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The Israeli Zombie Economy

A Reading of the Concept and Its Implications

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Abstract

This paper explores the concept of the 'Zombie Economy' as applied to Israel, analyzing its structural contradictions between apparent resilience and underlying fragility. Drawing on global economic literature and case studies such as Japan, Argentina, and China, it examines how Israel's economic indicators appear stable on the surface while being sustained by external support, political ideology, and ongoing occupation costs. The study highlights the discrepancy between international financial institutions' optimistic assessments and the economic realities of rising debt, declining foreign investment, and unsustainable military expenditures.[1]

Keywords: Zombie Economy, Israel, Occupation, Financial Fragility, External Support

Introduction

Describing the Israeli economy as a "zombie economy" (Zombie Economy) is an analytical expression that reflects a deep structural contradiction between a troubled economic reality and official indicators that show resilience and stability. This term, which emerged in economic literature to describe economies that continue to function despite the collapse of their fundamental foundations, has recently been used to analyze the Israeli economic situation, especially in light of the ongoing war on Gaza and the heavy costs of occupation and security policies.[1]

Research Problem

The core research problem addressed in this paper is the contradiction between the apparent economic stability of Israel, as reflected by traditional financial indicators, and the structural fragility resulting from prolonged occupation, declining foreign investment, and reliance on external support. This raises the question of whether the Israeli economy can be considered sustainable in the long run, or whether it reflects the dynamics of a "zombie economy" that depends more on ideology and external support than on genuine economic strength.

Research Methodology

This study employs a qualitative and quantitative research methodology that combines a review of economic literature, comparative case studies, and secondary data analysis. Sources include international financial institutions (the International Monetary Fund, the Bank for International Settlements, the World Bank), central bank publications, and academic journals. The analysis focuses on triangulation by comparing official narratives with market data, credit rating reports, and geopolitical developments. By applying the concept of the "zombie economy" to Israel, the methodology highlights structural contradictions and explores the sustainability of economic performance under prolonged occupation.

The Concept of the "Zombie Economy" and Its Origin

The term "zombie economy" first emerged to describe certain Asian and Latin American economies that appeared unable to achieve real growth and instead relied on external inflows or government intervention to remain artificially "alive." Academic literature more commonly uses the term "zombie firms" rather than "zombie economy" for entire states, but the phenomenon can extend to broad sectors to the point where the economy appears "artificially alive" due to external support and inflows.

For example, the Argentine mortgage market was described as "zombie": its size is less than 1% of GDP (compared to 10-15% in Brazil/Mexico), and transactions are conducted in cash dollars due to fear of inflation and currency fluctuations; yet, the mortgage market still exists, making recovery dependent on reforms and external liquidity [1]. In Japan, Caballero-Hoshi-Kashyap provided the classic analysis of "zombie lending," where large banks kept insolvent companies alive by rolling over loans and preventing "creative destruction," thereby reducing investment and employment in healthy firms and weakening productivity across sectors [2]. In China, the International Monetary Fund defines "zombie companies" as non-viable firms that continue to operate thanks to subsidized loans and local support, calling for continued action to reduce institutional debt [3].

Ryan Banerjee and Boris Hofmann define zombie firms as unprofitable companies that remain in the market instead of exiting through acquisition or bankruptcy-firms that cannot achieve profits over a long period, and whose market valuations indicate they will not do so in the future, which should normally exit the market [4]. Ricardo Caballero, Hoshi, and Kashyap define zombie firms as those receiving sufficient financial assistance from their creditors to survive despite weak profitability [5]. This behavior resembles the zombie metaphor in two ways: the economy has no real life, and second, it continues to exist thanks to external support, illusion, denial, and fantasy.

Thus, a zombie economy is a description of an economy, sector, or group of companies that appear outwardly active and continue to operate, but are in fact unproductive or unable to sustain themselves without relying on external support (such as low-interest loans, government intervention, or exceptional funding). These economies or companies do not generate sufficient profits to cover their basic costs, yet they continue to exist due to artificial support, which conceals their structural fragility.

Key Characteristics of the Zombie Economy and How It Is Measured Practically

A zombie economy can be diagnosed by a set of characteristics and indicators, the most important of which are:

- Inability to achieve real growth: meaning stagnant productivity accompanied by weak investment, with profitability insufficient even to cover debt servicing. The BIS (Bank for International Settlements) has documented that a rising share of zombies suppresses output growth [6].
- Dependence on support/inflows: This is one of the most important features, involving access to subsidized loans, postponement of loss realization ("zombie lending"), government subsidies, or conditional external financing rather than organic growth.
- Crowding out healthy firms: One consequence of the zombie economy is the so-called "crowding effect," where non-viable firms displace capital and labor at the expense of productive companies, thus hindering economic renewal by preventing weak entities from exiting the market [7].

As for measurement, the academic standard commonly uses criteria such as the interest coverage ratio being less than 1 for two consecutive years[1], along with a certain operational

[1] Interest Coverage Ratio (ICR) = EBIT / Interest Expense, Measures whether a firm earns enough to cover its interest payments.
Tobin's q = Market Value of Assets / Replacement Cost of Assets, Roughly, how the market values the firm compared to the cost of its assets.
Zombie firm condition: ICR < 1 AND Tobin's q < sector median for 2 years in a row.
Declassification condition: Either ICR > 1 OR Tobin's q > sector median for 2 years in a row.

age. The Interest Coverage Ratio (ICR) = Earnings Before Interest and Taxes (EBIT) / Interest Expense, measures whether a firm earns enough to cover its interest payments.

Tobin's q = Market Value of Assets / Replacement Cost of Assets. This ratio (approximately) indicates how the market values the firm compared to the cost of its assets. Zombie firm condition: ICR < 1 AND Tobin's q < sector median for 2 years in a row. Declassification condition: Either ICR > 1 OR Tobin's q > sector median for 2 years in a row.

These methodologies have been used in Japan, Europe, and Asia, and have been generalized to emerging economies.

Data Collection

This was done through a review of economic literature, comparative case studies, and secondary data analysis. Sources include international financial institutions (IMF, BIS, World Bank), central bank publications, and academic journals. The analysis focuses on triangulation by comparing official narratives with market data, credit rating reports, and geopolitical developments. Data was compiled into tables with sources clearly indicated as follows:

Table 1: Summary of Data and Sources

Date	Topic	Description	Strategic Importance	Source
2023	Bank of Israel intervention	Program to sell up to $30 billion + $15 billion FX swaps to calm shekel volatility	Supports currency stability	Reuters / Bank of Israel
2023–2025	Shekel value change	Peak weakness 4.3 ILS/USD (October 2023), then 3.38 (August 2025)	Reflects relative confidence in currency	Bloomberg / BoI
2023	Decline in foreign investment	Sharp decline in FDI (-29% in 2023) + sale of government assets by non-residents	Indicator of weak confidence	Bank of Israel / Financial reports
2024	Credit rating downgrade	Moody’s downgraded rating to A2 (2024), then Baa1 (2024/9)	Raises risk premium	Moody’s
2025	Secondary market confidence	Issuance of $5 billion bonds with $23 billion in orders (2025/2)	Shows funding capacity	Bloomberg
2025/6	Market volatility	Highest implied volatility of shekel since March 2023 (June 2025)	Reflects fragility of confidence	Bloomberg

Table 2: Indicators

Indicator	Current Status	Trend
USD/ILS	3.38 in August 2025	Improved since 2023
FDI (non-residents)	-29% (negative) in 2023	Ongoing slowdown
Credit Rating	Baa1 with negative outlook	Deterioration
Gov Bond Spreads (5Y)	Decreased after February issuance	Relative stability
5-Year CDS	Relatively high	Sensitive to events
Implied Volatility (FX options)	Peak in June 2025	Unstable

Table 3: Investment and Stock Market Performance

Item	Figures/Details	Source
Record 2023 sales	$2.7 billion (record year)	Israel Bonds (JNS.org, sdjewishworld.com)
US state and local governments' purchase of bonds	+$1.7 billion since start of war	ICIJ (icij.org)
Tel Aviv Stock Exchange performance (2023)	~28% increase in USD	Globes

Table 4: War Costs and Military Budget

Item	Figure/Percentage	Source
Military budget 2022	$23.41 billion	Macrotrends (macrotrends.net)
Military budget 2023	$27.50 billion	Macrotrends (macrotrends.net)
Annual military spending 2024	100 billion shekels (~$28 billion)	Reuters (Reuters)
Monthly military spending (pre-war → post-war)	$1.8 to $4.7 billion monthly	AP (AP News)
Military spending as % of GDP (2022 → 2024)	4.2% to 8.0%	OECD (OECD)
Total war cost until 2024 (inclusive)	250 billion shekels	Arab Center Washington DC

Table 5: Israel's Nominal Gross National Income (2021-2025)

Year	Nominal GDP	Change	Source
2021	489.71		World meters
2022	525	Increase	World meters
2023	513.61	Decrease 2.17%	World meters and macrotrends [9][10]
2024	540.38	Increase 5.21%	Trading Economics and World Bank [11] [12]
2025 (expected)	574	Increase 6.29%	World Economics

From this data, the following becomes clear:

Despite Israel's involvement in wars on multiple fronts-Gaza, the West Bank, Lebanon, Syria, Yemen, and Iran-requiring massive budgets to cover the costs of these ongoing conflicts for nearly two years, costs that even the strongest global economies could not afford, the data shows the Israeli economy, on the surface, with "resilient" indicators, raising serious questions about the true nature of this economy and its actual financing.

Examples of such indicators that portray the Israeli economy as resilient and sending positive signals include:

1. Overall increase in national income from $513.6 billion in 2023 to $540.38 billion in 2024, with an expected $574 billion in 2025-despite the mobilization of tens of thousands of reservists, most of whom were withdrawn from the labor market [9][10][11][12].
2. Continued trading of Israeli bonds in global markets, despite pressures and wars lasting two consecutive years. The Israeli government sold $5 billion in international bonds on February 12, 2025, with nearly $23 billion in orders [13]. The markets also witnessed waves of optimism and stock price increases, and a relatively strong recovery of the shekel in 2025 [14]. U.S. federal and state governments added more than $1.7 billion in purchases of Israeli bonds since the start of the war [15]. This shows that confidence has not vanished, but rather foreign demand for Israeli bonds is increasing globally-contrary to rational investment expectations during wars and unrest.
3. Relatively stable shekel exchange rate: The Bank of Israel announced a program to sell up to $30 billion and provide up to $15 billion in liquidity via FX swaps to calm shekel fluctuations during the 2023 war [16]. This framework remained a reference for subsequent stabilization policy. The shekel reached a momentary low of nearly 4.3 ILS/USD in Asian trading (October 9, 2023), then stabilized around 4.06 later that month. By August 15, 2025, the shekel rate was approximately 3.38 ILS/USD (representative official rate), a notable improvement from

2023 levels. The shekel also jumped 3.6-4.6% on June 16, 2025, amid improved risk appetite [17]. This suggests the shekel has transitioned from peak weakness to recovery. The strategic importance lies in the fact that improvement reduces import bills and improves inflation estimates, though it remains sensitive to geopolitical events.

4. Record levels in the Israeli stock market (Tel Aviv Stock Exchange) despite the war: Despite the conflict, the Tel Aviv Stock Exchange Index (TA-35) rose by approximately 28% in foreign currency (USD) since the beginning of 2023, making it one of the best-performing markets in the world [18].

In contrast, behind these figures lie alarming and noteworthy realities, such as:

1. Growing fiscal deficit due to military spending: AP News reported that the monthly military expenditure rate increased from $1.8 billion before October 2023 to $4.7 billion by the end of the year [19]. In 2024, the Israeli Ministry of Finance stated that the cost of the military conflict reached about 100 billion shekels (~$28 billion) [20]. According to the Arab Research Center (Arab Center DC), the total cost of the Gaza war until May 2024 reached 250 billion shekels [21].
2. Flight of investments, especially in the technology sector: The Bank of Israel shows a notable decline in non-resident investments in 2023, particularly FDI, with non-residents selling government bonds and "Makam." Reports estimate that FDI dropped by 29% in 2023 and foreign participation in debt issuance contracted. This is a clear sign of weakened external confidence at the peak of risk [22].
3. Declining investor confidence and rising cost of bond insurance (Credit Default Swaps): Moody's downgraded Israel to A2 with a negative outlook on February 9, 2024, then further downgraded to Baa1 in September 2024 amid widening geopolitical and financial risks [23]. This should naturally raise the risk premium.
4. Erosion of productive infrastructure due to the mobilization of tens of thousands of reservists into the army, supply chain disruptions, and tens of thousands of residents stockpiling in hotels due to lack of confidence in returning to their homes in the north and the Gaza envelope, thus increasing government expenditure costs.

The following results can be concluded:

1. Israeli Economic Indicators: Between Resilience and Collapse

Analysis of the data reveals signs that the Israeli economy is receiving significant funding through the sale of government securities to foreign entities, and the value of these bonds is being injected into the state budget to support the war effort, despite negative indicators that should logically raise concern and increase risk for these investing entities. Yet the opposite has occurred, raising suspicions and questions about the motives of these external actors.

In the Israeli context, researchers like Shir Hever have used the concept of the zombie economy to describe an economy that relies more on propaganda, aid, and unconditional Western support than on genuine internal strength [24]. Experts on ethics indicate that some U.S. state officials may have violated ethical boundaries in their dealings with Israeli bonds. Richard W. Painter, professor of law and former chief White House ethics lawyer, considered these practices to mix personal and official interests and exceed what is ethically acceptable [25].

Thus, the Israeli economy appears "alive and moving but without a soul"-that is, it is sustained by external support and artificial confidence rather than a genuinely stable economy. It appears that the Israeli occupation is financially unsustainable, as security and settlement costs exceed resource exploitation returns. Economic prosperity is not based on economic rationality but on a value system based on privileges and racial segregation. The primary motive for occupation is ideological rather than economic: many Israelis are willing to accept a lower standard of living if it ensures their dominance over Palestinians-revealing the fragility of the "zombie" economy [26].

2. Role of International Institutions (IMF, World Bank)

IMF and World Bank reports present a relatively optimistic assessment of the Israeli economy, highlighting its flexibility and recovery capacity. However, this optimism is criticized by researchers as containing a degree of concealment or politicization, with these institutions avoiding reference to the cost of occupation or the catastrophic consequences of ongoing wars. Some argue these reports serve as a political cover to sustain Western investment in Israel. In Table 5, Israel's national output rose by 5.21% in 2024 compared to 2023, and by 6.29% in 2025 compared to 2024-this is striking, given that hundreds of thousands of reservists were recalled from their jobs, non-resident investment dropped by 29%, the airport was closed for many days, and work halted for many days during confrontations with Iran and Hezbollah. How can national income rise at such rates?

3. Position of Credit Rating Agencies

Agencies such as Moody's, Standard & Poor's, and Fitch still grant Israel relatively high ratings (A+), although they have issued warnings about risks and downgraded it to Baa1. This raises a question about the independence of these agencies. They are accused of being lenient toward Israel compared to other countries with similar indicators, which may be explained by political pressure or betting on continued Western support.

4. Independence and Neutrality: Between Economy and Politics

Although these international institutions and credit agencies claim neutrality, reality shows that economy and politics are not separate in Israel's case. Absolute U.S. and European support is reflected in the assessments of international institutions, making them sometimes less bold in revealing the true fragility of the Israeli economy.

5. Misinformation and Economic "Zombification"

Israel does not operate under an information economy, but a "misinformation economy," as Hever explains, where economic activity is sustained and supported by false narratives, misleading media, and political cover [27]. Investors and governments continue to deal with Israel as if its economy were stable, despite growing evidence to the contrary. This manipulation resembles the zombie metaphor in two ways: the economy has no real life, and it continues thanks to illusion, denial, fantasy, and external support [27]

6. External Support for Israel: Political or Economic?

Israel enjoys nearly absolute support from major economies, especially the United States-not only through direct aid (such as $3.8 billion annually from Washington)-but also through bond purchases and ensuring investment flows. U.S. state and local governments and official institutions have purchased the equivalent of $1.7 billion in Israeli bonds since the start of the war.[15] According to Russ Mould, investment director at AJ Bell, quoted by Business Insider: "It appears that Netanyahu's government enjoys U.S. backing in foreign policy and security matters, and the country appears to be at the forefront of achieving its military and geopolitical objectives, at least for now"[28].

Table 6: Difference Between Zombie Economy and Zombie Firms

Item	**Zombie Economy**	**Zombie Firms**
Definition	An economy that appears stable on the surface but relies on external support (debt, aid, interventions) rather than real productivity	Companies that do not generate enough profits to cover interest and debt costs but remain alive through bank or state support
Characteristics	Inability to achieve self-sustained growth - Dependence on external financing/aid - High security or political costs that exceed gains	Low profitability and productivity - reliance on cheap loans or debt restructuring - their survival hinders the exit of inefficient companies
Indicators	Growing public debt - dependence on external borrowing - outflow of foreign direct investment (FDI) - weak market confidence	Interest Coverage Ratio (ICR) < 1- Tobin's q
Economic Impact	Weakens long-term stability and makes the economy vulnerable to shocks	Hinders innovation and renewal, reduces overall market efficiency
Japan Example	The economy as a whole has not turned into a zombie, but firms have slowed growth	Firms remained alive despite weakness after the 1990s bubble burst
China Example	Economy struggled to shift from investment to consumption	Non-productive state firms continued through state support
Argentina Example	Repeated economic crises due to public debt and fiscal deficit	Troubled housing and mortgage loans (Zombie Mortgages)
Israel Example	Economy appears strong (stable shekel, accepted bonds) but fragile due to occupation costs, declining investment, and external support	Companies rely on direct and indirect government support

Conclusion

An observer of the scene notices that the primary motivation is political: preserving Israeli dominance in the region and serving Western geopolitical interests, even at long-term economic cost. The direct economic gains for the West from supporting Israel are limited, but they are politically justified as an investment in a "strategic ally." It can be said that the Israeli economy lives in a distinctive "zombie" state. There are surface indicators suggesting stability, while deep structural crises are worsening due to occupation, wars, and dependence on external support. International institutions and credit rating agencies-consciously or unconsciously-contribute to reinforcing this image, raising questions about their neutrality and credibility. Israeli bonds are not bought for profit, but to finance its military campaign. The Israeli zombie economy reveals how media misinformation, ideology, and geopolitical complicity can sustain an unsustainable system. The question remains open: when will the mask fall and the truth of an economy living on "artificial respiration" be exposed?

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