

CHAPTER XVII

THE FINANCIAL TRANSACTIONS OF THE GOVERNMENT

THERE WAS a considerable fall in Government expenditure on defence in 1957, while there was a rise in expenditure on the absorption of immigration, chiefly immigrant housing, as compared with 1956. Revenue from taxes and other compulsory payments increased substantially; but inflationary pressure still emanated from the financial transactions of the Government, if to a lesser extent than in 1956.

The fall in defence expenditure reduced considerably Government purchases from abroad. The intensified expenditure on immigrant absorption was mainly effected by financing the demand of the public through the granting of loans from the Development budget. As a result, there was a decline in direct Government purchases of goods and services. On the other hand, there was a considerable increase in revenue from taxes and other compulsory contributions which, in 1957, were collected over the whole year. This was the result of the increase in rates and the expansion in the volume of taxes, which came into force in 1956 following the worsening defence situation. However, despite the increase in revenue from taxes and from other compulsory contributions collected from the public, these revenues were inadequate to finance total Government purchases of goods and services at home and abroad, and there remained a gap of IL. 79 million between taxes and purchases. This gap narrowed considerably as compared with the partial data available for April–December 1956.

Whereas the sum total of goods and services purchased by the Government decreased, there was no decline in purchases from the public at home. And, parallel to the increase in the collection of taxes and of compulsory contributions from the public, there was a considerable rise in loans granted to the public from the Development budget. In 1957, these were the principal changes in the financial relations between the Government and the public. As a result of these changes, the net flow of Government payments to the public, in excess of collections from it, was IL. 140 million, thus increasing the public's liquidity by this amount. These surplus payments were financed by the surplus of receipts over payments from abroad amounting to IL. 86 million, and by credit from the banking system, totalling IL. 54 million. According to partial data available for April–December 1956, it appears that, in 1957, surplus payments by the Government to the public were lower than those in the previous year. Moreover, a striking change occurred in the form of financing: whereas in 1956 about one-

third of surplus payments to the public were financed by receipts from abroad, and the remaining two-thirds by the banking system, the ratio of these two sources was reversed in 1957. It should be borne in mind that the increase in liquidity was caused in part by the transfer of Government receipts from abroad to the public.

The data relating to the financial transactions of the Government allow the use of two indicators to measure the inflationary pressure which resulted from these activity in 1957. One indicator measures the effect of the Government sector on the total demand of the economy, as a factor restraining the demand of the public through tax collection and other compulsory contributions reducing its income, on the one hand; and as a factor using part of the resources available to the economy, on the other hand. The second indicator measures the impact of the financial transactions of the Government on the demand of the public through changes in its liquidity. The effect of Government activities on the public's liquidity is arrived at by comparing total Government payments to the public, including the loans granted from the Development budget, with the total receipts from it, either for services rendered or for financial transactions.

Both indicators, the rise of IL. 79 million in total demand and the increase of IL. 140 million in the public's liquidity, point to the inflationary pressure which emanated in 1957 from the financial transactions of the Government. The import surplus from abroad curbed the impact of the inflationary pressure on the price level.

1. THE "BALANCE OF PAYMENTS" OF THE GOVERNMENT

In this chapter, an attempt will be made to draw up a "balance of payments" for the Government covering, as far as available data permit, all the financial transactions of the Government with the rest of the world, with banking institutions and with the public. Furthermore, an attempt has been made to classify these transactions according to the type of receipts and payments, distinguishing between transfers of goods and services, and financial transactions.

It should be stressed that, as long as no consolidated balance sheet of the central Government, the local authorities and the national institution is available, it will be difficult to give a clear and reliable picture of the interaction of these bodies in the financial field. The same difficulty arises as regards the transactions of these public bodies with the other sectors of the economy.

In order to get as comprehensive a picture as possible, all money flows between the Government and the other sectors have been shown as gross values for most items of receipts and payments. Contrary to the practice adopted in the reports of the Accountant-General of the Ministry of Finance, both sides of the balance sheet include the participation of the Jewish Agency in the financing of building carried out by the Housing Department of the Ministry of Labour, the expenditure of the National Insurance Institute, income from equalization funds, re-

imburement of taxes, receivable income, etc. On the other hand, trading enterprises of the Government (the railways, postal services and harbours) have not been included in the "balance of payments", apart from their trading profits or deficit. Income from financial transactions of the Government and the Reparations Corporation in their capacity as importers, say of food, have also been excluded, apart from profits or losses from these transactions and of changes in their stocks. The "balance of payments" covers all money flows and is also based, in addition to the reports and accounts of the implementation of the Ordinary and Development budgets, on the accounts included in the reports of the Accountant-General "Current Assets and Liabilities" of the Ministry of Finance. Apart from recording all Government transactions which are not reflected by the budgets, the inclusion of current assets and liabilities permits their recording according to the timing of payments to the Government.¹

2. THE MAIN TYPES OF RECEIPTS AND PAYMENTS

Table XVII-2 shows the "balance of payments" of the Government by types of receipts and payments. Even though data for the whole of 1957 are not comparable with those for April-December 1956 shown here, a very general comparison for these two years may be attempted. Whereas it would appear that no considerable change occurred in the total volume of receipts and payments for these two years, a number of important changes in their composition may be outlined.

The decline in Government expenditure on defence, following the Sinai campaign, brought about a fall in Government purchases from abroad. On the other hand, substantial increases were recorded in the other expenditure items: subsidies for consumer goods, loans from the Development budget and the repayment of long-term debts, chiefly to the rest of the world.

On the receipts side, the rise in revenue from taxes and other compulsory contributions stands out, mainly from income tax, defence tax and levies. Credit and net loans granted to the Government continued to rise, by IL. 109 million. This increase was, however, smaller than the rise which occurred in 1956: the scope of Government financing through an increase in indebtedness is beginning to show a decline. This is particularly true for the decline in the financing through short-term credit. It applies to the decline in short-term credit from abroad, and to the shift from the expansion of short-term credit from the banking system to that in long-term bank credit through the funding of part of the current advances of the Bank of Israel into a long-term defence loan.

¹ A more detailed explanation of the preparation of the balance of payments will be found in Chapter XX of the Annual Report 1956, where such a balance sheet for April-December 1956 is published for the first time. However, as the "balance of payments" for 1957 records gross values, more so than for April-December, these two balance sheets are not strictly comparable.

Table XVII-1 summarizes the increase in Government indebtedness by sectors, e.g. to the rest of the world, to the public in Israel, to the banking system and to the national institutions.

TABLE XVII-1
*Increase or Decrease (-) in Government Indebtedness, 1957**
(millions of IL.)

	<i>Long-term loans</i>			<i>Short-term loans (net)</i>
	<i>Amount received</i>	<i>Amount repaid</i>	<i>Net increase (1)-(2)</i>	
	<i>(1)</i>	<i>(2)</i>	<i>(3)</i>	
The rest of the world	109.0	49.2	59.8	2.3
The public	42.4	6.7	35.7	- 6.0
The banking system	65.0	—	65.0	-11.2
The national institutions	—	—	—	-36.6
<i>Total</i>	216.4	55.9	160.5	-51.5

SOURCE: Based on data submitted by the Accountant General, Ministry of Finance.
 * Excluding changes in indebtedness not reflected in the flow of receipts and payments.

3. THE FINANCIAL RELATIONS OF THE GOVERNMENT WITH THE OTHER SECTORS

Table XVII-3 shows the "balance of payments" of the Government with the other sectors; i.e. with the rest of the world, with the public and with the banking system. The relations with the public cover: (a) Government payments to the local authorities and the national institutions on the assumption that these flows are immediately transferred to the public; and (b) the participation of the Jewish Agency in the Government Housing Budget, assuming that this participation is rendered possible by receipts from the public and from the Government. This approach allows an analysis of the Government "balance of payments", despite the fact that no consolidated balance sheet covering the financial transactions of the public sector with the other sectors has so far been drawn up.

The Government "balance of payments" with the other sectors renders possible the analysis of Government activities as purchaser in the market of goods and services, as compared with Government activities intended to restrain the public's demand for resources which the Government itself intends to use. The most efficient measure at the disposal of the Government for the reduction of the demand of the public is to cut private income through taxes and other compulsory contributions. The gap between Government purchases of goods and services at home and abroad, and the reduction of private income through taxes

TABLE XVII-2

The "Balance of Payments" of the Government by Type of Transaction, 1957^a

(millions of IL.)

RECEIPTS		PAYMENTS	
<i>Transfers and transactions in goods and services on current and on capital account</i>			
Revenue from taxes and other compulsory contributions ^b	705.2	Purchases of goods and services on current account	488.8
Transfer payments from the public	10.4	Purchases of goods and services on capital account	118.1
Grants from the national institutions	47.4	Transfer payments	
Unrequited receipts from the rest of the world	140.1	to the public	71.7
		to local authorities	18.7
		Subsidies	97.1
Total	903.1	Total	794.4
<i>Transactions in financial assets</i>			
Long-term loans	216.4	Long-term loans from the Development Budget	254.5
Collections on account of loans	36.8	Repayment of long-term loans	55.9
		Repayment of advances made by national institutions	36.6
		Repayment of short-term loans (net)	14.9
Total	253.2	Total	361.9
<i>Total receipts</i>	1,156.3	<i>Total payments</i>	1,156.3

SOURCE: Based on data submitted by the Accountant General, Ministry of Finance.

^a A note on definitions and methods will be published shortly.^b Including income from equalization funds which are intended for subsidies.

TABLE XVII-3
The "Balance of Payments" of the Government, by Sectors,^a 1957
(millions of IL.)

PAYMENTS	RECEIPTS		
	<i>The Rest of the World</i>		
Unrequited receipts	140.1	Purchases of goods and services	
Long-term loans	109.0	on current account	84.7
Short-term loans (net)	2.3	on capital account ^b	31.1
			<hr/>
		Repayment of long-term loans	49.2
Total	<hr/> 251.4	Total	<hr/> 165.0
	<i>The Public</i>		
Taxes and other compulsory contributions	715.6	Purchases of goods and services	
Collections on account of loans	36.8	on current account	404.1
Long-term loans	42.4	on capital account	87.0
			<hr/>
Grants from national institutions	47.4	Transfer payments	
		to individuals	71.7
		to local authorities	18.7
			<hr/>
		Subsidies	97.1
		Long-term loans	254.5
		Repayment of long-term loans	6.7
		Repayment of short-term loans (net)	6.0
		Repayment of advances made by the institutions	36.6
Total	<hr/> 842.2		<hr/> 982.4
	<i>The Banking System</i>		
Credit (net) ^c	53.8		

SOURCE: Based on data submitted by the Accountant General, Ministry of Finance.

^a A note on definitions and methods will be published shortly.

^b Estimate.

^c Including credit for IL.11 million from foreign exchange deposits received from the rest of the world and designed for loans to the Government.

and compulsory contributions, may well indicate the excess demand created in the economy by Government transactions. In 1957, this gap amounted to about IL. 79 million, as shown in Table XVII-4.

TABLE XVII-4
Government Purchases, Taxes and Compulsory Contributions, 1956-1957
(millions of IL.)

	<i>April-December 1956</i>	<i>1957</i>
Purchases of goods and services at home and from the rest of the world	536.6	606.9
Taxes and other compulsory contributions (net)*	355.9	528.1
<i>The gap</i>	180.7	78.8

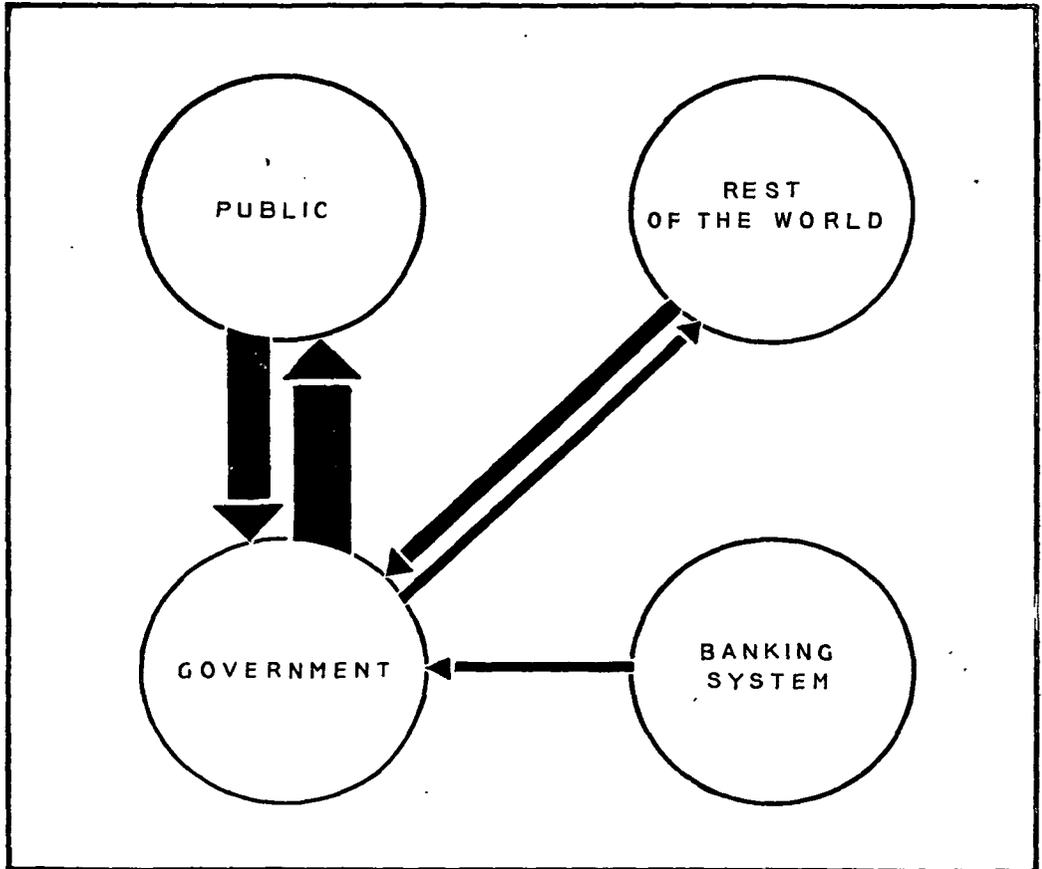
SOURCE: Based on data submitted by the Accountant General, Ministry of Finance.
* Revenue from taxes and other compulsory contributions and transfers from the public, less transfer payments and subsidies by the Government.

It would, therefore, appear that the excess demand created by the Government sector declined considerably more than the surplus (measured in the same way) for the April-December 1956 period, when it amounted to about IL. 181 million. This excess demand can serve as an indicator of the inflationary pressure generated by Government transactions. It is not possible, however, to infer the factors which made for an increase in the price level only from the existence of this inflationary pressure. For this purpose, the financial transaction of the rest of the economy with the rest of the world have to be included. The existence of an import surplus, partly rendered possible by unrequited receipts and long-term loans to the Government, weakened considerably the impact of the inflationary pressures on the price level, emanating both from the Government and from the public.

It should be stressed that this is only one way of measuring the inflationary pressure generated by the Government. The Government also used means of restraining the demand of the public, mainly by long-term loans from the public and, in particular, through the issue of securities. On the other hand, it should be borne in mind that, in Israel, the distinction between direct Government demand for goods and services and the financing of the public's demand through loans from the Development budget is somewhat arbitrary. First, in the long run, that part of these loans granted to public development enterprises will probably be transformed into grants. Secondly, the difference between direct Government investments and the investment activities of Government agencies in many cases is provisional and likely to change.

DIAGRAM XVII-1

Money Flows^a between the Government and the Other Sectors



^a Thickness of arrow corresponds to magnitude of the flow.

It may, therefore, be better to take the impact of Government activities on the public's liquidity as a more comprehensive indicator. This indicator compares total Government payments to the public with the public's payments to the Government. It does not dwell upon the distinction in principle of whether these flows affect the income of the public or the composition of its assets, and whether they affect the demand of the public in the same way.

The summary of the financial transaction between the Government and the public as shown in Table XVII-5 shows that, in 1957 the surplus of Government payments over Government receipts from the public amounted to about IL. 140 million. About two-thirds of these surplus payments were financed by counterpart funds of non-required receipts and through loans from abroad,

which was the main source of income of the Development budget. The remaining third of the surplus payments to the public was financed through credit granted by the banking system.

TABLE XVII-5
*Government Payments to and Receipts from the Public,
 and the Financing of the Difference, 1957*
 (millions of IL.)

<i>Payments</i>		
Goods and services	491.1	
Loans and credits (net)	224.6	715.7
<i>Receipts</i>		
Compulsory contributions, transfer payments and grants by national institutions (net)		575.5
<i>Excess payments over receipts</i>		140.2
<i>Financing of the Difference</i>		
From the rest of the world (net)	86.4	
From the banking system (net)	53.8	140.2

SOURCE: Based on data submitted by the Accountant General, Ministry of Finance.

Total government payments to the public¹ amounted to about IL. 992 million. About half of this amount was spent on the payments of salaries to civil servants and on the purchase of goods and services abroad. The flow of about IL. 255 million to the public represented long-term loans from the Development budget. Table XVII-6 shows the destination of loans from the Development budget granted to the public.

About IL. 97 million were transferred to the public in the form of subsidies, mainly in order to lower the prices of consumer goods and of exports. Transfer payments to individuals accounted for IL. 72 million. Government payments to the Jewish Agency and to the local authorities amounted to about IL. 55 million. After offsetting the financial transactions between the public and the Government, a net flow of IL. 225 million is arrived at, which was transferred to the public as debt repayment and as long-term loans. This amount, in addition to the IL. 491 million representing payments for the flow of goods and services from the public, bring the amount of total net payments to the public to about IL. 716 million.

¹ Before the offsetting of financial transactions.

TABLE XVII-6
*Loans Granted under the Development Budget,
 by Type of Borrower, 1957*

<i>Borrower</i>	<i>Million IL.</i>	<i>Percentages</i>
Government Corporations ^a	97.9	38.5
National institutions	43.6	17.1
Local authorities	9.5	3.7
The public	103.5	40.7
<i>Total</i>	254.5	100.0

SOURCE: Based on data submitted by the Accountant General, Ministry of Finance.
^a Corporations in which the Government is the major shareholder. Including, in addition to corporations listed in the explanatory remarks to the proposed budget for 1958/59, the "Mekoroth" Water Co. Ltd.

On the other hand, the Government collected from the public about IL. 725 million in taxes, compulsory contributions and in transfer payments. In addition, the Government received IL. 47 million from the national institutions, and about IL. 42 million in long-term loans—through the issue of securities—from the public. Collections from the public on account of loans represented about IL. 37 million. The net sum drained from the public—after deduction of transfer payments and subsidies from taxes and compulsory contributions—was IL. 576 million, while the gap between receipts and payments represented about IL. 140 million.

This gap was financed through a surplus of receipts over payments from abroad to the value of IL. 86 million. The surplus was created through unrequited receipts of the Government for about IL. 140 million, long-term loans amounting to about IL. 109 million and short-term credit amounting to IL. 2 million. Against these receipts—IL. 251 million—the Government paid IL. 165 million, including IL. 116 million for purchases of goods and services abroad, and repaid long-term loans to the amount of IL. 49 million.

The balance of surplus payments between the public and the Government was financed through credit—amounting to IL. 54 million—extended by the banking system.

4. FISCAL POLICY

In 1957, Government revenue from taxes was IL. 518 million, representing 19 per cent of private income. In 1957 the corresponding revenue amounted to IL. 426 million or 18.8 per cent. Revenue from taxes rose between 1956 and 1957 by IL. 92 million, an increase of 21.6 per cent. Private income rose by IL. 463 million, or 20.4 per cent. The rate of increase in revenue from taxes thus exceeded that of private income. However, the rise in tax revenue was inadequate

to prevent a considerable increase in demand. As a result, fiscal policy, besides the monetary policy of the Government, were among the main factors contributing to the high level of economic activity and to the inflationary pressure felt in the economy.

These data are, however, not fully representative of the rate of increase of Government income for the fiscal year 1957/58, as a relatively larger share of collections, and in particular of income tax, was received during this fiscal year in January–March 1958.

In Israel, the decisions relating to the volume of Government expenditure are to a large extent determined by social considerations. The Government is also guided by these considerations when determining the amount which can be drained from the population in taxes and loans. As a result, a gap may be created between Government expenditure and income which represents the Government deficit. In 1957, the Government deficit was financed through capital imports from abroad and through bank credit—mainly credit granted by the Bank of Israel.

Purely fiscal considerations determine in the main the decisions relating to the different forms of tax collecting.

There was a notable tendency in recent years towards an increase in the share of indirect taxes relative to direct¹ taxes. This tendency was not apparent in 1957 owing to the influence of the defence tax, a direct tax which was provisionally imposed as a result of the special defence expenditure. This tendency was mainly reflected in fiscal legislation designed to reduce the rates of direct taxes and to increase the number of commodities liable to indirect taxation.

The defence tax was collected over the whole of 1957: in 1956 it was levied only during part of the year. As a result, the share of direct taxes within total tax revenue rose from 45.3 per cent in 1956 to 46.6 per cent in 1957, whereas indirect taxes fell from 49.5 per cent to 48.5 per cent. Transfer taxes and licence fees fell from 5.2 per cent to 4.9 per cent. With the exception of the defence tax, the percentage share of direct taxes fell from 43.3 per cent to 41.7 per cent and that of indirect taxes rose from 51.3 per cent to 52.9 per cent.

Table XVII-7 shows tax revenue by source as well as the increase in revenue from taxes for 1956 and 1957.

The tendency in favour of the higher share of indirect taxes was due to the realization of the limitations inherent in direct taxation, mainly taxes on income. There was also a desire to increase the share of taxes on expenditure, principally in the form of indirect taxation. The policy which influenced this tendency is chiefly based on the assumption that, whereas tax rates on low and

¹ In this chapter the definition of direct taxes differs from that given in Chapter II, Resources, Product and National Income. In accordance with the U.N. definition, taxes as defined in Chapter II include national insurance and the reservists' fund, while property, land and inheritance taxes are excluded. The latter are, however, included in this Chapter.

TABLE XVII-7
Revenue from Taxes, 1956-1957

	1956		1957		Increase or de- crease (-)
	Million IL.	Per- centages	Million IL.	Per- centages	
<i>Direct taxes</i>					
Income tax	173,943		197,669		13.6
Defence tax	15,602		34,068		118.4
Property tax—urban	2,868		3,408		18.8
Property tax—rural	809		1,220		50.8
Land betterment tax	598		1,088		81.9
Inheritance tax	255		568		122.7
<i>Total direct taxes</i>	194,075	45.5	238,021	46.0	22.6
<i>Indirect taxes</i>					
Customs: General	79,779		92,564		16.0
Fuel	34,420		35,710		3.7
Excise: Cement	21,062		27,074		28.5
Tobacco	20,349		26,002		27.8
Tyres	1,893		2,525		33.4
Alcoholic beverages	9,143		10,831		18.5
Miscellaneous	18		28		55.6
Purchase tax	38,786		52,397		35.1
Foreign travel tax	2,701		3,721		37.8
Entertainment stamp tax	3,662		4,253		16.1
<i>Total indirect taxes</i>	211,813	49.7	255,105	49.2	20.4
<i>License fees and services</i>					
License fees: Radio	1,609		1,364		- 15.2
Vehicles	5,556		5,786		4.1
Drivers	362		957		164.4
Land registry	2,362		3,648		54.4
Stamp tax	4,945		6,523		31.9
Court fees	2,950		2,953		0.1
Other licenses and fees	2,431		3,777		55.4
<i>Total license fees and services</i>	20,215	4.8	25,008	4.8	23.7
<i>Grand total</i>	426,103	100.0	518,134	100.0	21.6

high income brackets are not exaggerated, the rates imposed in Israel on medium incomes are so high as to deter the will to work. These tax rates are also inclined to affect tax morale and lead to pressure by groups of employees for the granting of special tax relief. Apart from the shift to indirect forms of taxation, direct tax policy showed a tendency towards a reduction in tax rates, abolishing at the

same time special tax relief and reductions. The aim is the unification of direct tax rates as regards the population as a whole.

The tax authorities consider that there is scope to increase the number of taxpayers, to improve collecting methods and to raise tax morale. It is expected that as a result of these measures revenue will increase and will compensate for the loss of income through lower rates.

The direct taxation system was modified in 1957, when an exemption and allowance system was substituted for the tax credit system. According to the old system, allowances for marital status, paternity, age, professional expenditure etc., were deducted from the sum the taxpayer had to pay. The exemption and allowance system, on the other hand, provides for a deduction from assessable income before tax. The reduction in the amount of assessable income will result in a decline in the sum payable by the taxpayer by an amount which will rise together with an increase in income.

The principal purpose of this modification is to benefit those in the medium income brackets, mainly between IL. 4,000 and IL. 12,000 a year. In 1957, the marginal rates of income tax including the direct defence tax, which was also progressive relative to income, were as follows: 35 per cent of annual income of IL. 4,800, 47 per cent of annual incomes of IL. 6,000, and 55 per cent and 59 per cent of the annual income brackets of IL. 7,200 and IL. 8,400 respectively. These rates applied to heads of families with two children. As a result of these high marginal rates, even average tax rates remained high. They were 25.3 per cent for annual incomes of IL. 7,200 and 29.6 per cent for annual incomes of IL. 8,400.

The tendency towards the expansion of indirect taxation was reflected by the increased number of commodities liable to these taxes. In 1957, duties were imposed for the first time on raw materials for the plastics industry, at a rate of 45 per cent. Duties on carded wool represented 30 per cent and those on rayon were 30 per cent. The rate of exchange for imported chemicals was fixed at \$1=IL.1.800 in place of IL. 1.00=\$1.00. Imposts on tools, such as hammers and picks etc. were introduced. These taxes were largely fiscal in character. But they also have a general economic implication insofar as they lead to higher prices for imported raw materials. They further result in changes in the price relation of foreign and home-produced products, thus restraining the consumption of commodities so taxed.

The rates of purchase tax were also raised on certain commodities. The main forms of the tax raise were the levying of imports on imported goods; purchase taxes on finished products and levies which can be imposed at every stage of production, beginning with the raw material and ending with the finished product.