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RESEARCH PAPER

ISRAEL'S SECURITY AND ECONOMIC CONUNDRUM:

HOW DOES ISRAEL CONFRONT THE CHALLENGES OF A PROTRACTED WAR WITH IRAN?

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The Israeli economy is undergoing one of its most complex phases in decades, as the ongoing military escalation with Iran converges with the adoption of the largest budget in the state's history, at a moment when national security considerations appear to dominate economic decision-making. This acute intersection between security and economics has reshaped the allocation of resources within the state, prioritizing defense spending at the expense of growth trajectories and social stability.

In this context, Israel's 2026 state budget has been approved at an estimated total of 699 billion shekels, with a marked increase in defense allocations reaching approximately 143 billion shekels. This surge comes amid sustained security pressures and the multiplicity of military theaters, resulting in a contraction of the fiscal space available for civilian sectors such as health, education, and social welfare. This shift does not appear to be merely a temporary response, but rather reflects the cumulative costs of the protracted conflict with Iran and Hezbollah, which are estimated at around 47 billion shekels to date, with expectations of further increases should the escalation persist or expand.

This evolving fiscal landscape highlights the core dilemma confronting Israel today: the tension between meeting existential security requirements on the one hand and preserving the economy's capacity for growth and sustainability on the other. Each expansion in military spending is accompanied by a corresponding narrowing of the space available for investment in infrastructure and public services, with gradual implications for the quality of economic growth and the cohesion of the social fabric.

The repercussions of this dilemma extend beyond resource reallocation to raise deeper questions about the Israeli economy's ability to sustain this pattern of "structural fiscal strain," particularly in light of rising deficits and mounting pressures on public debt, and the associated challenges to long-term financial stability.

Accordingly, this moment warrants close examination as a structural turning point, in which the Israeli economy can no longer be analyzed in isolation from the security context; rather, the two have become components of a single, interdependent equation. This paper therefore seeks to deconstruct this equation by analyzing budgetary priorities, assessing their implications for the Israeli economy, and exploring their potential impact on growth trajectories, financial stability, and social cohesion in the period ahead.

Design & Art Direction

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First:

The Security-Economy Nexus in Israel amid the War with Iran

The relationship between security and economics constitutes a central pillar in understanding how Israel manages its resources in the face of strategic challenges, particularly in the context of the ongoing war with Iran and evolving regional dynamics. In this regard, the Institute for National Security Studies underscores in its 2025 policy document that national strategy rests on four interrelated pillars: national security, economic capacity, societal resilience, and international standing. This reflects an institutional perspective that views the economy as an integral component of a comprehensive security framework, rather than merely a supporting sector.

Within this framework, economic capacity serves as a key driver of the security apparatus, enabling the state to allocate the resources required for defense fronts without undermining long-term development trajectories. This capacity is grounded in a set of core pillars, most notably advanced human capital, strong institutional structures, a dynamic innovation ecosystem, and entrepreneurial culture, alongside social considerations—factors that collectively enhance the economy's ability to withstand crises and sharp fluctuations.

In the same context, the technology sector emerges as one of the principal pillars of the Israeli economy. It contributes significantly to GDP and functions as a primary engine of growth, export generation, and foreign investment attraction. According to the institute's assessments, the role of this sector extends beyond supporting economic performance under normal conditions to becoming a critical enabler of security capabilities during periods of conflict, whether through its applications in defense industries or by sustaining innovation and productivity levels despite the pressures of war.

Conversely, the document highlights the high degree of integration of the Israeli economy into global markets, rendering it particularly sensitive to regional tensions, especially amid continued escalation with Iran. Such tensions may negatively affect trade flows and foreign investment inflows, thereby imposing additional pressures on the domestic economy and increasing the burden on the state budget.

Accordingly, balancing security imperatives with the needs of the civilian economy remains a persistent strategic dilemma, requiring the formulation of flexible and adaptive fiscal and economic policies capable of responding to shifts in the security environment, while ensuring the continued ability to finance defense requirements without compromising economic stability or future growth prospects.

To examine the landscape more deeply, prior to the outbreak of direct war with Iran on February 28, 2026—under Operation "Roaring Lion"—Israel had managed to maintain a relative balance between national security requirements and economic stability. This balance rested on its traditional model, which combines a strong defense priority with the dynamism of a free-market, innovation-driven economy. In January 2026, the Bank of Israel projected economic growth of 5.2% for 2026, supported by the ceasefire in Gaza and the easing of supply constraints resulting from the large-scale mobilization of reservists. The economy recorded actual growth of 2.9% in 2025, following years of relative stagnation linked to the Gaza war. The initial defense budget for 2026 stood at approximately 112 billion shekels (around 6% of GDP)—a relatively high level, yet one that did not impede civilian recovery, supported by the strength of the technology and services sectors, low unemployment rates, and declining risks to foreign investment.

With the launch of Operation "Roaring Lion," this relative balance shifted into a more acute dilemma, as national security became an overriding priority. This led to the large-scale mobilization of reservists, a substantial increase in military spending, and the reallocation of significant resources toward the Iranian and Lebanese fronts. Consequently, on March 30, 2026, the Bank of Israel revised its growth forecast downward to 3.8% for 2026 (from 5.2% in January), assuming the war would conclude by the end of April. Meanwhile, the Ministry of Finance projected growth in the range of 3.3% to 3.8%, depending on the duration of hostilities.

Defense spending increased by more than 30 billion shekels (approximately $10–11 billion), bringing the total to over 142–143 billion shekels—the highest level on record—within an overall state budget estimated at between 699 and 850 billion shekels. The fiscal deficit target also rose to 5.3% of GDP (compared to 3.9% in initial projections), with public debt expected to climb to approximately 70.5% of GDP.

These developments lay bare the core strategic dilemma facing Israel, raising a fundamental question: was the balance between security and the economy ever sustainable in the face of multiple regional threats, or has direct escalation with Iran revealed an inherent contradiction requiring substantial and sustained economic sacrifice? The prioritization of security—encompassing continued strikes on Iran's nuclear and missile programs and engagement with proxy actors across multiple fronts—imposes immediate costs on growth, consumption, and investment, whether through the disruption of civilian activity or the expansion of defense spending at the expense of civilian budgets.

This contradiction thus gives rise to a deeper strategic question: to what extent can Israel sustain long-term economic attrition in pursuit of security gains, or will a protracted conflict ultimately necessitate a recalibration of priorities in favor of economic stability?

Second:

The Impact of War on Public Spending and the State Budget

The war in Gaza since October 2023, followed by the war against Iran, has triggered a profound and rapid transformation in the overall performance of the Israeli economy. The state budget has ceased to function merely as an instrument for allocating resources across development sectors and social services, evolving instead into a primary framework for managing a prolonged security condition—referred to by Israeli economists as a "mobilization economy." The government has repeatedly relied on emergency budgets and in-year fiscal adjustments, reflecting a departure from traditional financial planning stability and a shift toward a reactive approach closely tied to developments on the military front. In this context, the Bank of Israel notes in its annual reports that this pattern signals a transition toward a prolonged reallocation of resources in favor of security priorities at the expense of civilian growth and public investment, thereby generating structural pressures that undermine economic flexibility and the capacity for rapid recovery.

Military expenditure has expanded to unprecedented levels, according to data from the Ministry of Finance, with the defense budget exceeding 160 billion shekels in 2024, and continuing its upward trajectory in 2025 and 2026 as a result of the widening scope of military operations and the multiplicity of fronts. This increase has not been merely quantitative, but has been accompanied by a comprehensive reordering of budgetary priorities, whereby substantial additional resources have been redirected toward the military establishment through the reduction or postponement of civilian expenditures, including investments in infrastructure and long-term development projects.

Analyses by the Institute for National Security Studies indicate that this shift reflects a transition toward a model that prioritizes security over conventional economic growth, creating a structural imbalance in the allocation of public resources, negatively affecting overall economic efficiency, and constraining the economy's ability to achieve sustainable growth over the medium term.

In parallel, the war has had a clear and immediate negative impact on key macroeconomic indicators in Israel. The following table illustrates the main

Indicator	Pre-War (January 2026 Forecasts or 2025 Data)	Post-War (2026 Forecasts)
GDP Growth (2026)	5.2%	3.3%–3.8%
GDP Growth (2025, actual)	2.9%	Continued relative stagnation
Private Consumption Growth (2026)	Above 3.0% (previous forecasts)	3.0%
Broad Unemployment Rate (Ages 25–64, 2026)	3.3%	Average of 4.5%
Annual Inflation (2026)	Within 1–3% (stable)	2.2%
Budget Deficit (2026)	3.9% of GDP	5.3% of GDP
Public Debt-to-GDP Ratio (2026)	Below 70%	70.5%

One of the most prominent consequences of this transformation is what is referred to in economic literature as "fiscal crowding-out," whereby the expansion of military expenditure generates direct pressure on civilian spending within the state budget. As this trend persists, the government is compelled to repeatedly reorder its fiscal priorities, leading to the reduction or postponement of allocations to key sectors and a diminished capacity to invest in developmental and productive projects. Ultimately, the impact extends beyond the fiscal structure itself to affect the future trajectory of economic growth and the state's ability to diversify its sources of income.

This expansion in military spending has also been clearly reflected in deficit and public debt indicators. The fiscal deficit rose to levels ranging between 6% and 7% of GDP during the peak of military operations, driven by the substantial increase in defense expenditures, as well as costs associated with population evacuations, compensation payments, and the management of the war's domestic repercussions. This situation has pushed the government toward increasing reliance on borrowing to finance expenditures rather than current revenues, thereby intensifying pressures on the government bond market and raising borrowing costs.

In the same context, official estimates indicate that the cumulative cost of the war could reach hundreds of billions of shekels, with projections exceeding 200–250 billion shekels during the initial years of the conflict. This substantial financial burden has been reflected in the accelerated growth of public debt at a pace surpassing that of GDP growth, thereby narrowing the fiscal space available to the government in the future and constraining its capacity to respond to subsequent economic shocks.

Moreover, the financial burden is not limited to direct military spending; it extends to what may be described as a "compensation economy." The Israeli Ministry of Finance has allocated significant resources to compensate affected businesses, support workers who have lost their income or been forced into unpaid leave, and finance the reconstruction of damaged infrastructure. Over time, this component has become an increasingly prominent share of public expenditure, indicating that the cost of war is no longer confined to military operations, but also encompasses the management of its domestic economic and social consequences.

Within this context, the Bank of Israel has warned that the continuation of this pattern of elevated spending could generate structural pressures on the state's financial stability. As public debt rises and the cost of servicing it increases, the government's available policy options become more constrained—whether through raising taxes, reducing civilian spending, or increasing borrowing—each of which carries complex economic and social implications. Financial markets have already begun to reflect these risks through rising yields on government bonds, signaling a relative decline in confidence in the future fiscal trajectory should current conditions persist.

In light of the above, official data and economic analyses indicate that the war has ceased to be a temporary condition affecting the state budget and has instead become a structural factor reshaping the Israeli economy itself. The economy has gradually shifted toward a model dominated by security considerations, in which military expenditure expands at the expense of civilian sectors, while deficits and public debt increase alongside a relative decline in developmental investment. This suggests that the challenge is no longer one of managing a temporary crisis, but rather of restoring a balance between security imperatives and the sustainability of economic growth—a balance that appears increasingly complex amid continued regional instability.

Third:

The Performance of the Israeli Economy during the War

Israel's 2026 state budget has undergone a profound and unprecedented transformation in the country's history, as a direct consequence of the continued military escalation with Iran and its allies in Lebanon under Operation "Roaring Lion." On March 30, 2026, the Knesset approved the largest budget in Israel's history, with total expenditures amounting to 850.6 billion shekels (approximately $271 billion). This includes an operational spending ceiling of around 699 billion shekels, in addition to 77 billion shekels in revenue-contingent expenditures and 196 billion shekels in long-term commitments.

The budget features a record allocation for defense, ranging between 143 and 144 billion shekels (approximately $45.8–46 billion) for the Ministry of Defense alone, following the addition of 32 billion shekels in the latest revision, compared to the 112 billion shekels outlined in the original plan approved in December 2025. This represents an increase exceeding 120% compared to pre-war levels in 2023, when annual defense spending stood at approximately 65 billion shekels. This expansion was not a routine adjustment, but rather an immediate response to the operational demands of multiple fronts, including emergency arms procurement, large-scale reserve mobilization, and the extensive deployment of advanced air defense systems.

According to preliminary estimates by the Israeli Ministry of Finance published on April 12, 2026, the direct cost of the war with Iran had reached approximately 35 billion shekels ($11.5 billion) by that date. Of this total, 22 billion shekels were allocated to defense and security agencies—including emergency arms procurement, air operations, and reserve mobilization—while 12 billion shekels were directed toward compensation for affected parties and civilian expenditures, and 1 billion shekel was allocated to general spending on the home front.

Overall, the total cost of the conflict with Iran and Hezbollah has risen to approximately 47–65 billion shekels ($15–20 billion), according to recent Israeli economic reporting in outlets such as Calcalist and TheMarker, with projections indicating that it could reach 80 billion shekels or more if hostilities persist or expand. Daily costs are estimated at between 1 and 2 billion shekels, encompassing the large-scale mobilization of hundreds of thousands of reservists, the procurement of advanced air defense systems, and the operation of aircraft and drones across multiple fronts. This figure significantly exceeds the daily costs incurred during previous Israeli conflicts, such as "Guardian of the Walls" or even the early stages of "Swords of Iron."

To finance this expansion, the government raised the fiscal deficit ceiling from 3.9% to 4.9–5.1% of GDP, with the Bank of Israel projecting that it could reach 5.3% in practice. Horizontal spending cuts of 3% were also applied across most civilian ministries—excluding defense—generating savings of approximately 1.7 billion shekels, alongside the cancellation of fiscal reforms valued at 900 million shekels. These cuts affected sectors such as health, social welfare, education, higher education, and culture and sports, while increases in coalition funding for Haredi institutions (approximately 790–800 million shekels) and settlements were maintained. This has drawn widespread media criticism, with fiscal priorities described as reflecting political considerations at the expense of development.

As a result, defense spending now accounts for more than 20% of the total budget, significantly reducing the fiscal space available for productive and social sectors. The Bank of Israel warns that this trajectory could push public debt to approximately 70.5% of GDP by the end of 2026, up from around 68.8–69% currently, while debt servicing costs are expected to rise to 64.5 billion shekels—an increase of 15% compared to the previous year. Economic growth is also projected to slow to around 3.8%, down from 5.2% prior to the escalation, reflecting a diminished capacity to sustain robust growth under the pressure of elevated security spending.

In addition, economic reports highlight that fiscal pressures extend beyond direct military expenditures to include indirect costs such as compensation for affected businesses in the north, unemployment payments for displaced workers, and the rehabilitation of the wounded and affected families, which have collectively reached approximately 13–14 billion shekels to date.

Although these civilian costs remain lower than military expenditures, they have contributed to deepening the deficit and have driven the government toward greater reliance on both domestic and external borrowing, thereby increasing the risks associated with rising interest rates and their spillover effects on the private sector.

The continuation of the conflict further implies that the 2026 budget may prove insufficient, as the Ministry of Defense has requested additional allocations ranging from 33 to 65 billion shekels by the end of the year, particularly in the event of an expansion of ground operations in Lebanon.

From a broader perspective, the performance of the Israeli economy during the war with Iran indicates a structural shift in its overall trajectory. The economy has gradually transitioned from a model characterized by relative stability and innovation-driven growth toward one increasingly shaped by security imperatives and the costs of protracted conflict. Military escalation has reshaped the structure of the state budget, which is now increasingly directed toward financing emergency defense expenditures at the expense of development sectors and social services, thereby eroding the fiscal space available for civilian investment.

Consequently, the Israeli economy is undergoing a process of forced rebalancing, in which prospects for sustainable growth are receding in the face of rising security priorities, while pressures on debt and deficit indicators intensify. This reflects a clear shift toward a more fragile economic model in the face of geopolitical shocks, placing policymakers before a long-term dilemma between maintaining military superiority and ensuring the sustainability of economic stability.

Fourth:

The Internal Dilemma between Security and Societal Stability

Data released by the Bank of Israel in its March 2026 report indicate that the war in Gaza since October 2023, followed by direct escalation with Iran, has led to a tangible decline in the standard of living of Israeli citizens. The total cost of the war has been estimated at approximately 35,000 shekels per capita. The report notes that this decline is equivalent to a reduction of around 3,900 shekels per quarter in both actual and notional income, reflecting the direct and indirect costs of the war, including disruptions to external trade, capital outflows from the Israeli market, and the broader slowdown in economic activity.

The report further highlights that Israel entered the current confrontation while already facing structural gaps in infrastructure and human capital, factors that amplify the long-term impact of the war on growth rates. The bank emphasizes that the continuation of elevated security spending makes it difficult to place public debt on a downward trajectory without significant increases in tax revenues or improvements in labor market efficiency and participation rates, particularly among groups not fully integrated into the economy.

Within this context, the Bank of Israel recommends the implementation of a package of tax and fiscal reforms during the period 2027–2028. These measures include tax increases, the elimination of certain tax exemptions, and the introduction of levies on activities that negatively affect the environment and quality of life, such as carbon taxes, congestion charges, and taxes on single-use products. Despite their political sensitivity, the report considers these measures essential tools for enhancing fiscal sustainability and reducing the widening deficit.

The report also links long-term economic performance to the restructuring of public expenditure, advocating for the redirection of resources toward growth-supporting sectors, particularly education and the labor market. It underscores that future growth prospects depend largely on increasing labor force participation among Arab women and Haredi men, alongside the reallocation of certain budgetary expenditures that are deemed to have a negative impact on productivity.

In the same context, reports issued by the Bank of Israel and the Israeli Ministry of Finance indicate that the war ongoing since October 2023 has not been confined to military or security dimensions alone, but has instead produced a structural shift in the relationship between the state and society with regard to the allocation of public resources. This shift can be characterized as an “internal dilemma” between the imperatives of national security and the demands of daily living standards. As military expenditure has surged to unprecedented levels, the state budget has come under dual pressure: the need to finance ongoing military operations on the one hand, and to maintain a minimum threshold of social stability and essential services on the other. The Bank of Israel notes in its annual report that this dynamic reflects a transition toward a prolonged mobilization economy, in which public spending priorities are continuously recalibrated in response to security exigencies, thereby constraining the state’s capacity for long-term civilian planning.

Within this framework, data from the Israeli Ministry of Finance reveal that the sharp rise in defense spending during the period 2023–2025 has exerted direct pressure on civilian expenditure categories. Substantial resources have been redirected toward financing military operations, procuring equipment, and compensating affected populations, leading to a contraction in the fiscal space available for sectors such as education, healthcare, and infrastructure. This shift has generated a clear case of fiscal displacement, whereby security spending directly crowds out social expenditure, with adverse implications for the quality of public services and the government’s ability to implement strategic development projects.

From a macroeconomic perspective, the Bank of Israel highlights that the continuation of this spending pattern has resulted in a widening fiscal deficit and a marked increase in public debt, imposing growing constraints on the government’s capacity to finance essential living needs. Rising military expenditures are no longer financed solely through internal reallocation, but increasingly through public borrowing, which has significantly raised the cost of debt servicing. The bank warns that this trajectory creates a potentially destabilizing feedback loop: each increase in security spending contributes to a higher deficit, which in turn reduces the state's ability to sustain social expenditure, thereby intensifying the tension between security and domestic welfare and posing risks to medium-term social stability.

This challenge is further elaborated in analyses by the Institute for National Security Studies, which argue that the concept of security in Israel has evolved beyond a purely military dimension to become closely intertwined with internal socio-economic stability. Rising living costs, mounting pressures on the middle class, and declining quality of public services all directly affect the internal resilience of Israeli society during prolonged periods of conflict. The institute warns that one of the most serious consequences of this trajectory is the gradual erosion of the social contract between the state and its citizens, as an increasing segment of the population perceives that state priorities are disproportionately tilted toward security at the expense of basic livelihood needs—potentially leading to internal social fractures that could undermine national resilience over the long term.

Reports by the State Comptroller of Israel further indicate that the management of the war has placed significant strain on the capacity of state institutions to deliver essential services. Human and financial resources have been redirected toward security and military sectors, adversely affecting the efficiency of healthcare, local emergency services, and social welfare provision. These reports underscore that the crisis is no longer purely fiscal, but has also become administrative and structural in nature, as the government faces a compounded challenge: managing a prolonged external conflict while simultaneously preserving internal stability and meeting the daily needs of the population.

In this context, the Bank of Israel warns that the continued expansion of military expenditure without restoring balance with social spending could lead to a gradual erosion of the state's ability to sustain both security and welfare simultaneously. The current framework increasingly relies on public debt financing—an approach that is unsustainable over the long term, particularly amid rising interest rates and heightened sovereign risk. The bank emphasizes that the government's available policy options have become increasingly constrained, limited to raising taxes, reducing public services, or continuing to expand borrowing—each of which carries significant social, political, and economic costs that may further intensify internal tensions.

In sum, official Israeli data and analytical assessments reveal that the dilemma between security imperatives and living standards is no longer a theoretical or temporary issue tied solely to wartime conditions. Rather, it has evolved into a structural challenge reshaping the country's economic and social framework. While Israel continues to strengthen its security capabilities in response to escalating threats, it simultaneously faces mounting internal pressures related to the cost of living and the deterioration of public services. As a result, internal stability itself has become an integral component of the national security equation, placing Israel before a fundamental domestic dilemma: how to achieve a sustainable balance between the imperatives of security survival and the sustainability of economic and social life.

Fifth:

Israeli Strategies for Addressing the Dilemma

Since the escalation of military confrontation with Iran, Israel has adopted a strategic approach based on the principle of “rapid strike and economic containment,” aimed at shortening the duration of combat operations and preventing their transformation into a prolonged economic war of attrition. This approach has relied on limiting large-scale ground operations in favor of precise air and intelligence strikes targeting Iranian military infrastructure, thereby preserving the continuity of domestic economic activity and reducing reliance on prolonged reserve mobilization. An analysis by the Institute for National Security Studies indicates that this trend reflects a shift toward what may be described as a model of “relatively low-attrition warfare management,” in which specific military objectives are pursued without sliding into a comprehensive, long-term conflict that would impose a heavy burden on the Israeli economy.

Domestically, the government has translated this approach into a broad package of fiscal, monetary, and social policies, through which resources have been redirected toward sectors most affected by the war and most closely linked to security and social stability. These policies have included direct compensation and support programs for individuals and businesses, alongside fiscal and monetary measures designed to preserve financial stability and mitigate the effects of the economic shock, as well as the expansion of social support mechanisms for reservists, workers, and affected regions. These measures have been accompanied by adjustments in tax policy and public revenue instruments, reflecting an effort to balance rising defense expenditures with the sustainability of public finances.

Accordingly, the most prominent government measures can be organized along the following axes:

1. Supporting reservists and the workforce

In response to the escalating economic costs of the war with Iran, the Israeli government approved a comprehensive support package for reservists and their families, valued at approximately 6.2 billion shekels, as a key instrument for sustaining military mobilization without triggering a collapse in the labor market. This package was a direct response to the significant increase in reserve service days since February 2026, and the resulting labor shortages across productive and service sectors, particularly in technology, industry, and services.

The plan includes direct financial compensation for reservists during extended periods of service, as well as additional bonuses linked to the duration of deployment and the nature of combat assignments. It also provides targeted support for families affected by the absence of primary breadwinners. In addition, in-kind assistance has been introduced, including food support and essential services through partnerships with civil society organizations, most notably Latet, which plays a role in distributing food aid and humanitarian assistance to populations affected by the war.

On the legislative front, the government has adopted an expanded employment protection framework for reservists, stipulating that they cannot be dismissed for up to three months following the completion of their service, with the possibility of extending this protection period in cases of prolonged emergencies. This measure is intended to reduce the individual economic risks associated with mobilization and to ensure that workers do not lose their jobs due to military service, thereby serving as a key mechanism for maintaining labor market stability during wartime.

Government policies have also expanded to incorporate a social and psychological dimension, through cooperation with non-governmental organizations and civil society institutions to provide psychological support and social counseling for soldiers and their families, particularly in light of rising stress levels resulting from prolonged mobilization and the multiplicity of combat fronts. This dimension is viewed as part of a broader "social resilience" strategy aimed at preventing the military burden from evolving into a wider social and economic crisis.

2. Unpaid Leave and Unemployment Benefits

Amid mounting economic pressures resulting from the war, the Israeli Knesset approved in March 2026 a special legal framework regulating unpaid leave, applied retroactively from February 28, 2026. This framework is designed to manage labor market disruptions caused by partial school closures, population evacuations, and reduced economic activity across several key sectors, by allowing companies to place employees on temporary unpaid leave rather than proceeding with layoffs.

Under the new system, workers covered by this framework are entitled to unemployment benefits from the National Insurance Institution, with eligibility criteria adjusted to be more flexible under wartime conditions. In certain cases, the qualification period has been reduced to between 10 and 14 days of actual work disruption, or a minimum prior employment period of three months has been required in specific cases, such as residents of evacuation zones. Initial payments were scheduled to begin in April 2026, with the aim of minimizing the time gap between income loss and compensation.

It is estimated that this framework covers approximately 250,000 private-sector workers directly affected by shutdowns or the suspension of economic activity across multiple regions, particularly in the north and south. The framework also includes a key provision protecting workers from dismissal for up to three months during the war, with the objective of preventing the security crisis from evolving into a structural unemployment crisis.

Analyses by the Bank of Israel indicate that this measure reflects a shift in labor market policy toward managing emergency shocks, as the state seeks to preserve employer–employee relationships rather than allowing them to dissolve, thereby facilitating a faster economic recovery once military operations conclude. At the same time, however, the bank warns that such programs increase pressure on the social insurance system and raise the state's future financial obligations.

3. Compensation for Affected Businesses and Companies

During the war, the Israeli government adopted a broad framework to compensate for direct economic damages, allocating approximately 12 billion shekels within the state budget as a support package aimed at containing the decline in economic activity and ensuring the continuity of private sector operations. This package includes compensation for companies that incurred losses due to production stoppages or disruptions in supply chains, alongside support for workers who were forced into unpaid leave or experienced partial income loss as a result of the war's repercussions.

In support of the most affected areas—particularly in the north along what is referred to as the "frontline zone"—the government, beginning in March 2026, allowed companies to apply for advance compensation payments, with the objective of providing immediate liquidity to sustain operations despite losses caused by the security escalation. Government policies also included the expansion of financing programs targeting small and medium-sized enterprises, through concessional loans and emergency grants □□□□□□ economic recovery plans, given their relative vulnerability to geopolitical shocks.

In parallel, legal protections for workers during emergency periods were strengthened by extending measures prohibiting arbitrary dismissal in cases of shutdowns, evacuations, or disruptions in economic activity. This step aims to prevent the security crisis from evolving into a labor market crisis, and forms part of the government's broader effort to preserve labor market stability and protect human capital, particularly in the productive and service sectors most affected by the war.

4. Supporting Residents of Border Areas (North and South)

During the war with Iran, the Netanyahu government did not provide funding for hotel accommodation or state-paid temporary housing, as had been the case during the 2023–2025 period. Instead, support focused on facilitating safe return, offering limited grants to municipalities in the north, and assisting businesses in border areas through loans and grants. This approach drew criticism from residents and local officials, who described it as inadequate and reflective of "neglect" compared to earlier phases, particularly given the increased reliance on external donations and non-governmental organizations.

Over the longer term, Israel's strategy reflects the principle of "absorbing current costs to reduce future threats," with a focus on weakening Iran in order to lower future defense expenditures. Israel has managed the dilemma through a combination of rapid strikes, coordination with the United States, fiscal adjustments, and economic resilience, thereby maintaining positive growth despite the challenges. However, the continuation of tensions necessitates a flexible strategy that integrates military deterrence with economic adaptability to ensure long-term stability following the temporary ceasefire in April 2026.

5. Monetary Policy Measures by the Bank of Israel

The Bank of Israel pursued a cautious monetary policy during the war, deciding to maintain the policy interest rate at 4% during its monetary policy meetings on February 23 and March 30, 2026. This approach reflects an effort to balance support for economic activity with the containment of inflationary pressures, and underscores the continuation of a relatively tight monetary stance amid a volatile geopolitical environment and heightened uncertainty associated with the war.

The bank indicated that persistent inflationary pressures—driven by rising energy prices, supply chain disruptions, and fluctuations in domestic demand—have constrained the possibility of lowering interest rates despite the slowdown in economic growth. It further emphasized that prevailing security conditions impose additional limitations on any shift toward monetary easing, highlighting the prioritization of macroeconomic stability over short-term growth support.

Within this framework, the bank has focused on two primary objectives: maintaining exchange rate stability for the shekel and preventing sharp fluctuations, and mitigating the risk of capital outflows amid rising sovereign risk. These measures form part of broader efforts to sustain international investor confidence in the Israeli economy during the war, particularly in light of increased borrowing costs and elevated risk premiums.

6. Tax Exemptions and Social Incentives

Government measures included temporary tax exemptions on domestic income for new immigrants and returning residents (during 2025–2026), alongside incentives targeting middle-class employees and the expansion of tax brackets to ease the fiscal burden. These policies also focused on strengthening social welfare, healthcare, and education, with accompanying plans to address rising living costs. A significant portion of support relied on non-governmental organizations, such as American Jewish Joint Distribution Committee (JDC) and Latet, particularly in providing psychological support and employment assistance.

Future Challenges

Forward-looking assessments indicate that the Israeli economy is entering a more complex phase that extends beyond the notion of temporary crises, as persistent security tensions—particularly amid escalation with Iran and the multiplicity of fronts—are becoming a structural factor reshaping the very logic of macroeconomic management. Rather than functioning primarily as an instrument for development and growth, the state budget is increasingly evolving into a mechanism for managing security risks, reflecting a profound shift in national priorities between security imperatives and the requirements of long-term economic stability.

Within this context, a central dilemma is gradually taking shape: the widening gap between escalating security demands on the one hand and the shrinking economic space available for growth and investment on the other. The continuation of elevated defense spending in an unstable regional environment places mounting pressure on public finances, contributes to widening fiscal deficits, and increases reliance on borrowing, thereby raising the cost of debt and constraining future economic maneuverability.

The potential repercussions extend beyond this direct fiscal dimension to affect the structure of the economy itself. The reallocation of resources toward the security and military sectors risks weakening high-value productive sectors such as technology, innovation, education, and infrastructure. Over time, this trend may lead to a gradual—rather than immediate—slowdown in long-term growth, reflected in declining competitiveness and reduced attractiveness to foreign investment, particularly in strategic sectors.

At the social level, indicators suggest that the growing intersection between security and economic policy is exacerbating internal imbalances. Rising military expenditure exerts direct pressure on social welfare sectors and public services, widening social disparities and increasing the burden of living costs. This dynamic contributes to the reproduction of inequality, with middle- and lower-income groups bearing a disproportionate share of the economic costs associated with wartime adjustments.

The implications also extend to more complex levels, as the impact of war is no longer confined to conventional inflationary dynamics. Instead, it is reshaping the nature of inflation itself, linking it more directly to security risks through rising costs of production, transportation, insurance, and labor shortages driven by military mobilization. In this sense, inflation becomes a direct reflection of the security environment rather than merely the outcome of economic cycles.

In light of these developments, the contours of what may be described as "structural fiscal strain" are becoming increasingly evident. The state faces a pressing equation between financing expanding security requirements and preserving the sustainability of its socio-economic model. This situation imposes difficult policy choices—whether to raise taxes, reduce public spending, or expand borrowing—each carrying significant implications not only for fiscal stability but also for social and political cohesion, as well as public confidence in the state's capacity to manage its resources effectively.

Ultimately, these developments indicate that the core challenge ahead lies not only in managing the consequences of war, but in redefining the relationship between security and the economy within Israel. As the security environment becomes more entrenched as a structural condition, the economy becomes increasingly constrained by military considerations and less capable of achieving a sustainable balance between the imperatives of security and the requirements of economic growth—thereby crystallizing a long-term dilemma that will shape the trajectory of both the economy and society in the period ahead.

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