

Policy Brief

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Discussion points for Nagel Commission on next decade's defense budget and military development

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Abstract

Strong national defense is not possible without a developed economy, and a developed economy cannot exist without robust defense. As such, the upcoming Nagel Commission's determination of Israel's defense budget for the coming decade is crucial. This decision, following nearly a year of ongoing war, extends far beyond a simple debate over "a lot more money" versus "a whole lot more money" to fund Israel's future defense needs. It involves reconsidering the defense procedures and concepts that were in place until 2023. Israel's defense needs over the coming decade will lead to economic and social shocks unprecedented in its history. Consequently, this policy brief focuses on some of the significant macro-level questions that the commission must address before making decisions that will have historic implications for Israel's future.

A broad perspective is essential when forming recommendations regarding military needs and the defense budget for the coming decade. The issues discussed below pertain to big-picture questions that must be an integral part of the long-term strategic foundations of future annual budgets. All of the points below are based on two fundamental principles:

- National security and the national economy are closely related to one another.
 - Israel's economy cannot exist without security.
 - Israel will not have security if it does not have an advanced economy.

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- One of the fundamental principles in economics is that resources in all realms – money, manpower, time – are limited. This necessitates having to choose between alternatives. For example:
 - Individuals called up for two months of military reserve duty each year will not be able to continue to produce, as civilian workers, the same amounts as in the past.
 - Increasing the share of persons involved in defense-related R&D will come at the expense of civilian R&D. This, in turn, will negatively impact Israel's high-tech sector, the country's primary economic engine (only 10% of employed persons work in high-tech, yet they alone account for 50% of Israel's exports).

In light of the above, there are several points on which the commission must obtain answers from the Defense and Finance Ministries before it can propose significant changes for the coming decade:

1. When the IDF demands increased budgets – and I do not dispute the need for this – does the army evaluate whether past investments in resources and military personnel yield the expected return? Returns are not limited to financial values alone. They can be defined much more broadly, allowing for comparisons between alternatives when the scarcity constraint described above exists.

The following simple example illustrates this point: Missiles and other munitions fired at Israel can be shot down by rocket interceptors, planes, and other technologies. What is the success rate of each alternative, and what does it cost? In its requested budget increase, is the military seeking to increase spending on more of the same, or is this increase based on an examination of the relationship between interception successes and interception costs and an openness to changing the mix of interception alternatives in the future?

The IDF must provide the commission with a detailed list of objectives and goals (not only regarding interception), the alternatives for achieving them, and the expected return (based on success probabilities and cost) of each alternative for which the military is requesting future budgets.

2. If the Defense Ministry proposal becomes law, the annual number of days in military reserves (in the period following the end of the war) is expected to increase from 18 days per annum to 42 days for non-officer reservists (and service up to age 45 instead of age 40 before the war). The reserve burden on officers is expected to increase from 28 days to 55 days per year (and service up to age 50 instead of age 45 before the war). It is important to emphasize that this does not refer to annual reserve days during the war but to what will become the new normal after the war. As stated at the beginning of this policy brief, there is no economy without security, but there will be no security without

an economy. Therefore, in this context, the Ministry of Finance must provide answers to several questions:

- a. What are the reservists' (officers and non-officers) professions, in which economic sectors do they work, how much tax do they pay – and what is the expected (i) GDP loss and (ii) tax revenue loss if these individuals will not be engaged in productive activities for periods of one and a half to two months each year?
 - b. How many businesses are expected to stop employing workers who will be absent from work for periods of one and a half to two months each year?
 - How much is the employers' labor productivity expected to decline (if they are even able to remain open)?
 - What is the expected impact of the increased reserve duty on the economy's overall employment, productivity, output, and tax revenues?
 - c. If individuals are expected to spend one and a half to two months each year – a significant part of their economic lives – in military reserves, how will this affect the willingness of reservists to remain in Israel and continue bearing the burden, along with the physical risks to themselves and the economic risks to their families?
 - What are the estimates regarding the number of individuals who will decide to leave, and who are they? What will be the impact of such departures on GDP and the nation's tax revenues?
 - When these individuals leave, the military reserve burden and taxes on those remaining will increase, which could lead to the "spiral of collapse" described in the warning letter by 130 of Israel's leading economists on May 28th of this year (this letter is attached here as an appendix).
 - What will be the willingness of future generations to join a military that imposes such costs on them, and what will be the consequences of this for the army?
3. Taking into account the various aspects of point 2 above, the following question arises: Is increasing the burden of military reserves and military conscription on those already serving the only alternative the commission should consider?
- a. There are currently about 40,000 Haredi (ultra-Orthodox) Israeli men in the conscription ages of 18-20.
 - b. There are over 200,000 Haredi men aged 18-39 in Israel.
 - c. The share of Haredim in Israel's population doubles every 25 years. To illustrate the rapid changes taking place in Israeli society, roughly 6% of those aged 50-54 are Haredim. However, the share of their Haredi grandchildren among the country's 0-4 year-olds is four times higher (26%). In just one generation, this percentage will double. And then what?
 - d. The vast majority of these Haredi men do not receive an education consistent with the requirements of a modern economy – an economy that they themselves are dependent upon to supply their needs. A developed economy (which is essential for an advanced military) must operate in the highly competitive global market. Aside from the moral

- aspects of the issue, Israeli companies will not be able to remain competitive if they insist on working under economically suboptimal conditions, such as gender segregation, lack of integration of women as managers in all fields, etc.
- e. Israel's defense system, with all of the extraordinary burdens that it will have to deal with, cannot avoid entering the 21st century, which involves equalizing the burden across all sectors of Israeli society to prevent economic and military collapse in the future. Given the rapid growth of the Haredi community and the increased burden on those currently shouldering it in Israel's new reality:
 - A full application of Israel's military conscription laws on Haredi men needs to be considered, regardless of their educational or employment status (just as it is applied to non-Haredi students and employees). Aside from a small number of exceptions, this involves drafting the large mass of available individuals able to serve and alleviate the burden on servicemen being asked to further increase the personal and economic price that they are already paying – and the fact that around the corner, a national “spiral of collapse” process could begin, which will be impossible to stop once it starts.
 - The enlistment of Haredim must take into account religious needs such as kosher food. But above all, their enlistment must consider the IDF's needs, which must be defined for this committee. For example:
 - Should the IDF create more all-Haredi battalions like Netzah Yehuda, or do the army's increasing needs require that Haredim be placed according to military requirements and not sectoral desires – just as there are no units of secular or religious soldiers, but rather a mix of Israelis suited to the required IDF needs.
 - In light of the Haredi community's exponential growth and the need to integrate them into a global and competitive economy, as described in section 5.d above, Haredi men will need to adapt to an era in which women can and should be their teachers, managers and commanders.
 4. In light of what transpired during the war, should the defense establishment increase domestic production of its munitions needs? If so:
 - a. Beyond the cost to taxpayers, what is the expected alternative cost (in terms of reduced productivity and output) of workers shifting to defense production sectors from civilian employment sectors? What is the expected total cost to the economy of such a step?
 - b. In light of 4.a, are there other options (besides increasing local production) for supplying the required munitions, and what diplomatic and international prices would Israel have to pay to implement these alternatives?
 5. Does the defense establishment require a significant bolstering of its R&D capabilities to deal with future threats? If so:

- a. What is the additional budget that will be needed to attract individuals with the required skills?
- b. What is the expected price to the civilian high-tech sector in terms of the loss of quality manpower?
- c. What will be the cost to Israel's economy from the losses incurred by the civilian high-tech sector?
- d. In fact, the problem is considerably larger than the current shortage of suitable workers for military R&D and high-tech. It is at a scale that a strategic national defense plan must take into account and warn about. The average level of knowledge of Israeli children in core subjects such as mathematics, science, and reading is below that of all developed countries. The knowledge level of roughly half of Israel's children is below that of many third-world countries, and these children belong to the fastest-growing segments of the population (see Shores Institution publications for more information). As adults, they will only be able to sustain a third-world economy. But a third-world economy will not be able to maintain first-world healthcare, welfare, or defense – with all the existential implications this has for Israel's future. This is a quickly developing and dangerous demographic-educational trajectory that requires a fundamental solution that will ensure Israel's future.

A commission with the mandate to make recommendations regarding Israel's military needs and defense budget for the next decade must demand answers from the Defense and Finance Ministries on the above issues. Israel's rapid demographic changes must be a central component in formulating the commission's recommendations."

Appendix

To emphasize just how critical are the crossroads that Israel has reached, 130 of Israel's leading economists signed a public warning letter that leaves no room for doubt on the subject. The letter, publicized on May 28, 2024, is included here as an important appendix that the commission needs to be aware of. At its end is a list of signatories (among them, the author of this document), including 119 senior faculty members from Israel's research universities, including six deans, a former university president, the current president, and the former president of the Israel Economics Association. The list also includes economists who have served in senior management positions at the Ministry of Finance, the Bank of Israel, and the Prime Minister's Office.

The Shores Institution is an independent, non-partisan policy research center. The institution conducts impartial, evidence-based analyses of Israel's economy and civil society. Its objective is to assist in moving the country towards a sustainable long-term trajectory that raises Israel's living standards while reducing disparity among its citizens. To further this goal, the Shores Institution informs Israel's leading policymakers and the general public, both inside and outside the country, through briefings and accessible publications on the source, nature and scope of core issues facing the country, providing policy options that ensure and improve the well-being of all segments of Israeli society and create more equitable opportunities for its citizens.

Findings and points of view expressed in Shores publications are the authors' alone.

Warning issued by Israeli economists

The State of Israel and its Haredi (ultra-Orthodox) society are dependent upon one other. The country's prosperity is dependent upon the Haredi community engaging in its economy, security, and society. At the same time, without a robust economy that is capable of providing security, among other necessities, to its citizenry, Israel's Haredi society will not be able to exist over time.

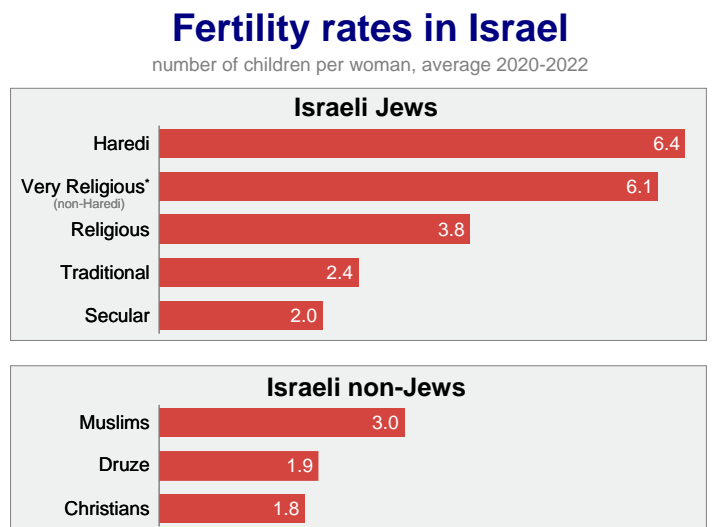
In light of this, we – Israeli economists – are issuing a clear and emphatic warning, that the combination of the policies of Israel's governments over time and the high growth rate of the Haredi population is leading the country towards an abyss, one that poses a very real and very grave threat to Israel's economy and society, including to the Haredi community itself.

Today, 22% of all children under working age (0-14 years old) are Haredim. By 2065, this share is expected to be roughly 50%, more than doubling the Haredi share in just four decades. Without sweeping, profound, and rapid changes in government policy, the State of Israel will face existential danger.

The policies of Israeli governments regarding Haredi society pose three fundamental challenges for the country: security, economic, and social.

Each of these challenges has serious and far-reaching implications for the future. Combined, these challenges pose a severe danger to Israel's future.

The first challenge stems from the heightened security threats faced by Israel. In the aftermath of the October 7 events, conscripts to the military as well as reservists are expected to experience significant, constant, and long-term increases in their military service. According to a bill recently submitted to the Knesset and supported by the defense establishment, the number of military reserve days is expected to increase dramatically: non-officer reservists will serve up to 42 days a year, until the age of 45 (compared to an average of 18 days and age 40 prior to the war) while officers will serve up to 55 reserve days a year, until the age of 50 (compared to 28 days and age 45 prior to the war). This increase in the military reserve burden has a direct budgetary cost to the economy estimated at approximately NIS 10 billion per year. More importantly, the heightened burden on the reservists carries substantially larger indirect costs, which will have devastating effects on



Source: Dan Ben-David, Shores Institution and Tel-Aviv University
Data: Central Bureau of Statistics, Ahmad Hlehel and Ayelet Zionov

* very religious (non-haredi) Jews living in the West Bank (comprising 22% of all religious Jews living there) in 2022 only

Israel's society and economic activity. A functioning economy cannot exist in a reality where many workers are absent for extended periods every year. Many self-employed individuals will face financial difficulties, the employment potential of salaried reservists will be harmed as companies will avoid hiring them, the productive capacity of businesses in the economy will be severely affected, and the quality of public service will deteriorate. Moreover, in a global economy, employees and firms can relocate their base of operations from one country to another with relative ease. A substantial increase in the reserve burden will likely lead to a wave of emigration among the most educated and skilled workers and the departure of many Israeli and multinational companies, which will not be able to accommodate the prolonged absence of their employees for reserve duty every year. The State of Israel may lose significant human capital as well as the economic contribution of many businesses, substantially harming the welfare of those remaining in Israel.

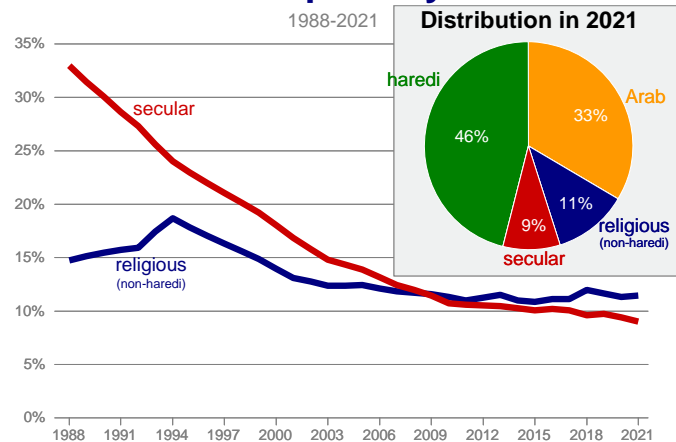
The second challenge is economic in nature. For generations, Israeli governments, and the current government in particular, have been funding Haredi schools that do not provide their students with the knowledge and tools needed for integration into a modern labor market. At the same time, the governments of Israel have been channeling extensive public resources to finance lifestyles that encourages Haredi non-employment and birth rates double and triple those of other population groups in Israeli society. This public spending is manifested in a variety of ways – from funding schools that do not teach core subjects, to a vast array of welfare benefits, subsidies and exorbitant sectoral-based public spending. According to the Bank of Israel, while the average Haredi household headed by individuals aged 25-44 receives NIS 2,800 per month from the government (net amount, after deducting tax payments, etc.), the average non-Haredi Jewish household pays the government NIS 2,200 per month (net amount, after receiving subsidies). Acquiescence to a Haredi education system that deprives its students of the knowledge required to cope thrive independently in a global economy, together with huge budgetary expenditures that are expected to grow at an exponential rate, will lead to a deterioration in Israel's living standards while seriously impairing the nation's ability to provide basic services to its citizens.

The third challenge is social and it concerns Israel future as a liberal democratic state. The increasing share of Haredim in Israel's population – in a process largely funded by the general public – is expected to yield substantial political power to the Haredim, enabling them to undermine Israel's liberal characteristics and promote sectoral legislation that will impose constraints on the non-religious sectors in Israeli society. Moreover, in light of the exponentially growing Haredi share in Israel's population, under the current system of government the Haredi leadership will be able to overturn in the future any political arrangement reached today to ensure their continued preferential privileges in the economic, security, and social spheres.

These three challenges – security, economic and social – mutually reinforce and exacerbate one another. Increasing the economic and security burden on certain parts of the Israeli public, while enabling a rapidly growing segment of the population to evade bearing their

civic burdens, are not sustainable processes, particularly given the problematic and complex security threats that Israel faces. **Without a change in the current trajectory, these processes endanger the country's very existence.** Many of those who bear the burden will prefer to emigrate from Israel. The first to leave will be those with opportunities abroad: physicians, engineers, high-tech workers, and scientists. Israel's remaining population will be less educated and less productive, thus increasing the burden on the remaining productive population. This, in turn, will encourage further emigration from Israel. This process of a "*spiral of collapse*" in which increasingly larger groups decide to emigrate, will further deteriorate the conditions of those who remain, while severely impacting populations with fewer emigration options, including the Haredi population itself. The demographic and economic processes that the city of Jerusalem has undergone in recent decades – its rapid decline in socioeconomic indicators and its increasing abandonment by large segments of its secular population – clearly illustrates this spiral of collapse phenomenon and the dangers facing the entire State of Israel. Jerusalem has Israel to support it. But Israel has only itself.

Share of pupils by education stream in Jerusalem's primary schools



Source: Dan Ben-David, Shores Institution and Tel-Aviv University
Data: Jerusalem Institute for Policy Research

It would be a grave mistake to believe that there is much time left to implement the changes required to prevent a national collapse. Collapses do not occur when the situation has completely deteriorated, but earlier, when a sufficiently large share of individuals anticipate that the decline is irreversible. Once Israel's burden-bearing population concludes that the country is on a permanently irreparable course, the national collapse will inevitably follow. At first gradually, and then suddenly and irreversibly.

To prevent a national collapse, Israel's leaders must recognize clearly the current reality and adopt without delay a strategy that will return Israel to a sustainable trajectory by addressing the three core challenges. This strategy must include the following critical steps, which are vital for a society desiring a future:

1. A comprehensive, nationwide, education reform that will include, among other things, immediate cessation of all public funding for schools that do not provide their students with the appropriate tools to integrate into a modern labor market. This includes termination of funding for schools that do not teach the full core curriculum. At the same time, all financial aid that incentivizes non-employment must be stopped, alongside a reduction in government funding that encourages high birth rates. A steady

process to eliminate these budgets will facilitate transition from the current situation to the new situation described here.

2. A more equitable distribution of the security burden across the population, while understanding that a major increase in the burden of reserve duty on persons currently serving will have devastating consequences for society and the economy, and is therefore not sustainable. Indeed, in a scenario where the entire military-age Haredi population serves in the army, the number of reserve days is expected to decrease by 50 percent – and over the years, by even more. It should also be noted that non-military national service programs will not prevent the significant increase in the security burden that will be imposed on those already serving today, with all the serious consequences that this entails.
3. Changes in the system of government and constitutional changes that will enshrine liberal rights and democratic values in a way that will prevent future infringement of them. Without such changes, the fear of future curtailment of rights will intensify the spiral of collapse that Israel is liable to be drawn into. Any new social arrangement must ensure mutual respect among all parts of society, allowing every individual to live according to their values and beliefs.

We, Israeli economists, warn in the strongest and clearest way possible of the dangers emanating from willful ignorance of processes that are steadily leading Israel towards an economic, security, and social abyss. **This is a clear and present danger to the country, one that we assess has a very high probability of realization. However, even if we are overestimating this probability, the enormous potential damage to the national security, basic risk management warrants the immediate adoption of a strategy that will return Israel to a sustainable trajectory.** We call on the general public, the senior public servants, and the political echelons to place the challenges we have raised here at the top of Israel's national priorities.

We are sounding the loudest possible alarm. History will not forgive Israel's current and future leaders – over the entire political spectrum – if they stand idly by.