025	2026	2027	2025	2026	2027	2025	2026	2027
High-Tech Sector	1.5%	1.2%	1.0%	2.0%	2.0%	2.0%	3.5%	3.2%	3.0%
Non-High-Tech Sector	0.5%	0.5%	0.5%	0.5%	0.0%	0.0%	1.0%	0.5%	0.5%
Business Sector	0.6%	0.6%	0.6%	0.7%	0.7%	0.7%	1.2%	1.2%	1.2%
Public Sector	3.5%	2.0%	2.0%	0.0%	0.0%	0.0%	3.5%	2.0%	2.0%
Total* (result)*	1.9%	1.3%	1.2%	0.2%	0.2%	0.2%	**2.1%**	**1.5%**	**1.4%**

Source: Aaron Institute

Employment: Based on past trends. For the high-tech sector, employment growth is assumed to be half of the rate in 2017–2022.
Output per worker: Based on past trends. For high-tech, GDP per worker growth assumed at the 2017–2022 rate.
* The gap between output growth and employment growth reflects expected productivity gains (measured as GDP per hour worked).

Economic Assumptions for 2025–2027: Gaza Occupation

Assumptions on employment growth, labor productivity, output, and overall GDP, 2025–2027

2027-2025	Employment			GDP per Worker			GDP		
High-Tech Sector	2025	2026	2027	2025	2026	2027	2025	2026	2027
Non-High-Tech Sector	1.2%	-1.0%	-1.0%	2.0%	0.0%	0.0%	3.0%	-1.0%	-1.0%
Business Sector	0.2%	1.0%	1.0%	0.0%	0.0%	0.0%	0.2%	1.0%	1.0%
Public Sector	0.4%	0.7%	0.7%	0.7%	-0.2%	-0.2%	1.0%	0.5%	0.5%
Total* (result)	3.5%	2.0%	2.0%	0.0%	0.0%	0.0%	3.5%	2.0%	2.0%
2027-2025	1.7%	1.3%	1.3%	0.2%	0.2%	0.2%	**1.6%**	**0.8%**	**0.8%**

Source: Aaron Institute

Employment: Based on past trends. For the high-tech sector, employment growth is assumed to be half of the rate in 2017–2022.
Output per worker: Based on past trends. For high-tech, GDP per worker growth assumed at the 2017–2022 rate.
* The gap between output growth and employment growth reflects expected productivity gains (measured as GDP per hour worked).

Aaron Institute's Macroeconomic Model for 2028–2035

Economic Sectors

1. High-tech
2. Business (exc. High-tech)
3. Public

Population groups

1. Non-orthodox Jewish
2. Orthodox Jewish
3. Arabs

Sectoral output is determined by physical capital, public infrastructure (mainly transportation), employment by population group and education, and sector-specific productivity

Assumptions

Employment: based on education targets

Infrastructure: based on closing transport gaps (Aaron Institute's framework)

Employment and Education Targets

2028 Onward:
4 Defense-Growth Scenarios

1. War Ending With an Arrangement, Growth-Enhancing Reforms
2. War Ending With an Arrangement, No Growth-Enhancing Reforms
3. War Ending Without an Arrangement, No Growth-Enhancing Reforms
4. Gaza Occupation, No Growth-Enhancing Reforms

Economic Assumptions

Economic Targets for Reform Scenarios

Human Capital Targets for 2035: Arab and Haredi populations

Employment Rate

Raise employment rate of Arab men (25–44) to 85%
Raise employment rate of Arab women (25–44) to 77%
Raise employment rate of Haredi men (25–44) to 66%

Education

Arab men – equalize technological education and reduce academic education gaps by 50% compared to Jewish Non-Haredi men
Women – close education gaps compared to Jewish Non-Haredi women
Closing education gap among Haredi men compared to Non-Haredi men

Wages

Reduce wage gaps among Arabs within each education group (ages 25–44) by 50%
Reduce wage gaps among Haredi men compared to Arabs within each education group (ages 25–44) by 50%

Economic Assumptions for the 2028–2035 Scenarios

Defense Expenditures

- Based on Ministry of Finance data and the Aaron Institute's defense budget assessments

Civilian Expenditures

- Based on past trends – maintained at a fixed share of 33.7% of GDP

Interest Rate

- Based on the government's marginal interest rate, required to pay on new debt and partial refinancing of existing debt each year
- Annual linear decline of 0.05 percentage points assumed between 2028–2035

Economic Implications of Sanctions on Israel

Exports account for ~35% of Israeli GDP

~40% of exports (14% of GDP) are directed to EU countries and others likely to impose sanctions and boycotts

A 10% reduction in exports to these countries is expected to lower GDP by ~1.0%

~25% of production inputs are imported to Israel from EU countries

A 10% reduction in imports of goods is expected to lower GDP by ~0.5%**

Negative link between exposure to economic sanctions and GDP growth rates*

- Sanctions imposed by the UN are associated with a decline of 2 percentage points in annual growth (over 10 years)
- Sanctions imposed by the U.S. are associated with a decline of 0.75–1 percentage point in annual growth

* Neuenkirch, M., & Neumeier, F. (2015). The impact of UN and US economic sanctions on GDP growth. European Journal of Political Economy, 40(PA), 110–125.

**According to input-output tables, the import component in final output is 0.25.

Estimated Overall GDP Loss from Sanctions: 1.5%

(Changes in ratio to baseline scenario, percentage points PPP)

	Sanctions Impact – Export		Sanctions Impact – Imports of Production Inputs		Total Impact	
	GDP	Employment	GDP	Employment	GDP	Employment
High-Tech	-2.1%	-2.5%	0.0%	0.0%	-2.1%	-3.2%
Business (exc. High-tech)	-0.8%	-0.9%	-1.2%	-1.8%	-2.0%	-3.1%
Public						
Total Economy	**-0.9%**	**-0.7%**	**-0.6%**	**-0.9%**	**-1.5%**	**-1.6%**

A 1.5% decline in GDP reflects an annual decrease of about 1.6% in employment, alongside reduced productivity and investment, leading to lower capital accumulation

Growth-Enhancing Economic Policies 2026 Onwards

Employment Enhancing Policy

Aligned with employment targets set by the 2030 Employment Committee

- **Projected employment growth:** (annual average) **2.3%**

Growth-Enhancing Structural Reforms

Investments in national infrastructure, regulatory and efficiency reforms, and budget reallocations toward growth-supporting areas

- **Projected productivity growth:** (annual average) **1.4%**

High-Tech Sector

Preserving high-tech as a growth platform for the economy and advancing the transition from a dual economy to an inclusive economy

- **Grows at the pace of overall employment and output – Stable share in employment and GDP** (pessimistic assumption)

Reduced Macroeconomic Risks

Projected interest rate in 2035: 4.0%
(gradual decrease starting 2026)

2027–2035: Contribution of Policy Reforms to Rapid Growth (%GDP)

Projection for 2035, based on fiscal adjustments and economic policy assumptions

With reforms, projected growth is 3.7% compared to a baseline of 2.5%

Field	Growth Driver	Contribution to Growth (%GDP)
Employment	Increase in **Arab** population employment	0.12%
	Increase in **Haredi** population employment	0.07%
Education	Raise education levels in **Arab** population	0.13%
	Raise education levels in **Arab** population	0.22%
High-Tech sector	Increase in high-tech share in employment	0.04%
Infrastructure	Raise transportation public capital	0.27%
Public sector	Improve productivity through digitalization	0.07%
Business sector	Increase in private capital	0.32%
Total		**1.2%**

Source: Aaron Institute

Growth Projections: War Ending With an Arrangement, No Growth-Enhancing Reforms

	2037 Estimates	Average Annual Growth Rate	Contribution to Growth
Employment (thousands)	5,447	1.7%	1.1%
Human Capital Index	10	0.0%	0.0%
Infrastructure Capital (billion NIS)	3,862	3.2%	0.3%
Non-Infrastructure Capital	1,762	2.5%	0.6%
TFP (Total Factor Productivity)	0.15	0.6%	0.6%
Total GDP (billion NIS, 2020 prices)	**2,283**	**2.5%**	**2.5%**
GDP per worker (thousand NIS, 2020 prices)	**419**	**0.8%**	**----**

Source: Aaron Institute

Growth Projections: War Ending With an Arrangement, No Growth-Enhancing Reforms

	2037 Estimates	Average Annual Growth Rate	Contribution to Growth
Employment (thousands)	4,669	0.1%	0.1%
Human Capital Index	10.0	0.0%	0.0%
Infrastructure Capital (billion NIS)	3,862	3.2%	0.3%
Non-Infrastructure Capital	1,658	1.9%	0.5%
TFP (Total Factor Productivity)	0	0.5%	0.5%
Total GDP (billion NIS, 2020 prices)	**1,972**	**1.0%**	**1.0%**
GDP per worker (thousand NIS, 2020 prices)	**422**	**0.9%**	

Source: Aaron Institute

Growth Projections: War Ending Without an Arrangement, No Growth-Enhancing Reforms

	2037 Estimates	Average Annual Growth Rate	Contribution to Growth
Employment (thousands)	5,368	1.5%	1.0%
Human Capital Index	10	0.0%	0.0%
Infrastructure Capital (billion NIS)	3,862	3.2%	0.3%
Non-Infrastructure Capital	1,615	1.6%	0.4%
TFP (Total Factor Productivity)	0.2	0.2%	0.6%
Total GDP (billion NIS, 2020 prices)	**2,185**	**2.0%**	**2.0%**
GDP per worker (thousand NIS, 2020 prices)	**407**	**0.5%**	

Source: Aaron Institute

Growth Projections: Gaza Occupation

	2037 Estimates	Average Annual Growth Rate	Contribution to Growth
Employment (thousands)	4,669	0.1%	0.1%
Human Capital Index	10.0	0.0%	0.0%
Infrastructure Capital (billion NIS)	3,862	3.2%	0.3%
Non-Infrastructure Capital	1,658	1.9%	0.5%
TFP (Total Factor Productivity)	0	0.5%	0.5%
Total GDP (billion NIS, 2020 prices)	**1,972**	**1.0%**	**1.0%**
GDP per worker (thousand NIS, 2020 prices)	**422**	**0.9%**	

Source: Aaron Institute

Debt-to-GDP Dynamics

Deficit in real terms (D_t): The gap between government revenues (T_t) and expenditures (G_t), in real terms

$$D_t = T_t - G_t$$

Debt in real terms (B_t): The cumulative sum of past deficits plus interest on existing debt

$$B_t = D_t + (1 + r)B_{t-1}$$

Annual increase in debt = deficit + real interest on last year's debt

$$B_t - B_{t-1} = D_t + r \cdot B_{t-1}$$

Debt-to-GDP ratio (b_t):

$$\frac{B_t}{Y_t} = \frac{D_t}{Y_t} + (1 + r) \cdot \frac{B_{t-1}}{Y_t}$$

Real GDP (Y_t): previous real GDP + real growth

$$Y_t = (1 + g)Y_{t-1}$$

Debt dynamics depend on the gap between the interest rate (r) and the growth rate (g)

$$\Rightarrow b_t = d_t + \frac{1 + r}{1 + g} \cdot \frac{\overbrace{B_{t-1}}^{b_{t-1}}}{Y_{t-1}} \cong d_t + (r - g)b_{t-1}$$

The larger the gap between the interest rate and the growth rate, the faster the debt-to-GDP ratio increases

If the interest rate is higher than the growth rate, debt-to-GDP ratio rises even in the absence of deficit

Growth-Enhancing Reforms | Human Capital and Employment

Raising employment rates among the Arab and the Haredi populations

2035 Targets

87%	65%	77%	85%
Ultra-orthodox Jewish women	Ultra-orthodox Jewish men	Arab women	Arab men

Contribution to Growth

0.27% GDP

Closing education gaps among the Arab and the Haredi Populations

2035 Target: Doubling Arab participation in technological occupations, reducing wages gap by half across all education levels

Contribution to Growth

0.37% GDP

Growth-Enhancing Reforms | Investment in Infrastructure

Investing in transport infrastructure to enhance accessibility, comparable to leading global metropolitan areas

NIS940B

2023-2040

~2.1% of annual GDP

Additional 1.3% of GDP allocated to other infrastructure investments

40%

Increase public transport's share of total travel from 20% to 40% by 2040

30kph

Doubling travel speed from 15 to 30 km/h

Contribution to Growth

0.35% GDP

Growth-Enhancing Reforms | Strengthening High-Tech and Digitalization

Strengthening the High-Tech Sector

- Annual growth of 3.5% in high-tech employment
  - Partly following the Perlmutter Committee recommendations to expand human capital in high-tech
- Strengthening academia–industry collaborations
- Creating a competitive and predictable business environment

Contribution to Growth

0.3% GDP

Compared to the scenario of no-growth in high-tech

Digitalization

- 25% reduction in service providers' working time through digital transformation and streamlined bureaucracy

Contribution to Growth

0.1% GDP