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THE ECONOMIC CONSEQUENCES OF DEMOCRATIC BACKSLIDING ISRAEL'S JUDICIAL OVERHAUL

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Abstract

In early January 2023, Israel's new governing coalition announced a plan for a judicial overhaul that would fundamentally weaken the power of the judiciary, the only meaningful check to the power of the executive branch in Israel. This paper describes the potential economic consequences of the judicial overhaul. We first discuss the extensive economic literature on institutions and their importance to economic development. Next, we use a large panel of countries to estimate the relationship between measures of institutional quality and four measures of economic development (GDP per capita, investment, innovation, and corruption). We use these estimates and the degradation of institutional quality in Hungary and Poland, two countries that experienced democratic backsliding, to forecast the potential long-run damage to the Israeli economy. Our calculations suggest that the judicial overhaul would have a dramatic negative impact on the Israeli economy. The estimated decline ranges from 9 percent in the most optimistic case to 45 percent in the most pessimistic one, both relative to an alternative scenario in which the judicial overhaul is abandoned. Finally, we describe the short-run negative effects of the judicial overhaul, particularly to the value of Israel's currency, financial assets and to the high tech sector.

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A. INTRODUCTION

In early January 2023, about a week after Israel's thirty-seventh government was sworn in, the Israeli public was presented with a comprehensive package of bills meant to engineer a profound, fundamental, and material change in the country's judiciary and the relations among the different branches of governance. Practically speaking, the legislative bundle was meant to lift constraints on the executive branch by narrowing the authority and powers of the judiciary and the government's legal advisors. Concurrently, the coalition promoted additional legislative initiatives and policy measures of similar character and significance. Below we refer to this set of demarches as "the coalition's initiatives" or "the judicial overhaul." The presentation of the judicial overhaul, its rapid advancement in the Knesset (parliament), and the widespread protest that it evoked have drawn the Israeli reality into an unprecedented era of uncertainty that is rocking Israeli society and raising basic questions about the balance of power among social groups, the structure of governance, and the essence of democracy. Amid the broad public struggle against the judicial overhaul, senior elements in the business, legal, academic, and political communities have criticized the measures fiercely. Conversely, the judicial overhaul also enjoys broad public support and the backing of a majority of Members of Knesset who were voted into office in elections held on November 1, 2022.

The community of economists in Israel and abroad has also been sharply critical of the judicial overhaul, warning against its adverse effects on the Israeli economy. On January 22, 2023, two former governors of the Bank of Israel, Professors Karnit Flug and Jacob Frenkel, published an opinion piece in which they cautioned that a blow to the independence of the judicial system is likely to impair growth and lower Israel's credit rating.[4] On January 25, an "economists' letter," signed by hundreds of economists in academia, cautioned against the potential damage that the Israeli economy would sustain if judicial overhaul were to be adopted in full, with emphasis on long-run harm to welfare and economic growth.[5] The signatories included Nobel Prize laureates in Economics and dozens of former directors general of economic ministries in the Government of Israel. Farther on, investment banks, international organizations, rating agencies, heads of state, private investors, and senior economists around the world urged the Government to reconsider the legislative initiatives and warned against the economic damage that the measures would inflict if they were to go through. In March and early April, the Budget Department of the Ministry of Finance, the

[4] Karnit Flug and Jacob Frenkel, "The Governors Warn: This Is How the Judicial Revolution May Impair the Credit Rating—and the Economy," Ynet, January 22, 2023 [Hebrew]. See also Porat Hirsch, Flug, and Kenneth Portal (2023), published the same day, dealing with the possible effect of the judicial initatives on Israel's credit rating and foreign investment.

[5] The first Economists' Letter, initiated and drafted by the authors of this paper among others, appears together with other documents on the economic effects at the website of the Economists for Israeli Democracy, https://economists-for-israeli-democracy.com/ .

Chief Economist of the Ministry of Finance, and the Bank of Israel issued reports foreseeing significant harm to the Israeli economy if the judicial overhaul would be implemented. On April 14, after issuing a special warning against the contents of the judicial overhaul on March 7, 2023, Moody’s Investor Service announced that it was lowering Israel’s credit outlook from positive to stable (Moody’s Investor Service, 2023b).[6]

The main purpose of this paper is to provide a detailed and well-grounded explanation of these multiple warnings in a way that will enable the Israeli public to understand the economists’ claims in depth. It presents the extensive economic research that demonstrates the long-run importance of institutions for economic development. The focal point in the relationship between the constitutional makeup of a country and its long-run economic prosperity is the consensus that has taken shape in this field, that “good” institutions, the kind that support economic development and growth, are characterized by an array of checks and balances that limits the government’s power. More specifically, much importance is attributed to mechanisms of review and supervision such as constitutional guardrails, an independent judiciary, the supremacy of the rule of law, and a professional and independent bureaucracy. These characteristics are closely associated with the judicial overhaul and the core issues of the current public debate in Israel. Therefore, in this study we aspire above all to clarify this relationship and examine the likely economic consequences of undertaking the judicial overhaul from the standpoint of the New Institutional Economics, which has dealt with this relationship at length in recent decades.[7]

After elaborating on the main theoretical arguments and frames of analysis in the literature, we will present a set of empirical evidence that supports the argument of a strong relationship between the effectiveness of checks and balances and long-run economic development. It is important to stress that in view of empirical identification limitations and the intrinsic difficulty in making reliable economic forecasts to decades ahead, this evidence is meant not to predict the exact impact of the judicial overhaul on long-run economic prosperity but to demonstrate the direction and the possible orders of magnitude of such

[6] The other large rating agencies, Fitch and S&P, also warned of adverse effects of the judicial overhaul, or of an attempt to impose such a measure without broad consensus, for Israeli’s future credit rating. See Fitch’s announcement, March 1, 2023 (Fitch Ratings, 2023 a), and S&P’s, May 12, 2023 (S&P Global Ratings, 2023).

[7] For some, the confrontation of principle between the pro-overhaul and the anti-overhaul camps is a debate over the essence of democracy: Is democracy a method that sets the principle of majority rule over everything else or one that invokes this principle to resolve controversies while defending and promoting additional important principles, such as rule of law and protection of minority rights? The opening postulate in this paper does not purport to take a stand on this issue, at least in its accepted sense. Instead, it assumes that the judicial overhaul is in fact meant to eliminate checks and balances against dominant political power groups, mitigating the ability to apply effective review of the executive branch.

effects.[8] However, in view of the vast accumulation of knowledge in economic research about the importance of an array of checks and balances for economic development, and the dire blow that this array is expected to sustain in Israel, our stance is that these estimates should be considered firm evidence of the magnitudes of the possible adverse economic impact. Despite the difficulty in generating exact and reliable forecasts, we believe the public and its elected officials need to recognize these magnitudes in order to debate the matter seriously and make intelligent and informed decisions, particularly in view of the dramatic and fateful implications of the decisions at stake.

To quantify the institutional characteristics, we present conventional indicators that are used to test the effectiveness of the array of checks and balances, with emphasis on those that probe the extent of judicial review of each country's executive branch across a wide range of countries and over a period of decades. In the first stage of the analysis, and in a manner consistent with the literature in this field, we find a positive statistical correlation between the indicators of judicial review and the most important and accepted indicator of long-run economic development: per-capita Gross Domestic Product (GDP) adjusted for purchasing power parity (PPP). Similarly, we explore the correlation between the institutional indicators and those reflecting important channels the literature describes—levels of per-capita fixed investment, innovation, and government corruption.

To estimate the relationship between the institutional indicators and long-run GDP per capita, we use two empirical approaches. The first uses a short panel data on which identification relies on controlled cross-sectional variation. This approach uses long-run variation in the quality of institutions across a range of countries in a manner that comports with what is known in the literature about the long-run implications of institutional characteristics and their continuity for economic development. This approach, however, makes the separate effect of individual institutional characteristics hard to identify reliably. Accordingly, we add an alternative approach that follows the empirical strategy of Acemoglu et al. (2019), basing identification on variations in institutional characteristics within countries over time. This approach has the advantage of yielding a more reliable identification of the institutional impact, isolating this effect from other effects, and controlling for the dynamic trends in per capita GDP. Its drawbacks are that it does not use the long-run variation across countries and the limited availability of GDP data adjusted for PPP, forcing us to use unadjusted per-capita GDP data. We regard these two approaches as complements to each other. Overall, the first approach yields larger estimates of the effect

[8] Generally speaking, economic analyses do not easily produce specific forecasts to the short term, let alone a term decades long. There are two main reasons for this. First, quantifying the impact of the judicial overhaul on the indicators that typify the method of governance is difficult and somewhat uncertain; second, the structural complexity of economic systems, such as states, makes any attempt to generate exact numerical forecasts to a term of decades ahead a very pretentious task. If these two reasons do not suffice, there are challenges of empirical identification that can be surmounted partly here.

than does the second one. According to both, however, judicial restraint of the executive has a dramatic effect, of first-order magnitude, on long-run economic development.

To link these correlations to the changes Israel is likely to undergo if the judicial overhaul is passed, we adopt two approaches to quantify the institutional changes. In the first approach, we deduce from the changes in these indicators in Hungary and in Poland to the foreseen changes in Israel given the similarities between the processes of democratic backsliding in these countries and in Israel. In the second approach, we use a simulation conducted by political scientists in Israel to estimate the change in the indicators of judicial review after the judicial overhaul is applied. By combining both of these with the statistical correlations described above, we obtain estimates that may reflect the magnitude of the damage that the Israeli economy is expected to sustain in the long term.

According to the calculations presented below, the blow to long-run per capita GDP will be dramatic. The estimated decline ranges from 9 percent in the most optimistic case to 45 percent in the most pessimistic one, both relative to an alternative scenario in which the judicial overhaul is abandoned. In 2022 terms, every 10 percent increment reflects NIS 175 billion in lost national income—NIS 92,000 per five-person household—each and every year.[9] As for the upturn in government corruption, the judicial overhaul, if applied in full, is likely to push Israel's level of public corruption to that of countries such as Cuba and China according to the negative scenario and to Slovakia or Fiji in the less-negative one. As stated, these estimates are not predictions. Yet even if their degree of accuracy is small, they paint a general picture of possible danger on an unprecedented scale that may hobble Israel's economic development for years to come and topple the country to the bottom tier of advanced economies.

We also discuss two characteristics of the Israeli economy that suggest that the damage will be especially acute and rapid. First, as we explain below, Israeli high-tech may be especially sensitive to changes in the institutional environment because it rests heavily on direct investment flows from abroad, which may be diverted easily and swiftly if this environment deteriorates. Moreover, there is a long-run risk of gradual but significant brain-drain of highly-skilled workers and entrepreneurs that account for the miraculous success of the domestic high-tech industry—especially since their possibilities of global mobility are the highest.[10]

Another reason for heightened concern in the Israeli case is the sectoral structure of Israeli society. The literature stresses, among other things, the impairment to long-run growth when institutions allow narrow ruling groups whose power is not well constrained to channel economic resources to their sectoral interest in a way that prevents efficient allocation of

[9] Israel's GDP in 2022 was NIS 1,756 billion or NIS 184,000 per capita (current prices, Bank of Israel, 2023, *Annual Report* for 2022).

[10] In a research report from the Aaron Institute, Eckstein et al. (2023) elaborate various scenarios of the effect of the global high-tech crisis and the judicial upheaval on growth. See also Section B of this paper on the importance of high-tech for the Israeli economy.

resources and degrades the conditions that support innovation. The implications of sector-based resource allocation are especially grave in Israel due to the high rate of natural increase and the problem of poor skills and low labor-force participation in Haredi ("ultra-Orthodox") society, which many economists consider the direst long-run threat to the future of the Israeli economy.[11]

We also document aspects of the highly significant economic damage that the Israeli economy has already sustained in recent months due to the upturn in business environment risk, negative market sentiment, and expectations that the future damage is likely to come to pass. At issue, among other things, are the emergence of yield spreads between Israel's equity indices and those abroad, the depreciation of the Israeli currency against the USD, and a decline in investments in domestic high-tech above and beyond the downward global trend in this sector. In particular, we examine the yields of the TA-125 and TA-35 indices as against the American S&P 500. We show that these indices trended almost identically until November 2022, when the most recent Knesset elections took place. From then onward, however, the trends clearly diverged, with Israeli equity indices falling far behind their American analogue. By early September 2023, the Tel Aviv indices showed 25 percent underperformance relative to the comparison index, which, we hypothesize, reflects the counterfactual scenario without the recent political shocks. The underperformance reflects both the local-currency decline in the Israeli indices and the currency depreciation that has occurred (11-12 percent loss of value in USD terms relative to an 18-19 percent increase in the American index). In other words, an investor who purchased Israeli equities on Election Day lost 25 percent in USD terms relative to an investor who chose to invest the same sum in US equities the same day. The blow that this has caused to Israeli households' wealth already adds up to hundreds of billions of NIS. Similarly, since late January 2023 the NIS has been depreciating aberrantly and rapidly relative to a forecast based on the S&P 500-tracking pattern that persisted systematically and strictly for much time. The decoupling took place within weeks of the publication of the judicial overhaul and gathered strength as the extent of the legislation and its foreseen hazards became increasingly clear. By early September, excess depreciation was estimated at 19 percent, more than 60 Agorot (NIS 0.6). Given the pace of developments in recent months and the incompleteness of available up-to-date data, these results should be taken with a grain of salt, of course. Similarly, to our way of thinking much of the short-run damage is symptomatic, attesting to what the Israeli economy is likely to undergo in the long term and not the main problem in itself; its severity reflects the hard times that the financial markets expect the Israeli economy to experience.

Naturally, no single piece of evidence that we present below proves the expected economic damage by itself or quantifies it in exact terms. The totality of the evidence, however, points to the same outcome. The cumulative knowledge in the literature concerning

[11] For the implications of the coalition transfers for haredi education, see the economic opinion attached to the Government resolution published by the Budget Division on May 12, 2023 (Ministry of Finance, 2023).

the relationship between institutions and economic development and the mechanisms that generate them, the long- and short-run empirical findings, and concern that the structure of the Israeli economy and society make the Israeli economy especially vulnerable to institutional shocks, lead to the conclusion that the danger is real and may even attain terrifying magnitudes.

The rest of this paper is structured as follows: Section B provides a brief background on the judicial overhaul and the state of the Israeli economy at the end of 2022, when it was about to be unveiled. Section C gives a comprehensive review of economic research on the importance of institutions for economic growth and welfare. Section D presents the empirical analyses that relate to the long-run implications. Section E focuses on damage already incurred, and Section F concludes.

B. BACKGROUND

2.1 The Israeli economy before presentation of the judicial overhaul

In 2022, Israel ranked thirty-second in the world in standardized per-capita GDP adjusted for purchasing power parity (IMF, 2022). Its economy was typified by growth and positive macro indicators that reflected continued recovery from the COVID-19 crisis.[12] Its labor market was improving, with labor-force participation rates climbing and the unemployment rate receding. The growth of economic activity engineered a steep improvement in the country's fiscal indicators; the state budget recorded a surplus of 0.6 percent of GDP and the public debt fell to 60.7 percent of GDP. Notwithstanding these auspicious data, the inflation rate jumped to 5.3 percent in 2022, far above the Bank of Israel's 1–3 percent target. The upsurge began back in 2021 and was strongly abetted by global supply constraints originating in the COVID-19 crisis and the war in Ukraine (Bank of Israel, 2023a). To cope with the inflation pressures among other things, the Bank of Israel raised its rate from 0.1 percent in April 2022 to 3.25 percent at year's end. The upturn in interest—domestic and foreign—forced households to pay more for their mortgages, slowed the construction industry, and dampened high-tech issues. More generally, alongside its strengths, the Israeli economy is coping with major challenges such as the cost of living with emphasis on housing prices, a dearth of physical infrastructure investment with emphasis on transport, and low labor productivity, foremost among the ultra-Orthodox and Arab populations.

The role of high-tech in the Israeli economy

High-tech is considered "the growth locomotive" of the Israeli economy, such that the secret of the country's economic growth in the past twenty years traces largely to the consolidation

[12] Per-capita GDP grew at a rapid 4.4 percent pace in 2022 (CBS, 2023), ranking Israel ranked seventh in growth rate among developed countries, which posted an average growth rate of 2.6 percent (OECD, 2022).

and prosperity of this sector. The establishment of the “start-up nation” and the inordinate level of innovation that typifies it catapulted Israel to world leadership in technology and innovation (IATI and Monitor Deloitte, 2023). According to the high-tech ecosystems index for 2022, which ranked countries by the quantity and quality of their high-tech centers and the quality of the business environment, Israel placed third in the world. Israel is also the country with the world’s largest number of “unicorns” relative to population (StartupBlink, 2023). According to the Global Innovation Index, Israel ranked sixteenth in the world in 2022 (WIPO, 2022).

High-tech generated 17 percent of Israeli GDP in 2022 (Ministry of Finance, 2023b) as against 10 percent in 2011 (Innovation Authority, 2023a). An analysis of the components of growth in 2017–21 shows that the growth of high-tech industry accounts for 45 percent of total GDP growth in Israel (IATI and Monitor Deloitte, 2023). In 2022, high-tech accounted for 49 percent of Israel’s total exports of goods and services (net of diamonds) and 56 percent of total exports of services. Israel is also an important player in the world of venture capital; in 2022, 4 percent of total venture-capital investment in the world made its way to Israeli high-tech companies, exceeding Israel’s share in global GDP some ten times over (Bank of Israel, 2023a). Concurrently, the number of new startups continued to decline in 2022 while the consolidation of large technology companies and international development centers progressed (Innovation Authority, 2023a).

High-tech accounts for more than 10 percent of employment in Israel. The growth rate of high-tech employment is especially high—12 percent in 2021, far outpacing the 1 percent growth of employment in the economy at large (Bank of Israel, 2023a; Innovation Authority and SPNI, 2022). High tech also contributes mightily to state tax revenues, its employees accounting for some 25 percent of total income-tax receipts—2.5 times greater than their share in the labor force (Ministry of Finance, 2023b). The contribution of high-tech workers to state tax revenues is a result of these workers’ productivity, which exceeds the norm in other industries by far. In view of these data, a blow to high tech would obviously have a direct and grievous effect on the entire Israeli economy.

However, the high-tech industry turns out to be a critical link that may suffer due to the proposed changes in governance and yet another element that makes the Israeli economy especially sensitive to institutional shocks. Since this industry almost exclusively relies on foreign capital, an increase in Israel’s country risk will probably cause investments in technology to head elsewhere quickly. In addition, the high skills of Israel’s high-tech workers, the English-speaking global environment in which they work, the global demand for labor in technology, and the ease of migration among technology workers are likely to make it easier for Israeli high-tech workers to find positions abroad if they wish to do so.

B.2 Our working assumption regarding the judicial overhaul

In this subsection, we present the working assumption of this paper on the impact of the judicial overhaul —foremost the legislative program that the Minister of Justice presented in early January—on Israel's institutions. We state for clarity that we neither intend to nor are able to discuss separately each segment of the legislative program and the legislative proceedings and policies attached to it; instead, we will contemplate all of them as part of a whole that has one main objective. Similarly, even if the fulfillment of the Rothman-Levin program in its original version has become much less likely since the scheme was made public, we will use the original format as a prototype for the coalition's intentions and ultimate goal. In Appendix A, we present the general contours of the judicial overhaul in greater detail and describe various positions concerning program.

As we see it, the main dispute between proponents and opponents of the judicial overhaul strongly reflects tension between two different conceptualizations of the essence of democracy. In one, the principle of the majority rule transcends all other considerations; to apply it, those who favor the legislation wish to remove obstacles to the actualization of the electorate's will, at least as it is embodied in the composition of the coalition in which a majority of the public's elected officials serve. According to the critics of the legislation, democracy means something broader than majority rule; it includes principles such as rule of law, upholding of minority rights, and meaningful representation of the interests of segments of the public that are not represented in the ruling coalition.

Our point of departure recognizes both sides' claims without attempting to determine the proper principles of democracy. It accepts the claims of the proponents of the reform, acknowledging that the legislative moves will indeed give the governing coalition much more latitude to do what it pleases and, in this sense, will promote the application of the principle of majority rule. It also accepts the argument of the other side: the methods used to attain this goal will eliminate checks and balances against the coalition's power in a constitutional ecosystem that already suffers from a paucity of checks and balances relative to other governing systems around the world. Accordingly, the point of departure in this paper is that both the proponents and opponents of the judicial overhaul acknowledge that the proposals are designed to limit the power and ability of the judiciary and the government's legal advisors to oversee and review government operations, specifically the power of the executive branch to pursue the objectives of the ruling coalition.

We do, however, accept the fear that this re-equilibration will deal a blow to the rule of law and make it more possible that the coalition will arbitrarily implement policies that will promote its favored interests at the expense of minority rights and interests of groups not represented in it. Within this generality, the reform and its accompanying legislative proceedings and policies will directly or indirectly threaten many basic rights such as property rights, non-discrimination, and freedom of expression. Another concern relates to the degradation of public administration and its sound lawful functioning, the public's trust in governmental systems, the ability to fight corruption, and policy-making in accordance with the law and the principle of equality.

We should emphasize that while there is no certainty that these dangers will come to pass, we assume that their fulfillment will become much more likely. Neither do we assume that the current constitutional array is flawless, let alone that the judges, legal advisors, and other officials are objective, impartial public servants who do their jobs without prejudice or political bias. Our postulate about them is that they are players who have power in the state's system and, alongside doing their jobs professionally, may sometimes influence the advancement or restraint of policy in accordance with their worldview and are partly independent of their superiors in the political hierarchy. From an economic perspective, however, the important implication of their independence and potency is that they help to diffuse power. The judicial overhaul, in contrast, is meant to neutralize them, subordinate them to the ruling coalition, or replace them with coalition loyalists. Thus, we interpret the goal of the judicial overhaul as part of an intention to remove checks to the coalition's power.

C. INSTITUTIONS AND ECONOMIC DEVELOPMENT :THE NEW INSTITUTIONAL ECONOMICS

According to one of the most dominant approaches in economic research today, the existence of "good" institutions is one of the most important determinants of long-run economic development. "Good" institutions are those that apply effective constraints to governmental power; in which legislation is general, universal, and equal; the bureaucracy is professional and independent; and an independent and effective judiciary that enforces contracts and gives protection and legal recourse to citizens and firms. In this section, we present this approach and some of the evidence that supports it.

The economic literature defines institutions as a society's "rules of the game."[13] Institutions are human-made rules that shape political, economic, and social interactions. Collectively, they determine the feasible set of actions of economic players and shape their incentives (North, 1981; 1990). Laws that protect private property effectively, for example, have a positive effect on individuals' decisions to save, invest, and innovate. A judicial system that enforces contracts mitigates uncertainty and the risk of doing business, thus affecting macroeconomic outcomes for the better. Laws and regulations concerning association, competition, and labor that assure freedom of occupation and allow firms to enter markets freely are essential for the existence of competitive markets and efficient resource allocation. Although studies occasionally focus on a particular institutional feature, the literature generally centers on the complete set of laws that together creates an institutional environment.[14]

The literature attributes special importance to the strength of a state's executive branch, the restraints imposed on it, and the diffusion of institutional power. There are two main

[13] For example: "Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction. In consequence they structure incentives in human exchange, whether political, social, or economic" (North, 1990: 3).

[14] For example: "Our view is that there is a 'cluster of institutions' […] that are important to encourage investment and growth" (Acemoglu, Johnson, and Robinson, 2001, footnote 3).

reasons for this emphasis. First, state capacity is crucial.[15] The state serves as "an institution of public order" that enforces laws and provides public infrastructures and goods that are essential for the sound functioning of markets. This demonstrates the need for a state with sufficient capacity to assure the quality of its institutions. Second, however, the ruler (or the ruling coalition) has excessive power and authority relative to other economic players. For example, it may enforce its laws selectively in order to benefit itself and channel economic resources to its own benefit, that of its cronies, and that of its support base, at the expense of the rights and interests of the rest of society. Furthermore, the ruling coalition can shape institutions and change the rules of the game "while playing." In the absence of an appropriate separation of power and effective constraints on its power, the ruler may indeed make rules that cater to itself (Greif, Milgrom, and Weingast, 1994; Hall and Jones, 1999; Acemoglu and Robinson, 2012).[16] If so, the key issue is the optimal balance between state power and its capacity to implement policies, and constraints that will prevent the exploitation of such power (Aghion, Alesina, and Trebbi, 2004).

Societies that managed to design an appropriate institutional setup that assures equal access to political and economic assets needed a solution that, while granting the executive branch power and capacity, compels those at its helm to refrain from misusing this power, despite having an incentive to do so. Absent such an obligation, eventually a ruler will arise who will misuse the power that he or she possesses, repressing the power of rival groups and the population at large. Alternatively, when rivaling groups amass enough economic and political power, they will seek opportunities to challenge and replace the incumbent ruler.

The main impediment to reaching such a solution is a problem commonly referred to in the economic literature as the "ruler's credible commitment problem." The problem pertains to a ruler who promises his subjects or other political and economic players to act in a certain way at some future time, in order to influence their current actions to his benefit. When that future point in time arrives, however, such an action countermands his interest and nothing will stop him from reneging on his initial commitment. His counterparties realize that, making his present commitment uncredible.

For example, governments that need to borrow money from the public may undertake to repay the loan and honor its terms ex post. When the date of payback arrives, however, they will have an interest to default, delay, or somehow worsen the payback terms. In the absence of mechanisms that will prevent this, investors will demand a higher interest rate to compensate for their risk. Under these conditions, these governments may find it hard to raise

[15] See, for example, Besley and Persson, 2009; Gennaioli and Voth, 2015; Dincecco and Katz, 2016.

[16] Consider the following: "One of the central questions about the institutional foundations of markets concerns the power of the state. The simplest economic view of the state as an institution that enforces contracts and property rights and provides public goods poses a dilemma: A state with sufficient coercive power to do these things also has the power to withhold protection or confiscate private wealth, undermining the foundations of the market economy" (Grief, Milgrom and Weingast, 1994).

debt.[17] Similarly, an executive authority that wishes to promote foreign investment may promise not to discriminate against foreign investors relative to domestic ones. However, in the future, it may have a political or economic interest in doing exactly so. An investor who realizes this and internalizes the risk may refrain from investing ab initio.[18] In these examples, it is not only economic activity that suffers; the executive's own interest is impaired by the absence of a future constraint to its ability to breach its commitments.

The solution that the economic and political literature proposes is the creation of an institutional setup that limits, by means of checks and balances, the executive and its ability to change the rules of the game "while playing." They serve as commitment devices and, for this reason, impart credibility to the executive authority's commitment. Namely, the executive can be trusted to honor its previous commitment because the institutions will not let it renege even if it wishes to. The ability to tie the executive's hands benefits both the executive and society at large (Acemoglu, Johnson and Robinson, 2005a; Acemoglu and Robinson, 2012).[19]

The theoretical framework put forward by Acemoglu and Robinson (2012), leading scholars of institutions in economics and political science, is useful for understanding the importance of checks and balances and institutions that constrain executive power for long-run economic development. This framework distinguishes between political institutions and economic institutions and defines two broad types of institutions: "inclusive" and "extractive". Inclusive institutions create a "balanced" playing field that promotes and incentivizes broad participation of an equally empowered public in the political, economic, and social system. Extractive institutions, in contrast, concentrate power in the hands of a small group—a ruling family, an ethnic, geographic or religious group, a distinct socioeconomic class, a ruling party, a military junta, a coalition of several of these, and so on.

Acemoglu and Robinson (2012), along with their many coauthors over the years, argue that only inclusive institutions can support economic development in the long run. Inclusive economic institutions assure effective property rights; an unbiased judiciary that enforces

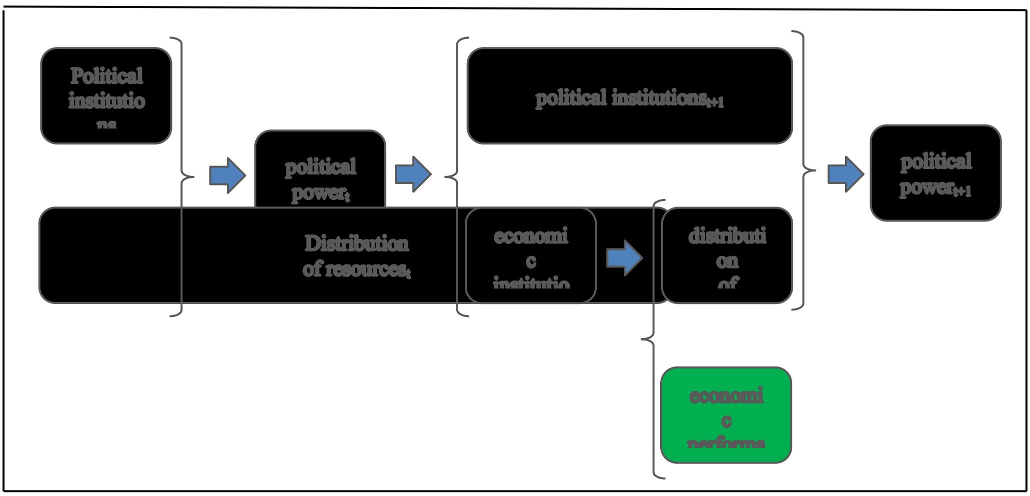
[17] North and Weingast emphasize this issue in the context of the institutional arrangement worked out in England pursuant to the "Glorious Revolution" (North and Weingast, 1989). Credit ratings, too, which test the level of risk in investing in certain countries, are influenced by the institutional environment and the effectiveness of constrints on the government, among other things due to the risk arising from the "commitment problem." (See, for example, Moody's announcement, March 7, 2023.)

[18] For example, Hirsch, Flug, and Kenneth Portal (2023) found that the relaxation of constraints onthe executive in Hungary, Poland, and Turkey was accompanied by a decline in foreign investment in these countries.

[19] To solve the commitment problem, the executive must also be limited in its ability to revise the institutional array, of course, because if it can shake off its institutional shackles it will put us back at our point of departure. In this sense, solving the ruler's commitment problem also requires some degree of institutional stability.

contracts and agreements; public services that support markets; innovation and economic activity by broad swathes of society; free entry to markets; and wide access to education. Thus, they create a structure of incentives that facilitate and encourage broad sectors of the population to take part in economic activity in a manner that comports with their abilities (Acemoglu, Johnson and Robinson, 2005a; Acemoglu and Robinson, 2012).

Figure 1
Schematic representation of the institutional dynamic and its effect on economic performance



Source: Acemoglu, Johnson and Robinson, 2005a.

Thus far, we have discussed the static advantages of inclusive economic institutions. Whence, however, do inclusive political institutions obtain their importance for long-run economic development and prosperity? The answer lies in the dynamic relationship between institutions and political power (Figure 1). The nature of institutions is determined in the political sphere through a process of social struggle between social groups with different interests. Political institutions determine the political “rules of the game” and, therefore, influence the apportionment of political power. Concurrently, economic institutions determine not only the functioning of economic markets but also the future allocation of resources, which affects, apart from future political institutions, the future distribution of political power. Those who have political power realize this and aspire to shape the economic institutions in a way that will preserve and amplify their future political power.

Therefore, a state in which there is a mismatch between the nature of the political institutions and that of the economic institutions is unstable. For example, when economic institutions are inclusive and thus allow broad sectors of society to amass economic resources, but the political institutions are extractive and concentrate much political power in the hands of a small group without applying a set of checks and balances, a dynamic that will change the situation is expected (Figure 2). One possibility is that economically empowered groups will use their resources to create farther-reaching diffusion of political power and make the political institutions more inclusive. Alternatively, the ruling political coalition may use its power to make the economic institutions more extractive, thus diverting economic resources to the satisfaction of its needs. It may, for example, adopt a policy of expropriation, limit the use and transfer of resources, enact arbitrary and discriminatory laws, and thwart unrestricted access to new and growing markets.

Figure 2
Schematic description of dynamic institutional equilibrium per Acemoglu and Robinson's (2012) theoretical framework

		Economic institutions	
		Extractive	**Inclusive**
Political institutions	**Inclusive**	↓ →	**Inclusive equilibrium**
	Extractive	**Extractive equilibrium**	← ↑

In contrast, when the nature of political and economic institutions is aligned, an institutional equilibrium emerges in which feedback mechanisms tend to maintain it. In an inclusive equilibrium, for example, much of the population possesses economic resources and plays key social and economic roles; accordingly, it is able to resist attempts by wielders of political power to reshape the institutions and make them more extractive. In this state of affairs, changes in the institutional equilibrium may arise due to exogenous shocks, such as technological changes or a shock to the array of international powers. Absent such shocks, the nature of the institutions tends to persist for many years (Engerman et al., 2002; Acemoglu, Johnson and Robinson, 2005a; Acemoglu and Robinson, 2012).

Over the years, economic research has accumulated ample empirical evidence supporting the argument that "good" (or "inclusive") institutions are among the most important determinants of long-run economic activity (Rodrik, Subramanian, and Trebbi, 2004; Acemoglu, Johnson, and Robinson, 2005b; Acemoglu and Robinson, 2012). In their seminal study, Hall and Jones found that the underlying determinants of productivity gaps among countries today are institutional quality and the nature of government policy. Disparities among countries in these underlying determinants explain gaps in physical and human capital stock and total productivity, and, therefore, economic development and standard of living (Hall and Jones, 1999). Similarly, Alfreto et al. (2008) found that poor institutional quality and its deleterious effect on investor risk are the main reasons for developing markets' failure to attract capital investments.[20] Poor institutional performance may also impair productivity by diverting resources to cronies and favored hangers-on of the executive authority. In their important and path breaking article, Hsieh and Klenow (2009) found that misallocations of capital and labor between firms within a given country explain a large share of the productivity gaps. If misallocation in the Chinese and Indian manufacturing sectors, focusing largely on overallocation of capital to government-owned enterprises in China and restrictions on firm size in India, were lowered to the US level, total factor productivity would increase by 30–50 percent and 40–60 percent in the respective countries' manufacturing sectors. The literature also shows that countries characterized by poor institutional quality, such as ineffective checks and balances, ineffective enforcement of investors' rights, and political instability, tend to pursue distortionary macroeconomic policies—high inflation rates, large budget deficits, and inflated currency values—and suffer more from higher volatility and economic crises (Acemoglu et al., 2003). In another branch of this literature, focusing on investigation of the nexus of institutions and the development of the financial sector, it is found that in countries where the judicial system provides inferior protection of investors' rights, the financial sector is less developed and its ownership structure is more concentrated (La Porta et al., 1997; 1998).[21]

More generally, the economic literature demonstrates the importance of institutional history for economic development, as the nature of institutions tends to persist, historical disparities in institutional quality affect the growth path for many years. In their groundbreaking studies, Acemoglu, Johnson, and Robinson (2001; 2002) argued that the nature of the colonial institutions established by the European conquerors around the world, some even centuries ago, explain a large portion of the development patterns that exist around the world today. The Europeans set up inclusive institutions in certain colonies and extractive ones in others, and the nature of those venerable institutions persisted and underpinned the institutions of the post-independence states going forward and to the present day. While extractive institutions may have been efficient in certain industries in the past (e.g., mining metals and growing certain cash crops), Acemoglu et al. argue that inclusive institutions were a prerequisite for industrialization after the Industrial Revolution and are essential for

[20] The fact that global capital is not routed to developing markets even though these countries have lower capital-to-labor ratios and, accordingly, should offer a higher return on capital, is known in the literature as the Lucas Paradox, due to the seminal paper of the Nobel laureate economist Robert Lucas (Lucas, 1990).

[21] It is also found that much of the disparity among countries in protecting investors' rights ultimately traces back to the legal tradition. Protection of investors' rights is the strongest in countries in which the legal tradition is based on British common law,

economic efficiency in a modern economy that relies on human capital, innovation, and investment. Consequently, erstwhile colonies where Europeans established "good" or inclusive institutions are much wealthier and more developed today than are those where extractive institutions were established. Since then, many additional studies in economics have documented the long-run causal effect of institutions, colonial and other, on economic development (e.g., Dell, 2010; Dell, Lane, and Querubin, 2018; Dell and Olken, 2020).

Democracy and economic development

While most of the literature on institutional quality paints in broad strokes and avoids discussion of any specific method of governance, a smaller strand within this literature examines the effects of democratic rule on economic development. Given the large overlap between the characteristics of democratic rule and those of inclusive institutions, we believe this strand of the literature complements the approach that tests the effect of institutional quality. It is challenging to estimate empirically a causal effect of democracy on growth because of a reverse causality problem (i.e., an influence in the opposite direction—of economic development on democratization processes). In their important study, Papaioannou and Siourounis (2008) tackled these two problems. Focusing on the "third wave of democracy," in which many countries underwent democratization, as a natural experiment, their study found that democratization induced a 1 percent annual increase in per-capita GDP growth. Growth is slow during the years around the democratic transition, but rises to a higher plateau in the medium and longer run. Acemoglu et al. (2019) use a similar empirical strategy and expand it to include, *inter alia,* short-lived transitions to democracy and nondemocracy. Their finding is similar: a significant positive relation between democracy and growth, democratization leading to a 20 percent increase in GDP per capita after twenty-five years. Imai et al. (2023), using the same data but applying a different empirical methodology, find, as do Acemoglu et al. (2019), that while democratization does not necessarily speed up the growth rate, retreating from democracy has a major adverse effect in the short and middle terms. It is also found that democracies tend to suffer less from economic crises and instability due to their ability to replace unsuccessful leaders and deal with social crises (Imam and Temple, 2023).

Among the studies that focus on mechanisms, Acemoglu et al. (2019) find that democratization contributes to growth by increasing investments, encouraging economic reforms, improving the provision of education and healthcare, and creating social stability. Other studies find that democracy prevents ethnic favoritism in public investment in transport infrastructure (Burgess et al., 2015) and that democratic decision-making increases citizens' cooperation and compliance, promoting citizenship that contributes to society (Bó, Foster, and Putterman, 2010).

Judicial independence and economic development

Another branch of the literature focuses on judiciary independence and constitutional review, finding beneficial effects on growth and the economic environment, as well as on the quality and objectivity of judicial decisions. Feld and Voigt (2003) found a positive effect of judicial independence on economic growth[22]; La Porta et al. (2004) reported a correlation between the independence of the judiciary and its ability to apply judicial or constitutional review comport with the existence of political and economic freedoms.[23] Judicial independence also comports with common law systems and is responsible for some of their beneficial effects documented by previous studies.

Furthermore, empirical evidence shows that strengthening judicial independence leads to better economic outcomes. Liu et al. (2022) studied the effects of a Chinese judicial reform that enhanced the independence of local courts and reduced their economic and administrative dependence on the government and politicians. They found a decrease in local protectionism in court rulings, especially among politically connected judges. Over time, this change even strengthened small and non-local firms' tendency to seek legal remedies against large local firms. The study's calculations suggest that the decrease in local protectionism pursuant to the reform is likely to boost domestic investment by 8.4 percent and Chinese GDP by 2.3 percent if implemented nationwide.

Connections between politicians and judges may stimulate corruption and impair the ability to punish wayward politicians even in countries where the judiciary enjoys formal independence. Lambais and Sigstad (2023) focus on the impact of political power on prosecutions of local politicians in Brazil for offenses concerning public misconduct. They find that the electoral victory of politicians against whom criminal proceedings are under way lowers the odds of conviction considerably, especially when the professional future of the judge hearing the case is not assured.

Other studies, focusing on judges' selection procedures, find that political selection processes are inferior to a more professional and merit-based selection methods. Ash and MacLeod (2021) study reforms in the way judges are named to supreme courts in US states in ways that make the proceedings more professional and less partisan. In certain states, the

[22] Judicial independence includes formal independence, i.e., a constitutional setup that requires formal sentencing by judges on the basis of relevant legal considerations only, alongside de facto independence, reflected in support mechanisms such as lengthy terms of service for judges, difficulty in impeaching judges, and unchangeable salaries.

[23] See, for example, La Porta et al., 2004, p. 447): "Besides seeking to influence judges, the executive and the legislature would also wish to pursue policies and pass laws that benefit themselves, democratic majorities, or allied interest groups. Constitutional review is intended to limit these powers. By checking laws against a rigid constitution, a court—particularly a supreme or a constitutional court—can limit such self-serving efforts. In effect, courts rather than legislators become final arbiters of what is law. Because constitutional review is used to counter the tyranny of the majority, it may be of particular benefit in securing political and human rights, as well as preserving democracy."

procedure was reformed, making judicial elections less partisan by delegating selection to a professional committee composed of senior attorneys and retired judges. In others, general elections for judges became nonpartisan. The study finds that judges who are chosen in a more professional manner write higher-quality rulings than do politically elected judges. Similarly, a reform of the judges' selection process in Pakistan, from appointment by the president at his sole discretion to appointment by a selection committee in which judges have a majority, resulted in less progovernment bias in rulings (Mehmood, 2020; 2022).

Independent bureaucracy, economic development, and corruption

The economic literature also studied the importance of an independent and professional bureaucracy for economic efficiency and development (Mauro, 1995; Besley et al., 2022:2). Professional and independent public administration is crucial for a country's economic development because it facilitates efficient taxation and regulation, equal law enforcement, and informed and inclusive distribution of public goods and services. Given the high importance of public administration in all areas of the state's activity, independence from political influence is another critical element in the array of institutional checks and balances. Contrastingly, a patronage-based system, in which the bureaucratic apparatus is not independent but rather subordinate to politics, impairs the economy in two ways: indirectly, by leaving more power in the ruler's hands, and directly, by installing public servants of lower quality and making the public administration's work less effective. Colonnelli, Prem, and Teso (2020) found, for example, that political connections explain a large share of municipal appointments in Brazil, particularly in posts where the mayor has far-reaching discretion and latitude in making appointments—resulting in filling positions with public servants of lower quality. Similarly, Xu (2018), focusing on colonial governors in the British Empire, found that governors connected with incumbent ministers were appointed to more desired colonies and at higher pay, but their political connections impaired their incentives, so that their professional functioning declined whenever they were associated with the incumbent minister. Furthermore, a reform in the appointment procedure that introduced a professional appointments committee and limited the minister's exclusive discretion surmounts the relationship between political connections and poor functioning. Similarly, Dahan (2016) found a strong negative relation between political appointments and government effectiveness.

Independent and professional public administration also helps to mitigate corruption at the national level and minimize its ill effect on economic development (Shleifer and Vishny, 1993; Mauro, 1995; Aghion et al., 2016; Gründler and Potrafke, 2019). For example, when the appointment of government officials is merit-based, the level of national corruption falls (Dahlström, Lapuente, and Teorell, 2012). Becker et al. (2016) demonstrated the persistence of this effect: Individuals living in areas that were historically exposed to sound and high-quality public administration under the Habsburg Empire tend today to have higher trust in the judicial system and the police, and report lower use of bribery in relations with them, even a century after the Empire collapsed and the frontiers that separated the regimes on both sides of the historical border disappeared. This result suggests that the quality of the bureaucracy shapes individuals' norms and expectations about corruption, and that these cultural traits are transmitted generationally and, therefore, may persist in the long run.

To summarize, the economic literature abounds with studies that underscore the central importance of "good" institutions for long-run economic development. This view is supported by a very broad body of research that includes vast numbers of articles and books. Much of this literature was written by the world's leading economists, and offers theory, a wealth of narrative evidence, and ample empirical evidence, including causal estimates of the effect of institutions on development across a range of locations and periods. In fact, this area of research is one of the most important, central, and fruitful fields of economic research in the past twenty-five years. The characteristics of growth-supporting institutions pertain in the most direct way to the issues that lie at the core of today's public debate in Israel: checks and balances that limit the government's power, judicial independence, democratic rule, and a professional and independent bureaucracy. The literature suggests that there is little doubt that the judicial overhaul will badly degrade the quality of institutions in Israel. This well-grounded insight underlies the warnings that the judicial overhaul will be harmful for the Israeli economy, that were voiced by hundreds of Israeli economists in academia, several leading economists abroad, Nobel Prize winners, and credit-rating agencies. The channels through which worse institutions affect the economy is multipronged and diverse and includes, but is not limited to, hampering investment, innovation, and productivity; causing corruption and misallocation; and jeopardizing judicious pro-growth economic policy.

D. THE LONG-TERM IMPACT OF THE JUDICIAL OVERHAUL ON THE ISRAELI ECONOMY

In this section, we present empirical analyses that demonstrate the strong relationship between institutional quality and economic development and estimate the possible magnitudes of the impact of the judicial overhaul, if realized, on Israel's economic development and performance in the long-term. The fundamental assumption of our analysis is that the legislation, once fully in effect, will impair effective judicial review of the executive branch and thus will degrade Israel's institutional quality in the long run.

First, we present an empirical analysis that demonstrates the basic economic argument regarding the importance of good institutions for long-run economic development. Our analysis documents a strong statistical relationship between standard indicators of the extent of judicial review of the executive and economic outcomes across a large sample of countries. We focus on four outcome variables of economic development. The first is GDP per capita adjusted for PPP, reflecting the country's average standard of living. Then we focus on three outcome variables that reflect some of the mechanisms that were highlighted in the literature: per capita capital investment, innovation, and public sector corruption. In the second stage, we use the changes in the judicial review indicators in Hungary and Poland, as well as a simulation of the change that the judicial overhaul is expected to create in Israel, to estimate a possible range of long-run economic damage that Israel is likely to face should the legislation pass.

D.1 Indices of judicial review of the executive

Various indices are used to measure the institutional quality of regimes around the world, including the extent of judicial review of the executive and the rule of law. These indicators, published periodically by international organizations, are meant to monitor trends at the level of a state or a geographic region and to allow for cross-country comparison.[24] As a rule, these indices are constructed based on a systematic methodology that includes collecting data from citizens and experts regarding the object being measured; weighting different positions, and assigning each country a score. Despite methodological differences among the different indices and the focusing of different indices on different aspects of democracy, the scores they yield are generally strongly correlated. Thus, a country that scores well on one democracy index also scores well on another democracy index based on a different methodology. Below we briefly describe the two indices we employ.

The WJP (World Justice Project) Rule of Law Index

This index was created, among other reasons, to measure the quality of constraints on the executive and the degree of judicial independence in countries around the world. It is based on questionnaires sent to thousands of local experts (academics, attorneys, etc.) and hundreds of thousands of citizens in about 140 countries. The questionnaires examine the perceptions and personal experience of the public and the experts in matters associated with the rule of law in eight categories, forty-four subcategories, and more than 500 variables. The data are aggregated into a score that reflects public opinion and are validated against other sources. The scores and categories are normalized to allow comparability across countries and over time (WJP, 2022).

The first category in the WJP index measures the degree of constraints on the executive, and a specific subcategory within it relates to the effectiveness of judicial constraints. The score in this subcategory is calculated by averaging the scores of eight questions that are sent to experts and three questions submitted to citizens. The questions pertain to the extent of separation of power among the three branches of government, of the state's compliance with judicial decisions, of constitutional and administrative judicial review, and the judiciary's independence from political pressures.[25]

[24] This comparison serves as a basis for academic comparative studies and analyses as well as practical uses such as economic ratings. For example, rating agencies use such indicators—the World Bank, for instance, employs an index of rule of law and an index of control of corruption—when they assess countries' ability to repay their loans (Fitch, 2023b).

[25] The wording of the questionnaire items is shown in Appendix B.

The V-Dem Institute's Varieties of Democracy Index

This annual index measures the strength of democracy in 202 countries. It ranks each country based on five separate principles that yield a composite indicator of democratic rule. They include the principle of electoral reality, which tests for free election of the state leadership, and the principle of liberalism, which tests for the presence of constraints on the executive and upholding of human rights in order to prevent tyranny by the majority. Each principle is composed of sub-components (eighty-seven in the total index) that are made up of indicators (473 in the total index) (Coppedge et al., 2021). Each country's final score is the weighted outcome of the scores of the five principles. On the basis of the final score, each country is placed in an appropriate category—from liberal democracy down to closed autocracy (V-Dem, 2022).

V-Dem's indicators and indices survey the effectiveness of the judiciary at length. The analysis we present uses a subcomponent of the V-Dem index—judicial constraints on the executive, composed of experts' assessments in relation to five relevant questions such as the extent of the executive's compliance with the constitution, the executive's compliance with the judiciary, and the independence of various judicial instances.[26]

The V-Dem index has a noteworthy drawback relative to the WJP index—it lacks a comprehensive survey of citizens and is based only on experts' opinions. Conversely, the WJP has been available only since 2012; therefore, it does not review earlier events that the V-Dem index covers. Another relevant advantage of the V-Dem over the WJP is that it includes data on Israel.

D.2 The relationship between indices of judicial review and economic development

In this subsection, we present empirical analyses that demonstrate the positive effect of judicial review of the executive on long-run economic development. In particular, we show the statistical relationship between scores of the judicial-review indices, described above, and several indicators of economic development, particularly GDP per capita. Our results are in line with those of a vast literature concerning the causal effect of institutions on economic development, described in Section C above.

We use two empirical strategies to substantiate the relationship between judicial review of the executive and long-run economic development: the first leverages differences in judicial constraints and level of economic activity across countries; the other centers on differences in judicial constraints within a given country over time. The main advantage of the first strategy is its ability to capture development gaps that resulted from institutional differences over very long periods of time, particularly in years for which data on GDP per capita are unavailable, in a way that reflects the argument in the literature about the long-run persistence of institutions. The advantage of the second strategy is a cleaner identification of the causal effect of judicial constraints on economic development within the sample years.

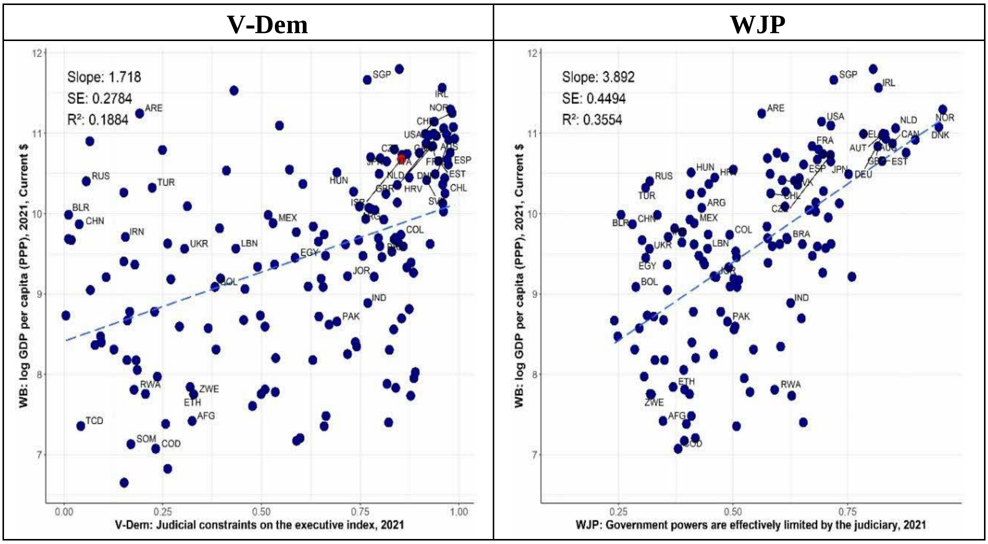
[26] The wording of the questionnaire items appears in Appendix C.

Although our discussion focuses on indicators of judicial constraints on the executive, it is important to note that the various indicators of institutional quality are strongly correlated. Since we do not separately control for other institutional characteristics, the estimation results do not necessarily isolate the effect of judicial review alone; instead, they may reflect the impact of a wide array of closely tied institutional characteristics. Since the judicial overhaul is not limited to the judiciary, but rather reflects a wider plan for a far-reaching institutional change, we interpret the estimation results regarding the potential long-run economic effects as different and complementary ways demonstrating the likely effects at large and not of specific aspects of the judicial overhaul only.

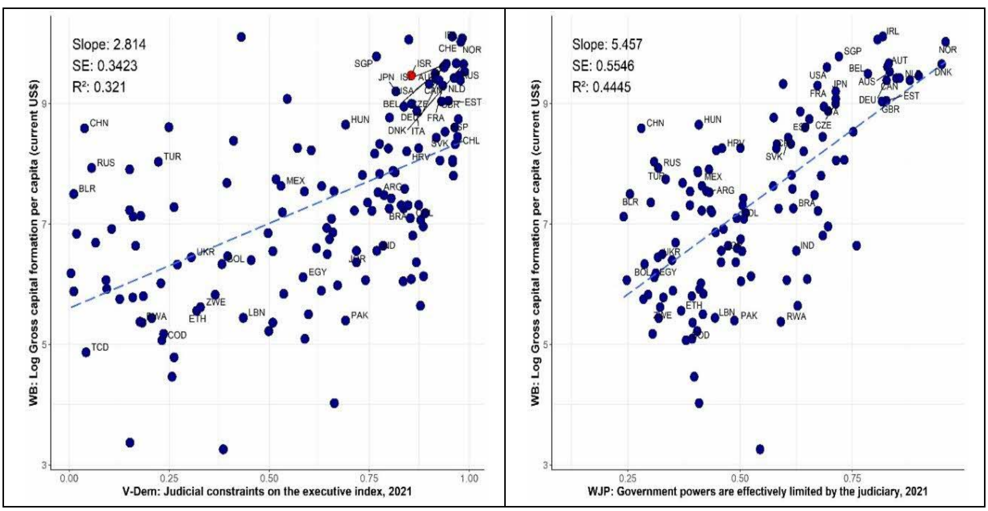
The estimates of the economic damage are based on a large sample of countries. There are, however, two reasons for concern that these estimates do not reflect well the full risk in the case of the Israeli economy. In many countries, the judiciary is only one element within a broader set of checks and balances that restricts executive powers; in Israel, given the other players' weakness or even absence, the judiciary plays an especially important and sometimes exclusive role in constraining the executive. In addition, the unique sectoral composition of Israeli society makes Israeli economy particularly susceptible to corruption and misallocations of resources. As a result, the impact of weakening judicial constraints in Israel is likely to be much more dramatic in Israel than in the rest of the world.

Figure 3 plots the raw relationship between indicators of judicial constraints on the executive and economic development in a cross-section of countries. Panel A plots the relationship between the judicial constraints on the executive and the natural log (hereinafter: log) of 2021 PPP-adjusted GDP per capita in USD. The right-hand subfigure uses the WJP index and the left-hand subfigure the V-Dem index. Both subfigures reveal a strong positive relationship between the extent of judicial constraints on the executive and the country's level of economic development. The relationship is stronger in the right-hand subfigure relative to that on the left, and the WJP judicial-constraints indicator explains 36 percent of the total variance in PPP-adjusted GDP per capita across countries.

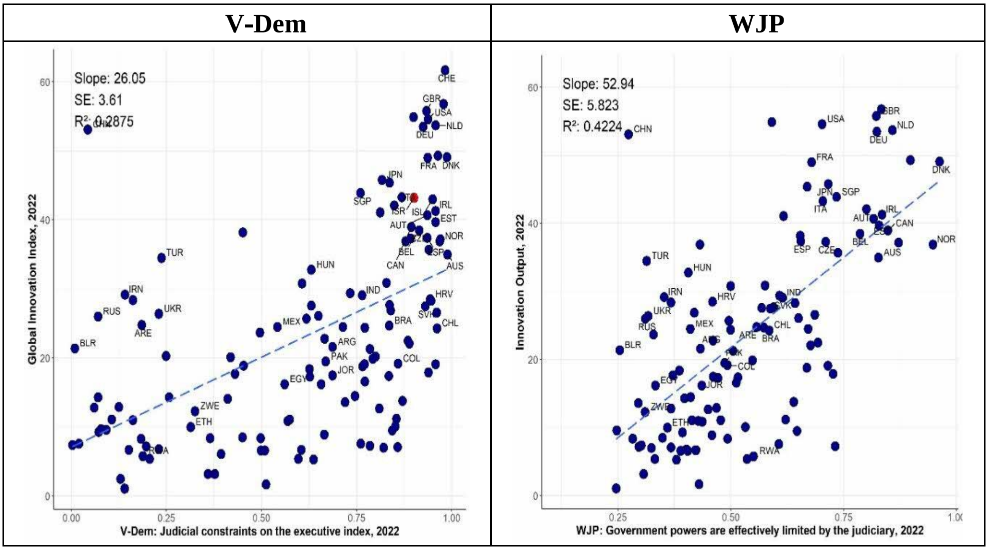
Figure 3
The relationship between judicial constraints on executive powers and long-run economic development and economic environment



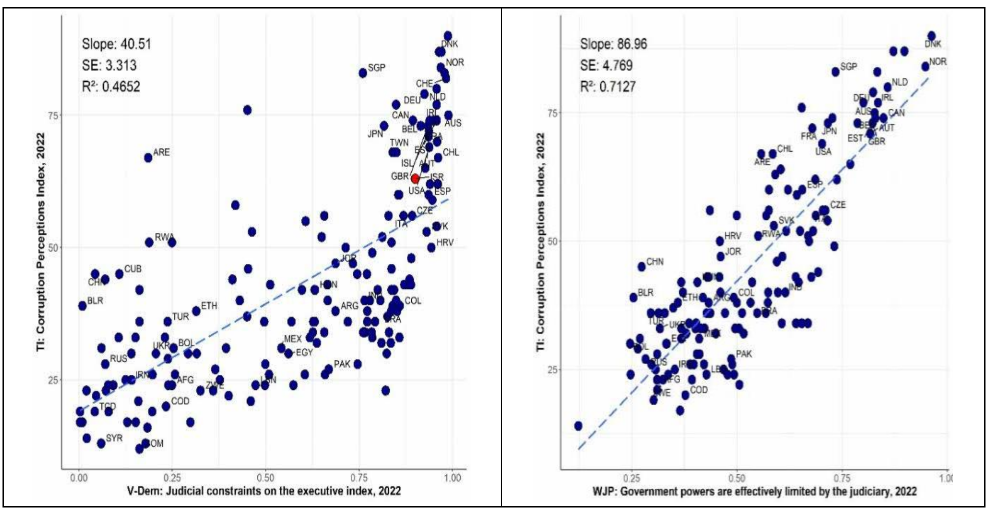
Panel A: Natural log of GDP per-capita in 2021, USD, adjusted for PPP



Panel B: Natural log of fixed capital investment per capita in 2021, USD



Panel C: Global Innovation Output Index, 2022



Panel D: Corruption Perceptions Index, 2022: the higher the score, the lower the level of corruption

Note: the figures use countries' cross-sectional data for the last year in which data for the dependent variable are available. The broken trend line represents expected values from a linear regression with one independent variable and an intercept.

Panels B–D focus on outcomes that reflect some of the economic mechanisms that account for the disparities in development. Panel B plots the relationship between the index of judicial constraints on the executive and fixed investment per capita. As the subfigures show, the correlation between the extent of judicial review of the executive and investment is positive and strong. Over time, lower levels of investment lead to less capital accumulation per worker and, in turn, to lower productivity. Panel C shows the relationship between judicial constraints on the executive and innovation, measured by the innovation-output segment of the Global Innovation Index.[27] Here too we find a strong positive relationship between judicial constraints on the government and a country's level of innovation[28]: effective judicial constraints on the government are correlated with a higher level of innovation, which contributes to higher productivity. Panel D presents a similar relationship between judicial constraints on the government and the Corruption Perceptions Index (for 2022), in which a high score represents a low level of corruption.[29] The subfigures document a positive correlation between the extent of judicial review of the executive and the Corruption Perceptions Index. Namely, when a country allows more comprehensive judicial review, its level of perceived corruption falls. The connection is especially strong in the right-hand subfigure (the WJP index), in which 71 percent of the variance in the corruption index

[27] The GII index, published annually since 2007 by the United Nations World Intellectual Property Organization, is meant to yield an in-depth picture of the state of innovation globally and in each country by analyzing a broad range of determinants of innovation level. The index examines 132 countries and is composed of eighty-one indicators aggregated into fields and divided into two general sub-indices: innovation outputs and innovation inputs. The innovation-inputs sub-index is divided into five groups of indicators: business environment, market sophistication, infrastructure, human capital and research, and institutions. The innovation-output sub-index is divided into two groups of indicators: knowledge and technology outputs and knowledge-createion outputs. The innovation-index indicators, harvested from a range of information sources, yield a score normalized to 1–100 (WIPO, 2022). For details, see Global Innovation Index 2022.

[28] The results are similar when we use the GII index, which includes innovation inputs alongside innovation outputs.

[29] The Corruption Perceptions Index examines the level of corruption perceived by experts and senior economic personalities in each country, using data from thirteen sources and estimates of corruption that were examined and normalized by the organization, including indicators from the World Bank, regional banks, the Economist Group's Intelligence Unit and the Freedom House Research Institute (Transparency International, 2022a). The indicator examines whether those questioned say that various acts of corruption, such as giving and taking bribes, appropriating public funds, nepotism, and others, are widespread in their countries. It also probes the public perception of the country's ability to fight corruption by examining its ability to pass and enforce anti-corruption laws, carry out transparency processes vis-à-vis civil society, and protect journalists and whistle-blowers. In 2022, Israel scored 63/100 on the Corruption Perceptions Index, ranking thirty-first in the world (Transparency International, 2023).

is explained by the extent of judicial review, relative to 47 percent of variance when using the V-Dem index (the left-hand subfigure).

An econometric analysis that covers all years for which relevant data are available and controls for separate continent time trends yields similar results, as expected.[30] Particularly, we use panel data to estimate the following regression:

$$EconomicOutcome_{st} = \beta JudicialConstraints_{st} + \theta_{ct} + \varepsilon_{st}$$

where $EconomicOutcome_{st}$ represents the outcome variable (log GDP per capita, log investment per capita, the innovation outputs index, and the corruption perceptions index) in state s in year t, θ_{ct} are continent-by-year fixed effects, where c is the continent in which state s is located, and ε_{st} is the error term. We cluster standard errors at the state level s in order to allow serial correlation within states. Our main interest is β, which represents the long-run relationship between the degree of judicial constraints on the executive and the economic outcomes of interest. In this specification, the effect of the judicial constraints is identified largely on the basis of long-run cross-sectional differences between states. This approach has the advantage of being able to capture institutional differences that evolved in each state over a very long history, in-line with the common finding in the literature of a long-run institutional persistence. For example, the nature of institutions founded by Jewish migrants in Mandatory Palestine (prior to 1948) shaped norms and the allocation of economic and political resources, and as a result, also affected the current level of economic development in Israel. Accordingly, even if the legislative judicial overhaul enter into law *en bloc* in the near future, the effects of past institutions will remain perceptible in the near term. The disadvantage of this approach is that it cannot disentangle the impact of institutional characteristics from that of other factors that remain mostly constant over time.

Table 1 presents the results. In Panel A, we use the WJP index and find a strong and statistically significant relationship between judicial constraints on the executive and the four outcome variables. In particular, a 0.1 increase in the judicial-constraints index is correlated with an increase of approximately 28.7 percent in the standard of living (Column 1),[31] an increase of about 45.3 percent in investment per-capita (Column 2),[32] a 33.0 point increase in the Innovation Outputs Index (Column 3),[33] and a 78.4 point improvement in the Corruption Perceptions Index (Column 4). All of these results are significant at the highest

[30] This means that estimating the effect of judicial restraints on government takes place "within" continents, such as to compare countries that impose stronger or weaker judicial constraints only within the same continent and to reveal time trends particular to each continent separately.

[31] $e^{0.1*2.522} - 1 \approx 0.287$

[32] $e^{0.1*3.739} - 1 \approx 0.453$

[33] $e^{0.1*0.956} - 1 \approx 0.100$

statistical level and indicate that the judicial constraints measure is strongly correlated with significant differences in long-run economic performance.

To allow a comparison of the strength of the relationship between the indices and the different outcome variables, we also present in Table 1 the normalized beta coefficients. We find that a one-standard-deviation increase in the WJP judicial constraints index is correlated with an increase of 0.39, 0.46, 0.39, and 0.74 standard deviation in log GDP per capita, log investment per-capita, the Innovation Outputs Index, and the Corruption Perceptions Index, respectively (the standard deviation is calculated using the distributions of 2021 data). In Panel B, we use the V-Dem index and find similar results. While the statistical relationship between this indicator and the outcome variables is slightly weaker, it remains first-order, as a 0.1 increase in the V-Dem judicial-constraints index is correlated with an increase of approximately 10.0 percent in the standard of living (Column 1).[30] The normalized beta coefficients are 0.27, 0.35, 0.36, and 0.61, respectively.

Table 1
Connection between judicial constraints on government and long-run economic development and economic environment

	Log GDP Per-capita (1)	**Log investment per-capita (2)**	**Innovation Outputs Index (3)**	**Corruption Perceptions Index (4)**
Panel A: WJP data				
Judicial constraints on the government	2.522*** (0.291)	3.739*** (0.371)	33.026*** (4.164)	78.401*** (4.667)
Beta coefficient (normalized)	0.394*** (0.046)	0.459*** (0.046)	0.393*** (0.050)	0.742*** (0.044)
Continent X year fixed effect	✓	✓	✓	✓
Number of observations	1,066	1,014	1,023	1,207
R^2	0.698	0.697	0.656	0.766
Panel B: V-Dem data				
Judicial constraints on the government	0.956*** (0.245)	1.595*** (0.285)	16.986*** (2.479)	36.037*** (3.142)
Beta coefficient (normalized)	0.267*** (0.068)	0.348*** (0.062)	0.359*** (0.052)	0.606*** (0.053)
Continent X year fixed effect	✓	✓	✓	✓
Number of observations	5,209	7,597	1,384	1,887
R^2	0.512	0.634	0.589	0.553

Note: standard errors clustered at the state level in parentheses. ***p<0.01.

As an alternative way to estimate the effect of institutional characteristics on economic development, we follow the specification of Acemoglu et al. (2019). In this study, the identification relies on institutional variation within a country, controlling for country fixed effects and the growth path in previous years.[34] The advantage of this approach, apart from allowing a dynamic estimation of the impact, lies in removing all of the variation that comes from countries' characteristics that are fixed over time. Therefore, the estimated impact can be more reliability attributed to the institutional characteristics of interest to us (i.e., the degree of judicial review on the executive) and not to other associated fixed differences. There are two drawbacks to this approach: it removes most of the institutional variation in the data—the cross-sectional variation across states, that was accumulated over a long history—and it requires a long panel data. Due to the latter constraint, we follow Acemoglu et al. (2019) and use GDP per-capita data that is not adjusted for PPP, but go all the way back to 1960. For this reason, we estimate the model using only the V-Dem index, which is available for those years.

The estimation equation takes the following form[35]:

$$GDPpc_{st} = \beta JudicialConstraints_{st} + \sum_{j=1}^{p} \gamma_j GDPpc_{s,t-j} + \theta_s + \delta_t + \varepsilon_{st}$$

where γ_j represents the coefficients of the outcome variables at a lag of j years, θ_s are state fixed effects, and θ_s are year fixed effects. Including the lagged outcome variable allows for a dynamic impact that accumulates gradually, such that arriving at a new long-run growth path may take many years. For example, Acemoglu et al. (2019) find that the impact of democratization is not immediate, but accumulates gradually and attains nearly total fulfillment only after twenty to twenty-five years. In a regression where the path of GDP is not controlled for, the β-estimator represents the effect of judicial constraints on GDP per capita in the long-run, and in a regression that that does control for this path it represents the short-run effect. We will focus on the effect of institutional characteristics on the long-run outcome, which may be derived in the latter specification from the estimated coefficients.[36]

Table 2 presents the results. Column 1 reports the result of the estimation with state fixed effects but without controlling for the lagged outcome variable, whereas Column 2 reports the estimation result from the basic specification of Acemoglu et al. (2019), which includes four lags of the outcome variable. In addition to the relevant regression coefficients, we also

[34] The authors stress that controlling for the previous growth path is especially important because transitions to democracy are usually preceded byslow growth; if these trends are not directly controlled for the estimated effect of democracy on economic development may be downward biased.

[35] This equation is a reconstruction of the main estimation equation in Acemoglu et al. (2019): Equation 1, p. 57, Table 2, Columns 1–4).

[36] The estimate long-run effect is obtained by $\frac{\hat{\beta}}{1-\sum_{j=1}^{p}\gamma_j}$. See Acemoglu et al. (2019), Equation 2, p. 59, and the explanations in Section A.III.

report the estimate of the cumulative long-run effect. The results are similar across the two columns. A 0.1 increase in the judicial-constraints index is correlated with an increase of approximately 3.3–3.7 percent in long-run GDP per-capita, as against an approximate 10 percent increase when the corresponding estimate obtained from Table 1, Panel B, Column 1 is used.[37]

Table 2
Connection between judicial constraints on government and long-run per-capita GDP

	Static estimate (1)	**Dynamic estimate (2)**
Judicial constraints on government	0.329^{**} (0.153)	0.029^{*} (0.017)
Long-run effect	0.329^{**} (0.153)	0.361^{*} (0.189)
State fixed effects	✓	✓
Year fixed effects	✓	✓
Previous growth path		✓
Number of observations	8,822	8,105
R^2	0.943	0.993

Note: Control of the previous growth path includes log GDP per capita in the previous four years. Standard errors are clustered at the state level in parentheses. *p<0.1, **p<0.05

D.3 The expected effect of the judicial overhaul on the long-run performance of the Israeli economy

To get an idea of the extent of long-run damage to the Israeli economy as a result of the judicial overhaul, we begin by estimating the expected change in the indices of judicial constraints on the executive in Israel should the judicial overhaul pass into law. To do this, we adopt two approaches. First, we deduce the intensity of the foreseen changes in Israel from the intensity of the changes in these indices in Hungary and Poland after these countries underwent democratic backsliding, it being assumed that the processes there strongly resemble those expected in the aftermath of the judicial overhaul. Second, we use a simulation conducted by political scientists in Israel to estimate the change in the V-Dem index. Based on these scenarios, we can quantify the intensity of the possible decrease in the indices of judicial constraints on the Government of Israel. Due to uncertainty, we regard these quantifications not as exact forecasts, but as suggestive examples that point to a reasonable range that may be used to estimate the long-run damage the Israeli economy may sustain (Subsection D.2 in this section).

[37] $e^{0.1\times 0.361} - 1 \approx 0.037$,$e^{0.1\times 0.329} - 1 \approx 0.033$

Expected effect of the judicial-constraint-on government indices on Israel's sovereign rating

a. Figure 4 describes the change in the Hungarian and Polish judicial-constraints indices in recent years. In Hungary, the Fidesz Party, headed by Viktor Orbán, came to power in 2010 and in Poland, the Prawo i Sprawiedliwość (PiS—Law and Justice) Party did the same in 2015. After their electoral victories, both parties made dramatic changes in their judicial systems and in the relationship between the judiciary and the executive. In both countries, the executive obtained more power in all matters related to the judiciary, including political appointment of judges and even mass dismissal of veteran judges. In addition, judicial review was scaled down by weakening the *locus standi* (right of standing) and barring the judiciary from involvement in administrative matters such as elections, corruption, and the right to demonstrate (Benvenisti, 2023). In Poland, the WJP index of judicial constraints on the executive fell from 0.735 to 0.499—a decline of 0.236 points—between the year PiS took power (2015) and 2022 (hereinafter: the WJP scenario).[38] The V-Dem index, in turn, dropped from 0.959 in 2014 to 0.607 in 2022—down 0.352 points (hereinafter: V-Dem Scenario A). In Hungary, the V-Dem index of judicial constraints on the executive dropped from 0.902 in 2009 to 0.631 in 2022, a cumulative decline of 0.271 points (hereinafter: V-Dem Scenario B).[39]
b. Researchers from the Political Scientists Forum for Israeli Democracy (Kahn-Nisser, 2023) performed a simulation that focused on the structure and functioning of the judiciary and its relations with the other two branches of government based on the Rothman-Levin roadmap. In consultation with the professional staff at V-Dem, they selected five items on the V-Dem questionnaire that focus on relations between the executive and the judiciary,[40] and asked five local experts to answer them assuming that the program presented by the Minister of Justice in early January would be passed into law. The values of the responses were processed on the basis of a method similar to that of V-Dem, *mutatis mutandis.* The simulation suggested that if the roadmap becomes law, the index of judicial constraints on the executive is likely to decline from its current value in 2022—0.901—to 0.53, for a total decrease of 0.37 (hereinafter: the V-Dem Scenario Simulation).[41]

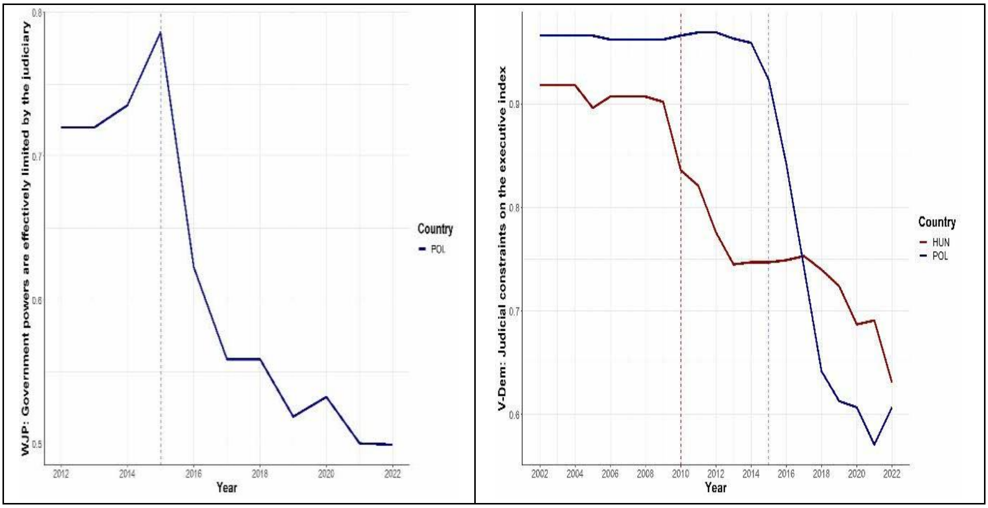
[38] WJP data are unavailable before 2012; therefore, the change in this index after Orbán's rise to power in 2010 cannot be tracked.

[39] Note that a cardinal comparison of the numerical changes in the two indices cannot be performed.

[40] As stated, the questions are shown in Appendix C. The political scientists also reviewed 153 bills submitted in the winter 2023 session of the Knesset and examined the extent of their impact on Israel's indicators and V-Dem index scores. They found that the passage of all these bills into law would have a negative impact on 418 indicators (out of 473), lowering Israel's standing from "liberal democracy" to "authoritarian electoral regime" (Kahn-Nisser, 2023).

[41] In two additional indices—the Liberal Component Index and the Liberal Democracy Index—Israel's score is also likely to tumble considerably.

Figure 4
Development of judicial review of government indices, Hungary and Poland



Panel A: Panel B: WJP index, Poland V-Dem index, Hungary and Poland

Note: the dashed red and blue vertical lines represent the year in which the Fidesz Party came to power in Hungary and the PiS Party took over in Poland, respectively.

The expected effect on long-run performance of the Israeli economy

Based on our estimations of the relationship between the indices of judicial constraints on the executive and the outcome variables using the two empirical strategies and the four scenarios of the expected effect of the judicial overhaul on the indices, we can assess the magnitude of the damage that the Israeli economy may face in the long term.

Table 3 presents these estimates for the first estimation strategy. The WJP scenario (Row 1) uses the estimates from Panel A of Table 1; while the three V-Dem scenarios (Row 2–4) use the estimates from Panel B. As reported in the table (Column 1), the Israeli economy is likely to sustain dramatic harm in the long run. The expected weakening of judicial constraints on the executive in the various scenarios is correlated with a long-run decrease of 23–45 percent in the standard of living relative to the economy's growth potential. Assuming that the damage accumulates steadily over the course of a twenty-five-year period, this implies that the annual growth will be 0.83 percent lower during this time (in the scenario of a 23 percent decrease in GDP) or 1.5 percent (in the event of a 45 percent loss of GDP).[42]

[42] By comparison, a forecast of the effects of the judicial overhaul on growth, issued by the Bank of Israel in early April and reflecting a scenario of rather fast dissipation of the effect of the changes, estimated the average damage at 0.8 percent of GDP each year. If the effect

These ranges resemble the aforementioned causal effect of democracy on development estimated by previous studies—around 1 percent per year (Papaioannou and Siourounis, 2008) or 20 percent to twenty-five years ahead (Acemoglu et al., 2019).

These results suggest that the welfare of Israeli citizens stands to suffer a very significant long-run decline relative to a scenario in which the judicial overhaul is abandoned. This cumulative damage is expected to be realized over a lengthy period, making it difficult to comprehend the extent of the danger that looms over the Israeli economy. The following exercise may be helpful in interpreting the extent of the damage: Suppose the judicial overhaul had been enacted long ago, such that the total damage foreseen in this estimation would have materialized by 2022; how would the Israeli standard of living have looked by then? The answer is 23 percent lower, which is tantamount to an annual loss of income of NIS 42,300 per capita, and a loss of 45 percent corresponds to an annual NIS 82,700 decrease in per-capita income—a cumulative loss of nine to eighteen years of growth.[43] It is important to note that this is not a one-off dip, but rather a permanent decrease relative to the potential growth path, i.e., a loss of this magnitude each and every year.

Table 3
The foreseen impact of the judicial overhaul on the long-run performance of the Israeli economy

	GDP per capita (1)	**Investment per capita (2)**	**Innovation Outputs Index (3)**	**Corruption Perceptions Index (4)**
WJP scenario	-44.9%	-58.6%	-7.794	-18.502
V-Dem Scenario Simulation	-29.8%	-44.6%	-6.285	-13.334
V-Dem Scenario A	-28.6%	-43.8%	-5.979	-12.685
V-Dem Scenario B	-22.8%	-35.1%	-4.603	-9.766

Note: the values in the table were obtained by multiplying the expected change in the index of judicial constraints on the government in the various scenarios by the relevant coefficient from Table 1, which represents the linear relation between the index and the relevant outcome variables, and in Columns1–2, their transformation from log to percent change.

As explained above, to understand why the standard of living may suffer such a dramatic blow, one may examine the possible damage to the economic environment and to growth promoting factors due to institutional changes in the spirit of the judicial overhaul. Table 3

of the legislative changes persists, however, the Bank of Israel estimates the average GDP loss at 2.8 percent per year (Bank of Israel, 2023b).

[43] Israel's Gross Domestic Product in 2022 was NIS 1,756 billion—NIS 184,000 per capita (current prices; Bank of Israel, 2023, *Annual Report* for 2022).

suggests that the foreseen mitigation of judicial constraints on the executive in the various scenarios is correlated with declines of 35.1–58.6 percent in per capita investment (Column 2), 4.6–7.8 points in the Innovation Outputs Index (Column 3), and 9.8–18.5 points in the Corruption Perceptions Index (Column 4). For comparison, these changes are tantamount to retreating to a level of per-capita investment between Latvia and Uzbekistan; a level of innovation outputs between Portugal and Belgium; and a level of government corruption between that of Bahrain, China, and Cuba, and that of Slovakia or the Republic of Fiji.

Table 4 presents the estimates for the second estimation strategy. The estimates of damage obtained here are smaller but nevertheless dramatic, reflecting very severe long-run degradation of the Israeli standard of living. The foreseen decline in judicial constraints on the executive in the various scenarios correlates with an 8.9–12.5 percent decrease in the standard of living in the long run relative to the economy's potential growth trajectory. This amounts to a loss of NIS 16,400–NIS 23,000 per capita or NIS 81,800–NIS 114,900 per five-person household in 2022 alone, and a loss of similar relative magnitude every year.

Table 4
The foreseen impact of loosening judicial constraints on government on long-run GDP per capita

	Static estimate	**Dynamic estimate**
	(1)	**(2)**
V-Dem Scenario Simulation	-12.2%	-12.5%
V-Dem Scenario A	-11.6%	-11.9%
V-Dem Scenario B	-8.9%	-9.3%

Note: The values in the table are obtained by multiplying the expected change in the index of judicial constraints on government in the various scenarios by the relevant coefficient from Table 1, which represents the linear relation between the index and the relevant outcome variables, and in Columns 1–2, their transformation from log to percent change.

As stated above, the estimates presented in Tables 3-4 do not allow us to produce accurate forecasts; rather, they demonstrate the possible magnitudes of the damage on the basis of reasonable assumptions. These results, as well as the extensive literature in economics surveyed above, suggest that an institutional array of checks and balances is crucial for economic development. Therefore, legislative initiatives that are expected to impair this array, which, in Israel, rests on relatively weak foundations to begin with, is likely to deal the Israeli economy and the standard of living of its residents a grievous blow in the long-run. The magnitudes of the economic damage that is reflected in our estimates are so dramatic that even if only the milder scenarios come to pass, or if the estimates are somewhat biased, a death blow to the economy and resilience of the State of Israel would be all too probable. Similarly, and especially given the special sensitivities of the Israeli economy to shocks of these kinds, the long-run damage may even be greater than estimated.

E. SHORT-RUN EFFECTS OF THE JUDICIAL OVERHAUL ON THE ISRAELI ECONOMY

In Section D, we discussed the grave economic harm that Israel may sustain in the medium- and long-run in view of the extensive literature on institutional quality and economic development (Section C). There are indications, however, that the markets are already responding to foreseen future harm and that the judicial overhaul may be inflicting meaningful damage on the Israeli economy right now due to an upturn in business environment risk, the emergence of negative market sentiment, and growing expectations of major economic degradation. In this section, we describe some aspects of this damage that we can already identify. In particular, we consider damage associated with impairment of institutions (Section E.1), the outflow of capital from Israel (E.2), and the blow to high-tech and innovation (E.3).

E.1 Lowering Israel's credit rating

A country's international credit rating reflects its ability to pay its public debt. The rating is set largely on the basis of the quality of the country's institutions. When the quality of institutions erodes, concern grows about the country's future potential economic growth and ability to pay its debts. As noted in Section B, the judicial overhaul is generating negative expectations about institutional quality and potential growth of the Israeli economy. Lowering the credit rating, however, is more than a mere symptom; it is an event that will probably have perceptible economic repercussions— in the present or in the near future. It is likely to make raising government debt more expensive, exacerbate the total debt burden, and, accordingly, lead over time to the contraction of government expenditure, impairment of government services, or tax increases, probably followed by degradation of income and welfare.[44]

On April 14, 2023, Moody's Investor Service (2023b) announced that it was lowering its Israel rating outlook from "positive" to "stable," explaining:

The change of outlook to stable from positive reflects a deterioration of Israel's governance, as illustrated by the recent events around the government's proposal for overhauling the country's judiciary.

And adding:

More specifically, the government's plans for an overhaul of the judiciary and the manner in which this reform has been handled have exposed some weakness in Israel's executive and legislative institutions. Compared to many other countries, Israel's institutional set-up relies to an important extent on judicial oversight and review.

The announcement appeared after it became clear that the Rothman-Levin program was unlikely to come to fruition in its original format, and our understanding is that Moody's

[44] The government debt in 2021 was NIS 1,068 billion (CBS, 2022). An increase in interest paid on the government debt has a direct effect on the cost of government debt (new issues and rollovers) and, indirectly, on the debts of the economy at large.

released it in order to warn against the heavy-handedness of the legislative attempts and the social rift that they had created. The statement was appended to a special caution from Moody’s, published on March 7, that explicitly mentioned the main provisions of the legislative program and pointed to its hazards (Moody’s Investor Services, 2023a):

In our view, if implemented in full, the proposed changes could materially weaken the strength of the judiciary and as such be credit negative. The planned changes could also pose longer-term risks for Israel’s economic prospects, particularly capital inflows into the important high-tech sector.

Some section headings of the document were warnings that left no room for misinterpretation:

Proposed reforms could weaken institutions and negatively impact its sovereign credit profile.

And:

Over the longer term, judicial changes could also damage Israel’s strong economic growth potential and raise geopolitical risks.

In early March, Fitch Ratings left Israel’s sovereign rating unchanged at A+ but warned that the planned changes might have future implications. S&P Global Ratings (S&P) did much the same in its report on Israel, issued on May 12, 2023. It decided to leave Israel’s rating and outlook unchanged for the time being, but only on the assumption that the original plan would fall through and be replaced by an alternative scheme, its contents unknown but resting on a broad consensus.

Notably, only a small part of Israel’s public debt, around 15 percent, is issued in USD and intended for foreign lenders. There is no doubt, however, that that an increase in the cost of raising debt abroad would trigger an upturn in borrowing from domestic sources, because the same factors that push up the cost of external issuing also raise the interest rate on domestic-currency bonds. In addition, a rating downgrade is also likely to resonate more broadly to the cost of business debt and foreign investment at large. Since a country’s sovereign rating is an indication of the level of risk associated with investing there, a downgrade may take a bite out of foreign investment generally and high-tech issues particularly. Israel’s high-tech industry relies largely on foreign capital; therefore, a credit downgrade may deal it a dire blow that, in turn, would impair state revenues, productivity, economic growth, and other important economic indicators. According to a simulation conducted by the Budget Division of the Ministry of Finance, if Israel’s sovereign rating had been downgraded in 2021, its GDP would have projected to contract by 1.4–4.6 percent and the share of employment in high tech would have fallen by 8–25 percent (Ministry of Finance, 2023a).

Finally, a downgrade of the sovereign rating may depreciate the domestic currency by reducing demand for it by foreign and domestic investors. Such depreciation would bring on a wave of increases in the prices of imported goods and push the inflation rate up. This, in turn, would drive the Bank of Israel to raise the domestic interest rate, impairing household consumption and slowing growth (Ministry of Finance, 2023a).

E.2 Capital movements: Yield spreads between domestic and foreign equity markets

In this subsection, we present convincing evidence of rapid and substantial capital movements since the coalition unveiled its plan for a judicial overhaul in early January 2023. A reasonable explanation for the patterns we observe is that the advancement of these initiatives in the Knesset and fear of deterioration of the domestic business environment prompted domestic investors, including major players in the Israeli financial market ("institutionals") to slash their exposure to Israeli financial assets by offering Israeli assets for sale. This, in turn, increased the supply of the domestic currency relative to foreign currencies, and resulted in devaluing these assets and causing the NIS to depreciate to an extent that would not have happened otherwise.

There are two main reasons for this trend: concern about short-run volatility due to the heightened uncertainty in the past few months, and the fear for the long run stability and the profitability of Israeli firms.[45] Both reasons reinforce the claim that investors are apprehensive about the future of the Israeli economy. In this sense, the phenomena we describe below are symptoms and not the problem per se. The immediate implication of these capital outflows, however, is that the value of Israeli domestic financial assets have depreciated drastically, causing the wealth of Israeli households to plummet. We will attempt to estimate its magnitude as we continue.

Excess currency depreciation

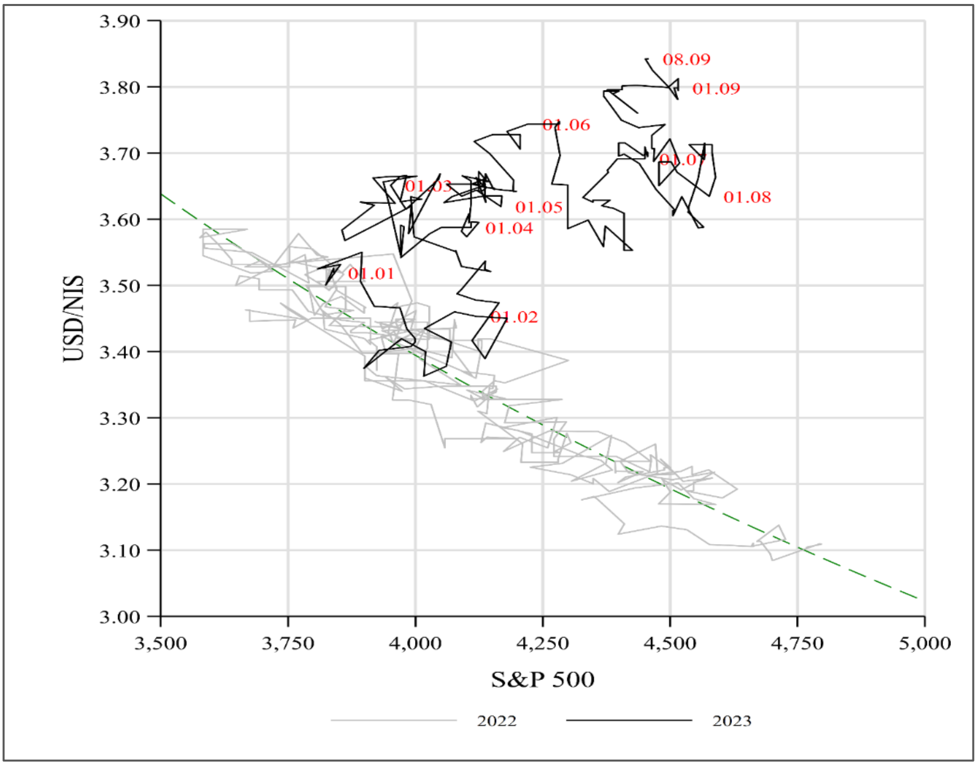
To estimate the extent of excess depreciation of the NIS against the USD since the judicial overhaul was announced in January 2023, we base ourselves on the strong short-run correlation that exists between the S&P 500 Index and the USD/NIS exchange rate. In the past ten years, the opening of Israeli forex-neutralized funds—those that invest in foreign indices and hedge this investment against volatility in the USD/NIS exchange rate—has become immensely important. To hedge their exposure to foreign capital markets, foremost the American market and above all the S&P 500, the funds must make large-scale purchases of NIS whenever the foreign indices rise and do the opposite when the overseas markets sink. This phenomenon, coupled with the growing sums of capital that these funds manage, has created a negative and very strong short-run correlation between the S&P 500 and the USD/NIS exchange rate (Ben Zeev and Nathan, 2022). Thus, we show in this subsection that the short-run correlation between the index and the USD/NIS exchange rate is so strong that one can use it to identify, with very high certainty, aberrant NIS depreciation or appreciation

[45] There are direct indications of an increase in the riskiness of the Israeli business environment, such as an upturn in the CDS index and widening of yield spreads between ten-year Israel sovereign bonds and similar American instruments, indicative of an upturn in the risk of doing business in Israel.

events. It follows that we can employ it to estimate the extent of excess depreciation of the NIS against the USD since the judicial overhaul became known.

To substantiate the strength of this statistical relationship, let us focus on the period from January 2022 to July 2023 (Figure 5). Until the beginning of 2023, the USD/NIS exchange rate closely tracked the visible and downward-sloping curve of the S&P 500 index. A log-linear regression illustrates the connection between these indices tellingly. On the basis of 2022 data, the daily standard deviation of the residuals from the predicted exchange rate was only 1.3 log point (!), the equivalent of 4.5 Agorot.[46] In other words, taking the S&P 500 as a given, one could predict the USD/NIS rate with an error of no more than 8 Agorot on around 90 percent of days, with hardly a day with a larger error than 10 Agorot.

Figure 5
Relation between the S&P 500 and the USD/NIS exchange rate since early 2022



Note: This figure plots the USD/NIS exchange rate against the S&P 500 index in each day during 2022-3. The first day of the month is 2023 is labeled. The dashed line represents the predicted exchange rate based on a log-linear regression on 2022 data.

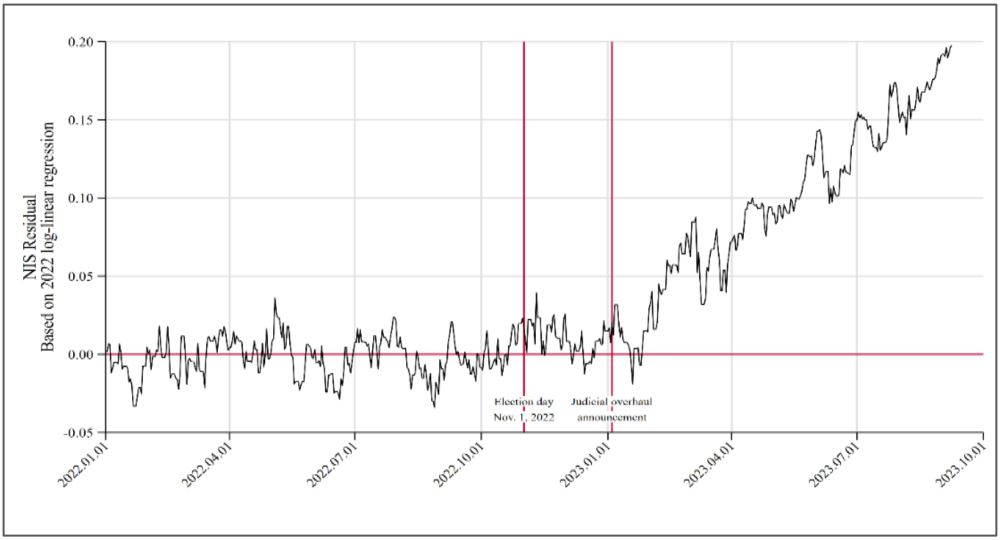
[46] An *Agora*, pl. *Agorot*, is 1/100 of a New Israeli Shekel. During the period of interest, the NIS was equivalent to 0.25-0.3 US cents.

As one may also see in Figure 5, the tight curve that prevailed since early 2021 was breached outward in late January 2023, coinciding with the stepwise increase in concern about the economic risks associated with the judicial overhaul. In particular, it was in the last week of January 2023 that the former governors of the Bank of Israel issued their warning and hundreds of economists in Israeli academia and dozens of former directors general of economy-related government ministries signed the "Economists' Letter." Such a deviation from the curve is highly uncommon and we are unaware of any evident reason for it to have happened just then other than the turmoil surrounding the judicial overhaul.[47] In fact, in the past five years, such breaches took place only twice and for obvious reasons in both cases: first for only two days at the peak of uncertainty surrounding the eruption of the COVID-19 pandemic (March 17–18, 2020) and again when the Bank of Israel revised its policy on purchasing foreign currency (January 2021). Thus, the depreciation in early 2023 was unusual and rapid relative to the longstanding pattern.

The regression analysis described above also yields a rough estimate of the extent of the excess depreciation, namely, the change in the USD/NIS exchange rate not explained by fluctuations in the US stock exchange. The "errors" relative to the forecasts, based on the regression coefficients for 2022, are plotted over time in Figure 6. As stated above, until the end of January 2023, the USD/NIS exchange rate adhered strictly to the pattern established by the curve; this is evident in the figure, which shows an absolute value of excess depreciation that is almost always smaller than 2 percent. Since then, however, the excess depreciation has been rising persistently, reaching 20% by early September 2023; by that time, the predicted USD/NIS exchange hovered around 3.19–3.23, while the actual rate was more than 60 Agorot higher (NIS 3.80–NIS 3.85).

[47] In the past year, for example, the Israeli and American central banks raised their rates, but the upturns were foreseen, gradual and, more important, almost concurrent in both markets. Similarly, there was no sudden intervention of the Bank of Israel in the foreign exchange market, as the Bank's reserve did not undergo an unusual change during that time. Therefore, these factors cannot explain the steep depreciation of the NIS relative to the forecast based on the S&P 500 index.

Figure 6
Excess NIS depreciation

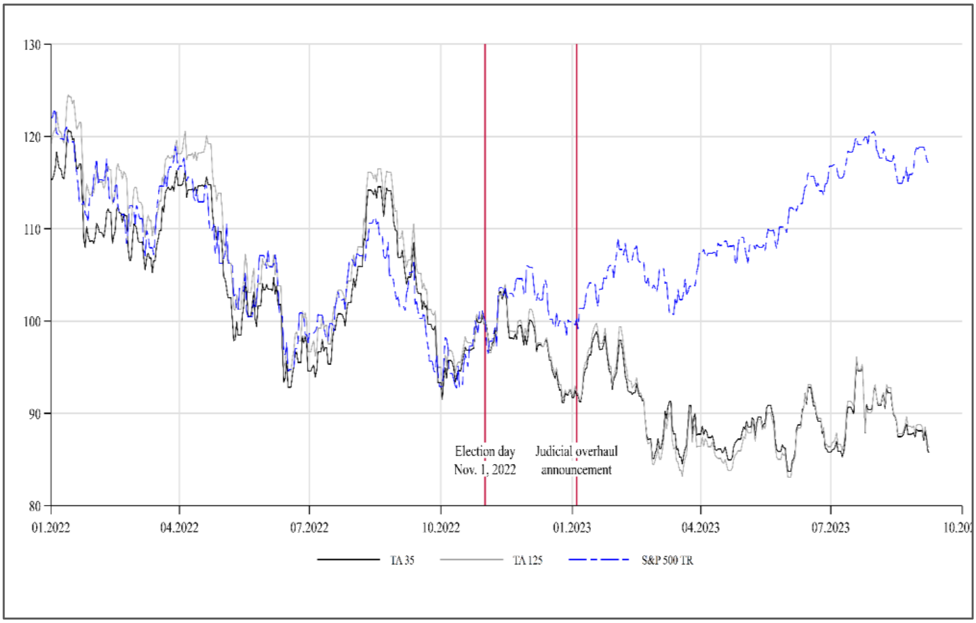


Note: Excess depreciation is the difference between the USD/NIS exchange rate and its predicted value based on log-linear regression on 2022 data, as a ratio of the predicted exchange rate. For example, in Sept. 8, 2023, actual exchange rate was 3.842 whereas the predicted exchange rate was 3.209, and therefore excess depreciation was $\frac{3.842-3.209}{3.209} = 0.197$.

Yield spreads in the equity markets

The performance of the Israeli stock market gives yet another perspective on Israel's capital outflow. Much as we acted to identify the excess depreciation of the NIS, we use the strong short-run correlation between the US and the Israeli stock indices to detect excess negative returns of Israeli stocks. The correlation may be seen well in Figure 7, which juxtaposes the time trend of the S&P 500 to that of the TA 35 and TA 125—the latter two converted into USD terms and all indices normalized to 100 on the most recent Election Day (November 1, 2022). As the figure shows, up to the end of 2022 the Tel Aviv indices tracked the American index with exactitude, with a few deviations and no drift. In fact, what we have here is an almost perfect pre-trend that allows us to hypothesize that, absent of shocks, the Israeli indices would have continued on the same path. Shortly after Election Day, however, the trends decoupled, the Tel Aviv indices branching away from the S&P 500 with remarkable vigor. By early September 2023, the TA indices were underperforming by 25–27 percent relative to the comparison index, which, in our judgment, approximates the counterfactual scenario absent the political shocks of recent months (12–14 percent loss of value in USD terms as against a 15–18 percent increase in value in the US index). The underperformance reflects not only the NIS slump of the Israeli indices but also the currency depreciation that occurred. In other words, an investor who bought Israeli stocks on Election Day would be left at this writing with 27 percent less in USD terms than an investor who invested the same sum in US stocks on the same day.

Figure 7
The Tel Aviv and S&P 500 indices



Notes: the values of the TA 125 and TA 35 indices and the American S&P 500 index are normalized to 100 on Election Day (November 1, 2022). The three indices trended almost identically until Election Day; afterwards, the Israeli indices and the US index parted ways. The spread widened steadily until the end of the sample period in early September 2023.

E.3 Bank of Israel interest rate hikes

The excess depreciation of the NIS against the USD is likely to cause import prices, domestic prices, and the inflation rate to rise. According to the Bank of Israel, 10 percent NIS depreciation translates into a 1–2 percent upturn in the inflation rate (Bank of Israel, 2023a). The inflationary surge in Israel is part of a global phenomenon that began with the COVID-19 crisis and continued with the Russia-Ukraine war. To cope with the inflationary pressures caused by these events, central banks in Israel and around the world tightened in the course of 2022 and raised their interest rates. In Israel, the rate was hiked from 0.1 percent in April 2022 to 3.25 percent at the end of 2022. In 2023 thus far, given that inflation has not slowed (for reasons including the depreciation of the NIS), the Bank of Israel raised its rate to 4.75

percent in May. Quelling inflation by means of monetary tightening is supposed to work by restraining demand, which is meant to dampen economic activity.[48]

E.4 Investments in Israeli high tech

The first quarter of 2023 saw a dramatic decrease in high-tech investments in Israel. A survey by the Start-Up Nation Policy Institute (Igalnlik, Patir, and Gabai, 2023), found that only USD 1.7 billion was invested in Israeli high-tech in that quarter as against USD 6.7 billion in the year-earlier quarter. The dramatic plunge traces to two different developments—a global slowdown in technology and matters in Israel directly associated with the judicial overhaul. According to the survey, if investment continues to decelerate at the same pace until year's end, investments in Israeli startups will come to only USD 6.8 billion in 2023, 60 percent lower than in 2022 and 75 percent lower than in 2021.

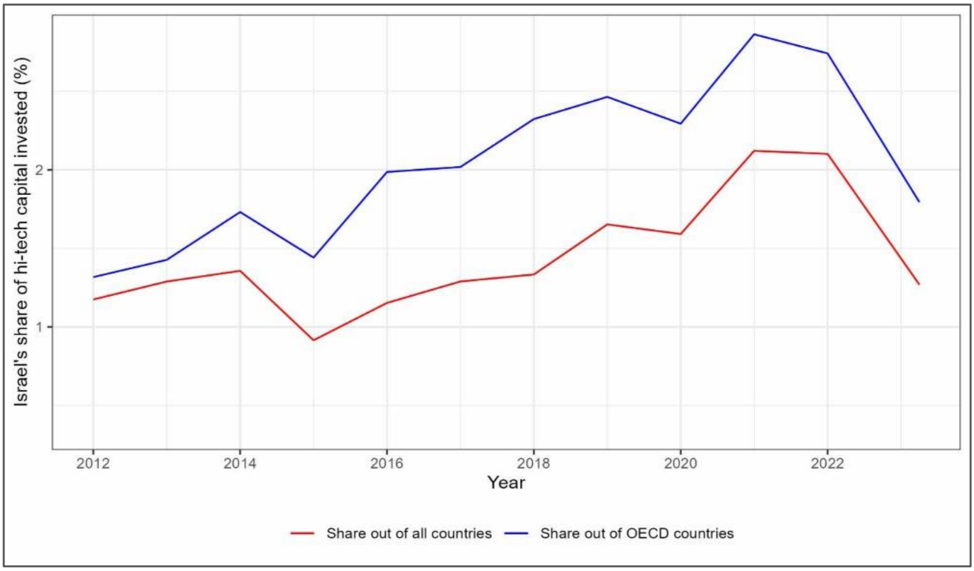
A survey by Start-Up Nation Central on March 22–23, 2023,[49] among 1,142 senior representatives of 873 Israeli high-tech firms, yielded severe findings about the harmful effects of the judicial overhaul on Israeli high-tech. For example, 84 percent of investors believed that the legislation would make it harder to raise money abroad. Of them, 40 percent expected for this reason to raise less than half of what they had raised in their previous round. Furthermore, 42 percent of the companies were considering moving their place of incorporation out of Israel and 30 percent said that they would consider moving staff abroad or offering them relocation packages. In addition, 46 percent of the firms reported having plans to move their funds out of Israel and 58 percent of those so reporting indicated that they were planning to move abroad more than 50 percent of their funds. Moreover, 79 percent of senior executives of companies in the middle of funding rounds reported that meetings with investors had been cancelled since the legislation began and 31 percent of those who reported this indicated that their meetings with investors had come to a total halt. Among international firms, 27 percent expected a decrease of more than 50 percent in R&D investment and 12 percent foresaw total cessation (SNC, 2023). One way of identifying the effect of the legislation on Israeli high-tech separately from the global downtrend is to test the change in the share of high-tech investment in Israel out of the total high-tech investment in the OECD countries or worldwide. In Figure 8, we use data from the financial-information company PitchBook (pitchbook.com), to examine how Israel's share in total technology investment changed in the first quarter of 2023 relative to a year earlier. As the figure shows, this share

[48] The increase in domestic interest is chilling economic activity in general and particularly on the real-estate market., In fact, tax revenues decreased dramatically in the first four months of 2023. According to reports from the State Revenue Administration, state tax revenues dropped by 7.4 percent in real terms in the first four months of 2023—direct-tax collection by 8.1 pecrent and indirect-tax collection by 1.6 percent—relative to year-earlier. The falloff of revenues has a direct effect on the expected deficit in 2023.

[49] The survey preceded the Prime Minister's announcement of the dismissal of the Minister of Defense and the decision to suspend the legislation.

grew steadily from 2015 to 2022 but fell steeply and significantly in the first quarter of 2023. One cannot, of course, unequivocally relate the steep decline on the judicial overhaul alone, but combined with the findings of the survey presented above it reinforces the assessment that the judicial overhaul is an important determinant of the decrease in investment in Israeli high-tech.

Figure 8
Israel's share of global high-tech investment



Note: the figure is based on data from PitchBook, Ltd. It plots the share of Israeli high-tech investment in total global investment (red line) and in the OECD countries (blue line) in 2012–2023. According to the figure, the share of investment in Israel slumped abruptly from 2.86 percent of investment in the OECD countries in the first quarter of 2023 to 1.79 percent in the first quarter of 2023, and from 2.12 percent of total global investment to 1.27 percent in that quarter.

A report published by the Israel Innovation Authority in early May 2023 also gives troubling indications of a slowdown in the domestic high-tech market that are not consequences of the global slowdown in this industry. In particular, it describes the decoupling of the domestic market from the global market, the domestic indices failing to track the international ones since the beginning of the year. Beyond the decoupling of the TA stock indices from US indices, described above, the Innovation Authority report detects a decrease in the number of vacant posts in high-tech in the first quarter of 2023 as against an upturn in the NASDAQ index that quarter. In the past, the two indices marched in tandem (Innovation Authority, 2023b).

The Authority also reports a clear preference of corporate founders to register their new startups abroad and not in Israel. Until 2023, for tax and other considerations, some 80 percent of new firms incorporated in Israel. Since February 2023, however, 50–80 percent of new firms have incorporated abroad. The change in trend apparently reflects entrepreneurs' deep concern and uncertainty about the advancement of the judicial overhaul. Registering a company abroad may have no immediate significance in terms of its real activity or the revenues that the state may collect from it, but it may help the company to site some or all of its activity abroad in the future. One must assume the abrupt reversal of trend attests to intentions to keep the option to do this in the future (Innovation Authority, 2023b).

E.5 Initial indications of degradation of the bureaucracy and increase in corruption

The judicial overhaul is also likely to weaken the bureaucracy, impairing the quality of public services and the ability to make and implement bureaucratic policy. The damage that has already begun is evident in the measures that accompanied the original program of the Minister of Justice, such as the Incapacitation Bill, the "gifts bill," the "second Deri bill," and attempts to fill senior public-service positions with political cronies without vetting by an appropriate search committee or in contravention of appointments committees' recommendations.[50] These bills and attempts in the matter of senior appointments evoke genuine fear of an upturn in public corruption. In addition, the OECD's draft report on Israel warned against an increase of corruption due to the weakening of the judiciary (Arlosoroff, 2023). Evidence of degradation of the public service can already be found. A recent survey by scholars at the Hebrew University among members of the civil service found that 54 percent of civil servants expect their influence on their ministries' policies to weaken somewhat and 71 percent of respondents are pessimistic about the ability of the civil service to attract and retain quality staff. These data may inspire competent workers to leave and deter new ones from joining (Ilan, 2023). In view of fears evoked by the survey of a decrease in the effectiveness of government services, we should note that several years ago, the effectiveness of the government in Israel already ranked twenty-first among the thirty-four OECD countries and fell short of the organization's average (Dahan, 2016: 11–12).

E.6 Is the damage reversible?

At the present writing, the coalition's ability to realize its schemes fully in the near future seems unlikely. If so, may some of the short-run damage already sustained be repaired? Moreover, may the long-run damage be avoided? There is reason to fear that the answer to both questions is negative. The concern originates in what many consider a breach of the "meta" rules—rules of the game that deal with changing the rules of the game. The April 2023 Moody's report emphasized the heavy-handedness of the coalition's attempts to force

[50] For details about these initiatives and attempts, see Appendix A.

a major reordering of government without attempting to mobilize a broad consensus behind it (Moody's Investors Service, 2023b):

The wide-ranging nature of the originally proposed changes and the speed with which the government attempted to push them through the Knesset, Israel's parliament, without an attempt to achieve broad consensus point to a weakening of institutions. In addition, the predictability of the country's executive and legislative institutions has declined.

That is to say, the very attempt to give the rules of the game a comprehensive and material overhaul without a broad consensus is harmful to the institutional resilience of the Israeli economy and the ability to sustain the state's institutions going forward. The sweeping move to pass the judicial overhaul into law without trying to anchor it in broad consent broke the unwritten rules of the political system, those that define how comprehensive changes such as these should take place. Therefore, even if a short-run compromise is found, there is reason to fear that future political alignments will again try to apply the original plan and this time, perhaps, the opponents will not manage to stop it or impose a compromise. When foreign investors consider whether to place their money at long-run risk and tether its fate to that of the Israeli economy, they will have to take account of the possibility of material and fundamental change in the business environment and the statutory framework in which they operate.

In contrast, and importantly, the dramatic events in Israel in the past few months also, however, give evidence of the strength of Israel's civil society and its willingness to mobilize in defense of democratic values and, through them, the economy. In its report cited above (Moody's Investors Service, 2023b), Moody's notes:

Civil society and other institutions such as the security establishment have shown themselves to be highly effective checks on the exercise of government power, while it remains to be seen how the strength and independence of the judiciary will evolve going forward.

Insofar as Israel's civil society power persists and even grows, it will be possible to assume, cautiously, that some of the damage already inflicted on the Israeli economy will not be irreversible.

F. CONCLUSION

In this paper, we spelled out the reasons for the immense concern that the judicial overhaul evokes among the large majority of economists who wish to see the Israeli economy thrive. The judicial overhaul is being promoted in disregard of its potential dramatic and long-run detrimental impact on the country's economic development. The ability to forecast economic outcomes, particularly in the long run, is limited. However, the best and latest knowledge in the economic literature, along with a broad and accumulating battery of empirical findings, raise dire fear that the judicial overhaul may cause major and unprecedented harm to Israel's economic future and that the plausibility of this ghastly scenario is too large to overlook. The concern is that the judicial overhaul will undermine the institutional foundations of the Israeli economy by handing excessive and uninhibited power to a narrow majority that has become dominant in the political system, enabling it to channel resources to sectoral and personal needs, develop "crony capitalism," impair economic rights and interests of groups not represented in this coalition, corrupt the civil service, promote brain drain, and, generally speaking, create economic "rules of the game" that will sabotage the possibility of attaining long-run economic growth. The various approaches that we used to estimate the magnitude of the economic damage point in multiple ways to the possibility of dramatic economic harm, equal to many years of lost growth. Rather significant, short-run evidence shows that the capital markets indeed detect dangers such as these, and that their rapid responses are already destroying wealth estimated in hundreds of billions of NIS.

Clearly, the purpose of the judicial overhaul was to reform governance in Israel in a way that would comport with civil goals that its members hold sacred, treating economic outcomes as not the alpha and the omega of the matter. It would be proper, however, to undertake so wide a reordering of governance with abundant attentiveness, caution, and fear and trembling, so that all the implications of the demarche—including those that its promoters have not intended—be amply thought through. Accordingly, we feel it our duty to point to the effects of the judicial overhaul on the long-run development of the Israeli economy and to sound a clear warning about them. Without such development, a complex society that operates in an unstable security environment cannot be maintained for long. Unfortunately, it has become clear in the past few months that these issues were not borne in mind as the judicial overhaul was being promoted. In this sense, the current study makes up for essential staff work that was never done.

The conclusion of this study for policy is that the judicial overhaul, in its original format or in some other format similar to it, must be stopped and abandoned. In any subsequent initiative that would comprehensively revise Israel's orders of governance, the implications for the future of the Israeli economy and society must be given due weight.

Appendix A: Implications of the Program

In this Appendix, we give an overview of the gist of the constitutional and judicial controversy surrounding the judicial overhaul. We present several salient arguments for and against the advancement of each of the main provisions of the Rothman-Levin plan. The purpose of this survey is to establish the grounds of the basic assumptions of the study, specified in Section B.2.

The gist of the judicial overhaul

The most conspicuous component of the judicial overhaul is the proposed recomposition of the Judges Selection Committee. According to the proposal, the committee would be expanded from nine members to eleven: three government ministers, three chairs of Knesset committees (at least one of whom from the opposition), two public representatives appointed by the Minister of Justice, and three justices of the Supreme Court. A majority of six committee members would be needed to make any appointment (including of Supreme Court justices). Implicit in this proposal is the granting of de facto control over the appointment of judges to all instances to the government—in contrast to the situation today, in which broad cooperation among several players is needed and no player has effective control. In addition, the President of the Supreme Court would be chosen by this committee, in contrast to the "seniority" method that is applied today in practice (Forum of Lecturers for Democracy, 2023: 7, 12–14).

Several of the legislative initiatives aim to limit judicial review of the executive and legislative branches. Thus, the High Court of Justice would be limited to dealing with the constitutionality of a statute only in full panel and would be allowed to strike down a statute only by an 80 percent supermajority (twelve justices). The High Court would also be able to declare a law unconstitutional only if it clearly clashes with a provision enshrined in a Basic Law, and it would not be allowed to review the passage of Basic Laws[51] regardless of how they are legislated. In addition to all the foregoing, even if the High Court does invalidate a statute, the passage of an override clause that would allow a majority of sixty-one members of the Knesset to invalidate the invalidation has been proposed (Barak-Koren, 2023: 6). As for other administrative decisions by elected officials (and, in some versions, by all government authorities), it is proposed that the reasonability standard, which the Court sometimes invokes to invalidate decisions typified by extreme unreasonability, be abolished or severely cut back (Fuchs et al., 2023a: 35).

Finally, two changes pertaining to the institution of government ministries' legal advisors have been proposed. First, the advisors would be subordinated to elected officials and their

[51] In the current state of affairs, the Court can thwart the passage of a new Basic Law and thus check the legislature's constitutive power. Judicial review of this kind has been widely criticized, mainly in the argument that the Court has appropriated powers never granted to it and has disrupted the balance among the branches in favor of the judiciary (Bakshi, 2021).

posts would become positions of trust. Second, their views would be nonbinding in all respects. These changes would materially revise the institution of governmental legal advisory, who today are appointed in a competitive hiring process. In addition, current practice makes legal advisors' decisions binding on the ministry and the minister in charge and even allows a legal advisor to refuse to represent the state (Barak-Koren, 2023: 6, 21–22).

As the Rothman-Levin program was promoted, the coalition, or members thereof, took additional initiatives to advance bills or decisions that, while not integral parts of the program, are similar in nature and goals due to their attempt to change the rules of the game and the accepted norms in Israel's form of governance. For example, the passage of the Incapacitation Bill and the attempt to pass the so-called "Second Deri Bill" and the "Gifts Bill" seem to be tailored to the personal needs of the Chair of the Shas Party, Aryeh Deri, and of the Prime Minister, Benjamin Netanyahu (Friedman and Shapira, 2023). On top of these came the decision to add government representatives to the district planning boards (Nardy, 2023), an initiative to transfer the judicial authority of the Civil Service Commission's disciplinary tribunal to the Knesset (Bareli, 2023), allowing more than one minister to serve at a ministry, and invalidating the possibility of four Members of Knesset breaking away from a faction (Friedman and Shapira, 2023).

All of these converge with a series of statements and attempts to promote policy measures that have the effect of concentrating power in the ruling coalition's hands by eliminating checks and balances. The coalition agreements of the Thirty-Seventh Government, for example, call for the cancellation of the "team of directors"—a pool of candidates for directorship posts in government-owned enterprises, established in order to keep these appointments free of political considerations, interests, and connections (Harel-Fischer, 2023). Furthermore, government ministers have already attempted to appoint individuals to positions for which they fail to meet the threshold conditions. Salient examples are the appointment of Moshe Bar-Zaken as Deputy Director General of the Ministry of Transport, after the Appointments Committee disallowed his appointment as Director General of the ministry (Zagrizak, 2023); the Prime Minister's attempt to appoint the Likud activist Yossi Shelli to the post of acting Chief Statistician even though Shelli lacks the requisite professional experience; and the attempt by the Minister of Education to transfer the appointment of the director of the National Library to his authority (Zerahia, 2023). Concurrently, ministers, notably the Foreign Minister and the Minister of Communication, made aberrant declarations that were interpreted as threats to the independence of the Bank of Israel (Azoulay and Eichner, 2023).

Gist of arguments of proponents and opponents of the judicial overhaul

One of the arguments against the proposed recomposition of the Judges Selection Committee is that the change would pollute judges' decisions with political considerations by subordinating the judges to the authority of the committee members, who would control their promotion and even their unseating (Forum of Lecturers for Democracy, 2023:6, 12–14). It is also argued that in view of the structural weakness of the legislative branch, the proposal would give the executive disproportional power (Barak-Koren, 2023: 14). Also noteworthy is concern about degradation of the quality of the elected judges; because the politicians lack the tools to evaluate the professional credentials of a candidate for the bench, the voice of the judges and representatives of the Bar Association is needed. Incumbent judges' involvement in selecting their successors also leads to the application of the principle of accountability—the judges are answerable to the public for the quality of the judiciary because it is they who appoint the judges. The proposed changes may lead to the appointment of politically loyal or less professional judges. Furthermore, subordinating judges to a chance political majority may destabilize their rulings on constitutional issues in view of occasional changes in the political calculus, making their decisions less predictable and more arbitrary (Forum of Lecturers for Democracy, 2023: 2, 10–13; Fuchs et al., 2023:7).

On the other hand, some argue that judges' dependence on the principle of separation of powers will be assured, among other things, because in practice it is almost impossible to unseat judges. It is also argued that in many countries, judges are chosen by politicians one way or another and by control of the coalition, and that claims about impairment to the judges' professional quality are not voiced in these countries. Moreover, the membership of members of the Bar Association on the committee, a body not known for lack of political bias and one that is feared to represent interests not necessarily consonant with the public's welfare, does not contribute to the public's trust in the appointment proceedings. Beyond this, it has been argued that the structural veto power that representatives of the judiciary (judges and representatives of the Bar Association together) hold in the current composition of the committee has led in the past to the disqualification of worthy candidates on the basis, *inter alia*, of their political views. Since political considerations already play a role the choice of judges, it is alleged, there is justification for enhancing the power of the elected echelon and giving the government dominance, bringing the judges' world closer to that of the public and bolstering the latter's faith in the judiciary. Such a change would also cause control of the composition of the Judges Appointment Committee to change frequently due to frequent changes in the composition of the coalition, preventing a narrow power center—the judges and the Bar representatives—from controlling the committee for long, as it does today (Erlich, 2023: 8–9.

As for judicial review of legislation, the opponents of the program claim that the override clause and limiting the Court's ability to invalidate laws to cases in which they contravene an express provision of a Basic Law may leave numerous rights, such as the right to freedom of expression, to equality, and to freedom of and from religion, no longer assured. The risk is that any chance majority in the Knesset would be able to override entitlements enshrined in Basic Laws, thus opening way to arbitrary legislation that would menace the most fundamental democratic principles. As for the composition of the Court that is needed to invalidate a law, the demand for a supermajority of justices would impair the legitimacy of statutes that are not invalidated but that, in the view of a majority of justices, should be invalidated (Barak-Koren, 2023: 15–19; Fuchs et al, 2023a, 12–25).

It is counter-argued that even though Israel has neither established a constitution nor given the Basic Laws explicit constitutional status, the Supreme Court has effectively reinforced the Basic Laws without authority to do so, unreasonably broadened its interpretation, and appropriated the right to strike down statutes by these means, all of which without broad social consent to any stage of the process. Therefore, it is important to establish that judicial review that may diminish elected officials' latitude be implemented with great restraint. In addition, the invalidation of basic laws by the Court is injurious to the future chances of enacting a constitution and the Court's growing involvement in legislation is harmful to the public's trust in the Court (Erlich, 2023: 4–5).

As for invalidating the reasonability standard, some claim that it serves as the sole instrument of control in decision-making in critical policy matters that entail some extent of control. Even in more mundane matters, eliminating the standard may result in the degradation of basic rights, particularly those relating to personal property, and encourage the Government to implement policies harmful to the public's welfare, such as unequal resource allocation for political motives. These changes would also do away with substantive control of the appointment and dismissal of senior officials, possibly promoting crony appointments and exacerbating corruption in the public service (Mordechai, 2023).

Even some opponents of the judicial overhaul have criticized the reasonability standard. Where it comes to general policy decisions, for example, it is claimed that the current situation, in which the High Court of Justice interferes with the executive branch's discretion with neither the professional expertise nor a public mandate to do so, is indeed faulty. The Court's ability to meddle in all matters creates continual uncertainty among legislators and members of the executive branch who do not know whether the policies they make together will be implemented as intended. This being the case, Barak-Koren claims that the use of the reasonability standard should be restricted so as to disallow judicial review of pronouncedly policy-related matters (Barak-Koren, 2023: 4, 20–21).[52] Proponents of the legislative changes who favor this provision believe that the reasonability standard allows the High Court and the Attorney General to promote political interests by introducing extraneous considerations that weaken the ability of the public's elected officials to implement their policies. The Supreme Court justices, it is claimed, discriminate in their interpretation of the reasonability standard in a way that comports with elected officials' political-party affiliation. In regard to appointments, too, the Court and the Attorney General invoke the reasonability argument in a non-equal way by disqualifying certain candidates for appointments in order to influence the identity of senior officials and the public service (Koppel, 2023).

[52] For example, raising taxes, social benefits, return of territories, release of prisoner agreements, and so on. Importantly, Barak-Koren does acknowledge the importance of the reasonability standard, including that relating to decisions of elected officials, but only in matters concerning authority and discrimination.

As for the proposed revisions of the institution of the legal advisor, the concern as a rule is that impairing the advisors' independence and authority would eliminate rule-of-law restraints on the executive branch. It is argued that subordinating the legal advisors to the political echelon may impair the quality of their decisions and taint their opinions with non-legal considerations, casting doubt on the soundness, reliability, and effectiveness of the bureaucracy. Legal advisors serve as watchdogs in their remits and need to make sure that the rule of law is upheld; therefore, any infringement of their independence would endanger the incidence of the rule of law on the executive (Luria and Benvenisti, 2023). Similarly, the proposal to amend the rule such as to make legal advisors' recommendations non-binding would most likely degrade the rule of law. There is also concern about appointing private attorneys to positions of trust: They may be snared in conflicts of interest and pollute their opinions to government ministers with additional and extraneous considerations that would impair the government's professionalism (Barak-Koren, 2023, 20–22).

Conversely, it is argued that the revisions are needed in order to avoid situations in which the legal advisor can veto government decisions in ways that transgress the principle of majority rule and the ability to implement policy. The current situation also ostensibly contravenes the tenet of matching power to responsibility by empowering legal advisors to invalidate policies while leaving responsibility for the implications of commission or omission in the hands of the political echelon. As a result, the legal advisor has no incentive to approve policies that benefit the public (Erlich, 2023: 9–10). According to a milder criticism, the state and the political echelon should be given additional power to express their views in legal matters, meaning *inter alia* that they should be able choose independent legal advisors to represent them (Barak-Koren, 2023, 20–24).

The opponents of the judicial overhaul claim that the constitutional situation in Israel is already exceptionally weak in restraints on the executive. We accept this argument. In all sixty-six countries surveyed, for example, at least one of the following constraints exists: a bicameral legislature, a president who has powers, a federative structure, a district-based electoral system, membership in the European Union, and subordination to the International Court of Human Rights. In Israel, none of these is in place (Cohen, 2018). In this context, it is also important to mention the absence of a constitution that would restrain the executive and the weakness of the Basic Laws, which are susceptible to amendment by a small majority (Fuchs and Kremnitzer, 2019, 68–69). This argument is further validated by the weakness of the legislative branch (the Knesset) in the Israeli model and its inability to supervise the executive (Navot, 2023; Friedman and Friedberg, 2023). From all the foregoing, it may be seen that all the countries examined have more mechanisms of restraint to parliamentary power than Israel has and that the judiciary is nearly the sole source of restraint to executive power (Cohen, 2018: 34; Fuchs et al., 2023b). Hence, it is feared that the decisive influence of a package of cumulative statutes that limits judicial review of the coalition will not steer the branches to a healthier equilibrium. Instead, it will deal a substantive blow to crucial characteristics of democracy; specifically, it will recalibrate the balance of forces so as to allow the coalition to operate under insufficient checks and balances.

Appendix B: Questions for Use in Calculating the Judicial Constraints to the Executive Segment of the WJP Index

The index is calculated by means of an average-of-average of five questions sent to experts and the three questions sent to citizens (Botero and Ponce, 2010: 39).

The wording of the questions that were sent to the experts follows (where otherwise not noted, the extent of agreement with the statement should be chosen):

1. In practice, the government's power is not concentrated in one person but is distributed among different independent branches, for instance the President or Prime Minister, the Congress or legislative body, and the judges.
2. The government always obeys the decisions of the high courts, even when they disagree with these decisions.
3. Please choose the statement that is closest to your views on how the judiciary operates in your country:
   (a) When legal questions or possible violations are raised, the judiciary reviews executive actions and uses its powers to declare government actions illegal or unconstitutional
   (b) The judiciary reviews executive actions, but is unwilling to take on politically sensitive issues and/or is limited in its effectiveness
   (c) The judiciary does not effectively review executive policy
   (d) Don't know/Not Applicable
4. In practice, the national courts in [Country] are free of political influence in their application of power**.**
5. Based on your experience, out of all the cases in which the government had an interest (as a litigant or third party), in what percentage (%) of them did the government exercise undue influence to affect the outcome of the case?
6. Please tell us how significant are the following problems faced by the criminal courts in the city where you live:
   — Lack of independence of the judiciary from the government's power.

Below are the questions sent to the public at large:

1. Please assume that one day the President decides to adopt a policy that is clearly against the [COUNTRY] Constitution: How likely are the courts to be able to stop the President's illegal actions?
2. In your opinion, most judges decide cases according to: What the government tells them to do/What powerful private interests tell them to do/What the law says.
3. Assume that a government officer makes a decision that is clearly illegal and unfair, and people complain against this decision before the judges: In practice, how likely is that the judges are able to stop the illegal decision?

Appendix C: Questions for Use in Calculating the Judicial Constraints to the Executive Segment of the V-Dem Index

A. Question: Do members of the executive (the head of state, the head of government, and cabinet ministers) respect the constitution?

Responses:

0 Members of the executive violate the constitution whenever they want to, without legal consequences.

1 Members of the executive violate most provisions of the constitution without legal consequences, but still must respect certain provisions.

2 Somewhere in between (1) and (3). Members of the executive would face legal consequences for violating most provisions of the constitution, but can disregard some provisions without any legal consequences.

3 Members of the executive rarely violate the constitution, and when it happens they face legal charges.

4 Members of the executive never violate the constitution.

B. Question: How often would you say the government complies with important decisions by other courts with which it disagrees?

Clarification: We are looking for a summary judgment for the entire judiciary, excluding the high court. You should consider judges on both ordinary courts and specialized courts.

Responses:

0 Never.

1 Seldom.

2 About half of the time.

3 Usually.

4 Always.

C. Question: How often would you say the government complies with important decisions of the high court with which it disagrees?

Responses:

0 Never.

1 Seldom.

2 About half of the time.

3 Usually.

4 Always.

D. Question: When the high court in the judicial system is ruling in cases that are salient to the government, how often would you say that it makes decisions that merely reflect government wishes regardless of its sincere view of the legal record?

Clarification: We are seeking to identify autonomous judicial decision-making and its absence. Decisions certainly can reflect government wishes without “merely reflecting” those wishes, i.e., a court can be autonomous when its decisions support the government’s position. This is because a court can be fairly persuaded that the government’s position is meritorious. By “merely reflect the wishes of the government” we mean that the court’s own view of the record, its sincere evaluation of the record, is irrelevant to the outcome. The court simply adopts the government’s position regardless of its sincere view of the record.

Responses:

0 Always.
1 Usually.
2 About half of the time.
3 Seldom.
4 Never.

E. Question: When judges not on the high court are ruling in cases that are salient to the government, how often would you say that their decisions merely reflect government wishes regardless of their sincere view of the legal record?

Responses:

0 Always.
1 Usually.
2 About half of the time.
3 Seldom.
4 Never.

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