Israeli Economic Growth:
20 Years Ago and 20 Years From Now

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Few observers would have expected the Israeli economy to flourish as it has over the 20-year period that marked the beginning of this century. After all, the period began with the devastating violence of the Second Palestinian Uprising or "Intifada." Four years of Palestinian suicide bombings, shootings, stabbings and rocket attacks followed by Israeli reprisals killed more than 1,000 Israelis and 3,000 Palestinians. The violence finally ebbed after Palestinian Authority Chairman Yasser Arafat died in November 2004.

Casualties on both sides were tragic, and the economic toll was painful. In 2000, just prior to the Second Intifada, gross domestic product (GDP) per capita in Israel was $28,000 (in 2019 inflation adjusted dollars). Over the next four years, per capita incomes fell by 12% in Israel, foreign tourism collapsed by half, and GDP per capita did not recover to its year 2000 peak until 2006.

Nonetheless, despite an inauspicious start to the 21st century filled with conflict, violence, and dashed hopes for peace, the Israeli economy boomed over the next two decades, while several wealthier, more peaceful countries stagnated.

Israeli GDP Per Capita Now Higher than France, Japan and Italy

In 1999, one year before the Second Intifada began, the Israeli economy prospered amidst the global technology boom. Even so, at that time, Israeli GDP per capita was 28% lower than France, 13% below Italy and 45% below Japan's. Twenty years later, in 2019, the estimated Israeli GDP per capita of about $42,000 exceeds all three of these countries. Israeli GDP per capita was 55% of the United States' in 1999 while today it is 66% (GDP per capita in the U.S. is an estimated $64,000 at present).

Between 1999 and 2019 the Israeli economy grew 4% per year from $175 billion to $380 billion. Even as population expanded by a rapid 2% per year from 6.1 million to more than 9 million, average household income also grew by a robust 2% per year. The total market capitalization of Israeli stocks increased from $88 billion in 1999 to $247 billion today.

Out of the 20 developed country economies with GDP per capita higher than Israel in 1999, only Ireland, Singapore, and Australia grew individual incomes faster. Remarkably, Israel's current GDP per capita even exceeds dynamic export powerhouses such as South Korea and Taiwan. Israeli per capita income also exceeds Spain's and is almost double oil-rich Saudi Arabia's.

How, then, did Israel's economy bounce back from the catastrophic effects of the Second Intifada years?

Prosperity and Security are Inextricably Linked

To stanch terrorist infiltration from the Palestinian Authority, Israel started building a separation barrier in 2002. Following completion of the first phase in the summer of 2003, successful suicide bombings dropped precipitously, and the Israeli economy started to recover. Suicide bombings inside Israeli territory eventually ceased as security barrier construction progressed. Imperfect but Improved security helped the Israeli economy avoid recession during the Global Financial Crisis of 2008-2009 and maintain relatively steady growth over the past decade.

Israel currently spends about $16 billion to maintain its military, or about 4% of GDP. Good data do not exist for Israel's enemies, but the Iranian military budget is estimated to range between $13 billion (World Bank) and $20 billion (British International Institute for Strategic Studies). Jane's estimates that Hezbollah military expenditures are about $1 billion per year with a potential force of 50,000 fighters and 150,000 rockets. Iran funds a variety of militias in Syria, Iraq and Yemen with capability to attack Israel, not to mention Hamas and Palestinian Islamic Jihad in Gaza and the West Bank.

Existential Threats Motivate Growth-Enhancing Economic Reforms

Sustained economic growth is vital to Israel's military defense. A growing economy allows Israel to raise living standards for its people while also investing in security. In turn, strong security provides necessary space for the economy to grow. Over the past 20 years, Israel paired significant military investments with substantial economic restructuring and reform. Israeli GDP per capita now exceeds Japan, Italy and France because these countries did not adopt obvious but politically unpopular reform policies over the past two decades. They do not face existential threats.

Economic restructuring and reform continue apace in Israel, laying the foundation for sustained economic growth. Over the next 20 years, Israel's security expenditures are likely to grow substantially, but its military burden should remain constant as its economy expands. This security imperative is one reason why we believe the economic performance of the past 20 years will likely repeat in the coming 20.

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