Reichman University Aaron Institute for Economic Policy
In memory of Aaron Dovrat

Economic Challenges for 2025–2035
Security and Political scenarios

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In light of the government's decision to Occupy the Gaza strip, the Aaron Institute for Economic Policy at Reichman University conducted an analysis in early September 2025, examining the economic implications of three possible security and political scenarios: (1) ending warfare and reaching international agreement concerning the civil administration of the Gaza Strip; (2) ending the war in Gaza without international agreement; (3) full occupation of the Gaza Strip involving prolonged civil administration by Israel.

The economic analysis distinguishes between the short term (2025–2027) and the long term (2028–2035). For each scenario, estimates were produced for the required reserve force mobilization, the share of workers expected to be absent from the labor market, defense expenditures, and their implications for the deficit, growth, and debt-to-GDP ratio. **This analysis provides an economic quantification of the various scenarios, enabling decision makers to anticipate expected costs and assess the financial and macroeconomic risks associated with alternative policy and security strategies.**

Each scenario is based on assumptions regarding the duration and intensity of the conflict and the extent of damage to the home front. These assumptions determine the required reserve mobilization, defense spending, and expected economic disruption. Some scenarios also assume diplomatic isolation and even sanctions—developments already underway and promoted by several countries. Overall, the calculations are grounded in economic data, historical experience, and international research. The potential economic loss from sanctions is assessed based on estimated effects on exports and imports.

It is important to note that the purpose of the analysis is not to predict the future but to present decision makers with a structured framework of possible scenarios, their economic risks, and the potential growth trajectories associated with them. War entails substantial direct costs: rocket and missile attacks disrupt industry and commerce, while reserve mobilization removes tens of thousands from the labor force. Conversely, growth-enhancing policies and diplomatic agreements enable development and welfare. Researchers at the Aaron Institute analyze these scenarios in collaboration with security experts and former senior officials, assessing their implications in terms of key economic variables—employment, productivity, and investment. These serve as the basis for calculating growth, deficit, and debt projections. As reflected in the Institute's prior work, this is a practical analytical tool—not a speculative forecast.

It is also essential to understand that discrepancies that may later emerge between ex-ante estimates and realized outcomes do not indicate methodological failure, but rather the inherent uncertainty of security conflicts. Just as defense officials cannot precisely predict the duration of a campaign against Hezbollah or Iran, or the extent of damage to the home front, economic analysts cannot fully anticipate their exact macroeconomic effects. **In both of those operations, the defense establishment's achievements exceeded expectations**, resulting in total damages and costs that were roughly 75% lower than the preliminary estimates, and consequently, the actual economic cost proved substantially lower than projected.

The scenarios are:

In all scenarios examined, it was assumed that a fiscal adjustment of 2% of GDP (through expenditure cuts or tax increases) would take place during 2026–2027.

1. **Ending warfare in Gaza through an agreement by the end of 2025:** End of the Gaza war through a negotiated arrangement by the end of 2025: This scenario is expected to materialize if Phase B of the Trump Plan is implemented. The arrangement would reduce the required scale of reserve mobilization and include the deployment of an international force to oversee civil administration and reconstruction in the Gaza Strip starting in 2026. Under this scenario, the economy returns to a growth path as early as 2026, with projected annual growth of 3.6% in 2026 and 3.7% in 2027, resulting in debt-to-GDP ratio of 68% by the end of 2027.

Under this scenario, in the long term (2028-2035), we assume that if growth-enhancing reforms are implemented in parallel—aimed at improving employment rates and labor productivity through investing in human capital, employment, and infrastructures, particularly transportation and digitalization—the Israeli economy will grow at an annual rate of 3.7%. This growth also reflects the expected increase in the high-tech sector's share of total employment and GDP, allowing the Israeli economy to maintain its position as an international technology hub.

In this scenario, the relatively low deficit and robust economic growth in 2028–2035 enable the stabilization of the debt-to-GDP ratio at approximately 67%–68%. It should be noted that this scenario also accounts for the defense buildup required to address security threats, as recommended by the Nagel Committee.

Under a security scenario involving the end of hostilities through a negotiated arrangement **without the implementation of growth-enhancing reforms**, GDP growth during 2028–2035 is expected to average only 2.5% per year.

2. **Continuation of the situation that prevailed prior to Operation *Chariots of Gideon II* and without agreement:** in this scenario, military activity continues at the same level intensity observed in the third quarter of 2025, alongside ongoing Israeli responsibility for food distribution in the Gaza Strip. Projected growth is 1.3% in 2025 and 1.7% in 2026. The required defense expenditures under this scenario raise the deficit to 8.3% in 2025 and 7% in 2026, while the debt-to-GDP ratio in that year is expected to reach 71.8%.

Under this scenario, in the long term (2028–2035) and in the absence of growth-enhancing reforms, GDP growth rate slows to an annual average of 2%. The forecast assumes a negative impact on the GDP growth potential due to the emigration of skilled labor (brain drain), driven by security and economic uncertainty. Finally, this scenario entails severe risks to the financial stability of the Israeli economy, with debt-to-GDP ratio continuously rising—from 72.4% in 2027 up to 88% in 2035.

3. **Full occupation of the Gaza Strip and continued civil administration by Israel:** the cessation of the war prevented the realization of this scenario. Had it materialized, the IDF would have conducted highly intensive military operations in the final quarter of 2025 and through 2026, including large-scale mobilization of approximately 100,000 reservists.
   Under to international law, Israel would have been responsible for providing food and basic civil services to Gaza's population. The military operations, combined with the costs of administering Gaza's civil affairs—including food distribution—would have raised defense expenditures in 2025 and 2026 to over 8.5% of GDP annually and increased the fiscal deficit to 5.6% and 6.9%, respectively.
   Under this scenario, GDP growth would have been severely undermined—0.7% in 2025 and 1.1% in 2026—resulting in negative per capita GDP growth (a decline of 1.1% in 2025 and 0.7% in 2026). These outcomes would have jeopardized Israel's financial stability: the debt-to-GDP ratio was projected to rise to 74.9% by the end of 2026 and 77.6% in 2027. Such debt levels were expected to trigger a substantial downgrade of Israel's credit rating, a sharp increase in risk premiums, and higher government financing and debt rollover costs. It was

further assumed that under a full occupation scenario, **no growth-enhancing reforms**—such as investments in human capital, employment, infrastructure (particularly transport), or economy-wide digitalization—**would be implemented**.

This scenario would have entailed major risks for Israel's economy and financial stability. First, **it would not have been fiscally possible to implement the defense budget in full.** A significant deterioration in civilian services was expected—particularly in healthcare, education, and transport investment. In addition, such a scenario would have further worsened Israel's standing **in the international sphere**, with economic sanctions likely to harm both exporting firms, especially in high-tech, and domestic production due to difficulties importing raw materials and intermediate goods.

According to the analysis, substantial economic sanctions would have reduced annual growth during 2028–2035 by 2.5 percentage points relative to the economy's potential growth path, **resulting in** a pronounced slowdown in GDP growth, with average annual growth of only 1%. This forecast implied multiple years of negative per capita growth and a decline in citizens' standard of living. The combination of low growth and high defense expenditures would have resulted in large fiscal deficits and a sharp, sustained rise in the debt-to-GDP ratio—exceeding 90% as early as 2030. The combination of **weakened civilian services and security**, low growth, and international isolation could have triggered increased emigration of young skilled professionals ("brain drain"), further deepening the economic deterioration. This emigration would likely have been particularly severe in the high-tech sector and, together with the declining attractiveness of Israel as an R&D hub, would have led to a sustained reduction in the sector's share of total employment.