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LA RIFORMA GIUDIZIARIA IN ISRAELE E IL SUO IMPATTO SUL  
MERCATO DELL'HIGH-TECH

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# INTRODUCTION

This dissertation discusses Israel's internal political situation and its repercussion on its economy, that is mainly based on the high-tech industry.

I will start with a brief introduction on Israel's recent formation and the implications it has brought, such as the lack of a true and independent state, the Israeli government's structure, and the political difficulties that have emerged over time.

The judicial reform proposed by the Minister of Justice Levin, and later by Rothman, is scrutinized. The reform has the goal of limiting the power of the Supreme Court, but it is widely believed to undermine the democratic principles upon which the State is founded. The political situation has led thousands of people to gather every Saturday since January of the current year, in order to protest the proposed reform. People of every age participate in the pacific demonstrations. It is also worth noting how many high-tech workers attend these protests in order to have their voices heard and make understand the implications of the proposed reform on the Israeli high-tech industry; citizens who take part to the protests show their support and worrying for this sector.

In fact, Israel's state is also known as Silicon Wadi, a word pun with "Silicon Valley," owing to the significant growth seen in the high-tech sector in recent years. Israeli economy is based primarily on this sector, and since January 2023, it has been influenced by the government's reform efforts: investments have been reduced or in extreme cases suspended, CEOs of startups and major corporations have demonstrated their worries for the economic consequences of the reform. Is Israeli economy changing and dropping down because of the proposed reform or is it just an implication of the recession that is affecting all the world? How important is the high-tech sector in the economy? What will the implications and consequences be?

Data, interviews, and surveys have been used to understand and analyze the current political and economic situation. All the documents the paper is based on have been published during the first seven months of the current year – the economic direction could change in the next months due to a change in politics, to the political stability, the global economic shift. Since the circumstances are constantly changing, we cannot draw conclusions, but we can get an idea on how the scenario may evolve in the months ahead.

# CHAPTER I

## ISRAELI CONSTITUTIONAL FRAMEWORK

### *1. Israeli Constitutional Background*

The history of Israel is quite fragmented and complicated, and it's marked by ongoing wars and disputes over its territory. By the end of 1800, Jews from all over the world had begun to settle in the disputed territory, under a movement (both political and religious) called Zionism: they wished to build a Jewish homeland in Palestine. And, after the First World War, it was decided that Great Britain would have been in charge of the administration of the territories of Palestine and Transjordan because it had previously supported the establishment of a state for Jews in Palestine. As a consequence of the World War II and Holocaust, the Partition Plan for Palestine was adopted by the United Nations establishing two separate nations, the Arab one and the Jewish one, as well as the internationalization of Jerusalem. In the meanwhile, the Zionism movement was trying to establish an independent Jewish nation. During 1948 a civil war broke out between the Palestinian Arabs and the Yishuv<sup>1</sup>, but on May 14 Britain formally ended the Mandate (with which it was administrating the territory) and, thanks to David Ben-Gurion, Israel proclaimed its independence.

But the day after Israel gained independence, it sprang into conflict with the five surrounding Arab states – Lebanon, Syria, Iraq, Jordan and Egypt – beginning the Arab-Israeli War. The Armistice Agreement between Israel and Saudi Arabia, Lebanon, Egypt, and Georgia was signed in 1949, putting an end to the Arab-Israeli war. During and right after the war, Jewish moved from the Arab territory to Israel; while Arabs were expelled from Israel and sent to the Arab territories, in West Bank or Gaza. A few years later, in 1967, in a conflict known as "the Six Days War", Israel conquered the Golan Heights, the West Bank, the Gaza Strip, and the Sinai Peninsula. Israel eventually established colonies throughout the Israeli-occupied areas and annexed East Jerusalem and the Golan Heights.

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<sup>1</sup> Jewish residents in the land of Israel prior to the establishment of the State of Israel in 1948.

Israel has signed peace treaties with Egypt, returning the Sinai Peninsula, and with Jordan; however, the many attempts to end the Israeli-Palestinian issue have not been successful. More recently, relations have been improved with a number of other Arab nations, but it is still in conflict with Gaza Strip, the West Bank and the Golan Heights. Even if more than 135 UN member nations officially recognize Palestine as a nation, the Jewish state does not. Many countries have spoken up for new peace treaties supporting a two-state solution – in this way the two states could peacefully co-exist – but at the same time they recognize Israelis and Palestinians will not agree on borders.

Israel is not only fighting a war against Palestine, but it is also dealing with widespread protests around the nation – particularly in major cities, such as Tel Aviv, Jerusalem, and Beersheba – as a result of a judicial reform planned by the government at the start of the current year. The reform directly contradicts the fundamental laws that underpin democracy: consequently, every Saturday, citizens gather to protest.

To fully understand the proposed reform, however, it must be clear how the Israeli government works.

## ***2. The Israeli Government***

The nation has adopted proportional representation, universal suffrage, and a parliamentary system. The Knesset<sup>2</sup>, Israel's unicameral legislature, elects the prime minister, who acts as the head of state.

The President, as the head of state, presides over the government. Then there's the separation of powers: the legislature, which includes the Knesset, committees, mayors, council heads, and local councils; the executive, which involves the prime minister, government, state comptroller, and ombudsman; and the judiciary, which includes the court system and the attorney general.

The only governing entity with legislative capacity in Israel is the Knesset, the country's house of representatives. It also plays a crucial part in forming the State of Israel's constitution, even if Israel does not have a proper constitution. The Knesset also serves in a number of quasi-judicial capacities and oversees the activities of the government (executive branch). The State Comptroller and President of the State are chosen by the Knesset in its capacity as an elective body. The Knesset, whose home

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<sup>2</sup> The State of Israel – The Knesset. < <https://main.knesset.gov.il/en/about/pages/knessetwork.aspx> > Accessed 20 May 2023

is in Jerusalem, is composed by 120 members and is not chosen by direct popular vote: they participate in the general elections as candidates within the parameters of the party lists. Article 4 of the Basic Law states that the Knesset is elected in general, national, direct, equal, secret, and proportional elections. The Knesset is elected for a four-year term, although it has the power to dissolve itself earlier by enacting a statute to that effect. The next elections' date is likewise set by this statute. The Knesset may also be dissolved early if the State Budget is not approved within three months of the start of the fiscal year or if the Prime Minister recommends dissolution and the President accepts that recommendation due to widespread opposition to the Government that makes it difficult for it to function effectively.

### **3. The Knesset and Its Functions**

The Knesset has four main different functions.

First, as the legislative body, the Knesset's primary duty is to pass legislation. Legislation can be proposed by a committee of the Knesset, the government (government bills), or one or more members of the Knesset (private bills). The Knesset Plenum and its committees carry out the legislative process with the aid of the Knesset's legal advisers. Unless a statute specifies otherwise, the Knesset Plenum must vote in favor of a bill in order for it to pass.

The Knesset has also the aim of writing a constitution. The Constituent Assembly, which later became the Knesset, was mandated by the Proclamation of Independence to draft a constitution for the State of Israel. Due to the fact that this process has not yet been finished, it was determined that the Basic Laws would be passed by the Knesset and then combined with certain general provisions and a suitable introduction in order to form the State of Israel's Constitution. The Knesset has already approved 14 Basic Laws.

The third function of the Knesset is the supervision of the government. According to the basic law "The Government is collectively accountable to the Knesset and keeps office thanks to the trust of the Knesset".<sup>3</sup> Debates in the Plenum, motions for the agenda, parliamentary questions, and

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<sup>3</sup> Ibid (2)

committee hearings when ministers and their deputies are called to account for their deeds are all ways that the Knesset monitors the Government.

According to the Basic Laws, “Knesset members may ask to call the Prime Minister to a debate in the Plenum on a subject of their choosing with the support of at least 40 other Knesset members. At most, this request may be made once a month”.<sup>4</sup>

The Knesset has the right to express no confidence in the government in accordance with the Basic Law. “A resolution of the Knesset, approved by a majority of its Members, may be used to express no confidence in a government after that government has made public announcements about its fundamental policies, its composition, and the distribution of ministerial responsibilities. The Knesset member who will serve as the alternative Government's leader must also be identified in the resolution. Once the Knesset has given its support, the new Government will be formed, and the ministers will then take up their positions.”<sup>5</sup>

The State Control Committee and the Knesset Plenum debate the reports of the State Comptroller, who also acts as the Ombudsman<sup>6</sup>. These reports cover a few topics that fall under the purview of the government, local governments, the military, individuals and organizations acting on behalf of the state, institutions, funds, and any other government-run authority, as well as every organization that receives state funding and is subject to legal inspection.

Another function of the Knesset is, by secret ballot, choosing the State Comptroller and President of the State for separate seven-year terms. Along with choosing its representatives in the body that elects the Chief Rabbinate Council, each Knesset also chooses its members to represent it on the Committee for the Appointment of Judges, the Committee for the Appointment of Rabbinic Judges, the Committee for the Appointment of Qadis, and the Committee for the Appointment of Madh'hab Qadis. The Knesset also approves government cabinet appointments.

Knesset has quasi-judicial and other functions: such as, the removal of the immunity of Knesset Members and the power to oust the state's president and state comptroller. The Knesset also has the power, in certain situations, to oust the Prime Minister from office. Additionally, the Knesset performs ceremonial duties.

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<sup>4</sup> Ibid (2)

<sup>5</sup> Ibid (2)

<sup>6</sup> Oxford Dictionary – ‘an official appointed to investigate individuals' complaints against maladministration, especially that of public authorities.’

#### **4. The Hypothesis of a Constitution**

It is clear that among the functions of the Knesset there was the aim of writing a constitution.<sup>7</sup> The First Knesset and the Constituent Assembly were unable to create a constitution, thus the Knesset began to pass fundamental laws, called Basic Laws, on a variety of topics. When all fundamental laws have been passed, along with a suitable introduction and a number of general edicts, they will collectively make up the State of Israel's constitution.

There are some relevant issues regarding Basic Laws and ordinary laws for two primary reasons: the process for approving ordinary and basic law is fairly similar, and there is no legal instrument that separates the legal issues of the two types of law. One of the most important issues is whether the basic laws take precedence over the ordinary laws. There are divergent views on this specific issue. Some contend that, unless they contain an express provision to the contrary, basic laws are not superior to ordinary laws. This group of people support their stance with the justification that a basic law cannot be given superior status because it is enacted by an ordinary majority (i.e., a majority of those voting). Others contend that basic laws are better since they were created by the Knesset, which served as the Constituent Assembly, and that one may infer this from the fact that they are classified as "basic laws" alone.

What happens when a basic law and an ordinary law enacted after the basic law is enacted clash? Although the solution to this question has not yet been incorporated into a statute, the High Court of Justice has addressed it in a number of decisions.

On September 24, 1997, the High Court of Justice, which consisted of 11 judges, nullified many legal provisions governing the practice of investment consulting. They do not comply with Basic legislation: Freedom of Occupation, according to the High Court, "to a degree which supercedes that required to realize the goal of the law."<sup>8</sup>

On October 14, 1999, the High Court of Justice issued a decision, stating that a law's provision that violated the Basic Law: Human Dignity and Liberty was unlawful. The relevant section of the Military Judgement Law was Article 237a(a), which allowed a military police officer to hold a soldier for four days without first taking him before a court.<sup>9</sup>

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<sup>7</sup> The State of Israel – Basic Laws. < <https://main.knesset.gov.il/en/activity/pages/basiclaws.aspx> > Accessed 20 May 2023

<sup>8</sup> Ibid (7)

<sup>9</sup> Ibid (7)



Even if there is not yet a statute with the solution to this issue, it seems clear that the ordinary law is not taken into account.

According to Israeli court interpretation, the 11 Basic Laws have constitutional precedence above main legislation.

## 5. *The Current Institutional Crisis*

After explaining how the government operates and the difficulties concerning the constitution, Basic Laws and ordinary laws, it may be easier to understand the present political environment and the judicial reform the government is attempting.

At the beginning of this year, in January 2023, the Minister of Justice Levin and the Knesset's member Rothman presented two similar but not equal proposals of law regarding a reform in judicial review.

Both the proposals "seek to limit the Court's authority to strike down legislation to those cases that substantively contradict an explicit provision of the basic law"<sup>10</sup>. Moreover, Levin's proposal states that the Supreme Court to nullify laws needs a majority of 80%; while Rothman proposes a unanimous vote in order to invalidate a law. It is more than clear that it would lead to a limitation of the Supreme Court's authority in interpreting Basic Laws to protect human and fundamental rights over which it has not yet been legislated. Both reaching the unanimous vote, or the 80% majority is quite difficult, it is something that would practically never happen in substance. How can the Supreme Court defend citizens and fundamental rights?

According to Levin's proposal, judgements to invalidate certain laws would have no precedent for other laws. In other words, the invalidation procedure would be much more difficult because the Court would be required to rule on any statute that is comparable to those that are already incompatible with a fundamental law (Basic Law).

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<sup>10</sup> Amichai Cohen and Yuval Shany 'Reversing the Constitutional Revolution' (Lawfare). Accessed 22 May 2023 < <https://www.lawfareblog.com/reversing-constitutional-revolution-israeli-governments-plan-undermine-supreme-courts-judicial>>

A rule known as an "override clause"<sup>11</sup> – in the proposal presented by Levin – would let the Knesset pass legislation that nullifies a Basic Law. According to the Supreme Court's interpretation, an ordinary law can be deemed "unconstitutional" when it contradicts a Basic Law, and this is particularly applicable when it violates human rights clearly without any type of justification. The 'override clause' rule allows the Knesset to re-enact a statute that was struck down by the Supreme Court as unconstitutional. Moreover, the 'override clause' would allow a legislation to be immune to the judicial review because it would be 'protected' since the first approval. Because it only takes a majority of members to overrule basic laws, the Knesset's majority is growing in power.

In certain versions of the plan, the override provision would even allow a legislation to be covered in this manner when initially passed, making it completely immune to court scrutiny. According to an early proposal given by numerous Knesset members, the backing of only 61 Knesset members would be sufficient to override portions of the Basic Laws; in other words, the number required to rule over the legislature. This means that the majority is allowed to do anything it wants to, ignore High Court rulings and violate Knesset-enacted Basic Law.

Since the Supreme Court is the primary check on the political majority's authority in Israel, there is no decentralization of power. It lacks a bicameral legislature, a constitution, and a president elected through a separate public vote, as previously stated. This scenario limits the Supreme Court's jurisdiction to conduct constitutional reviews of laws approved by the Knesset, which is controlled by the government. In terms of the overriding clause, Israel – being the Supreme Court the only balancing mechanism – would become a very weak democracy: minorities and human rights (guaranteed by Basic Law) would have no significant protection against the majority.

Some may argue that because the Knesset majority is elected, it reflects the desire of the people majority; therefore, if it has total authority, it is not incorrect. The explanation is that democracy is based on a number of ideals, and not only on the majority rule. According to democracy, the principle of majority, thankfully, must be weighted alongside the others that compose the same democracy.

The constitution is an aspect in defending democratic values. However, in Israel, the Basic Law may be modified (by majority vote or by majority of the head), which acts as a constitution and, as a result, is already quite weak. At this time to reform or damage human rights, the Knesset must openly contend Basic Law and so face public scrutiny. Instead, enacting the 'overriding clause', which gives

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<sup>11</sup> Amir Fuchs 'The override clause explainer' (The State of Israel). < <https://en.idi.org.il/articles/46387> > Accessed 22 May 2023

Knesset members the authority to overturn fundamental law in order to execute the ordinary law, would weaken the present constitution (and hence Basic Law) even further.

The article<sup>12</sup> written by Amir Fuchs gives a well-written explanation of what would happen. “Some assert that an override clause is part of a legitimate ‘constitutional dialogue’ between the branches of government. But in Israel, if the last word is left to the legislature, which also controls the constitution, – he writes – there would be no real dialogue, but only a unilateral power grab that would undermine the existing constitutional ‘dialogue’, in which the Court can strike down laws (and the Knesset, the legal advisors, and the entire system are aware of that possibility). All of this would change if the Knesset always had the last word: we might see a situation in which the Supreme Court, which has always been very cautious about striking down laws, would have fewer qualms about doing so.”

As a result, it is apparent that, given the position in which Israel finds itself, passing the overriding clause would significantly jeopardize democracy, with the potential of undermining the fundamental rights protected by the 'constitution' through the Basic Laws. There are numerous elements to take into account, but passing the clause would undermine the foundations on which democracy is founded, as guarded by the constitution and hence by Basic Law. It would result in a significant power imbalance in favor of the Knesset majority and against the Supreme Court (which ensures constitutional observance).

Supreme Court does not have the jurisdiction to conduct judicial review of Basic Laws, states the last section of Levin’s proposal. As already said, the process for approving ordinary and basic law is fairly similar, and there is no legal instrument that separates the legal issues of the two types of law. In other words, the Supreme Court would lose the power to review the laws.

Enacting those two proposals, would be the ‘end of judicial review of Knesset legislation’<sup>13</sup>, the Knesset could always override or re-enact the legislation. It is very interesting the position of some Knesset legal advisers “The arrangement represents a very considerable reduction of the limits imposed on the legislative and executive branch and results in serious harm to the principle of separation of powers and distribution of governmental powers which is core principle in a democratic regime. Moreover, given the importance of imposing limits on governmental power as a central tool

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<sup>12</sup> Ibid (11)

<sup>13</sup> Amichai Cohen and Yuval Shany ‘Reversing the Constitutional Revolution’ (Lawfare). Accessed 22 May 2023 <<https://www.lawfareblog.com/reversing-constitutional-revolution-israeli-governments-plan-undermine-supreme-courts-judicial>>

for protecting human rights and the “rule of the game” in democratic regimes, there is a weighty concern that the proposed arrangement would allow serious harm to the protection afforded to these rights and principles.”<sup>14</sup> These statements reflect a clear resistance to Rothman's idea, specifically condemning the lesion of power separation (at the core of democracy), which would make safeguarding persons with fundamental rights impossible.

## **6. The Protests**

Many areas of democracy and the country are clearly concerned, ranging from legal advisers to economics to regular residents who planned and carried out public demonstrations and strikes in reaction to the ruling government’s desire for broad judicial reform. Thanks to Avi Himi, head of the Israel Bar Association<sup>15</sup>, every Saturday, from the beginning of the current year, thousands of people – old, young, teachers, students, kids, legals, hi-tech workers – have took part in protesting against the planned reform of the government. In an interview, Himi said “Our judicial method anchors universal values that are infrastructure for our shared lives. If there is no equality, morality or justice, and there is legislation that harms one minority or another – that’s not democracy. The new government does not have the right to change the method of governance in Israel”.<sup>16</sup>

The fact that thousands of people take to the streets to protest every Saturday – blocking highways – shows how worried the population is about their rights not being preserved. But why Israelis elected a right-wing government? It is probably due to the fact that Israel is a new state, it does not have a long history, it is only 70 years old and so one side wants to retain its identity and it takes time; while the other side wants to avoid making choices without being heard, it probably wants a revolution, wants to be progressive, current and in sync with the rest of the world. This led to the fact that young people especially are concerned about their country's future, and they are demonstrating to protect the state itself and their rights. They are aware of the situation, and they are trying to do everything

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<sup>14</sup> Ibid (13)

<sup>15</sup> It was established in 1961 and it’s an autonomous statutory entity in order to incorporate the lawyers in Israel and to assure the standard and integrity of the legal profession. Accessed on 24 May 2023 < [https://www.israelbar.org.il/english\\_index.asp#:~:text=The%20Israel%20Bar%20Association%20was,integrity%20of%20the%20legal%20profession](https://www.israelbar.org.il/english_index.asp#:~:text=The%20Israel%20Bar%20Association%20was,integrity%20of%20the%20legal%20profession) >

<sup>16</sup> Toi Staff (Times of Israel) ‘Israeli bar chief slams plan to limit to court’ Accessed on 24 May 2023 < <https://www.timesofisrael.com/israeli-bar-chief-on-plans-to-limit-high-court-they-want-to-turn-us-into-hungary/> >

they can to make the government stop the judicial reform, it is actually working: their will and tenacity are so strong that the government has suspended the reform.

IDI'S Viterbi Family Center for Public Opinion and Policy Research carried out a survey among Israelis on the judicial reform proposed by Levin: it is not hard to believe that "66% of Israelis think the Supreme Court should have the power to strike down a law if it is incompatible with the Basic Laws."<sup>17</sup> The survey asked a variety of questions about the power of the Supreme Court, gender equality, LGBTQ rights, Israeli Arabs rights, civil service, the economy. And it is a confirmation of the fact that the population does not want a change in the way the government works, and that people are seriously afraid of what could happen if the reform would be accepted.

After three months of demonstrations, President Netanyahu declared a postponement on the government's proposed judicial amendments, stating that he was "not willing to tear the nation in half ... When there's a possibility of avoiding fraternal war through dialogue, I, as prime minister, will take a time out for that dialogue."<sup>18</sup> However, Netanyahu decided to remove his defense minister, Yoav Gallant – since he is opposed to the judicial plans making a public announcement to reject the proposals – and this decision led to even more protests: flights were canceled at Tel Aviv's airport, local governments, transportation, nurseries, people working in banks, and IT professionals joined the strike. Despite the demonstrations, a legislative committee approved sections of the legislation proposed, and so the reform could still be approved.

"If the plans for the judiciary go ahead in their current form after the Knesset break, Israel is still likely to face a constitutional crisis in which the Supreme Court could strike down legislation, and the coalition could choose not to comply."<sup>19</sup> Even many of Israel's allies have shared their concern about the state's course: the president Joe Biden, in particular, has indicated his worry by urging Netanyahu to abandon efforts to overhaul the court system.

Many supporters – and workers too – of Israel's hi-tech industry joined the demonstrations, fearing that the change will have an impact on this vital sector of the country's economy.

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<sup>17</sup> Tamar Hermann, Dr. Or Anabi 'Only a Minority of Israelis Support the Proposed Judicial Overhaul'. Accessed 24 May 2023 < <https://en.idi.org.il/articles/47968> >

<sup>18</sup> Bethan McKernan 'Israel: Netanyahu announces delay to judicial overhaul plan' (The Guardian). Accessed 25 May 2023 < <https://www.theguardian.com/world/2023/mar/27/israel-netanyahu-judiciary-plans-halt> >

<sup>19</sup> Ibid (18)

## CHAPTER II

### ISRAELI HIGH TECHNOLOGY

#### *1. The Background of Israel Economy*

The Israeli economy evolved in unique and separate ways in the Jewish and Arab contexts throughout the past century. The economic expansion in the Jewish world has been mostly driven by capital inflows and immigration. As previously stated, thousands of Jews migrated to Palestine in waves starting by end of the nineteenth century as a result of the Zionist movement, and by the Declaration of Independence, they constituted about 35% of the entire population. Public and private (for the most part) funds were collected thanks to Zionist institutions, leading to capital inflows. As a consequence, during periods of heavy immigration, the national product grew quickly, but there was frequently a period of regression and adjustment, after the waves of immigration. ‘‘In the period from 1922 to 1947 real net domestic product (NDP) of Jewish sector grew at an average rate of 13.2% ..... NDP per capita in the Jewish sector ... by the end of the period was 8.5 times larger than in 1922.’’<sup>20</sup> This statement clearly shows that the Jewish sector of the economy has seen significant growth. They concentrated on a variety of sectors, including farming, manufacturing, the construction of houses, and services – counting a first form of government led by Jewish institutions and health, business and educational sectors.

In the following years, another wave of immigration led to a doubling of the Jewish population and, in 1952, an extremely strict policy was put in place, subjected to price restrictions, and rationing of essential goods. As a consequence of German reparations, the sale of State of Israel Bonds abroad, and US support – such as loans and money transfers – significant capital inflows came into Israel. Between 1950 and 1965, these significant capital inflows permitted Israel to accomplish a high rate of growth, culminating in an annual growth rate of 11% in real GDP and 6% in per capita GDP.<sup>21</sup> All this enabled a huge investment program, mostly funded by a special government budget –

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<sup>20</sup> Nadav Halevi ‘A Brief Economic History of Modern Israel’ < <https://eh.net/encyclopedia/a-brief-economic-history-of-modern-israel/> > Accessed 5 June 2023

<sup>21</sup> Ibid (20)

encouraging the development of new sectors (such as the textile one) and exports, in addition to the usual ones.

After the ‘conquest’ of the West Bank and Gaza Strip in 1967, Israel’s and the occupied territories’ economy were somewhat intertwined. Trade in products and services grew and Palestinians were hired in Israel, mainly in the sectors of construction and agriculture, which had a great effect on the economy of Israel – but not on a large scale. The employment in Israel led to a big development for the Palestinian economy, which grew quickly. In 1994 the two factions signed an economic agreement: Israel had the control of the foreign trade policy and Palestinians obtained limited authority over some imports. The two main wars between Israel and Palestinians – the well-known intifadas of 1980s and 2000s – made Israel establish a budget to defense.

The economy of Israel has changed through the past century: agriculture and low-tech industries have seen declines while high-tech industries have grown to become the most vital.

## **2. How and when Israel Became a Start-Up Nation**

While between 1950 and 1970 the living conditions in Israel doubled, in the following two decades Israel experienced an economic stagnation: the infrastructure was insufficient for that amount of people, immigration stopped, unemployment turned into a major problem and inflation grew from 13% in 1971 to 445% in 1984<sup>22</sup>. As a consequence of a lengthy period of dangerous circumstances, limited chances, and economic stagnation, many Israelis left for the Silicon Valley in order to join the developing start-up and venture capital sector.

In the meanwhile, in 1974 Intel opened in Israel its first Research and Development (R&D) due to the potential it saw in Israelis who were living in the States. The team created a microprocessor that was tiny enough to move computing to the workplace and houses: these chips were so innovative that the well-known IBM decided to use it for its PCs. In 1985, inflation was highly reduced thanks to the implementation of a new policy and, thanks to the large emigration of Israelis, in the 1990s – when Israel started to see a period of economic recovery – economic relations were easily created between Silicon Valley and Israel.

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<sup>22</sup> Ntegra ‘The Story of The Israel Start-up Nation’ < <https://www.ntegra.com/insights/israel-start-nation> > Accessed 5 June 2023

In this completely newly created and imaginative atmosphere, Israelis began developing a significant number of start-ups, largely encouraged by their overseas contacts who invested in their new businesses. During the last decade of the twentieth century, Israel grew extraordinarily in the sector of high technology, increasing by 35% of the total and boosting industrial exports by 13.2 billion dollars.<sup>23</sup>

In 1992 the Israeli government developed a plan – also known as Project Yozma<sup>24</sup> (yozma in Hebrew means ‘initiative’) – that focused on an economic stabilization. The initiative had several goals, including starting creative sectors by investing in new venture capital funds, incentivizing corporations to experiment and develop by taking risks, and personally investing in small Israeli businesses. The project was also looking forward to enticing overseas investors by promising a doubling of any investment with government money, offering insurance that covered 80% of an inconvenient risk, and granting tax incentives to multinational venture capital companies operating in Israel. By pursuing out this strategy, the government achieved the goals it set for itself: “venture capital investments soon jumped from \$58 million to \$3.3 billion; Israel ranked second only to the United States in invested private-equity capital as a share of GDP; and it also led the world in the share of its growth attributable to high-tech ventures by 70%.”<sup>25</sup> As a small nation, Israel focused on the global market, and the rise of the internet, which eliminated any geographical barriers, resulted in a boom in the country's economy.

Another element that has led to and continues to lead to innovation in Israel is mandatory military service. The Israeli Defense Force (IDF) has a unique unit – unit 8200, whose purpose is to intercept, monitor, and investigate rivals’ data and communications – that teaches young Israeli recruits in hacking, cyber-spionage, and coding – even smartphone applications. What is interesting is that many Israeli start-ups are made up by men and women who previously worked in the same unit during the army: when it comes to hiring new engineers and programmers, they usually go to their old unit, knowing that the military has spent a significant amount of money on choosing and educating its recruits – this is one of the reasons why the high-tech sector is all about personal relationships and connections.<sup>26</sup> “It is almost impossible to find a technology company in Israel without people from 8200, and in many cases the entrepreneur, the manager or the person who had the idea for the project will be someone from 8200” says Yair Cohen – former commander of Unit 8200 – “The men and the

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<sup>23</sup> Ibid (22)

<sup>24</sup> Social Impact Israel ‘Israel Took The Initiative in Innovation with Project Yozma’ < <https://socialimpactil.com/sdg8-israel-took-the-initiative-in-innovation-with-project-yozma/> > Accessed 7 June 2023

<sup>25</sup> Ibid (24)

<sup>26</sup> Tobias Buck ‘Israel’s army of tech start-ups’ (Financial Times) < <https://www.ft.com/content/d45b0c5c-1a83-11e1-ae4e-00144feabdc0> > Accessed 7 June 2023



women who have served in 8200 are uniquely suited to the start-up economy.”<sup>27</sup> Mandatory military service – and in this particular case, Unit 8200 – as well as training programmers, engineers, and hackers, promotes teamwork and motivation, all of which are necessary to save the lives of the fellow inhabitants and protect the Country. “If you are a Unit 8200 graduate, that carries real weight in the tech world – the equivalent of a law degree from Harvard or Yale”<sup>28</sup> states Yerman in his article about high-tech in Israel. Unsurprisingly, these skills turn out to be very solid characteristics in the fields of labor and high-tech. Aharon Ze’evi Farkash and Gil Shwed are two distinct instances of programmers educated by Unit 8200: Farkash was a former commander of Unit 8200 and founder of *FST21 Ltd.* (Farkash Security Technologies – later renamed *FST21 Biometrics*) that supplied technologies and services for home and container safety; Shwed was part of the Intelligence Corps and is the co-founder (with Shlomo Kramer who was part of the Unit 8200 too) and CEO of *Check Point Software Technologies Ltd.*, one of Israel’s leading high-tech companies.

### **3. The High Technology Economy**

It should be noted that the high-tech sector has developed enormously and continues to grow as a result of incubators, organizations, and institutes that have invested in, assisted, and supported entrepreneurs. For example, the Israel Innovation Authority has created programs that are used as templates for other countries; the Startup Nation Central is an organization that assists local entrepreneurs in growing; and there are various incubators in the industry.

Israel has mostly been active in Research and Development since its early forays into high-tech, bringing many international tech companies to invest in Israel and its success has been in attracting international investors to acquire or fund firms while keeping the labor in the country. The Israeli high technology reached the 45% of Israeli exports amounting to \$45 billion in 2017<sup>29</sup>; and it consists of several sectors: Cybertech & Homeland Security, Agrifood-tech and Water, Information Technology, Smart Transportation, Automotive, Climate Tech, Life Sciences and Health Tech.

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<sup>27</sup> Ibid (26)

<sup>28</sup> Jordan Yerman ‘A Startup Nation: Why Israel Has Become The New Silicon Valley’ <  
<https://apex.aero/articles/startup-nation-israel-become-silicon-valley/>> Accessed 8 June 2023

<sup>29</sup> Italia-Israel Chamber of Commerce ‘Israel’s Leading Industries – The Driving Sectors in Israel’s Economy’ pdf.  
Accessed 8 June 2023

### **3.1. Cybertech & Homeland Security**

This sector is one of the most progressive in the whole world due to the Israel geo-political condition leading to invest a high number of capitals in the sector. Innovative technologies are frequently tested with the aim of opposing the periodic risks that the country must face. Among the innovative technologies and automated systems taken into account, there are video surveillance, border control, biometrics scans, but also IED (improvised explosive device) and UAV (unmanned aerial vehicle) systems. In this leading sector more than 300 companies are operating, here some of the most important: Check Point – mentioned above, founded by Gil Shwed –, Milper Ltd, CyberArk, Biocatch, IMI Systems, Aeronautics, Defensoft.

### **3.2. Agri-Food and Water Technologies**

#### Agri-Food technology industry

AgriFood Tech refers to technical advancements and capabilities that alter the way food and other agricultural goods are grown, harvested, packaged, stored, transported, processed, and sold “making the farm-to-table process more efficient, sustainable and safe.”<sup>30</sup> The industry finds solutions for fertilization, smart irrigation, animal monitoring, pollination, precision agriculture, big data analytics software, plant sensors, autonomous robots, as well as others. Israelis started to look for solutions long before it became a worldwide necessity due to the country’s land and limitation of natural resources. In the last 6 years, 2020, despite Covid-19, has been the year with the highest investments in the sector, reaching a total of \$812 billion. In the Agritech sector there are more than 300 startups including: Seed-X, PlantArcBio, GreenOnyx, Agri-Light, Greeneye, Agritask, SaveFoods.

#### Foodtech industry

The Foodtech industry is a branch of the AgriFood sector, that has recently grown. In the past years the demand for food has highly increased all over the world due to an increase in population encouraging the development of the foodtech industry, especially in Israel. 230 Israeli foodtech companies are already profiting on the country's prowess in the industry as a startup nation: a total of \$1.4 billion was invested in this sector between 2017 and 2022, alternative proteins received the greatest proportion of investment, ahead of innovative additives.<sup>31</sup> According to the Good Food

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<sup>30</sup> Start-up Nation Central ‘Agrifood Tech solutions’ < <https://startupnationcentral.org/sector/agrifood-tech/> >  
Accessed 9 June 2023

<sup>31</sup> James Spiro ‘Mapping Israel’s Foodtech sector’ < <https://www.calcalistech.com/ctechnews/article/r1im1c6pj> >  
Accessed 8 June 2023

Institute, there are over 100 alternative protein companies in Israel and over 40% of them are considered companies with game-changing technology that have the potential to revolutionize the future of protein. The biggest companies operating in this field are MyBiotics, Unispectral, Vertico, Tapingo, Varcodes.

### Water Technologies

Israel is the most advanced country in the world regarding the 'reusable' water: big investments have been made in this field, especially the desalination process in order to be water-independent even if the country is mainly desertic. Israel is also very cautious about wastewater: it reuses the water for agricultural and urban irrigation, recycling 90% of its waste.<sup>32</sup> Foresight, H2, EcoWave Power, Desalitech are only some of the 200 industries of this vital sector for Israel.

### **3.3. Information Technology**

Between 1998 and 2009, this industry gained 400%, expanding by about \$4.7 billion (from \$1.5 billion in 1998 to \$6.2 billion in 2009).<sup>33</sup> The sector includes the development and use of information systems, cyber security, software, computing, communication infrastructures, command and control systems, advanced communication solutions, semiconductors, telecommunication, and other related activities. There are several R&D departments from multiple firms working worldwide in the sector in the country, such as Google, Apple, Samsung, Intel, Microsoft, Motorola (being one of the first companies to land in Israel in 1997), and many more.

### **3.4. Smart Transportation and Automotive**

The field of smart transportation and automotive is supported by the Israeli Government through financial incentives to the companies operating in this sector. As large-scale automobiles are not produced in Israel, the country focuses on and prioritizes the production of components, modules, and maintenance. The start-ups operating in this field, using military technology to advance the automotive industry, are developing ever more sophisticated approaches to increase safety, efficiency, air quality, and performance on the roads, such as location-based services technologies that make driving experience safer and smarter, gestures and behaviors recognition. Many vehicle

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<sup>32</sup> Start-up Nation Central 'The Israeli Water-Tech Sector' < [https://startupnationcentral.org/wp-content/uploads/2021/09/2-pager-watertech\\_screen.pdf](https://startupnationcentral.org/wp-content/uploads/2021/09/2-pager-watertech_screen.pdf) > Accessed 9 June 2023

<sup>33</sup> Italia-Israel Chamber of Commerce 'Israel's Leading Industries – The Driving Sectors in Israel's Economy' pdf. Accessed 8 June 2023

manufacturers throughout the world, including Italian manufacturers in recent years, have attempted to strike agreements to collaborate with startups to bring automation to all types of vehicles.

The Ecomotion Week is held every year, during which Israeli startups exhibit their products and seek investors. Delegates come from all over the world to create partnerships, collaborate, and to establish investments between businesses and startups. In occasion of the Ecomotion Week, the Italy-Israel Chamber of Commerce has coordinated meetings between prominent Italian firms (including Telepass, Agrati Group S.P.A., Italdesign S.P.A., CNH Industrial, and Iveco S.P.A., and others) and Israeli innovative startups, with the aim of reaching agreements.

### **3.5. Life Sciences**

The rapid expanding field of life science has evolved with the rise of high-tech in Israel, implementing surgical instruments, lasers, imaging, and training tools. The number of life sciences enterprises in Israel increased considerably between 2005 and 2014: 66% of life sciences firms were created during that decade, and between 2011 and 2014, around 36% of firms formed developed digital healthcare goods.<sup>34</sup> Many scholarly articles on life sciences and clinical medicine have been written; one in every three Israeli scientists specializes in some part of life sciences, making Israel one of the countries with the highest per capita concentrations of scientists (145 for every 10,000 citizens).<sup>35</sup> The most important startups operating in this field are: ETI Dental Industries Ltd, BrainsWay, IOptima, Noris Mediacal, Vayyar, Elastimed, etc. Moreover, many multinational corporations (such as Google, Yahoo, IBM, Motorola, and so on) have Israeli branches or supervise multiple Israeli R&D facilities.

## **4. Conclusions**

In just a few decades, Israel's economy has risen dramatically, first in the primary sectors (manufacturing, construction and services) and later in the high-tech sector, becoming the most important one. The government promoted the growth of the industry in question by supporting numerous initiatives (the most prominent of which was the Yozma Project), but the military service

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<sup>34</sup> Ministry of Economy and Industry State of Israel 'Israeli Health & Life Sciences industry' < <https://investinIsrael.gov.il/ExploreIsrael/sectors/Pages/Health--Life-Sciences.aspx> > Accessed 9 June 2023

<sup>35</sup> Ibid (34)

played a critical role, teaching young people in the usage and production of army-related software and applications. Following their military service, many of them found themselves working in high-tech collaborating on the founding of several high-tech enterprises. Israel has made significant investments in high-tech, rising to second place after the United States in the field in just a few decades. It has grown in a variety of sub-sectors, including climate-tech, transportation, agri-food tech, and health-tech, achieving excellent results in all of them and becoming a worldwide example. The question currently is whether Israel will retain its second-place position in the world because of the global economy's decline and Israel's political-economic condition.

## CHAPTER III

### THE ECONOMIC REPERCUSSION OF THE JUDICIAL REFORM

#### 3.1. General considerations on the impact of the judicial reform

“In the modern world, economic growth and prosperity require stability, a legal system that guarantees – among other things – property rights, compliance with budget legislation, respect for the central bank law (the Bank of Israel Law), enforcement of regulations promoting competition, and clear and stable rules of the game that enable and facilitate the development of a long-term planning horizon.”<sup>36</sup>, the professors Frenkel and Flug wrote in an article regarding the Israeli economy.

In order to grow, the economy needs stability. But, due to Covid-19 and Russia's subsequent invasion of Ukraine, the world economy has experienced a series of big crisis in recent years, hurting the high-tech industry too. The Israeli economy has performed particularly well in recent years, thanks in part to record levels of foreign investment in Israel's high-tech sector. The economic environment, however, has shifted, and the worldwide economic recession and fall in accessible capital are already having an impact on the Israeli economy. All the world is experiencing a period of geopolitical and geoeconomic instability and the approval of the judicial reform, followed by the economic repercussion, will harm Israel's economic image at this crucial moment of big instability across the globe, and even more difficult to restore it. While before there were quite a few jobs offers and high salaries due to strong competition, especially in Israel, wages and job opportunities are now lower: this is not just due to the political circumstances, but also to a balance between wages, labor, and job offers. The Israeli economy functions in a very competitive environment; everything Israel does is scrutinized, Israel is a world-wide example and countries use Israel as a model regarding high-tech economy. In this competitive environment, any damage to the Israeli economy caused by premature and unwise policies is likely to be costly and difficult to fix.

However, we should keep in mind that the use of technology is continually expanding, therefore a rise in demand in everything technological, which will most likely lead to a new increase in demand

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<sup>36</sup> Jacob Frenkel and Karnit Flug ‘The Proposed Reform of the Judicial System Poses Risk to the Israeli Economy’ <<https://www.ipost.com/opinion/article-730095>> Accessed 15 June 2023

both for labor and competition. In fact, the most pressing issue is that, while the rest of the world is recovering from the global crisis, Israel is falling behind because of the proposed reform: clearly, the present political environment is unsettling, bringing uncertainty and instability to the workplace, particularly in the high-tech industry. This raises many concerns in the high-tech sector: many workers, representatives, and CEOs join protests to block the implementation of the reform, or, at the very least, to re-establish a climate of stability and security, which will for sure help the economy.

Israel seems to be following in other countries' footsteps. In Hungary, after the attack on the judicial system that started after the 2009 elections, the credit rating has decreased for several years and remains lower than it was before 2009; the impact of the reforms on foreign investments considerably greater than in other nations in the years after the global economic crisis<sup>37</sup>. Foreign investment temporarily fell in Poland when in 2016 the judiciary was weakened, compared to a small growth in the Organization for Economic Co-Operation and Development (OECD) nations on average<sup>38</sup>. Even in Turkey, after the limitation of judicial review in 2015, the recession in foreign investment was considerably worse than other countries.<sup>39</sup> These three scenarios exemplify how a change in the judiciary can affect the economy of a country. Each case must be examined independently, and all elements must be always considered, but it is crucial to acknowledge that there is a connection among seemingly unrelated activities, such as the ability for judicial scrutiny of government decisions and investor confidence in a stable economy. The attempts to impair the judicial review raise the probability of harsh and unpleasant economic and fiscal consequences.

The transfer of authority to a political majority to choose and elevate judges, may quickly lead to foreign entities losing trust in the Israeli court system and discourage business initiatives.<sup>40</sup> Due to risk management and investor demands, Israel may witness a shift of its enterprises abroad. Every overseas transaction has specific legal risks, which are essentially non-existent when the investor invests in his or her own country: professional risks (the worry that local courts may incorrectly interpret the set of agreements), risks of a lack of expertise or comprehension of the applicable legislation, and the possibility that foreign interests will influence the courts.<sup>41</sup>

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<sup>37</sup> Ibid (36)

<sup>38</sup> Ibid (36)

<sup>39</sup> Ibid (36)

<sup>40</sup> Daniela Ginzburg 'Innovation Authority report: while the world is recovering, the Israeli high-tech market continues to decline' < <https://www.israelhayom.co.il/tech/tech-news/article/14322292> > Accessed 29 June 2023

<sup>41</sup> Ibid (40)

Foreign investors' fears would be amplified by the proposed reform: judges nominated by politicians and whose elevation is contingent on a political decision may be exposed to foreign pressure and interests. On one hand, Israel's venture capital market is highly concentrated and the number of significant international firms investing in Israel is restricted; on the other hand, the fear of losing investors and buyers may motivate high-tech entrepreneurs to relocate their companies or operations overseas as part of a risk-management strategy.<sup>42</sup>

### 3.2. *Actual changes in the economy*

In early March, Israeli firms traded on Wall Street filed their annual reports, providing investors with potential investment risks, with a lot of companies adding the implications of government-promoted legal system reforms in Israel to the list of risks.<sup>43</sup> Despite this, several Israeli corporations have chosen not to include the reform in their annual reports.<sup>44</sup> The lawyer Ron Ben-Menachem, who represents Israeli companies traded on Wall Street, partner and head of international capital markets at the Herzog firm, said in an interview “The inclusion of risk factors in the annual report, is meant to avoid investor claims against the firm, as if we had not informed and warned them of the danger. .... We advise such clients not to incorporate this disclaimer automatically. Management must analyze and evaluate whether proposed changes to the legal system, or reactions to suggested changes, may have an impact on the company's operations or financial outcomes.”<sup>45</sup>

Even if Israeli companies can decide whether to include the planned reform among the risks, a report published by the Innovation Authority of Israel speaks for itself: it emerges that the fourth quarter of 2021 was the highest period for Israeli high-tech financing, the local tech businesses, primarily growth enterprises, raised more than \$9 billion. Investment in start-ups in Israel fell by about half in 2022 compared to the previous year, totaling approximately 16 billion dollars.<sup>46</sup> Despite the economic crisis generated by the Covid-19 and the countless layoffs caused by the pandemic, the high-tech

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<sup>42</sup> Ibid (40)

<sup>43</sup> Habib Waldhorn ‘The warning from the reform of the law has become a standard in the reports of high-tech companies from Israel’ < <https://www.globes.co.il/news/article.aspx?did=1001440303> > Accessed 15 June 2023

<sup>44</sup> Ibid (43)

<sup>45</sup> Ibid (43)

<sup>46</sup> Daniela Ginzburg ‘Innovation Authority report: while the world is recovering, the Israeli high-tech market continues to decline’ < <https://www.israelhayom.co.il/tech/tech-news/article/14322292> > Accessed 29 June 2023



industry kept growing in the past years. But data for April 2023 reveal that the rate of new start-ups registered overseas has grown to more than 50%, up from roughly 20% in prior years, indicating a deterioration in entrepreneurs' trust in the stability of the economic environment in Israel.<sup>47</sup> This is an actual issue for the Israeli economy, and it is easily attributed to the reform proposed in January 2023; furthermore, the Israeli market is essentially entirely dependent on international finance, implying a high degree of reliance on external variables.<sup>48</sup> If there are specific local circumstances driving capital raising to continue to drop, despite a worldwide recovery trend, there are legitimate grounds for concern.

In a statement on the impact of judicial reform for Israeli high-tech, Shlomo Dovrat, head of the Aaron Institute for Economic Policy and co-founder of Viola Ventures, said that the judicial reform is putting Israel “under an existential threat”; he also stated “Israeli high-tech is built on four main pillars. The first one is the entrepreneurs, Israeli high-tech is highly dependent on them, take 50 people away and half of the Israeli tech is gone. ... And those entrepreneurs are global citizens, they will be more than welcome by any other country in the world. The second pillar is, of course, labor and the ability of this human capital, we need free spirited, creative people who are global in their nature, who are curious. ... The third pillar, which is very important, is foreign investors. ... There are no local investments in high-tech, all the money comes from abroad. The reason foreign investors come here is because there is an independent judicial system, clear laws on intellectual property, law on taxation, there is stability, and if there is an issue they can go to the court. When these things are gone, investors leave too. ... The fourth pillar is that Israel does not have local market, is all about exports, and the 54% exports is high-tech.”<sup>49</sup>

Shlomo Dovrat thus highlighted the reasons why investors support Israeli high-tech businesses, noting that one of the key reasons is the independence of the judiciary system. As it turns out, it is unsurprising and evident that if a reform like the one proposed was enacted, a domino effect would take place: investors would take steps backwards – as they have already begun to do – consequently, the entrepreneurs would be driven to leave Israel, taking their businesses with them. And the economy of Israel would collapse because, as mentioned above, Israel's economy is mostly built on high technology: if this vital sector fails, the country's economy as a whole fails. As Dovrat said “If Israel is any more a welcome citizen of the world, we are losing those markets and there is no high-tech industry.”

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<sup>47</sup> Ibid (46)

<sup>48</sup> Ibid (46)

<sup>49</sup> Israel Democracy Institute ‘How Will the Judicial Reform Impact Israel’s Hi-Tech Sector? Shlomo Dovrat’. 6 March 2023 < <https://www.youtube.com/watch?v=n0ltqtSMM5c> > 17 June 2023

The precarious situation in which Israel finds itself is worsened further by the global economic crisis that is being experienced all over the world.<sup>50</sup> The globe has stopped investing, the public markets have gone down and there is generally less money for investments, consequently for tech investments. It has to be taken into account that, at this time of global crisis, the judicial reform plan throws Israel into a state of instability and uncertainty, which, for the reasons explained above, does not benefit the country's economy.

According to the Start-Up Nation Policy Institute's research<sup>51</sup>, there was a dramatic decrease in investment in start-ups in the first three months of the current year, only \$1.7 billion, “the lowest level of investment in Israeli start-ups since 2018”<sup>52</sup>, with the 40% of the funds going to only three start-ups. Additionally, the number of deals fell considerably, setting the lowest record ever at 112. Even though investment data shows a considerable drop, the study highlights that start-ups financed during peak periods (between 2019 and 2021) should be able to weather the ongoing slowdown without sliding below the record low until the end of 2023. Therefore, the issue does not arise with previously financed firms but with the new ones seeking capital. Furthermore, although it appears that several firms will be unaffected by the economic downturn by the end of the current year, it should be remembered that the majority of employees in Israel work in the high-tech industry. The research points out there is an inclination to a phenomenon known as the "sleeve reversal": Israeli companies become effectively foreign corporations thanks to a shift in the ownership structure. Start-ups that have not yet followed this trend are likely to be required to adopt the conditions proposed by foreign investors, thereby shifting the Israeli ownership of firms to a foreign entity. In terms of the domino effect, it will become increasingly difficult for Israeli employees to remain in the nation, but they will be increasingly willing – and forced too – to leave Israel. Leading Israel to lose its human capital.

An additional report<sup>53</sup> released in early July by the Start-Up Nation Policy Institute, showed that economic conditions in the second quarter of 2023 did not improve, but rather worsened. Total investment dropped for the sixth quarter in a row in the second quarter of 2023: in the first six months

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<sup>50</sup> Ibid (49)

<sup>51</sup> Start-Up Nation Policy Institute 'Israeli Tech Ecosystem Review – Investment during the first quarter of 2023 and public sentiment survey towards the high-tech industry' < [https://snpi.org/wp-content/uploads/2023/04/Q1-2023-Update-English\\_Final.pdf](https://snpi.org/wp-content/uploads/2023/04/Q1-2023-Update-English_Final.pdf) > Accessed 17 June 2023

<sup>52</sup> Ibid (51)

<sup>53</sup> Start-Up Nation Policy Institute 'Israeli Tech Ecosystem Overview – Overview of the first half of 2023 with a focus on the second quarter' < <https://www.storydoc.com/5d662c0f663f17d29047f62992d9038e/4065793c-d49a-401d-9b79-a26b157959fc/64a15bfc578067000c7c6743> > Accessed 5 July 2023

of the current year, barely \$3.7 billion has been invested in Israeli start-ups, determining a 68% decline compared to the same period in 2022.

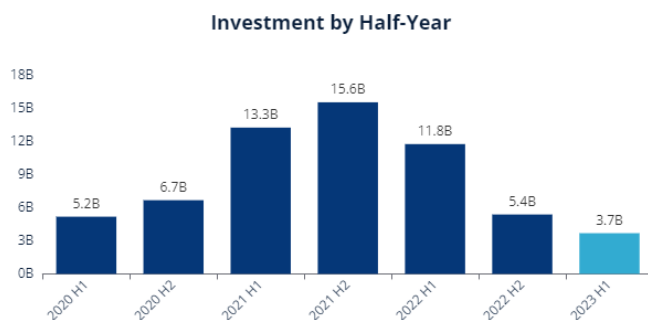


Figure 1 - Investment data from the Start-Up Nation Policy Institute – Israeli Tech Ecosystem Overview

It is hard to say with certainty that the downturn in the Israeli economy is only related to judicial reform, especially given the worldwide economic situation, which is surely contributing to Israel’s drop.

However, it is also worth noticing that United States and Europe, in the second quarter of 2023, have recorded an increase in investments of 15% and 34%, respectively. Even if in both continents some of tech centers witnessed a drop between April and June 2023, their economy is showing a recovery, unlike Israel – as we can see in the graphic below.

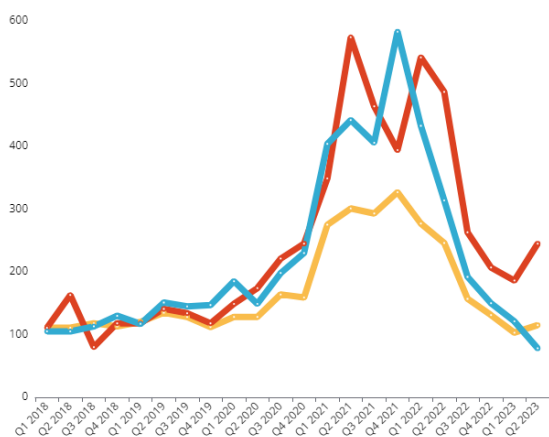


Figure 2 - Data from the Start-Up Nation Policy Institute – Israeli Tech Ecosystem Overview.

The red line in the graph represents Europe, the blue one is Israel and the yellow one is the United States. It is evident that Israel is not recovering from the global recession in the way U.S. and Europe are slowly doing; even if there is not a huge difference the two continents are slowly recovering, while Israel keeps falling down.

“Between April and May, at least ten Israeli firms – clients or potential clients – contacted us to learn more about what is going on and what the effects and repercussions of a corporate inversion and becoming a U.S. company would be.” said Tamir Chagal – corporate lawyer at ‘Sullivan & Worcester’ – in an interview<sup>54</sup>. “And before the proposal of the judicial reform, almost no company

<sup>54</sup> Tamir Chagal was interviewed by Francesca Belli on zoom on the 27<sup>th</sup> of May 2023

reached to us to know more about being an U.S. company. Moreover, we asked why they wanted to know all these information and all of them said that one of the reasons was the proposed judicial reform.” He also explained that some of the companies are negotiating with European funds to receive investments, at the beginning it was starting to take place, investors were enthusiastic and keen, but after the political turnover they started to “get cold feet”, they became more cautious and requested to wait to see how the situation would have developed, “none is actually saying it, but when you look at the timeline before the proposal of the reform everyone was very excited, and after it they started to be more careful and to hesitate.”<sup>55</sup> Chagal's statement is confirmation of the data reported above: the judicial reform is having a huge impact on Israeli economy, making even more difficult to recover from the global recession.

High-tech industry and protests are related, and a lot of employees who work in this field join the demonstrations to raise awareness about the economic challenge that the proposed judicial reform represents for the country. A survey involving 1050 participants was carried out: it has been demonstrated that the participants' viewpoints match with their level of support for the high-tech sector – in other words, individuals who support the high-tech industry feel that the protest is reasonable as well.<sup>56</sup> Investors are probably more concerned with stability than with the political environment; "if they observe that there is no significant change for a long period of time, they will probably start investing again."<sup>57</sup> – said Chagal. However, the atmosphere generated by the protests does not reflect stability, but rather a state of disorder.

On the 23<sup>rd</sup> of July the Start-Up Nation Policy Institute published an innovation economic survey<sup>58</sup> to better understand the leaders' reactions to the proposed judicial reform. The poll demonstrates once again how bad the judicial reform is influencing Israeli high-tech sector. Investors acknowledge that judicial reform is influencing their investment strategy in a way that will hurt Israeli firms' capacity to attract capital, including the fact there are more and more investments in foreign firms. Most of the companies have started to take significant initiatives to make legal and financial adjustments to the judicial reform – including moving their cash outside Israel, registering firms abroad and relocating their employees.<sup>59</sup> The companies that have not started yet to take the active steps mentioned above stated they are thinking about doing it: “68% of Israeli startup companies have begun taking active

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<sup>55</sup> Ibid (54)

<sup>56</sup> Start-Up Nation Policy Institute 'Israeli Tech Ecosystem Review – Investment during the first quarter of 2023 and public sentiment survey towards the high-tech industry' < [https://snpi.org/wp-content/uploads/2023/04/Q1-2023-Update-English\\_Final.pdf](https://snpi.org/wp-content/uploads/2023/04/Q1-2023-Update-English_Final.pdf) > Accessed 17 June 2023

<sup>57</sup> Tamir Chagal was interview by me on zoom on the 27<sup>th</sup> of May 2023

<sup>58</sup> Start-Up Nation Policy Institute “Start Up Nation Central innovation ecosystem survey: Examining the economic impact of the judicial reform process” pdf. Accessed 23 July 2023

<sup>59</sup> Ibid (58)

legal and financial steps; 22% of companies report that they have diversified cash reserves outside Israel and 37% of investors say companies have withdrawn some of their cash reserves and moved them abroad; 8% of companies report they have already begun the process of changing HQ locations, and 29% reported their intention to do so in the near future; 67% of investors are investing or are considering investing in foreign companies.”<sup>60</sup>

	Type of action	Action taken	Intentions forward
Companies	Moving cash outside Israel	22%	31%
	Laying off employees	19%	15%
	Moving HQ location	8%	29%
	Relocating employees	Not asked	21%
Investors reporting on portfolio companies	Moving cash outside Israel	37%	Not asked
	Laying off employees	25%	71%
	Moving HQ location	20%	69%

Figure 3 - Table summarizing active steps and intentions of firms - Start-Up Nation Central Innovation ecosystem survey.

Moreover, most of the firm leaders – such as investors – feel that delaying the legislation or enacting a measure reached by broad consensus is the only way to improve the overall outlook of the Israeli high-tech industry: 44% of firm leaders believe the best remedy would be stopping the legislation, such as 43% of investors, while 31% of firm leaders and 40% of investors believe in a wide consensus.

Avi Hasson, CEO of the Start-Up Nation Central, said “Companies and investors are taking active steps to move activity away from Israel and this behavior has increased significantly over the past three months. Concerning trends like registering a company abroad or launching new start-ups outside Israel will be hard to reverse. As an organization with a mission to strengthen the technology industry in Israel, it is our duty to share this data with decision makers in Israel and provide an up-to-date picture of the situation as it unfolds.”<sup>61</sup>

Despite analysis, surveys, demonstrations, and interviews with important economists, lawyers, entrepreneurs, and other representatives who have publicly expressed their concern about Israel's economic future because of the reform's adoption, the reform has been implemented. The day after the publication of the poll, on Monday 24<sup>th</sup> of July 2023, there was the second vote (out of three) to approve the judicial reform, which ended up being an affirmative vote. As a result, the outcome of

<sup>60</sup> Ibid (58)

<sup>61</sup> Ibid (58)

the approval of the judicial reform led to intensifying demonstrations and opposition of the population. Now that the reform has been approved, it remains to be seen if the demonstrations will continue and what it will happen to Israel. Will Israel face stability again followed by a period of recovery and economic growth? Or will Israel face even more damage and economic drop?

## CONCLUSION

Due to the global recession, there has been a drop in the Israeli high-tech economy, such as in the Israeli economy in general. It is not clear if the fall in the economy is mainly due to the proposed reform or if it is only difficult for Israel to recover from the global recession; but data of the first seven months of the current year shows that the proposed judicial reform has been having a huge impact on the high-tech economy.

Citizens are involved not only in the political situation because they are worried for their rights, but also for the economic shift and recession in the high-tech sector. One of the surveys that have been analyzed shows that citizens are aware of the importance of the high-technology sector and its impact on Israel; and that they are worried about what could happen to Israel also from an economic point of view.

Data, interviews, and surveys have been used in order to understand and analyze the current political and economic situation, and suggest that the economic direction could change in the next months due to a change in politics, to political stability, global economic shift.

We can get an idea of how the scenario will evolve in the months ahead. If the reform will be approved the protests may increase, startups may move their headquarters abroad, and the Israeli hi-tech market will move abroad.

It will be interesting to see how the economy will react to the approval (or not) of the proposed reform. If investors only care about stability and so once the situation will not change for a long period of time and they will invest again without caring for the political situation; or if the approval would definitely shift investors away from Israeli high-tech.

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