Chapter 6
The General Government and its Financing

- The central government's deficit totaled 3.7 percent of GDP, which exceeded the budget ceiling and the 2018 deficit by 0.8 percent of GDP. The general government's deficit continued to expand this year and reached 4.5 percent of GDP, even though GDP and its growth rate were close to their potential levels.
- The 2019 budget was approved nine months earlier than usual. This made it easier for the government to operate in 2019 even though elections were declared and it became a transitional government.
- The (gross) public debt to GDP ratio declined by one percentage point this year despite the large deficit, thanks to the reduction in government reserves at the Bank of Israel, the improvement in the terms of trade, the moderate increase in the CPI, and the appreciation of the shekel.
- The rate of expansion in public expenditure was more moderate this year, following a rapid expansion in previous years. However, it remained higher than the rate set by the expenditure rule, as a result of the government decision to raise the ceiling to beyond the level set by the rule.
- Primary civilian expenditure accounts for 32.6 percent of GDP. Since 2015, it has grown by about 1.9 percent of GDP, but remains among the lowest in the OECD. Only a small proportion of the gap with other OECD countries is due to differences in demographic composition between Israel and the other developed countries.

1. MAIN DEVELOPMENTS

The general government deficit continued to grow this year, to 4.5 percent of GDP. The expansion of the deficit since 2015 reflects a combination of reduced tax revenues and an increase in public expenditure.

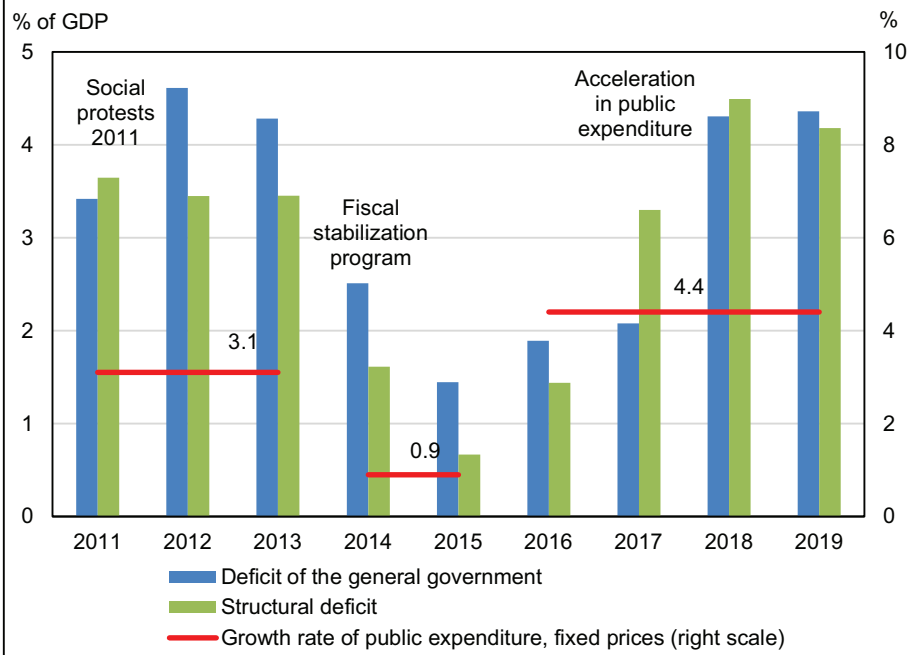
The deficit of the general government[1] continued to grow this year, reaching a level of 4.5 percent of GDP, similar to its level at the beginning of the decade, prior to the fiscal stabilization in 2013 and 2014 (Figure 6.1) and 3.1 percentage points higher than its level in 2015, when the 34th government was sworn in.[2] The growth of the general government's deficit was the result of an increase of 1.5 percent of GDP in public expenditure since 2015, a result of government decisions to allocate resources toward social and economic objectives that were part of the coalition agreement when the government was formed, and of a drop of 1.6 percent of GDP in revenues as a result of the lowering of tax rates (Table 6.1). The deficit has grown continuously even though the economy is at full employment and output has grown beyond what was forecast for the period. The government's budget deficit grew to 3.7 percent of GDP this year, which is 0.8 percent of GDP higher than the target set by the government and the deficit in 2018, despite the rapid growth. The deficit of the local governments has also grown during the past two years. Despite the growth in the deficit, the ratio of (gross) public debt to GDP declined by one percentage point, primarily due to the reduction in government balances with the Bank of Israel and a rapid increase in output prices due to the improvement in the terms of trade and the appreciation of the shekel.

The government decision to increase public expenditure alongside a reduction of tax rates led to an increase in aggregate demand and a reduction in inequality, and has supported an increase in GDP in recent years. However, it also led to a sharp increase in the structural deficit. Although windfall revenues in 2016 and 2017 allowed the

[1] The general government deficit is based on the National Accounts rules and includes the government deficit plus the deficit of the National Insurance Institute, the national institutions, the local authorities, and public non-profit organizations. The calculation of the government deficit differs from that of the State Budget. Although it is based on the budget data, part of the expenditure is calculated differently. For example, the interest on the public debt is calculated on a cumulative basis, i.e. total commitment for interest payments during the reporting year, rather than actual payments as in the case of the State Budget. In 2019, the central government deficit (plus the surplus from the activity of the National Insurance Institute) in the calculation of the general government deficit was 4.0 percent of GDP, compared with a budget deficit of 3.7 percent of GDP. To this is added the deficit of the local authorities, which totaled 0.3 percent of GDP and the deficit of the public non-profit organizations, which totaled about 0.1 percent of GDP. The detailed calculation can be found in Table 6.A.9 in the appendix to this report.

[2] According to the definition of the Central Bureau of Statistics (hereinafter: CBS), the deficit of the general government was about 4.0 percent of GDP. The reason for the difference is that the CBS deducts revenues from land sales from public investment because, according to its interpretation of international accounting rules, land sales constitute a negative government investment. Most OECD countries have had negligible revenues of this kind in recent years. (The OECD average is 0.05 percent of GDP; the deduction reflects activity such as sales of farmland that the State had developed, as in Poland, or the purchase and renovation of public housing units followed by their sale to eligible individuals, as in the Netherlands.) In Israel, in contrast, these revenues originate from the sales of land historically owned by the State, i.e., realization of assets, and are estimated at 0.5 percent of GDP. Since the realization of assets is essentially a financing activity and sales have been quite volatile in recent years, we present public expenditure without the deduction in order to reflect the macroeconomic effect of government activity, and land sales are presented as a financing line, which offsets the increase in the debt.

Figure 6.1
Acceleration in Public Expenditure from 2016 to 2019, and expansion of the structural deficit, 2011 to 2019



SOURCE: Based on Central Bureau of Statistics data.

government to maintain a relatively low deficit, there were no such windfalls in 2018 and 2019 and the deficit rose sharply, converging to the level of the structural deficit. The decline in the debt-to-GDP ratio until two years ago was driven by the rapid growth in GDP, and gave the government fiscal room to maneuver in order to deal with crises. However, the procyclical path chosen by the government—a rapid increase in expenditure and a reduction of tax rates while the economy is in an expansionary phase—did not make it possible to fix the deficit at a stable long-term level.

The approval of the 2019 budget early in 2018 and prior to the dispersal of the Knesset made it easier for the public sector to operate this year.

During 2019, Israel had a transitional government, following two sets of elections (one in April and one in September) that did not enable the formation of a government. The government approved the 2019 budget about nine months earlier than usual, thus making it easier for the public sector to continue operating and allowing it to avoid operating under the restrictive framework of a transitional budget up until the beginning of 2020. Nonetheless, the early approval of the budget required a major update of the approved expenditure plan at the beginning of 2019. Since the planned measures to increase revenues were canceled or cut back during the time that had passed from the approval of the budget until the beginning of the year, the deficit exceeded its target, as mentioned, even though the growth in GDP and wages, which increased tax revenues, were actually somewhat higher than forecast in the original budget.

Table 6.1
The main components of the general government's revenue and expenditures, 2013–19

(percent of GDP)

	2013	2014	2015	2016	2017	2018	2019
Total public revenue	**36.3**	**36.5**	**36.8**	**36.3**	**37.5**	**35.9**	**35.2**
Income from property	0.8	0.7	0.7	0.5	0.6	0.5	0.5
Total taxes	**30.6**	**30.8**	**31.1**	**31.0**	**32.3**	**30.8**	**30.3**
Indirect taxes on domestic production	12.0	12.0	12.2	11.5	11.9	11.8	11.5
Indirect taxes on civilian imports	3.4	3.7	3.4	3.9	3.1	3.2	3.0
Direct taxes, fees and levies	10.1	10.0	10.3	10.4	12.1	10.7	10.5
National Insurance Institute revenue	5.1	5.1	5.1	5.2	5.3	5.2	5.3
Grants	1.3	1.3	1.4	1.4	1.1	1.1	1.0
Other[a]	3.6	3.6	3.5	3.5	3.5	3.5	3.4
Total public expenditure[b]	**40.6**	**39.0**	**38.2**	**38.2**	**39.6**	**40.2**	**39.7**
Current expenditure	36.4	35.1	34.5	34.3	35.2	35.8	35.5
Domestic civilian consumption	17.1	17.0	16.9	17.0	17.5	17.8	17.8
Domestic defense consumption	4.6	4.5	4.4	4.3	4.4	4.5	4.4
Defense imports	1.0	1.0	1.0	1.0	0.7	0.7	0.7
Direct subsidies	0.7	0.7	0.7	0.7	0.8	0.9	1.0
Transfer payments on current account	9.5	9.4	9.4	9.3	9.7	9.6	9.6
Interest payments[c]	3.5	2.5	2.1	2.1	2.2	2.4	2.1
Transfer payments on capital account[d]	1.9	1.8	1.7	1.6	1.8	1.8	1.8
Investments of the general government[b,i]	3.6	3.4	3.2	3.4	3.7	3.8	3.7
Primary civilian expenditure[b]	**31.5**	**30.9**	**30.7**	**30.8**	**32.3**	**32.6**	**32.6**
Total deficit of the general government[b]	**4.3**	**2.5**	**1.4**	**1.9**	**2.1**	**4.3**	**4.5**
Central government deficit (excluding provision of credit)[e]	3.1	2.7	2.1	2.1	1.9	2.9	3.7
Deficit using international definition[b,f]	4.4	2.6	1.5	1.9	2.2	4.4	4.7
Current deficit of the general government	3.2	1.9	1.2	1.4	1.2	3.4	3.7
Total cyclically adjusted deficit using international definition[b,f]	4.5	2.9	1.3	2.0	2.3	4.6	4.9
Net public debt[g,h]	62.2	61.8	60.1	58.4	56.8	57.4	57.2
Gross public debt[g]	67.1	65.8	63.9	62.0	60.5	60.9	59.9

[a] Includes transfer payments from the public on the current and capital accounts, imputed pensions, depreciation, capital transfers from abroad, and transfers from abroad to National Institutions and nonprofit organizations.

[b] Excludes the decline in revenues from the sale of state-owned land.

[c] In 2018, the Central Bureau of Statistics revised the calculation for interest expenses from 1995 onward, and they are now calculated on a cumulative nominal basis plus indexation differentials on the public debt.

[d] Includes mortgage subsidies and transfers on the capital account to nonprofit organizations and businesses.

[e] The central government deficit is calculated according to various definitions.

[f] SOURCE: OECD.

[g] Excluding municipalities' debts to the government.

[h] Net public debt equals the gross public debt minus active loans minus government deposits with the Bank of Israel.

[i] The figure includes public investments and investment grants.

SOURCE: Based on Central Bureau of Statistics data.

The growth in government expenditure continued this year at a higher rate than specified by the expenditure rule. The increase, which began four years ago, was not accompanied by a parallel increase in sources of revenue.

The growth in government expenditure continued this year at a higher rate than specified by the expenditure rule, in accordance with the government decision to raise it to beyond the rate determined by the rule, although the rate of increase was more moderate than in previous years.[3] This increase is based on the repeated changes in the rule, and reflects the government's difficulty in implementing the policy that it decided on at the expenditure level permitted by the rule. The increase in government expenditure has continued for four years, and the vast majority of the increase is of a permanent nature. It was not accompanied by a parallel increase in revenue sources. On the contrary, tax rates were reduced. This was manifested in the continuous growth of the structural deficit (which is the gap between government expenditure and revenue without the influence of the business cycle or one-off revenues). Although the government deficit remained low during the first two years of the government's tenure due to windfall revenues, during its latter two years there were no such revenues and the deficit converged to a level similar to that of the structural deficit.

One of the areas in which government expenditure has grown in recent years is investment and investment grants in the capital account (which mostly finance the investment by government infrastructure companies). These grew by 3.2 percent of GDP in 2015 and 3.8 percent of GDP in 2018, while declining somewhat this year. Alongside government activity in infrastructure projects, expenditures in this item—and the changes in it—also reflect the political cycle in investment by local governments.[4] The level of this type of activity declined this year after a sharp increase in 2018, the year in which local elections were held. Figure 6.2 shows that the last three local election campaigns were characterized by a sharp increase of investment prior to the election year and a subsequent decline.[5] During the local elections, it was primarily investment in educational and transportation infrastructure that was increased and then reduced following the elections.

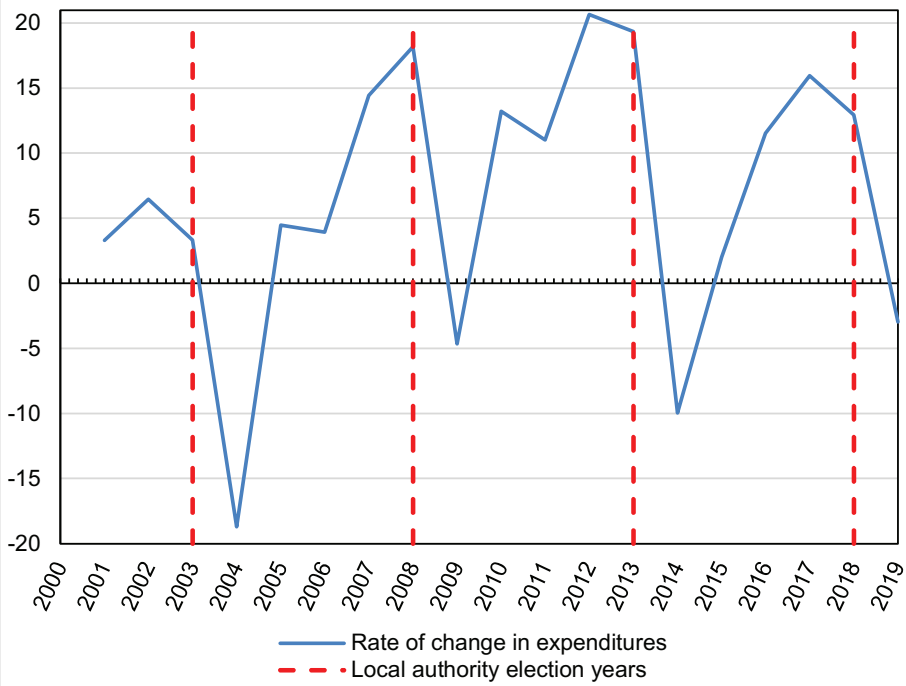
The lack of a government following the two election campaigns in 2019 prevented the approval of the 2020 budget, and since the beginning of the year the government has been operating according to a transitional budget. This kind of budget has a contractionary effect on government expenditure since it limits monthly expenditure to 1/12 of the original 2019 budget and places limits on the approval of expenditure not included in it.

[3] For the definition of the fiscal rule, see footnote 11.

[4] See Chapter 6 of the Bank of Israel *Annual Report* for 2018. T. Baskaran, S. Blesse, A. Brender, and Y. Reingwartz (2014), "Revenue Decentralization, Central Oversight and the Political Budget Cycle: Evidence from Israel"; A. Brender (2003), "The Effect of Budget Performance on Election Results in the Local Authorities in Israel from 1989 to 1998", *Israel Economic Review*, 75, 113–136. [Hebrew]

[5] The elections in 2003 were held during the economic crisis of the early 2000s and immediately after a fiscal stabilization program was adopted, which included a major reduction in government transfers to local governments.

Figure 6.2
Investments in Local Authorities, Change from Previous Year, 2000–19 (percent)



SOURCE: Central Bureau of Statistics.

2. ISRAEL'S FISCAL AGGREGATES FROM AN INTERNATIONAL PERSPECTIVE

The tax burden in Israel is lower than in other OECD countries, and the gap is widening. Nonetheless, the gap in primary civilian expenditure has narrowed in recent years.

Figure 6.3 presents Israel's main fiscal aggregates in comparison to the average of the OECD countries. The general government deficit in Israel adjusted to the accepted international definition is significantly higher than the OECD average and the widening of the gap in 2019 does not reflect the effect of the business cycle, as can be seen from the seasonally adjusted deficit.[6] In 2008, the gap in the tax burden between Israel and the other developed countries widened, and it has continued to widen over the years (except in 2017 when there were windfall revenues).[7] In 2019, it reached more than 4 percent of GDP, partly due to the lagged effect of the tax reductions in previous

[6] See Chapter 2 of this report for a discussion of the output gap, which is the basis for the calculation of the seasonally adjusted deficit.

[7] In 2017, there were windfall revenues (the sale of Mobileye and the IPO of the Tamar Petroleum company) and a sharp increase in tax revenues from dividends due to a temporary discount on the tax rate.

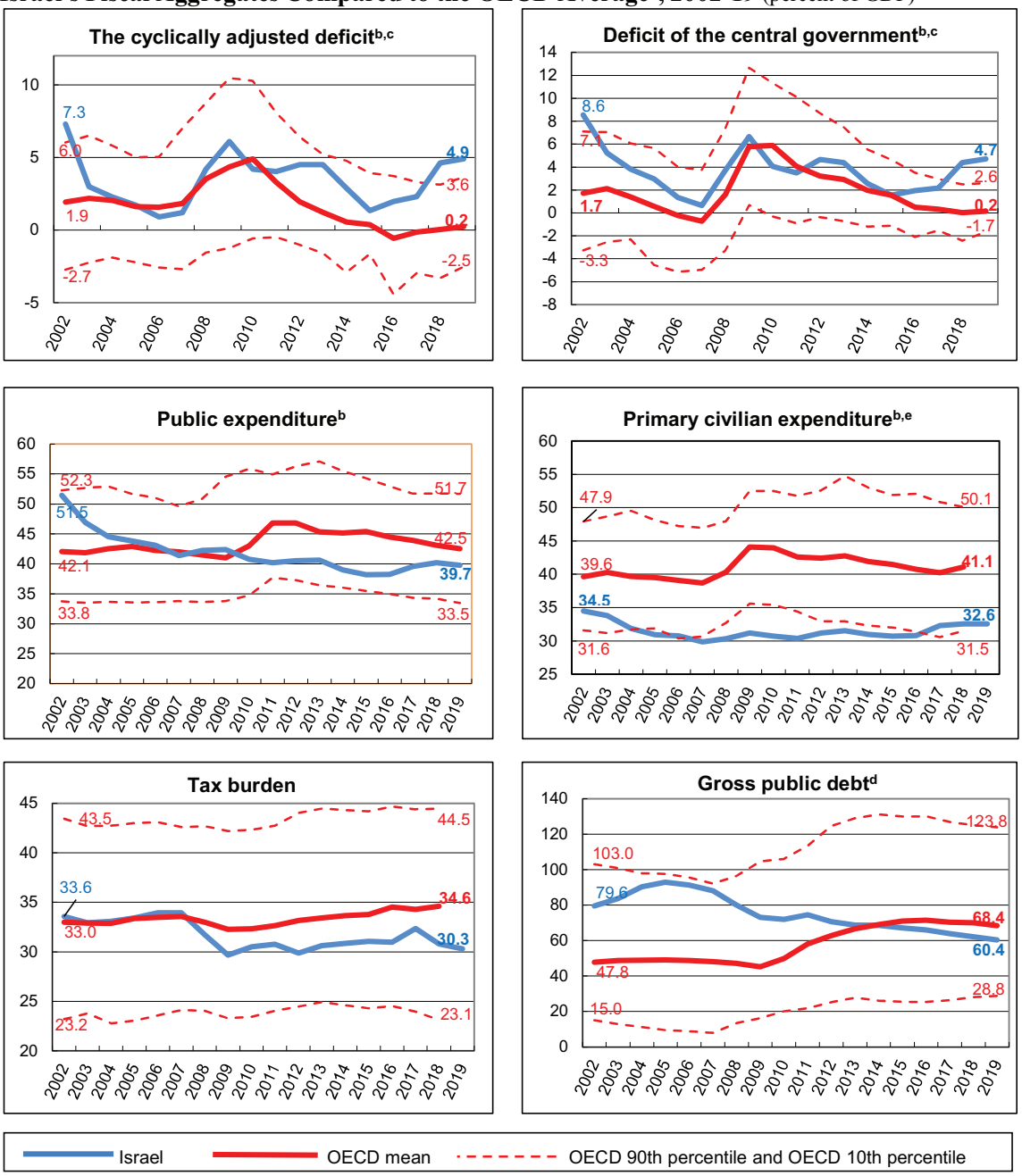
years.[8] In contrast, the accelerated growth in public expenditure brought its weight in GDP to near the OECD average, although this year there was a small decline, primarily because the improvement in the terms of trade led to an increase in output prices. Between 2016 and 2018, defense expenditure and interest payments as a share of public expenditure declined, which led to an increase in the share of expenditure dedicated to civilian expenditure.[9] However, primary civilian expenditure as a share of GDP in Israel is one of the lowest among the developed economies.

One positive fiscal development in recent years has been the drop in the public debt to GDP ratio, which is lower than the average among the developed economies This ratio has fallen rapidly since the fiscal stabilization in 2013, and its downward trend was supported by the government decision to use a significant part of the windfall revenues in 2017 in order to reduce the debt. During the last two years, the decline in the debt-to-GDP ratio has moderated significantly due to the increase in the deficit and despite the supportive macroeconomic environment. The continuous decline in the ratio brought it to a level of 59.9 percent in 2019, which is lower than the OECD average, which increased significantly following the economic crisis in 2008 and began to fall only in recent years and only moderately.

[8] A. Brender and E. Politzer (2018), "The Effect of Changes in Tax Rates on Tax Revenues in Israel," *Economic Quarterly*, 62, 87–128. [Hebrew]

[9] For further details on the changes in the weights of public expenditure categories according to their purposes, see Chapter 6 of the Bank of Israel *Annual Report* for 2018.

Figure 6.3
Israel's Fiscal Aggregates Compared to the OECD Average[a], 2002-19 (percent of GDP)



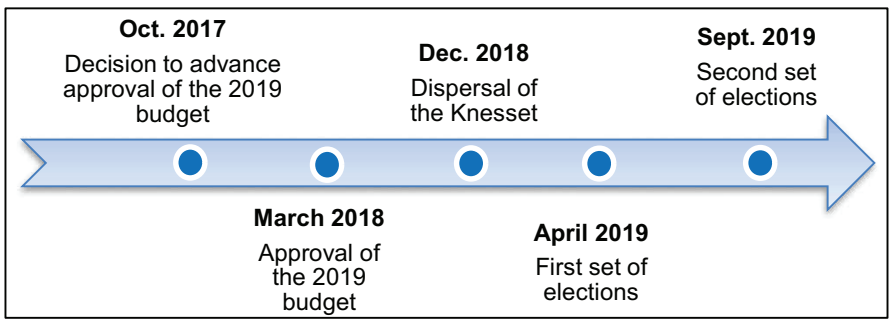
[a] Data for OECD countries are arithmetic means of all member countries for which there are data.
[b] Deficit, cyclically adjusted deficit, expenditure, and civilian expenditure data for Israel are according to the accepted international definition and taken from the OECD systems.
[c] Excluding the reduction of revenue from the sale of state-owned land. See discussion in Footnote 2.
[d] Data are in line with the International Monetary Fund's definition, and are taken from the IMF systems.
[e] There are still no data for OECD countries for 2019, and for some countries with missing 2018 data (Australia, Chile, Japan, South Korea, Latvia, Mexico, New Zealand, and Turkey), we assumed that defense expenditures in 2018 remained the same as in 2017.
SOURCE: Based on OECD and Central Bureau of Statistics data, OECD Revenue Statistics 2018, and IMF.

3. THE GOVERNMENT BUDGET: APPROVAL OF THE 2019 BUDGET AND GOVERNMENT ACTIVITY DURING THE TRANSITION PERIOD

After the dispersal of the Knesset in December 2018, there was a transition government in Israel during 2019. Despite the early dispersal of the Knesset, government activity in 2019 was based on an approved budget, since the government and the Knesset had already approved the 2019 budget in March 2018, about nine months earlier than usual (Figure 6.4).[10] The early approval of the budget made things easier for the government, since without an approved budget it would have had to operate under a transitional budget in 2019, which would have limited the ministries' freedom to maneuver and would have made it difficult to take actions that are not included in the budget base. However, due to the time that passed between the planning of the budget and its implementation some of the taxation measures planned for 2019 (as early as the end of 2017) were not implemented or were only partially implemented. In the update of the budget numbers in January 2019, the total amendments on the expenditure side added less than one percent to the budget, a moderate deviation considering the fact that the budget was approved a year earlier. In contrast, the revenue forecast was reduced by about NIS 6.5 billion, which increased the projected deficit from 2.9 to 3.5 percent of GDP. During 2019, the deficit continued to grow, and by the end of the year it had reached 3.7 percent of GDP, which is significantly higher than the 2.9 percent target. The deviation from the deficit ceiling reflects a revenue shortfall of about NIS 9 billion relative to the forecast in the original budget and a deviation of expenditure of about NIS 3 billion beyond what appeared in the original budget (Table 6.2).

The growth in the deficit in 2019 was expected already at the beginning of the year, and it largely reflected revenues that were lower than the forecast that was made prior to the approval of the budget.

Figure 6.4
Main Fiscal Events



[10] Usually, the government approves the budget around August and the Knesset gives final approval towards the end of December.

When the budget was approved, the government approved a deviation from the expenditure rule, such that total expenditures will be 3 percent higher than what is permitted according to the rule.

The rapid increase in expenditure with only a small deviation from the expenditure ceiling was possible since the ceiling itself was raised during the approval of the budget. According to the formula of the expenditure rule, expenditure in 2019 was meant to rise by 2.8 percent in nominal terms over its 2018 level (and 2.5 percent after being adjusted for the change in prices).[11] However, in order to budget the programs that the government had approved, the ceiling was raised by an additional 2 percent, and during the budget discussions another addition of 1 percent was approved. Thus, after adjusting for the change in prices, the total increase of the budget expenditure ceiling was 5.5 percent, which translates into an addition of over NIS 20 billion to the budget base. Relative to 2018, this represents an increase of 5.1 percent.

Table 6.2
Components of the net deviation from the original government budget for 2019

(current prices)

	2018 performance	2019		
		Original budget	Performance	Difference between budget and performance
	(NIS billion, net, excluding credit)			
Deficit (-)	**-38.9**	**-40.2**	**-52.2**	**-12.0**
of which : Domestic deficit	-36.2	-38.1	-48.1	-9.9
Deficit abroad	-2.7	-2.1	-4.1	-2.0
Revenue	**338.6**	**356.7**	**347.6**	**-9.2**
of which : Domestic revenue	335.7	354.7	345.7	-9.1
Taxes[a]	308.3	324.7	318.4	-6.4
Loan from the National Insurance Institute	23.5	23.8	22.8	-1.1
Other revenue[b]	6.8	8.2	6.5	-1.7
Expenditures[a]	**377.5**	**396.9**	**399.8**	**2.8**
of which : Domestic expenditures	371.9	392.9	393.7	0.9
Expenditures abroad	5.6	4.1	6.0	2.0
Defense	67.7	69.0	69.8	0.8
Interest, repayment of principal to NII, and credit subsidies	49.8	52.3	51.4	-0.9
Civilian ministries and transfer payments	259.9	275.6	278.6	3.0

[a] Including VAT on defense imports.

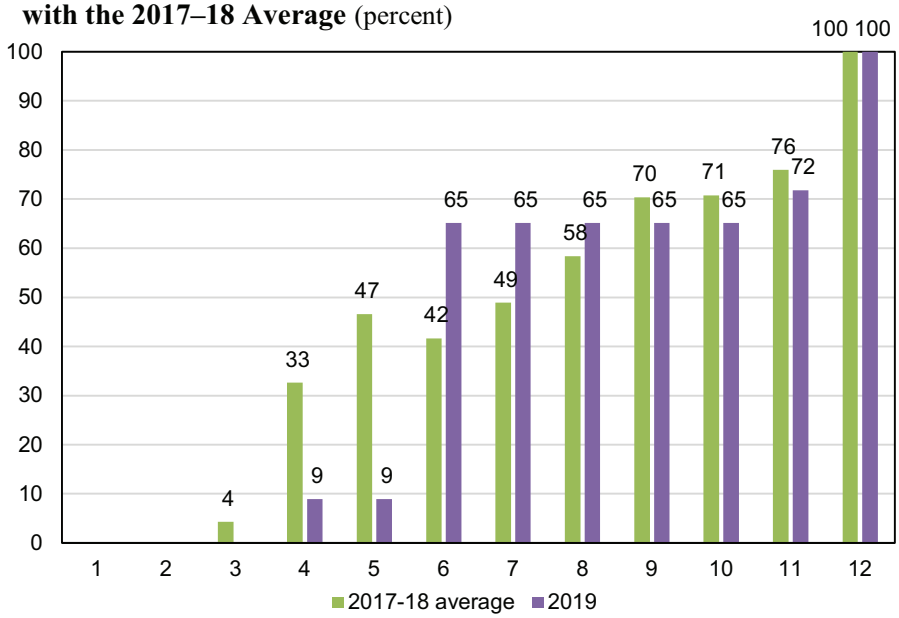
[b] Revenue from interest, royalties and dividends, and other revenue.

SOURCE: Based on Accountant General, 2019 budget performance.

[11] The budget expenditure ceiling can be raised according to the expenditure rule, which is defined by the following formula: the desired debt-to-GDP ratio set by the government (50 percent) divided by the actual ratio (61.2 percent when the budget was being prepared in 2019) multiplied by one percent, plus the average rate of population increase during the previous three years.

Despite the early approval of the budget, restrictions were imposed on government activity during 2019 for its nature as a transitional government. Thus, for example, there were delays in transferring budgets from one line to another for the limited activity of the Finance Committee, whose function it is to approve Ministry of Finance requests for such transfers.[12] A delay in payment for previous commitments makes it difficult to manage the budget on an ongoing basis, since part of the budget is used to finance commitments from the previous year.[13] Due to the delay, only 9 percent of the annual transfers had been carried out by June, as compared to about half during the previous two years (Figure 6.5).[14]

Figure 6.5
Cumulative Distribution of Budget Transfers in 2019 Compared with the 2017–18 Average (percent)



SOURCE: Knesset website.

[12] The Budget Law defines how resources are allocated in the budget. In special cases, a transfer is necessary from one line to another. This is referred to as a budget transfer and requires the approval of the Finance Committee. During the transition period, the Knesset committees are hardly active, and in order to organize a meeting of the Finance Committee a request must be submitted to the Government Secretary.

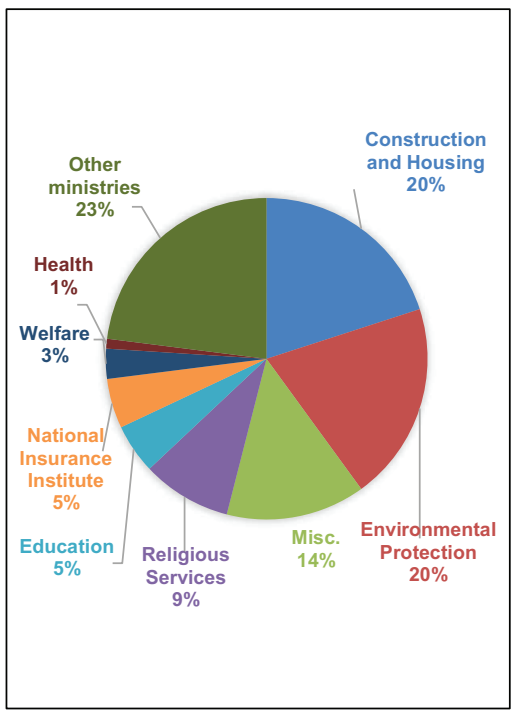
[13] Eliezer Schwartz, "Description and Analysis of the Changes in the Budget", Knesset Research and Information Center, July 2013. [Hebrew]

[14] About 80 percent of the budget transfers involve budget surpluses that were allocated in the previous year's budget but not used. These are usually expenditures for which a commitment was made but the payment stage was not reached during the budget year or expenditures that involve long-term projects. The total budget surplus each year is about NIS 25 billion, which is about 7 percent of the approved budget, and most of the surpluses are channeled to the goals for which they were originally allocated ("committed surpluses"). In the case of the surpluses for which there was no commitment (about NIS 3.5 billion per year), the Ministry of Finance—with the approval of the Finance Committee—can allocate them toward goals other than those for which they were earmarked. Most of these transfers occur in December.

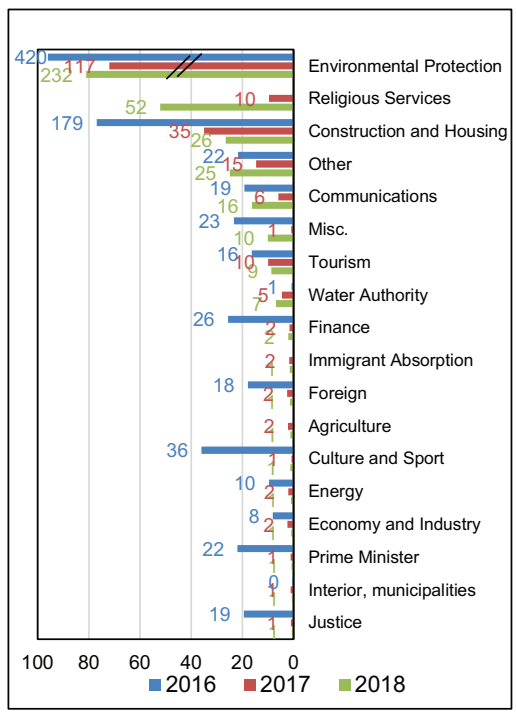
The delay in the allocation of noncommitted surpluses—totaling about NIS 3.5 billion—is divided unevenly between the government ministries. An examination of the allocation of surpluses in 2017 and 2018 shows that the Ministry of Housing and Construction and the Ministry of the Environment each received about one-fifth of the total noncommitted surpluses, and the Ministry of Religious Services received about 9 percent (Figure 6.6a). For these ministries, this constitutes a significant portion of their annual budget (Figure 6.6b). Apart from the problem of the delay, the budget processes in recent years indicate the need to improve the budgeting procedures in these areas, which will increase the transparency of the budget process and the efficiency of activity in those ministries that are financed systematically by budget surpluses.

Figure 6.6
Distribution of Noncommitted Budget Surpluses

a. Distribution of budget surpluses by government ministry, 2017–18 average



b. Budget increment from surpluses, by government ministry, 2016–18
(percentage of original budget)



SOURCE: Knesset website.

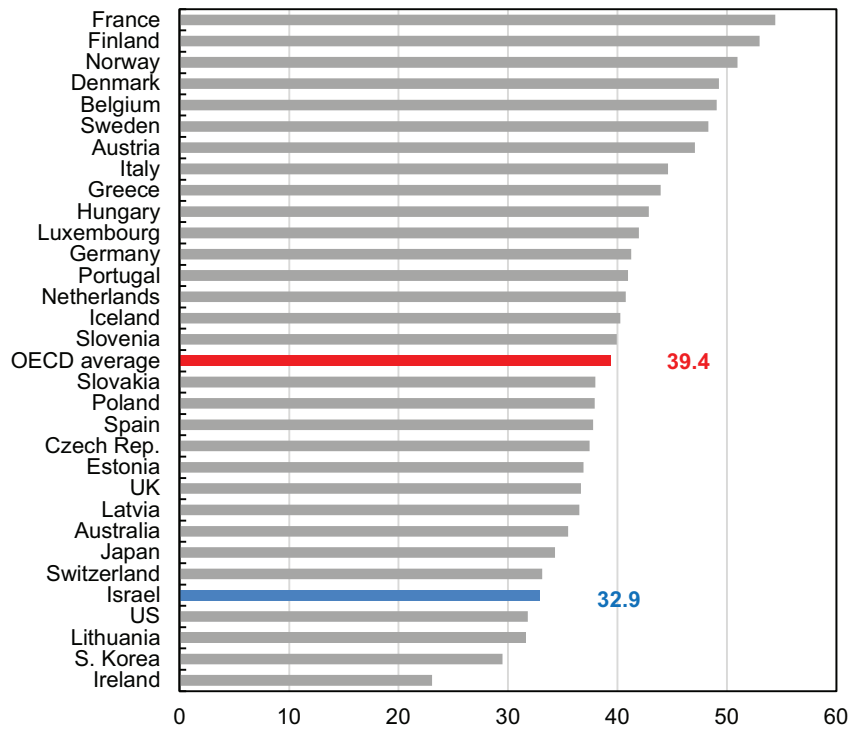
Primary civilian expenditure compared to other countries

The acceleration of government expenditure in recent years has contributed to the growth in public expenditure as a share of GDP and the reduction in the gap relative to the average of the developed economies to about 3 percent of GDP. The level of public expenditure in Israel is derived from the government's socioeconomic preferences with regard to desired services, the degree of government intervention in income distribution—in the present and in intergenerational planning—and the willingness of the public to shoulder the tax burden required to finance the expenditure. The tax burden in Israel is significantly smaller than the OECD average (by about 4 percent of GDP), and despite the increase in recent years, public expenditure is also lower. Due to the particularly high expenditure on defense and financing of the public debt in Israel, the weight of primary civilian expenditure is one the lowest among the developed economies (Figure 6.7).

Despite the relatively low level of civilian expenditure in Israel, there are three areas in which it is higher: education, culture and religion, and housing and community services.

Despite the relatively low level of (primary) civilian expenditure in Israel, there are three areas in which it is higher: education, culture and religion, and housing and community services (Figure 6.8).[15] Some of these differences can be explained by

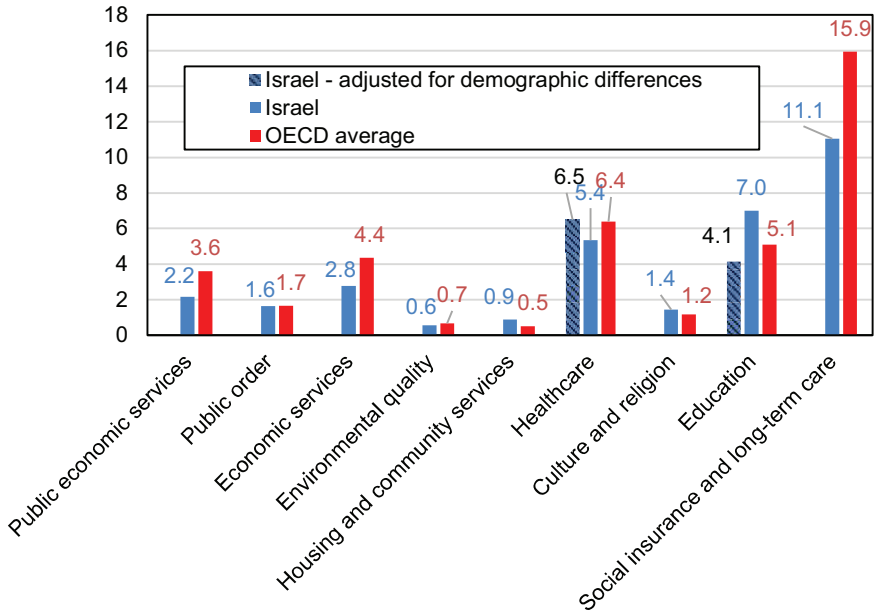
Figure 6.7
Primary Civilian Expenditure, 2017 (percent of GDP)



SOURCE: Based on OECD data.

[15] The analysis was carried out using 2017 data, the last year for which there are detailed data.

Figure 6.8
Primary Civilian Expenditure by Purpose, Israel and the OECD[a,b,c], 2017 (percent of GDP)



[a] Excluding the decline in revenue from the sale of state-owned land in the "Economic Services" item.
[b] Equivalized expenditure on education, calculated as the product of per-child education expenditure as a share of per capita GDP multiplied by the average proportion of students up to age 18 in the OECD countries.
[c] Equivalized expenditure on healthcare, calculated on the basis of the capitation formula of expenditure in Israel.
SOURCE: Based on OECD data.

demographic factors. The dependency ratio—the ratio of the number children and the elderly to the working age population—in Israel is the highest among the developed countries. This is because the proportion of children in the total population in Israel is 1.6 times that of the average for the developed countries. Equivalizing the expenditure on education shows that if the proportion of children in the Israeli population were identical to the average in the developed countries and if Israel would maintain its current level of expenditure per child, this expenditure would be 2.9 percent of GDP lower than its current level.[16] The equivalized level of expenditure (4.1 percent of GDP) is lower than in the reference countries (5.1 percent of GDP), a result of the fact that per child expenditure on education in Israel is lower than the OECD average.

While the high proportion of children in the total population increases education expenditure, the low proportion of the elderly in the population reduces public expenditure on healthcare, since healthcare expenditure increases with age. According

[16] The standardized expenditure on education is calculated as the product of current education expenditure per child in Israel as a percentage of per capita GDP and the average proportion of children up to the age of 18 in the OECD countries.

to the capitation formula—which reflects the expected expenditure on healthcare per individual according to age—public healthcare expenditure is five times higher for adults above the age of 65 than for children. The proportion of the elderly within the population in Israel is about 40 percent of the OECD average. The equivalization of expenditure on healthcare shows that if the age distribution in Israel was identical to the OECD average, and if Israel maintained the current level of healthcare expenditure per individual in Israel, healthcare expenditure in Israel would be 1.1 percent of GDP higher than its current level, and would be similar to the average level in the developed countries.[17]

The growth rate of the population, which is higher in Israel, requires a higher level of investment. The level of investment, which is the main component of the economic services budget line, is lower in Israel than in other OECD countries. Additional investment is needed since the rapid growth in the population is quickly eroding the stock of capital, which is dispersed among more people. In order to maintain a given per capita stock of capital, a higher level of investment is required.

The larger average proportion of the elderly population in the OECD countries is also reflected in higher expenditure on social insurance and long-term care. The vast majority of the difference in expenditure on these items is explained by the gap in total expenditure on old age pensions, which is 4 percent of GDP higher in the OECD countries than in Israel (Figure 6.9). This is the result of the relatively low proportion of the elderly in the population, but also the difference in the structure of the welfare system, which is more generous in the OECD countries. The equivalization of expenditure on old age pensions[18] in view of the demographic differences shows that if the proportion of the elderly population in Israel was identical to that in other developed countries, and the current level of old age pensions remained the same, total expenditure on old age pensions would be 3.1 percent of GDP higher than it is now. The equivalized level of expenditure (8.1 percent of GDP) is still lower than in the reference countries (9 percent of GDP), a reflection of the more generous payments in those countries.

The equivalization of expenditure on family and children in view of the difference between the proportion of children in the population in Israel and the average of the developed countries reduces it from 1.4 to 0.9 percent of GDP. The 0.5 percent of GDP decline due to the high proportion of children in the population is a result of the relatively low level of the children's allowance in Israel. It should be mentioned that during the past decade transfer payments for children were replaced by various types of support that do not appear in the budget line for public expenditure on family and children: additional tax credit points for parents, the expansion of the earned income tax credit for working parents, the implementation of the Free Education Law for three-year-olds, and more.

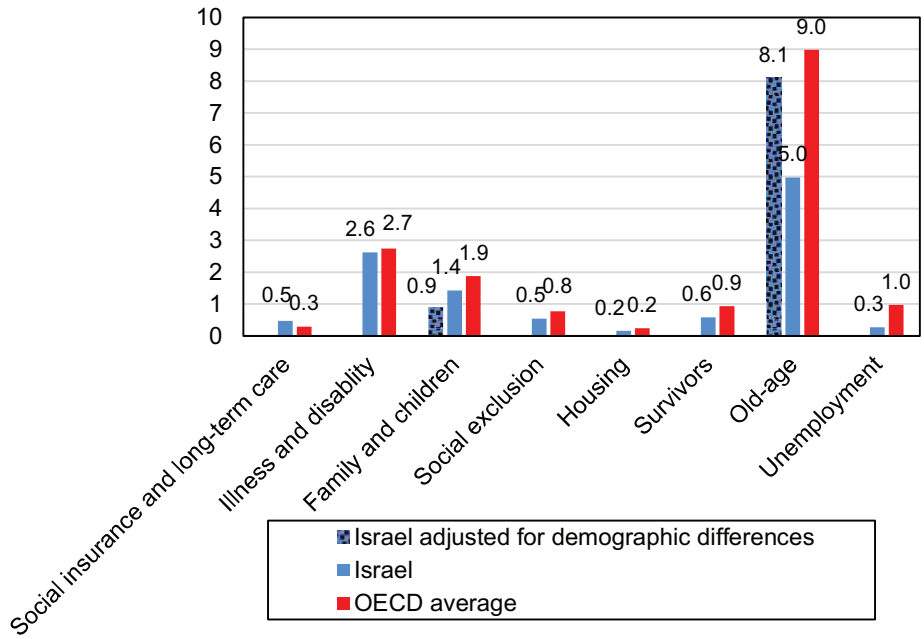
[17] The equivalized expenditure on healthcare was calculated on the basis of the capitation formula of expenditure in Israel and according to the average weight of the various population groups in the developed countries.

[18] The budget line for old age expenditure also includes the payment of defined benefit pensions.

Most of the gap in civilian expenditure between Israel and the OECD countries reflects socioeconomic preferences.

The total effect of equivalization due to demographic differences as described above offsets only about one percent of the gap between the level of primary civilian expenditure in Israel and the average of the developed countries. Thus, most of the gap reflects the socioeconomic preferences of the public and the governments of Israel during the last two decades, and is not the result of demographic differences.

Figure 6.9
Expenditure on Social Insurance and Long-Term Care, Israel and the OECD[a,b,c], 2017 (percent of GDP)



[a] Excluding the decline in revenue from the sale of state-owned land.
[b] OECD average excluding Australia, US,and South Korea due to missing data.
[c] Equivalized expenditure on the eldery is calculated on the basis of differences in the proportions of individuals aged 64+, between Israel (11%) and the OECD average (18.3%).
SOURCE: Based on OECD data.

4. GOVERNMENT REVENUE

The general government's revenues (including those of the local governments and the National Insurance Institute) totaled about NIS 496 billion in 2019. This represents 35.2 percent of GDP, a drop of 0.7 percentage points relative to the previous year. Total revenue increased by 3.8 percent in nominal terms, compared with the faster growth (5.9 percent) of nominal GDP. Tax revenues fell by 0.5 percentage points to a level of 30.2 percent of GDP, which was primarily the result of a drop in revenue from indirect taxes.

Tax revenues were lower than forecast in the original budget for 2019. Since the actual growth of real GDP (3.5 percent) was higher than in the original budget (3.1 percent) and output prices grew more than forecast, tax revenues, which were lower than forecast, did not reflect the effect of cyclical factors but rather the cancelation (or deferral) of new policy measures that had been slated for implementation (such as raising the excise tax on various products[19], the taxation of the Jewish National Fund, green taxation, and the taxation of hybrid cars) totaling NIS 2.9 billion; a decrease in the estimated revenues from policy measures that were implemented (such as limiting the use of cash and a reduction in the diesel arrangement); and the extension to 2019[20] of temporary orders related to tax exemptions, which were instituted in previous years. There was also a gap relative to the original budget in the case of "other revenues" (revenue from interest, royalties and dividends, and other sources), where a 21 percent increase had been forecast relative to 2018 but in fact these revenues fell by about 4 percent.

Relative to 2018, tax revenues in the budget rose by 3.3 percent in nominal terms, lower than the growth in nominal GDP (5.9 percent). Excluding changes in legislation and one-off revenues, tax revenues rose this year by 3 percent in real terms. According to the tax model of the Bank of Israel Research Department[21], the main factor in the growth of these revenues was the growth in GDP, while the slowdown in imports relative to the previous year worked to reduce them.[22] About 60 percent of the increase in tax revenues was the result of an increase in the collection of direct taxes. In contrast, revenue from indirect taxes rose at a moderate rate, making only a small contribution to the growth in tax revenues. This was due to the drop in revenues from import taxes, which offset the rapid growth in domestic VAT revenue.

Excluding changes in legislation and one-off revenues, tax revenues rose this year by 3 percent in real terms.

5. THE PUBLIC DEBT AND ITS FINANCING

The public debt grew by about 4.6 percent (NIS 37.5 billion) in contrast to the previous year, to about NIS 847 billion at the end of the year. The public debt to GDP ratio declined by one percentage point, to 59.9 percent of GDP. The increase in the government deficit acted to raise the debt-to-GDP ratio, but most of the increase was offset by the rapid growth in nominal GDP (the denominator of the ratio). This occurred against the background of the rapid rise in output prices, as a result of the improvement in the terms of trade (Table 6.3). In addition, the strengthening of the shekel, which

The increase in the government deficit acted to increase the debt-to-GDP ratio, but most of the increase in the debt was offset by the rapid growth in nominal GDP. This occurred against the background of the rapid rise in output prices, as a result of the improvement in the terms of trade.

[19] The excise tax on petcoke and on solvents.

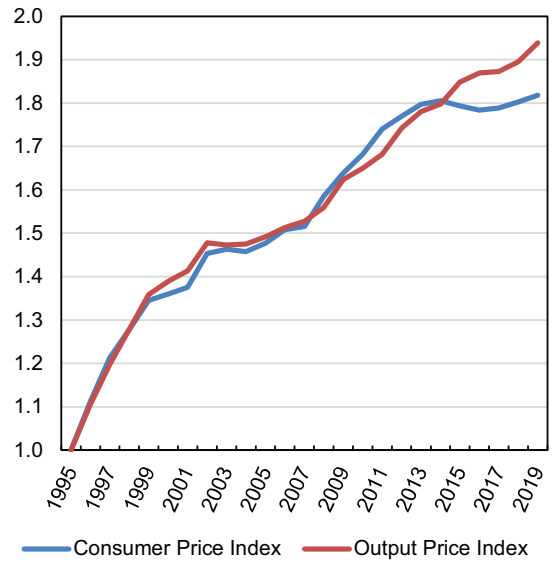
[20] The cancelation of tariffs on cellular phones and clothing and footwear in April 2017 and the cancelation of tariffs and purchase taxes on household appliances, cosmetics, clothing, and toys in December 2017. The total cancellation of tariffs was estimated at about NIS 1.4 billion.

[21] A. Brender and G. Navon (2008), "Forecasting Government Tax Revenues and an Analysis of the Forecast's Uncertainty", *Economic Quarterly* 55(4), 489–526. [Hebrew]

[22] In addition to the slowdown in imports, the import of hybrid vehicles, which are more lightly taxed, increased by about 80 percent. The import of vehicles that run on gasoline and diesel fuel declined by about 7 percent.

affected the valuation of debt denominated in foreign currency, contributed to the reduction in the debt-to-GDP ratio. About half of the reduction in the debt ratio this year was the result of the government's use of funds in its account with the Bank of Israel, such that the net public debt ratio (the public debt less the government's deposits at the Bank of Israel and the balance of active loans provided by the government in the past) fell by only 0.2 percentage points (Table 6.1). Revenues from the repayment of credit by the public (primarily mortgages provided in previous decades), which in the past were a significant factor in the decline of the gross debt-to-GDP ratio, continued to decline, as the stock of loans diminished in size.

Figure 6.10
Consumer Price Index and Output Price Index, 1995–2019 (index)



SOURCE: Based Central Bureau of Statistics.

The most significant factor in reducing the debt ratio this year was the increase in output prices. Over time, output prices rise at a similar rate to the CPI, to which about half of the public debt is indexed. However, in recent years the increase in output prices accelerated, which contributed to a lower debt ratio. Figure 6.10 presents the development of output prices and the CPI over the years.

The continuous drop in the debt-to-GDP ratio has contributed to the decline in the government's financing expenses (Figure 6.11). The total (net) interest payments on the debt totaled 1.9 percent of GDP in 2019, a drop of 0.3 percent of GDP relative to the previous year. The expenditure fell in 2014 due to the increased premium on bonds sold at a higher price than their denominated value. In recent years there has been an increase in the expenditure due to the increased subsidization of interest on earmarked bonds whose proportion of the public debt has been growing over the years (Figure 6.12). The level of interest rate expenditure is high relative to other developed countries. The gap narrowed since the 2000s, to only 0.2 percent of GDP in 2015, although in recent years it has again widened.

Table 6.3
Components of the increase in the gross public debt, 2014–19

(percent of GDP)

	2014	2015	2016	2017	2018	2019
Debt at the end of the previous year	67.1	65.8	63.9	62.0	60.5	60.9
Nominal growth of GDP	-3.1	-3.3	-3.1	-2.3	-2.7	-3.4
Net capital inflow	1.7	1.7	1.8	1.2	2.5	3.2
of which : Government's cash deficit (excluding credit)	2.7	2.1	2.1	1.9	2.9	3.7
Net repayment of credit by the public[a]	-0.4	-0.5	-0.2	-0.1	-0.1	0.0
Privatization proceeds	-0.2	-0.3	-0.1	-0.1	-0.2	-0.1
Funding beyond the financing deficit[b]	-0.5	0.4	0.1	-0.5	-0.1	-0.4
Revaluation of shekel-denominated indexed debt[c]	-0.1	-0.3	-0.1	0.1	0.2	0.2
Revaluation of foreign currency-denominated debt	0.9	-0.1	-0.2	-0.6	0.5	-0.7
Adjustment to issuance costs	-0.3	-0.2	-0.2	-0.1	-0.1	-0.1
Remainder[d]	-0.4	0.3	-0.1	0.2	-0.2	-0.2
Debt at year end	**65.8**	**63.9**	**62.0**	**60.5**	**60.9**	**59.9**

[a] Including the provision of credit and principal collection.

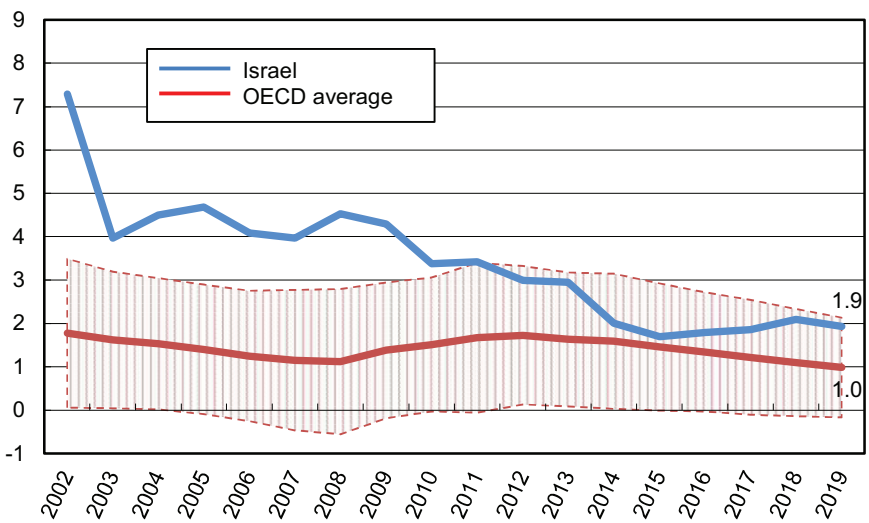
[b] Funding surplus.

[c] Effect of the increase in the Consumer Price Index during the year on indexed debt.

[d] As a result of roundings.

SOURCE: Bank of Israel.

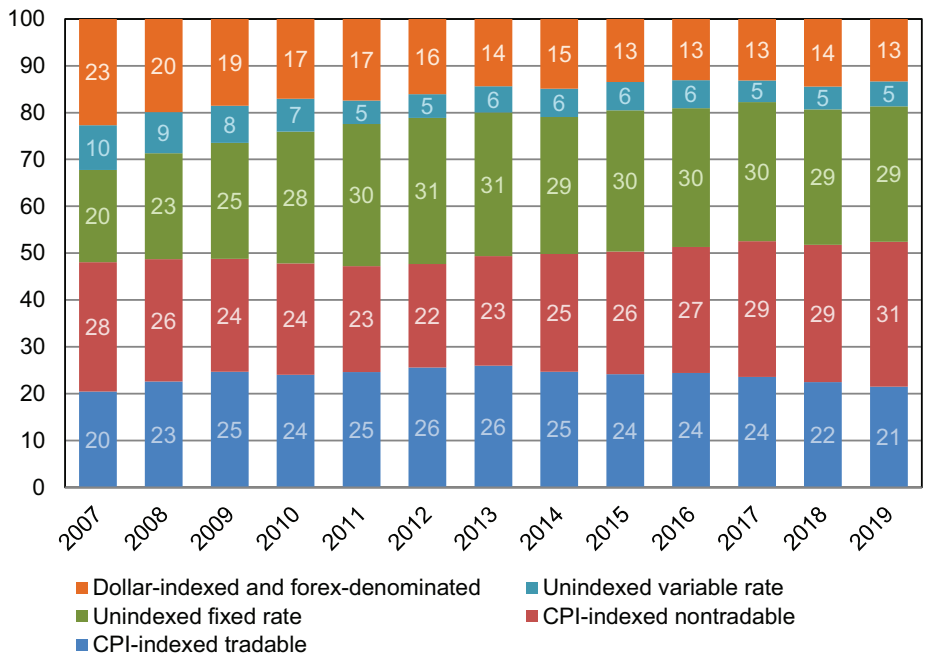
Figure 6.11
Net Interest Burden on Public Debt in Israel and the OECD 2002–19[a] (percent of GDP)



[a] The shaded area is the range of the interest burdens in the OECD countries between the 10th and 90th percentiles.

SOURCE: OECD.

Figure 6.12
Outstanding Government Debt by Components, 2007–19



SOURCE: Based on Ministry of Finance.