

The Flood That Drowned Israel's Economy: Two Years of Attrition and Isolation



Operation Al-Aqsa Flood marked a turning point in the history of the Palestinian cause, triggering the longest and most costly military confrontation since the Nakba. As the war enters its third year, Israel finds itself mired in a prolonged war of attrition that has failed to achieve its declared objectives whether the elimination of Hamas or the full recovery of its captives by force.

Economically, Israel has transformed in the span of two years from a model frequently praised in international reports into a burdened and overextended economy. Military spending has surged to unprecedented levels, costing millions of shekels daily. At the same time, domestic and foreign investment has plummeted, and key sectors such as technology, tourism, agriculture, and trade have contracted.

The financial strain has been immense. The budget deficit has ballooned, and national debt now stands at around 70% of GDP, resulting in rising prices, diminished purchasing power, and a labor shortage due to the mass mobilization

of reservists.

Credit rating agencies have downgraded Israel's standing, tarnishing its reputation as a safe haven for investment. Economic caution is spreading globally especially in Europe where calls to reassess trade agreements with Israel and impose sanctions linked to its military conduct in Gaza are on the rise.

This crisis runs deeper than any economic aftermath of previous wars (2009, 2012, 2014, 2021), raising serious questions about Israel's ability to regain economic balance in the near future.

Between mounting debt, the erosion of productive sectors, and declining global confidence, Israel faces a long-term economic test no less daunting than its military and political challenges.

The Cost of War

Since October 7, 2023, Israel's military operations have incurred staggering costs. In the initial months, daily expenses ranged between 1 to 1.5 billion shekels (\$270–400 million) for ground and air combat and logistics. By early 2024, the cost dropped to 350 million shekels daily (\$94 million) and has stabilized at that level.

By mid-2025, Israel's war on Gaza had cost between \$60 and \$90 billion the highest financial toll in its military history. This drawn-out engagement included a wide restructuring of military deployment, long-term reserve mobilizations, and large-scale arms deals with the U.S. and Europe, covering precision munitions, fighter jets, and new defense systems.

According to the Stockholm International Peace Research Institute (SIPRI), Israel's military spending rose 65% in 2024 to reach \$46.5 billion the world's second-highest rate after Ukraine. This surge has directly impacted the national budget, squeezing civilian sectors and forcing increased domestic and international borrowing.

In 2025, Israel passed its largest-ever budget: 756 billion shekels (\$215 billion), a 21% increase from the previous year, with \$39 billion allocated to the Ministry of Defense alone.

Mounting Financial Pressures

In 2022, Israel posted a budget surplus and 6% growth, supported by a manageable debt load external debt was just 15% of total public debt (\$50 billion), while foreign reserves stood at \$230 billion. This fiscal health was a key strength underpinning Israel's international credit standing.

That picture changed drastically in October 2023. Military spending soared while

tax revenues declined amid an economic slowdown. The deficit widened to 7% of GDP, up from an average of 3% pre-war.

Mass displacement from northern and southern Israel added further strain, as the government funded shelter, housing, and monthly compensation for tens of thousands of displaced civilians and affected businesses.

This unprecedented displacement, starting in late 2023, created a dual burden: sustaining a wartime economy while managing an internal refugee crisis, intensifying pressure on the Finance Ministry and deepening the national deficit.

Rising Debt, Falling Credit

To cover its mounting expenses, Israel ramped up borrowing. Public debt rose from 60% in 2022 to 70% in 2024 the highest in decades. Loans to fund the war alone surpassed \$76 billion.

This borrowing spree significantly raised debt servicing costs, undermining the government's ability to fund public services. Global credit agencies responded with a series of downgrades, signaling falling investor confidence.

Public services—healthcare, education, infrastructure—have deteriorated as defense spending monopolized resources. To narrow the deficit, Israel raised the VAT from 17% to 18% and increased health and social security deductions.

Declining Investment and Financing

In 2024, Israel recorded its lowest levels of foreign direct investment in over 15 years, down by 35–40%. Ongoing war and political uncertainty have driven capital flight to more stable markets.

The economic output shrank by 3.5%, with per capita GDP falling by 4.4%. Growth stagnated at just 1% the lowest in the OECD.

The internal market has suffered: over 46,000 businesses have shuttered, and unemployment has surged, especially in tech, tourism, and agriculture. Experts warn of long-term damage.

Without renewed investment and with an accelerating brain drain, Israel risks becoming a low-tech economy akin to those of the developing world.

Social Impact and Living Standards

The economic downturn is directly affecting Israeli society. Inflation and rising costs of living are squeezing consumers. Reservist mobilization has created a severe labor shortage, particularly in construction, agriculture, and tech.

An Israeli Employment Bureau survey found 75% of reservists face financial hardship, with 20% fearing job loss upon return. The toll of war casualties, injuries, and trauma has further burdened the state, adding pressure on the

Finance and Defense Ministries.

Leading economists such as Manuel Trajtenberg and Itai Ater warn that Israel's once-resilient economy is now flashing red. Indicators include falling investment, rising debt, cost of living pressures, and the paralysis of manufacturing, trade, and tech sectors.

Key Sectors Hit by War

The war's economic fallout has devastated Israel's foundational sectors. The high-tech industry 12% of the workforce, 20% of GDP, 64% of exports, and 25% of income tax revenue has been especially hard hit.

Between 10–15% of tech employees were drafted into reserves. In 2025, the number of local tech workers fell while those working abroad rose. Now, 390,000 remain in Israel compared to 440,000 overseas.

The investment environment collapsed, with funding for startups down over 50%. Both domestic and foreign firms suspended or relocated operations, eroding Israel's edge as a regional tech hub.

The Finance Ministry launched a compensation plan offering fixed grants for small businesses, covering up to 22% of operating expenses and 75% of salaries for large firms, plus direct payments to employees and low-interest loans.

Tourism also collapsed: foreign visitors dropped by more than 75% in two years, and domestic tourism suffered due to recurring military call-ups and instability. The result: a deep slump hitting hotels, airlines, and related businesses.

Agriculture was crippled, especially near Gaza and the northern border, as thousands of farmers abandoned their fields. Domestic trade also declined amid falling purchasing power and soaring production and transport costs.

Exports and construction were squeezed. The latter alone lost 150 million shekels daily after Israel revoked 80,000 Palestinian work permits. Efforts to recruit foreign workers have failed to bridge the gap.

Turkey's boycott of Israel further strained the construction and manufacturing sectors, given Turkey's role as a key supplier of building materials. Sourcing alternatives has raised costs.

Reservist mobilization ballooned to 450,000 by May 2025 nearly 20% of the workforce leading to labor shortages, company closures, and population displacement near combat zones, exacerbating economic and social losses.

Comparison to Previous Wars

Since 2008, Israel has fought repeated wars in Gaza, each with some economic toll. However, past conflicts were brief and did not inflict structural economic

damage. The economy typically rebounded quickly, maintaining investor and institutional confidence.

In 2009, after a three-week war, Israel absorbed infrastructure damage and minor sectoral losses. Strong external support helped recovery. The 2012 conflict lasted just a week with limited economic disruption.

The 2014 war spanned seven weeks, revealing more pronounced attrition. Yet, Israel returned to growth within months, retaining its investment appeal. Even the 11-day 2021 “Guardian of the Walls” operation caused manageable damage.

Eroding International Reputation

Until early 2023, Israel was widely seen as a magnet for investors, tourists, and scientists a model of technological excellence. Its credit ratings reflected that strength.

The Gaza war upended this image. Political instability, investor doubts, and capital flight have eroded its appeal, especially among startups and research hubs.

Three major credit agencies downgraded Israel's rating post-war, raising borrowing costs and increasing debt burdens. For the first time in decades, Israel is seen as a risky economy.

International trade has also been affected. In Europe, voices are growing louder to revisit trade ties with Israel. Norway's sovereign wealth fund has divested from several Israeli companies. Other funds may follow. Academic, cultural, and sports boycotts are also expanding.

Two years into the war, Israel's economy is facing its most perilous moment in decades. The IMF warns of continued hardship into 2026. The direct costs of war have morphed into a chronic economic drag, exposing structural vulnerabilities and undermining Israel's reputation as a resilient economy.

Unlike previous short-lived wars, this prolonged conflict has unleashed unprecedented attrition, casting doubt on Israel's role as a safe investment destination. Once branded the “Start-up Nation,” Israel now confronts deepening isolation and economic regression.

If comparisons are to be drawn, this war resembles the aftermath of the 1973 Yom Kippur War. That conflict ushered in a 14-year economic slump dubbed the “lost decade,” resolved only through political settlements under Yitzhak Shamir and Yitzhak Rabin, leading to the Madrid Conference and the Oslo and Paris Accords.

Today, both Israel's government and opposition refuse meaningful negotiations,



placing the country on a path toward renewed isolation economically and politically.

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