

BOOK REVIEW: “THE TRANSITION TO ILLIBERAL DEMOCRACY:  
ECONOMIC DRIVERS AND CONSEQUENCES”

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In a recent interview with the New York Times, a former Israeli prime minister pointed out that “... in order to stay the strongest country in the Middle East, we also need to stay the strongest democracy in the Middle East”.<sup>3</sup> This remark might sound surprising given that the country is in the midst of a war that many observers have identified as threatening its very survival. A recent volume edited by Assaf Razin (2024) provides instead an economic perspective on why this argument is actually very plausible.

In “The Transition to Illiberal Democracy: Economic Drivers and Consequences”, a group of leading economists provide a compelling analysis of the recent attempts at weakening Israel’s democratic institutions, analyzing their causes and consequences.

Needless to say, the essay collection is both timely and insightful, and provides arguments for the optimists, but also for those who are very concerned for the future of both Israel and the Middle East more generally.

The immediate context is well known. After years of unstable governments, the cabinet formed by Prime Minister Netanyahu in December 2022, introduced proposals for a far reaching reform of the judiciary. Once these proposals became public, large swaths of Israel’s civil society took to the streets, and a months-long series of protests managed to significantly slow down the legislative progress of the reform. Then came the attacks of October 7, 2023; and for the time being the initiative has been “frozen”, while the country is engaged in its longest armed conflict.

Why have the proposed reforms been so controversial? Israel is a centralized parliamentary democracy, which lacks many of the checks on the executive powers that other democracies have, like a constitution, a bicameral parliamentary system, or a federal government structure. Legislative changes introduced in 2001 have induced some observers

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<sup>3</sup> “The Interview: Yair Lapid Says the World Misunderstands Israel”, The New York Times, April 27, 2024 available at <https://www.nytimes.com/2024/04/27/magazine/yair-lapid-interview.html>.

to argue that the Knesset has now a weak supervisory capacity over the executive, as several provisions significantly reduce the incentive for members of the majority to criticize a sitting government (Lurie et al. 2022).

The Netanyahu government's recent proposals were aimed at limiting the Supreme Court's ability to exercise judicial review and would enable the Knesset to override a Supreme Court ruling by simple majority. Importantly, they would also change the judicial appointment process. Currently, when there is a vacancy on the Court, a 9-member committee recommends a potential new judge to be formally appointed by the President of Israel. The committee is made up of three currently serving Supreme Court judges, two cabinet members, two members of the Knesset and two representatives of the Israel Bar Association. While this arrangement might look somewhat convoluted to an external observer, the rationale behind it is that in the absence of a formal constitution, it ensures that the legal profession holds a majority on the committee; and as a result, it can limit the government's influence on the judiciary. The proposed reform would instead see the majority of the members of the committee appointed directly or indirectly by the ruling coalition, essentially ending the separation of powers in Israel. This reform has thus been perceived as a life threat to democratic institutions, and has been compared to the autocratic developments recently experienced in countries like Hungary or Poland.

The first essay of the volume (Razin and Sadka, 2024) provides a broad overview of the economics of regime change, positioning the recent Israeli experience in the broader context of the populist wave that has swept through many democracies over the past couple of decades.

The second essay summarizes the literature on the link between judicial independence and economic performance. In a somewhat provocative discussion, Eichengreen (2024) argues that while the causal effect of democratic institutions on growth is not yet completely settled, he regards "... the relationship of judicial independence to growth as unambiguous". As a result, "... countries seeking to maintain economic stability and prosperity tamper with judicial independence at their peril."

While the literature on modernization has argued that economic growth can affect democratization and vice-versa, I am not aware of studies showing that the transition from a democratic government to an autocracy can improve a country's economic performance. With this in mind, Yuchtman's (2024) essay starts by highlighting how, "If Israel slides into autocracy, the consequences will be felt globally, by further polarizing a volatile region and undermining Israel's economic position as a global information technology hub." While Eichengreen's argument in favor of an independent judiciary focuses on its key role in enforcing contracts and protecting property rights, Yuchtman takes a broader perspective. Democracy – his argument goes – thrives because of institutions that go beyond the simple presence of formally democratic elections: they can be formal or informal, they can have been set up by government or civil society and they can be based on formal laws or commonly accepted norms. Judicial independence is key in supporting a thriving democracy because it allows these complementary institutions to work effectively, for example by protecting free

speech or the freedom of association, or the right to criticize or protest against the government. From this perspective, the mass protests sparked by the proposed reform of the Israeli judiciary can be seen as a manifestation of the de facto power of civil society in the country – and as an investment in maintaining this power. When the judiciary is no longer independent – like in the recent experience of Hong Kong – civil society’s ability to exercise its de facto power is greatly diminished, and formal democratic institutions are likely to turn into empty shells. The very fact that Israeli civil society has been able to sustain such a prolonged fight for the survival of an independent judiciary is a very positive development, which will hopefully prevent an authoritarian drift.

Eichengreen’s message that tampering with judicial institutions might have negative consequences for a country’s long run economic prospects is reinforced by the findings of Ater, Raz, and Spitzer (2024), who instead take a short run perspective. Specifically, their essay analyzes the performance of the Israeli financial markets between January 2022 and September 2023. Taking advantage of the fact that the country’s stock markets are dominated by a small number of large institutional investors and that the investors’ appetite for Israeli forex-neutralized funds has grown dramatically over the past ten years, they show that – before January 2023 - the S&P 500 Index could be used to precisely predict both the performance of the major index in the Tel Aviv Stock Exchange, and the US Dollar/NIS exchange rate. As a result, the behavior of the S&P 500 Index can be credibly used as a counterfactual against which the effect of local shocks can be assessed. Their analysis indicates that the proposed reform of the judiciary introduced in January 2023, and the uncertainty it created, led to a large excess depreciation in the NIS, together with significant losses in the value of Israeli stocks, reducing the prosperity of local households, already in the very short run.

Szeidl and Szucht (2024) illustrate how another institution is key to the working of liberal democracies: independent media. Focusing on the recent experience of Hungary under the Orban government, they show how a captured media can be used to develop alternative realities, channel pro-government propaganda, and discredit independent experts as a source of advice in public decision making. The resulting decline in the public’s trust toward science has important consequences, as exemplified by the public’s response to the COVID-19 pandemic, which saw government supporters less likely to get vaccinated as compared to supporters of the opposition.

What are the long run causes of the polarization we observe in Israel’s society? Ben-David and Kimhi (2024) provide an insightful and sobering analysis of the role played by demography and the educational system. The starting point of their study is that labor productivity in Israel falls below the OECD average. This is surprising given that the share of the population in Israel with an academic education is among the highest in the world. According to the authors, the main problem is represented by the low average quality of the education attained – as shown by consistently low PISA scores, and the very large inequalities that exist in the system, at all levels – i.e., in primary, secondary and tertiary education. One important additional feature of the Israeli school system is that differences in

academic achievement are related to religious affiliation. While non-religious Jewish pupils perform slightly above half of OECD countries, religious Jewish students perform significantly worse than the OECD average, and Arab Israeli pupils placed below nine out of the ten predominantly Muslim countries that took part in the 2018 PISA exams. The relationship between religious affiliation and academic performance tends to make these differences persistent over time and across generations, resulting in intergenerational educational mobility in Israel being lower than in many other advanced economies. Inequalities in educational attainment are then reflected in large differences in income, resulting in sections of the religious population – especially among the ultra-Orthodox (Haredim) remaining - according to Ben David and Kimhi - “financially dependent in perpetuity on government benefits secured by the politically powerful Haredi parties”.

This argument is further developed in the last essay of the book (Yashiv, 2024), which also emphasizes the key role played by differences in fertility rates among the various subgroups of the population. In particular, as fertility is higher among the more religious groups, the inequalities discussed by Ben-David and Kimhi might well grow over time, and as a result, a further increase in the level of political conflict in Israel’s society cannot be ruled out. The long term consequences of such a development could be dear – the basic social contract might be undermined, with the possibility of a breakup of the country into a secular, democratic Israel, and a clerical, non-democratic Judea in conflict with each other.

The essays of this timely volume offer a clear discussion of some of the main challenges faced by Israel today, highlighting commonalities and differences from the experience of other democracies threatened by authoritarian forces. They also provide arguments both for concern and for optimism about the country’s future.

The cultural and demographic forces that are behind many of the current struggles and that are somewhat unique to the country’s history are unlikely to disappear in the short run. The presence of large groups of religious conservatives, often not fully integrated in the market economy and living off government subsidies is problematic for democratic institutions. As Yashiv (2024) points out “Populist and religious conservatives... share goals that are anti-democratic, and are ready to redistribute resources from productive sectors and groups to their own sectors, or groups, shamelessly.” While these groups are active also in other contexts, the unique history of Israel, and in particular the lack of a formal separation between state and religious institutions, has made this problem particularly acute and a simple solution hard to come by.

The large inequalities in educational attainments that exist both between the different ethnic groups, but also within the Israeli Jewish majority are also very concerning. A number of different factors contribute to the situation, but importantly they have all led to levels of intergenerational educational mobility that fall significantly below those of the leading OECD countries (Ben-David and Kimhi 2024). If we believe in the De Tocqueville (1835)

hypothesis<sup>4</sup> that actual and perceived social mobility are key to the stability of democratic institutions, this is another source of concern for the future. Policies aimed at reducing educational inequality can thus play a potentially very important role, but they might meet the opposition of religious conservatives, who have traditionally found a more modern and market oriented school curriculum nonappealing.

On the brighter side, the months-long protests that saw the sustained mobilization of hundreds of thousands of civilians between January and September 2023 are a sign that Israel's civil society is vigilant and willing to work hard to defend the institutions that have made the country the Middle East's leading democracy. This gives hope that the autocratic drift that has been experienced by many other recently established democracies might be contained in Israel. While protests can be indeed seen as an investment by the civil society in its de facto power (Yuchtman 2024), the return to this – as all other investments - is intrinsically uncertain. In the case of Israel this uncertainty is compounded by external threats and geopolitical instability, which might end up deterring civil society's engagement.

Looking forward, the analysis carried out in the volume provides support to the idea that making democracy stronger is indeed necessary to ensuring the future success of Israel. At a very basic level, the country has been built by immigrant *olim*, but unless it is able to continue to offer opportunities to the best and brightest of its citizens, emigrant *yordim* might become increasingly common. In fact, in 2023 net emigration from Israel was up and 30,000 more people left the country than entered it.<sup>5</sup> While I have not yet seen a careful analysis of who the recent emigrants are, anecdotal evidence indicates that highly skilled workers have started to leave (Yashiv 2024), as they would find a hollow democracy a place in which they would enjoy no political or economic future. If the talents behind Israel's recent economic success move away, this will weaken the country and make the whole Middle-East more unstable.

<sup>4</sup> For some cautionary notes on the limits of de Tocqueville's argument, see the recent work by Acemoglu, Egorov and Sonin (2018). For a cross-country empirical assessment of the link between social mobility and political stability, see Houle (2017).

<sup>5</sup> "Israel's emigration rate jumps as it learns to count", Dror Marmor in Globes, 26 February 2024.

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