

Chapter 5

The Public Sector

1. MAIN DEVELOPMENTS

The public deficit declined from 3.8 percent of GNP in 1989 to 1.7 percent in 1990, reflecting an increased external surplus and a reduced domestic deficit (Table 5.1). The latter represents a decline in domestic public demand, from 29.8 to 29.1 percent of GNP, and a rise in net tax-transfer revenues, from 24.7 to 25.7 percent of GNP. This year's narrowing of the deficit cannot be read as indicative of the future: towards the end of the year, the government committed itself to future outlays (not as yet quantifiable) in order to tackle immigrant absorption.

The government's policy must be judged in the light of the needs of immigrant absorption. There were two supplementary budgets in 1990—Budget 2 in July and Budget 3 in September (see appendix)—intended to make the adjustments required by immigration. The magnitude of the influx took the policy-makers by surprise, but although some of it could have been foreseen, the government was slow to take the necessary steps. The supplementary budgets included outlays on initial absorption (on which the decision was taken at the end of 1988), as well as measures dealing with housing and employment, intended to reduce uncertainty. The government committed itself to give purchase guarantees and engage in own-account construction (housing) and to guarantee investments (employment). The failure to grasp the magnitude of the influx led to these measures being deferred, diminishing the effect on economic activity and the deficit. Towards the end of the year, the sluggishness of the economy induced the government to take action. The figures of government expenditure on immigrants indicate that the main emphasis has been on housing and initial living expenses, while the employment problem was given lower priority. The direct contribution of immigration to the domestic budget deficit came to less than 1 percent of GNP in 1990; if immigration-related transfers from the rest of the world are included, the direction of the effect is not clear.

The initial outlays rise sharply when the immigrants arrive and their growth rate declines in the course of time, whereas the government's revenue rises gradually, as the immigrants enter the labor force and become taxpayers. It follows that the budget deficit will grow substantially in the next two years. If a large deficit is not to upset economic stability, it must be a temporary one and be perceived as such; any substantial deficits

Table 5.1
General Government: Receipts, Expenditure, and Deficit, 1980-90^a

	(percent of GNP)										
	1980-84	1985-90	1983	1984	1985	1986	1987	1988	1989	1990	1990, NIS mill.
Expenditure											
Domestic	59.8	52.1	57.0	58.8	55.7	53.2	51.9	50.5	51.3	50.3	50,679
Foreign	11.7	9.4	9.0	13.4	14.3	11.5	9.6	7.8	6.8	6.4	6,468
Total	71.4	61.5	66.0	72.2	70.0	64.7	61.5	58.3	58.1	56.7	57,147
Receipts											
Domestic	48.5	48.5	50.2	42.4	48.9	51.5	51.0	48.8	45.5	45.5	45,832
Foreign	12.3	12.7	11.4	17.5	22.3	16.1	10.8	8.8	8.7	9.5	9,577
Total	60.8	61.2	61.6	59.8	71.2	67.6	61.8	57.6	54.2	55.0	55,409
Deficit (-)											
Domestic	-11.3	-3.6	-6.8	-16.4	-6.8	-1.7	-0.9	-1.7	-5.8	-4.8	-4,847
Foreign	0.7	3.3	2.4	4.1	8.0	4.6	1.2	1.0	1.9	3.1	3,108
Total	-10.7	-0.3	-4.5	-12.4	1.2	2.8	0.3	-0.6	-3.8	-1.7	-1,739
Deficit financing											
Net money creation	1.8	0.7	0.7	2.8	5.7	0.7	0.5	-5.5	0.1	2.7	2,767
Net domestic borrowing	3.0	-0.6	-0.2	0.3	-6.2	-4.0	0.2	0.6	5.6	0.1	94
Net borrowing from abroad	5.5	-1.3	3.6	5.1	-3.8	-1.8	-2.1	4.9	-4.3	-0.9	-866
Residual	0.3	1.6	0.4	4.2	3.2	2.3	1.1	0.7	2.5	-0.3	-256
Total	10.7	0.3	4.5	12.4	-1.2	-2.8	-0.3	0.6	3.8	1.7	1,739
Public debt											
Domestic	116.5	108.5	113.4	118.2	127.2	112.1	105.2	100.0	105.2	101.6	102,378
Foreign	39.1	32.5	38.5	48.8	53.1	40.6	31.5	25.7	23.9	20.4	20,532

^a General government deficit—income less expenditure.

Net money creation—increase in narrow money base (currency in circulation and deposits of commercial banks with the Bank of Israel less Bank of Israel expenses on the money base (interest paid on deposits of commercial banks, changes in the discount window loan, etc.).

Internal public debt—excludes the government's commitment under the Bank-Share Arrangement.

External public debt—the annual estimate of the public debt, domestic and foreign, is calculated as the arithmetic mean of quarterly debt/GNP ratios.

SOURCE: Based on Central Bureau of Statistics data.

Table 5.2
Principal Components of General Government Income and Expenditure, 1980-90^a

	(percent of GNP)										
	1980-84	1985-90	1983	1984	1985	1986	1987	1988	1989	1990	1990, NIS mill.
Expenditure											
Domestic											
Civilian	17.6	16.7	17.2	17.8	16.3	16.3	16.4	16.9	17.1	16.9	17,048
Defense, net	14.2	11.0	14.0	14.2	12.7	11.0	10.8	10.6	10.4	10.1	10,199
Investment	2.4	2.2	2.5	2.0	1.9	2.0	2.5	2.4	2.3	2.1	2,070
<i>subtotal: Direct domestic demand</i>	<i>34.3</i>	<i>29.8</i>	<i>33.7</i>	<i>34.0</i>	<i>30.9</i>	<i>29.3</i>	<i>29.7</i>	<i>29.9</i>	<i>29.8</i>	<i>29.1</i>	<i>29,317</i>
Subsidies	5.6	3.4	5.7	6.2	4.8	3.1	3.1	3.5	3.1	2.6	2,642
Transfer payments	11.2	11.9	10.8	10.2	10.4	11.3	11.3	12.4	13.3	12.8	12,916
Credit subsidies	4.5	1.2	3.2	3.2	2.0	1.5	1.5	1.0	0.7	0.6	585
Real interest payments	4.2	5.8	3.5	4.8	7.5	8.0	6.3	3.6	4.5	5.2	5,219
Total domestic expenditure	59.7	52.1	57.0	58.4	55.6	53.2	51.9	50.5	51.3	50.3	50,679
Expenditure abroad											
Direct defense imports	6.7	4.9	3.9	6.3	7.4	4.1	7.2	4.9	2.8	3.0	2,987
Advance payments on defense imports	0.2	0.0	0.4	1.0	0.3	2.3	-2.1	-1.1	0.4	0.3	334
Nominal interest payments	4.0	4.0	4.0	5.3	5.9	4.6	4.0	3.5	3.1	2.7	2,736
Other	0.7	0.5	0.7	0.7	0.7	0.5	0.6	0.5	0.5	0.4	412
Total expenditure abroad	11.6	9.4	9.0	13.3	14.3	11.5	9.6	7.8	6.8	6.4	6,468

Receipts**Domestic**

Taxes and transfers	43.1	44.7	45.9	37.8	44.8	47.8	47.3	45.1	41.7	41.7	42,008
Income from property	2.6	1.3	1.7	1.6	1.4	1.1	1.1	1.2	1.3	1.4	1,411
Other	2.8	2.5	2.6	2.7	2.6	2.6	2.6	2.5	2.5	2.4	2,413
Total domestic	48.4	48.5	50.2	42.1	48.8	51.5	51.0	48.8	45.5	45.5	45,382

From rest of the world

Income from foreign investment	2.1	1.0	1.8	1.4	1.2	1.0	0.8	0.8	1.0	1.1	1,157
Unilateral transfers	9.7	11.3	9.2	15.4	20.6	14.7	9.6	7.7	7.3	8.1	8,136
Publicly-financed nonprofit institutions	0.5	0.4	0.4	0.5	0.5	0.4	0.4	0.3	0.4	0.3	284
Total from rest of world	12.3	12.7	11.4	17.4	22.3	16.1	10.8	8.8	8.7	9.5	9,577

Total income	60.7	61.2	61.6	59.5	71.1	67.6	61.8	57.6	54.2	55.0	55,409
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* Investment—structures and equipment. Central Bureau of Statistics estimates (Bank of Israel estimates in previous issues of the *Annual Report*).

Tax revenue—direct and indirect taxes (excluding import duties on direct defense imports) and transfers from households.

Subsidies—subsidies to domestic production, imports and exports.

Credit subsidy—subsidy element of credit to firms and export credit.

Real interest payments—nominal interest paid to domestic factors by general government and the Bank of Israel.

Income from property—domestic operating profit of the Bank of Israel *plus* other income from property and entrepreneurship (rent, dividends, interest).

Other income—imputed pensions and depreciation.

Direct defense imports excluding taxes.

Other expenditures—maintenance of diplomatic missions abroad; Bank of Israel expenditure on coins and banknotes; participation in international institutions (including U.N. force in the Sinai Peninsula).

SOURCE: Based on Central Bureau of Statistics data.

incurred in the next few years threaten to destabilize the economy, unless they are temporary and perceived to be such, something that can be attained by drawing up a five-year budget.

Total transfer payments remained at the 1989 level (Table 5.6), but their composition changed. National Insurance benefits again rose, by 3.3 percent;¹ and repayment of compulsory loans² declined by NIS 1 billion, whereas absorption-basket transfers rose by NIS 600 million.

Direct domestic public demand, unchanged in 1989, rose by 1.3 percent in 1990 (Table 5.4). Domestic defense outlays were unchanged; since GNP rose, this means that the defense burden declined in spite of the increased budget called for by the Iraqi threat. Civilian consumption rose by 2.7 percent, principally because of the immigration. Government nondwelling investment, down by 3 percent in 1989, declined by 6 percent in 1990. There was no increase in highway investment in spite of the backlog of the early 1980s.

The 4.3 percent rise in tax revenues (deflated by the CPI) was chiefly the result of this year's economic recovery. Direct taxes were steady while indirect taxes were up by 9.3 percent (on domestic output) and 7.3 percent (on imports). The fact that direct tax receipts did not rise was due to unprecedented rebates to firms, amounting to 2.1 percent of GNP. Legislative changes increased the revenue by 1.6 percent (VAT was raised from 15 to 16 percent, income tax rates were reduced, and employer contributions to National Insurance were raised by 1.2 percentage points). The VAT was again raised in 1991, to 18 percent. The shift from direct to indirect taxes in the past two decades is common to most western economies and has implications for both the efficiency of resource allocation and the distribution of income.

As reflected in the deficit (whether actual or adjusted for the business cycle), fiscal policy was contractionary. This conclusion rests on the small fiscal effect of immigration in 1990, the rise in the net tax/GNP ratio, and the economies of scale embodied in public services at a time of immigration.

General government saving (investment *less* the total deficit) rose this year; but as usually defined, this magnitude loses much of its usefulness during periods of immigration, since some of the current outlays on immigration should be regarded as investment.

2. FISCAL POLICY

The fact that the domestic budget deficit declined this year (both including and excluding debt servicing and repayment of compulsory loans) means that—unless cyclical factors are involved—fiscal policy was contractionary. Recall that unemployment, high in 1989,

¹ Unless otherwise specified, rates of change are in real terms.

² Compulsory loans are defined as a tax when levied and a transfer when repaid.

Table 5.3
General Government Expenditure by Type of Intervention, 1980-90

(percent)

	Average		1985	1986	1987	1988	1989	1990
	1980-84	1985-90						
Public goods								
Defense (domestic)	20.0	17.8	18.1	17.0	17.6	18.3	18.0	17.8
Defense imports	9.3	7.9	10.6	6.4	11.7	8.5	4.8	5.2
Advances on defense imports	0.3	-0.0	0.4	3.5	-3.5	-2.0	0.7	0.6
Administrative services ^a	6.3	7.0	6.1	6.7	7.3	7.3	7.5	7.3
Investment	3.4	3.6	2.7	3.2	4.0	4.0	3.9	3.6
Total	39.3	36.2	37.9	36.7	37.0	36.2	35.0	34.6
Social services								
Merit goods ^a	18.9	20.7	17.9	19.0	20.0	22.0	22.4	23.0
Education	10.5	11.6	10.1	11.0	11.1	12.4	12.4	12.6
Health	5.1	5.4	4.7	4.9	5.2	5.5	5.6	6.1
Welfare	3.3	3.8	3.1	3.2	3.6	4.1	4.3	4.3
Current transfers	11.2	15.8	12.4	14.4	15.3	16.5	17.5	18.9
Subsidies ^b	6.1	3.6	5.0	3.2	3.2	4.1	3.2	3.0
Total	36.2	40.1	35.3	36.6	38.4	42.6	43.1	44.9
Direct intervention (business sector)								
Credit subsidy	6.2	1.9	2.9	2.3	2.4	1.8	1.2	1.0
Capital grants	3.5	2.3	1.9	1.9	2.3	2.5	2.2	2.8
Foreign trade subsidies	1.8	1.9	1.9	1.6	1.9	2.0	2.1	1.7
Total	11.5	6.0	6.7	5.8	6.6	6.2	5.4	5.5
Other								
Compulsory loan	1.0	1.5	0.5	1.2	0.7	2.4	3.2	0.9
Interest on public debt								
Internal	5.8	9.4	10.7	12.3	10.3	6.1	7.7	9.1
External	5.6	6.4	8.5	7.2	6.4	6.1	5.3	4.8
Other	0.5	0.3	0.3	0.3	0.5	0.4	0.3	0.2
Total	13.0	17.6	20.1	20.9	18.0	15.0	16.5	15.0
Grand total	100.0							
Percent of GNP	71.4	61.5	69.9	64.7	61.5	58.3	58.1	56.7

^a Estimated from the general government consumption figures; for 1988-90 provisional estimate based on the change in the number of employee posts.

^b On local production. The main item is subsidies on essential goods and services.

SOURCE: Based on Central Bureau of Statistics data.

rose further in 1990, and that this tends to increase the deficit. Thus if unemployment falls back to the pre-1989 level, the deficit will narrow, because higher employment augments the revenue substantially, while there is a small decline in outlays as less unemployment benefit has to be paid. The expected increase in both the growth-rate of

GNP and the unemployment rate makes any attempt to adjust the deficit for the business cycle problematic. Table 5.B6 presents several such estimates under different assumptions. The adjusted deficit serves as another indicator of fiscal policy, and it too leads to the conclusion that fiscal policy was contractionary, compared with 1989.

This conclusion rests on the fact that the fiscal effect of immigration is not yet large in 1990, since most of the immigrants arrived only in the second half of the year. Moreover, the ratio of net taxes to GNP rose only slightly, while there were economies of scale in defense. However, the result of government decisions taken at the end of the year (buy-back guarantees for immigrant housing, own-account construction, and investment guarantees) will increase the next few years' deficit.

Because of the pressure for fiscal expansion connected with immigration, it is not enough to set a deficit of 5½ per cent of GNP as a fiscal target, something that can be done by raising taxes along with spending—to the detriment of economic growth. In order, therefore, to ensure that the economies of scale in public consumption materialize and that the share of public services declines, another target must be set, namely an upper limit to the path of the public spending/GNP ratio.

Table 5.3 presents public spending by type of intervention. This classification makes possible a partial analysis of the effect of public spending on resource allocation and income distribution. Defense consumption, government investment, and administrative services are public goods not produced by the private sector, and their share declined this year, as it has throughout the 1980s. Spending on social services, which rose throughout the decade, did so this year as well. Merit goods such as education are substitutes for private output: if they were not produced by government, the private sector would supply them to some extent. The share of this category rose this year owing to the increase in the number of people receiving transfers. According to the National Insurance Institute's annual survey, transfer payments have a substantial effect on the income distribution. Thus in 1989, the Gini index was 0.57 before transfers and 0.19 after transfers.

The degree of direct intervention in the business sector did not change in 1990. However, the government's recent decision on housing, investment, and employment may change the trend. Intervention in construction stepped up considerably in 1990, in order to meet the needs of immigrants. There were several policy reversals during the year. The initially hesitant response encouraged contractors to sit back and wait, in the knowledge that the government would be forced to go further, as indeed it did when it turned out that the industry was not responding to the growing housing needs. The principal measures then adopted included buy-back guarantees and a variety of grants. In order to reduce the uncertainty, the government decided to embark on own-account construction, reversing previous policy. It was also decided that the government would guarantee investment. The wage subsidization announced in early 1991 will be in effect for only nine months, and the additional employment generated will therefore be in jobs which contribute little to GNP growth. This would certainly not be so in the case of a permanent reduction of labor costs (for example by lowering the employment tax).

Table 5.4
Direct Demand of General Government, 1986–90^a

	NIS million			Annual change, percent								
				Price			Quantity					
	1988	1989	1990	1988	1989	1990	1986	1987	1988	1989	1990	
Consumption (net)												
Civilian	11,578	14,324	17,322	22.0	21.2	17.8	-0.2	3.7	3.6	2.1	2.6	
Defense	11,183	11,453	13,922	12.3	25.8	15.9	-17.9	31.0	-6.0	-18.6	4.9	
Total	22,760	25,777	31,244	17.2	24.1	16.9	-9.8	17.1	-1.7	-8.8	3.7	
Domestic consumption (net)												
Civilian	11,400	14,806	17,048	22.2	21.2	17.9	0.5	3.7	3.8	2.0	2.7	
Defense	7,197	8,600	10,199	17.3	21.7	17.6	-5.8	2.2	3.8	-1.8	0.8	
Total	18,597	22,686	27,247	20.2	21.4	17.8	-2.1	3.1	3.8	0.5	1.9	
Investment	1,594	1,873	2,070	20.2	21.0	17.8	4.0	9.5	-1.4	-2.9	-6.2	
Direct demand	24,354	27,650	33,314	17.4	24.0	16.9	-9.0	16.6	-1.7	-8.4	3.1	
Direct domestic demand	20,191	24,559	29,317	20.2	21.4	17.8	-1.7	3.5	3.4	0.2	1.3	
Government-guaranteed construction ^b	312	403	1,344	16.7	18.1	17.5	-27.5	-5.9	-5.2	9.2	184.2	

^a For more detailed information see Table 5.B2.

^b Private housing construction with government guarantee to purchase unsold apartments.

SOURCE: Based on Central Bureau of Statistics data.

3. DEFENSE

Total defense outlays rose by a real 4.9 percent (Table 5.4) as a result of a substantial (15 percent) increase in the volume of defense imports. Since these are subject to large fluctuations, this cannot be interpreted as a change in the trend of defense spending. Domestic defense outlays hardly changed, with no change in purchases from local producers and a slight increase in labor input.

Table 5.5
Indicators of Defense Expenditure, 1980–90

	Percent of: GNP <i>plus</i> unilateral transfers ^a	Defense consumption as percent of GNP			Compensation of employees: defense as percent of total
		Total (2)	Domestic ^b (3)	Domestic <i>plus</i> foreign funding ^c (4)	
	(1)	(2)	(3)	(4)	(5)
1980	20.3	23.2	14.0	17.4	10.5
1981	21.7	24.5	14.0	17.5	10.3
1982	19.8	21.6	14.9	18.9	10.8
1983	17.0	18.8	14.0	17.8	10.0
1984	18.9	21.7	14.2	18.7	10.3
1985	17.9	21.8	12.7	17.7	9.6
1986	13.8	16.0	11.0	15.1	8.9
1987	17.3	19.4	10.8	14.4	8.7
1988	15.4	16.5	10.6	13.8	9.3
1989	12.7	13.9	10.4	13.2	9.2
1990	12.7	13.8	10.1	12.5	9.2

^a Unilateral transfers converted to NIS at the effective exchange rate.

^b Local-currency expenditure net of domestic sales.

^c Budgeted foreign-currency outlays and principal and interest on U.S. government aid.

SOURCE: Based on data of the Central Bureau of Statistics and the Ministry of Finance.

In spite of the military precautions called for by Iraq's invasion of Kuwait in August 1990, the defense burden did not increase, as can be seen in Table 5.5 (in fact according to three of the indicators shown, it declined). This is part of a long-run trend that set in after the build-up which followed the Yom Kippur war.

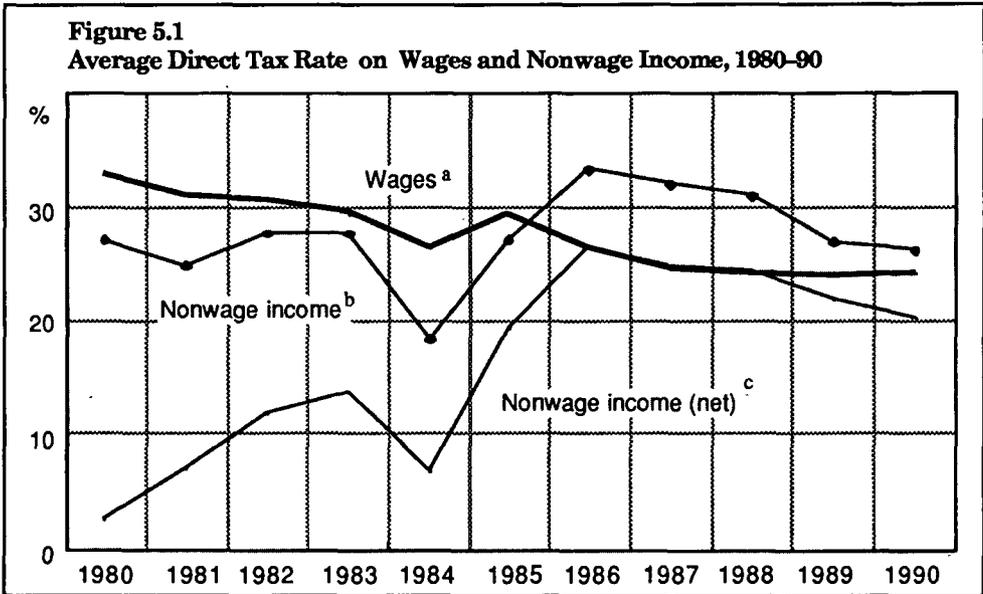
In dollar terms U.S. government military aid has remained at the same nominal level since 1985; its purchasing power is, however, declining. The ratio of U.S. aid to GNP declined from the 1985 peak of 8.5 percent to 4.1 percent in 1990. On the one hand, this means lessened dependence on foreign funding; on the other, it increases the burden on the local population.

Israel's defense outlays depend on political events in the Middle East and on the (domestic and foreign) resources available for funding. Population growth does not

necessarily call for higher defense spending; the influx of immigrants will therefore reduce the proportion of resources allocated to it. Once the immigrants share the burden of national service and reserve duty, the average duration of reserve duty will be reduced and its adverse effects on the economy lessened.

4. TAXES AND TRANSFERS

Total tax and transfer receipts (deflated by the CPI) rose by 4.3 percent, after declining steeply in 1989. Deflation by the implicit price index of GNP, the relevant index when measuring the burden on producers, shows a greater increase. Most of the additional revenue is due to the recovery of economic activity—private consumption and imports of consumer durables, including motor vehicles, which are highly taxed; legislative changes contributed 1.6 percentage points to incremental tax returns.



^a Excluding company managers' salaries.

^b Gross business sector income at factor cost, excl. salaries (except company managers).

^c Less credit subsidies and capital transfers to firms.

SOURCE: Based on Central Bureau of Statistics data.

The tax/GNP ratio remained at 41.7 percent this year (Table 5.7), well below the level of 1985-88. There are several reasons for this. The import tax/GNP ratio declined by 3 percentage points in 1987-90, and the direct tax rate/GNP ratio by slightly less. Since 1987, customs and other import duties have been reduced or abolished (mostly in 1987-88) in accordance with free-trade agreements with the EC and the United States,

Table 5.6
Direct Taxes, Compulsory Loans, and Transfer Payments, 1985-90

	NIS million						Annual change, percent ^a			
	1985	1986	1987	1988	1989	1990	1987	1988	1989	1990
Income tax	4,355	7,092	8,814	10,795	11,597	13,405	3.7	5.3	-10.7	-1.4
Wages and salaries	1,835	2,528	3,393	4,499	5,287	6,313	12.0	14.0	-2.3	1.9
Non-wage income	2,520	4,564	5,421	6,296	6,310	7,092	-0.9	-0.1	-16.7	-4.1
Companies	680	1,379	1,385	1,860	1,460	1,481	-16.2	15.5	-34.7	-13.4
Self-employed	587	1,031	1,207	1,207	1,334	1,704	-2.3	-14.0	-8.1	9.0
Cooperative members and managers	550	815	1,188	1,288	1,483	1,770	21.6	-6.8	-4.2	1.9
Deduction at source	704	1,339	1,640	1,941	2,033	2,137	2.2	1.8	-12.9	-10.3
National insurance contributions	1,777	2,715	3,188	3,773	4,505	5,446	-2.0	1.8	-0.7	3.2
Wages and salaries ^b	1,593	2,338	2,680	3,176	3,777	4,665	-4.4	1.9	-1.1	5.4
Nonwage income	184	377	508	597	728	781	12.5	1.0	1.4	-8.4
Surtax on inventories	9	-1	0	0	0	0	-132.2	-100.0
Property levy	157	244	28	0	0	0	-90.3	-100.0
Fees and fines	85	186	299	369	486	619	33.8	6.2	9.5	8.7
Total direct taxes	6,384	10,236	12,330	14,937	16,588	19,470	0.5	4.2	-7.6	0.2
Current transfers to households	2,245	3,780	4,841	6,120	7,884	10,169	6.9	8.7	7.1	10.1
Through National Insurance	1,696	2,884	3,564	4,505	5,743	6,948	3.1	8.7	6.0	3.3
Other	549	896	1,277	1,615	2,141	3,221	18.9	8.8	10.2	28.4
Transfers to private nonprofit institutions	140	244	335	422	554	753	14.4	8.4	9.2	16.0
Current	129	225	287	365	480	656	6.4	9.4	9.4	16.6
Capital	12	19	48	57	74	97	108.1	2.1	8.0	11.9
Capital transfers to firms	350	515	728	918	975	1,506	17.9	8.5	-11.7	31.8
Repayment of compulsory loans	101	321	252	955	1,511	488	-34.5	226.2	31.7	-72.4
Total transfer and loan payments	2,835	4,860	6,156	8,415	10,924	12,916	5.7	17.6	8.0	0.9

Transfers received	322	629	970	1,271	1,808	2,173	28.7	12.7	18.3	2.6
Current ^c	48	76	101	159	196	201	11.0	35.1	2.5	-12.5
Capital ^d	274	553	869	1,112	1,612	1,972	31.1	10.1	20.6	4.4
Net transfer payments	2,513	4,231	5,186	7,144	9,116	10,743	2.3	18.5	6.1	0.6
Direct taxes <i>plus</i> transfers received	6,706	10,865	13,300	16,208	18,396	21,643	2.1	4.8	-5.6	0.4
Net direct taxes and transfers	3,870	6,005	7,144	7,793	7,472	8,727	-0.7	-6.2	-20.3	-0.3

^a Deflated by the CPI.

^b Includes managers' salaries.

^c From households and private nonprofit institutions.

^d Taxes such as land appreciation tax and other transfers from firms.

SOURCE: Based on data of the Central Bureau of Statistics and the Ministry of Finance.

Table 5.7
Taxes, Subsidies, and Transfers, 1980-90

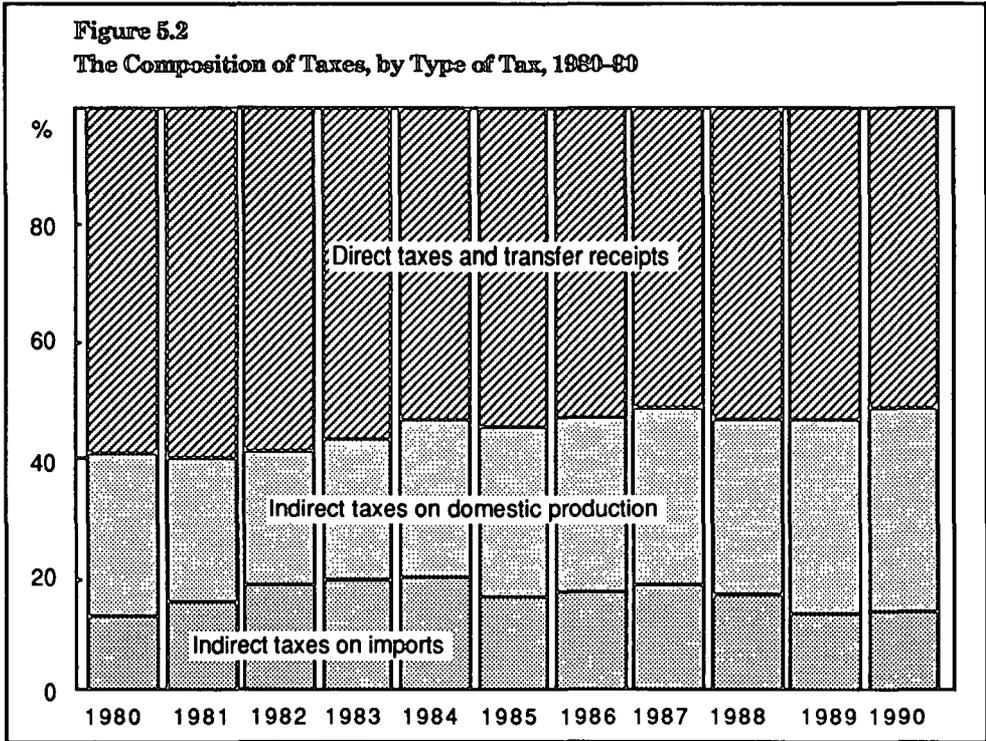
(percent of GNP)

	1980-84	1985-89	1984	1985	1986	1987	1988	1989	1990	1990, NIS mill.
Taxes and transfers										
Taxes and transfer payments	43.1	44.7	37.8	44.8	47.8	47.3	45.1	41.7	41.7	42,008
<i>less</i> Subsidies and transfer receipts	16.8	15.3	16.4	15.2	14.4	14.4	16.0	16.3	15.4	15,558
<i>less</i> Credit subsidies	4.5	1.2	3.2	2.0	1.5	1.5	1.0	0.7	0.6	585
Total	21.8	28.2	18.2	27.6	31.9	31.5	28.1	24.7	25.7	25,865
Direct taxes										
Direct taxes and transfer receipts	24.9	23.7	20.2	24.6	25.4	24.3	24.0	22.3	21.5	21,643
<i>of which</i> Income tax	15.9	15.3	13.0	16.0	16.6	16.1	16.0	14.1	13.3	13,405
<i>less</i> Transfer payments	11.2	11.9	10.2	10.4	11.3	11.3	12.4	13.3	12.8	12,916
Total	13.7	11.8	10.0	14.2	14.0	13.1	11.5	9.1	8.7	8,727
Indirect taxes, domestic										
Taxes	10.9	13.9	10.2	13.0	14.3	14.4	13.5	13.8	14.5	14,602
<i>less</i> Subsidies	4.4	2.2	4.7	3.5	2.0	1.9	2.4	1.9	1.7	1,686
<i>less</i> Credit subsidies to firms	2.6	1.2	1.8	1.8	1.5	1.4	1.0	0.7	0.6	582
Total	4.0	10.5	3.8	7.7	10.7	11.0	10.1	11.3	12.2	12,334
Net foreign trade taxes	4.5	6.0	4.5	5.7	7.1	7.4	6.4	4.4	4.8	4,804

SOURCE: Based on Central Bureau of Statistics data.

permanently reducing the revenue from this source. Direct tax rates were also lowered. However, most of the decline in revenue since 1987 is due to the recession of 1988–89.

The net tax/GNP ratio rose from 24.7 to 25.7 percent, reflecting a decline in transfer payments and subsidies. The changes in tax rates affected the composition as well as the amount of the revenue. In March 1990, VAT was raised from 15 to 16 percent; four months later, personal income tax rates were lowered, while the tax base was widened. In addition, the employer contribution to National Insurance was raised by 1.2 percentage points in April. As a result, an additional NIS 650 million was raised in taxes, and there was a shift from direct to indirect taxation.



SOURCE: Based on Central Bureau of Statistics data.

The VAT was introduced in 1976 at a rate of 8 percent, and, as in most western countries, it has risen steadily since then. At the same time, there has been a corresponding decline in income tax. As can be seen from Figure 5.2, the share of indirect taxes on domestic production has been rising since at least 1980, at the expense of direct taxes. Import taxes to some extent serve as a substitute for devaluation so that the decline in their share reflects changes in exchange-rate policy (and that is why they are segregated from other indirect taxes).

APPENDIX: IMMIGRATION AND THE BUDGET

The 1990 budget was based on a forecast of 40,000 immigrants. While it was still in preparation, it became clear that the number would be far higher, and in the event all forecasts fell far short of reality. The original appropriation for immigration was NIS 1 billion, most of it for housing. A supplementary budget (Budget 2) was presented in July; it was based on the assumption that 150,000 immigrants would arrive during the fiscal year (April–March), and additional sums of NIS 300 million for housing and NIS 365 million for initial absorption were appropriated. The reserve was raised to NIS 1.3 billion, evidently because it was by then already clear that the number of immigrants would exceed the revised forecast. Finally, Budget 3 (presented in September) was based on a total of 200,000 immigrants in 1990; again, the emphasis was on housing. At the same time an economic program was brought before the government, but most of its proposals have not been carried out. The presentation of a budget drawn up on assumptions known at the time to have no basis in reality increased uncertainty and detracted from public confidence in the government's fiscal policy.

Table 5.A1
Government Outlays on Immigration, 1990 and 1991^a

	1990			Total	1991 Original budget
	Original budget	Supplementary (Budget 2)	Supplementary (Budget 3)		
Forecast immigration ('000)	40	150	220		300
<i>NIS million</i>					
Construction	321	1,047	472	1,840	4,795
Mortgages	335	230	296	861	2,512
Initial absorption	283	692	152	1,127	2,203
Other transfers	0	0	96	96	309
Social services	100	127	95	322	714
Infrastructure	0	84	26	110	225
Total	1,039	2,180	1,137	4,356	10,758

^a At 1990 budget prices.

SOURCE: Budgets and supplementary Budgets 2 and 3 for 1990; for 1991, budget proposals and a document presented to the government together with the budget proposal.

The number of immigrants on which the 1991 budget³ is based is 300,000. The appropriation for the absorption basket (the grant for immigrants' initial living expenses) is NIS 2.2 billion. It was earlier decided to reduce the grant (as part of measures to narrow the budget deficit), but the Ministry of Finance has already abandoned this

³ Fiscal years will henceforth coincide with calendar years, and the 1991 budget therefore covers the nine months April–December.

decision. As can be seen in Table 5.A1, the major part of the immigration budget, some NIS 7.2 billion, is devoted to housing. On the supply side, this includes buy-back guarantees to contractors, own-account construction by the government, temporary housing, grants for shortening construction times, and purchase of caravans; on the demand side, there are subsidized mortgages for immigrants. The appropriation for social services is NIS 700 million. At the same time, it was decided to lower the standard of social services for immigrants by increasing the size of language classes and reducing financial aid to students and tutoring facilities for immigrant children. The appropriation for investment is NIS 225 million, intended primarily for expansion of the road, water, and sewage infrastructure. An amount of NIS 140 million is allocated to the Ministry of Labour for vocational training in courses and with firms; some of the amount will be spent on day-care centers and other social services for immigrants.

The proportion of the budget devoted to employment problems shows the order of priorities adopted, with employment coming after initial absorption and housing. The decision to reduce labor costs in order to expand employment (September 1990) was dropped. Instead, it was decided (six months later) to subsidize industrial wages, a procedure whose disadvantages are many.

Table 5.B1
Indicators of Civilian Public Services, 1980-90

(percent)

	General government civilian consumption					
	Percent of			Percent of total		Dependency ratio ^e (1980=100)
	GNP	Private consumption ^a	Per capita ^b (1980 = 100)	Employment ^c	Compensation of employees ^d	
1980	18.4	33.7	100.0	29.3	26.0	100.0
1981	18.0	32.1	100.5	29.8	25.7	99.6
1982	17.7	30.1	100.0	29.8	24.3	99.1
1983	17.6	29.1	100.2	29.3	24.0	98.4
1984	18.2	31.7	100.0	29.3	25.0	98.5
1985	16.8	27.6	97.9	29.9	23.0	98.5
1986	16.6	25.6	96.3	29.7	21.8	98.5
1987	16.8	25.3	98.2	28.8	20.9	98.5
1988	17.1	26.4	100.1	29.0	21.5	98.5
1989	17.4	27.0	100.4	29.4	22.3	98.3
1990	17.2	26.8	99.9	29.4	22.6	98.3

^a Excluding private nonprofit institutions.

^b At 1986 prices.

^c Public services as percent of total.

^d General government as percent of total.

^e Percent of population aged 0-24 and 65+.

SOURCE: Based on Central Bureau of Statistics data.

Table 5.B2
Direct General Government Demand, 1986–90

	NIS millions			Percent change over the preceding year							
				Price			Quantity ^a				
	1988	1989	1990	1988	1989	1990	1986	1987	1988	1989	1990
Consumption, total											
Civilian											
Wages and salaries	8,127	10,047	12,180	25.8	23.2	19.1	-2.9	0.6	2.3	0.3	1.8
Purchases	2,316	2,900	3,513	15.0	17.1	15.4	9.7	13.9	7.3	6.9	5.0
Depreciation	1,134	1,377	1,629	12.0	17.5	15.4	1.7	5.6	4.2	3.3	2.5
Total civilian	11,578	14,324	17,322	22.0	21.2	17.8	-0.2	3.7	3.6	2.1	2.6
Defense											
Wages	3,505	4,147	4,936	23.5	22.5	17.8	-6.3	-1.8	7.3	-3.4	1.0
Domestic purchases	3,713	4,476	5,289	11.6	21.4	17.4	-5.4	5.1	1.4	-0.7	0.7
Purchases abroad	4,018	2,887	3,762	3.1	25.3	13.3	-35.8	93.1	-17.2	-42.6	15.0
Subtotal	11,236	11,510	13,987	12.3	25.8	15.8	-17.9	30.7	-5.9	-18.5	4.9
<i>less</i> Sales to rest of world ^c	53	57	65	17.5	22.1	11.0	-6.5	-15.9	20.5	-11.9	2.7
Total consumption	22,760	25,777	31,244	17.2	24.1	16.9	-9.8	17.1	-1.7	-8.8	3.7
Domestic consumption											
Civilian	11,400	14,086	17,048	22.2	21.2	17.9	0.5	3.7	3.8	2.0	2.7
Defense, net	7,197	8,600	10,199	17.3	21.7	17.6	-5.8	2.2	3.8	-1.8	0.8
Gross	7,218	8,623	10,225	17.3	21.7	17.6	-5.8	2.1	3.9	-1.9	0.8
<i>less</i> Sales ^b	21	23	26	17.5	22.1	11.0	-6.5	-15.9	20.5	-11.9	2.7
Total domestic consumption	18,597	22,686	27,247	20.2	21.4	17.8	-2.1	3.1	3.8	0.5	1.9
Investment^c	1,594	1,873	2,070	20.2	21.0	17.8	4.0	9.5	-1.4	-2.9	-6.2
Total direct demand, net	24,354	27,650	33,314	17.4	24.0	16.9	-9.0	16.6	-1.7	-8.4	3.1
<i>of which</i> Domestic, net	20,191	24,559	29,317	20.2	21.4	17.8	-1.7	3.5	3.4	0.2	1.3
Government-guaranteed construction ^d	312	403	1,344	16.7	18.1	17.5	-27.5	-5.9	-5.2	9.2	184.2

^a Real rate of change (base year is 1986).

^b The domestic component of sales to rest of world is assumed to be 40 percent.

^c Excluding housing.

^d See note b to Table 5.5.

SOURCE: Based on Central Bureau of Statistics data.

Table 5.B3
Indirect Taxes and Subsidies on Domestic Production, 1984-90

	NIS million							Real annual change, percent ^a			
	1984	1985	1986	1987	1988	1989	1990	1987	1988	1989	1990
Indirect taxes											
Taxes on economic activity	620	2,790	4,686	5,888	6,786	8,487	10,854	4.8	-0.9	4.0	9.2
Value added tax ^b	402	1,798	3,112	3,881	5,004	6,186	7,716	4.0	10.9	2.8	6.5
Purchase tax	49	187	344	388	419	454	452	-5.9	-7.0	-9.9	-15.0
Fuel tax	49	277	356	375	501	618	1,036	-12.0	14.9	2.6	43.1
Employers' tax	87	316	579	521	496	576	692	-24.9	-18.1	-3.4	2.5
Other ^c	33	212	296	723	366	653	958	104.1	-56.5	48.3	25.3
Property taxes	5	40	65	87	131	191	272	10.5	30.0	21.2	21.5
Local rates	86	515	1,032	1,448	1,747	2,189	2,831	17.1	3.8	4.2	10.4
Other taxes ^d	41	192	322	459	495	532	645	18.8	-7.2	-10.6	3.4
Total indirect taxes	752	3,538	6,106	7,882	9,159	11,399	14,602	7.7	-0.0	3.5	9.3
Subsidies											
Subsidies	342	951	875	1,063	1,607	1,533	1,686	1.4	30.0	-20.7	-6.1
Imputed credit subsidies	133	483	626	790	702	568	582	5.2	-23.6	-32.7	-12.6
Total subsidies	475	1,434	1,502	1,853	2,309	2,101	2,268	3.0	7.2	-24.3	-7.9
Net indirect taxes											
Excluding imputed credit subsidies	409	2,587	5,231	6,818	7,552	9,866	12,916	8.8	-4.7	8.6	11.7
Including credit subsidies	276	2,103	4,604	6,028	6,850	9,298	12,334	9.2	-2.3	12.9	13.2

^a Deflated by annual average CPI.

^b Includes VAT paid by private nonprofit institutions and VAT on wages of financial institutions.

^c Includes tobacco tax, cement excise, stamp duty, licences and fees and, since 1985, taxes for the fuel equalization fund.

^d Earmarked surpluses and taxes.

SOURCE: Based on Central Bureau of Statistics data.

Table 5.B4
Taxes and Subsidies on Imports, 1984–90

	NIS million							Real annual change, percent ^a			
	1984	1985	1986	1987	1988	1989	1990	1987	1988	1989	1990
Taxes on civilian imports	537	1,991	3,517	4,688	5,131	4,585	5,763	11.2	-5.9	-25.7	7.3
Value added tax	214	820	1,245	1,666	1,713	1,857	2,635	11.7	-11.6	-9.8	21.1
Customs ^b	108	392	774	765	795	422	518	-17.6	-10.6	-55.9	4.8
Purchase tax	139	541	1,268	1,950	2,245	1,986	2,388	28.3	-1.0	-26.4	2.6
Other taxes ^c	76	239	229	307	378	320	222	11.9	5.8	-29.6	-40.8
Subsidies	-16	-82	-109	-88	-88	-25	8	-32.9	-13.8	-76.4	-127.3
Net taxes (civilian imports)	553	2,073	3,626	4,776	5,219	4,610	5,755	9.9	-6.0	-26.5	6.5
Taxes on defense imports	89	419	383	762	650	551	736	66.2	-26.7	-29.5	14.0
Net foreign trade taxes											
Excl. credit subsidies	421	1,635	3,065	4,044	4,355	3,602	4,807	10.1	-7.4	-31.2	13.9
Incl. credit subsidies	328	1,568	3,062	4,040	4,352	3,599	4,804	10.1	-7.4	-31.2	13.9

^a Deflated by annual average CPI.

^b Excludes fines; from 1983, includes import levy.

^c Includes foreign travel tax (from 1982); the tax element of the compulsory deposit on imports (from 1983); the levy on purchases of foreign currency (from 1983); the impost on imports of services (from 1984); the impost on foreign travel fares (from 1985).

SOURCE: Based on Central Bureau of Statistics data.

Table 5.B5
Wages, Taxes, and Disposable Wages per Employee Post, 1985-90^a

	Percent of gross wage						Real ^b annual change, percent				
	1985	1986	1987	1988	1989	1990	1986	1987	1988	1989	1990
Half average wage											
Income tax ^c	3.3	0.1	0.3	1.0	0.5	0.2	-97.6	399.5	210.4	-44.0	-66.8
Net taxes ^c	-3.3	-9.2	-6.8	-5.4	-6.2	-6.5	229.5	-20.2	-15.6	13.5	4.7
Disposable wage income	103.3	109.2	106.8	105.4	106.2	106.5	18.1	5.9	4.4	-0.4	-0.6
Net wage	91.9	95.6	94.3	93.7	94.1	94.5	16.2	6.8	5.0	-0.7	-0.5
Average wage							11.6	8.2	5.8	-1.2	-0.9
Income tax ^c	16.2	13.1	13.3	13.9	13.4	11.7	-10.2	9.3	10.4	-4.2	-13.5
Net taxes ^c	16.6	15.1	15.5	16.3	15.8	14.1	1.5	11.0	10.9	-4.3	-11.6
Disposable wage income	83.4	84.9	84.5	83.7	84.2	85.9	13.6	7.7	4.9	-0.5	1.1
Net wage	79.3	81.5	81.3	80.8	81.2	82.9	14.8	8.1	5.0	-0.6	1.2
Nominal 1986 wage^d											
Income tax ^c	18.2	13.2	11.9	11.6	11.3	9.7	-27.3	-9.5	-3.3	-2.3	-13.6
Net taxes ^c	18.9	15.2	13.1	11.0	11.8	10.0	-19.7	-13.7	-15.8	6.9	-14.9
Disposable wage income	81.1	84.8	86.9	89.0	88.2	90.0	4.6	2.5	2.4	-0.9	2.0
Net wage	77.4	81.5	82.7	83.1	83.4	84.9	5.3	1.5	0.5	0.3	1.8
Double average wage											
Income tax ^c	30.6	26.4	25.9	26.4	26.0	25.2	-4.1	5.9	8.2	-2.7	-4.4
Net taxes ^c	33.1	30.1	29.7	30.3	29.9	29.0	1.1	6.7	8.2	-2.6	-3.9
Disposable wage income	66.9	69.9	70.3	69.7	70.1	71.0	16.8	8.9	4.8	-0.5	0.4
Net wage	64.8	68.2	68.8	68.2	68.6	69.5	17.6	9.2	4.9	-0.6	0.4

^a Net wage is gross wage less income tax and employee's National Insurance contribution; disposable wage income is net wage plus child allowances.

^b Adjusted to beginning of month (when wages are normally paid).

^c Income tax was calculated assuming one earner and 2 children per family. Net taxes: income tax and employee's National Insurance contributions less child allowance for two children.

^d 1986 wages at current tax rates.

SOURCE: Based on data of the Ministry of Finance and the National Insurance Institute.

Table 5.B6

Alternative Estimates of the Domestic Deficit at Full Employment, 1988–90^a

(percent of GNP)

GNP growing at	Actual deficit	Elasticity = 1		Elasticity = 0.8	
		Variant A	Variant B	Variant A	Variant B
<i>3 percent</i>					
1988	-1.7	0.1	-1.4	-1.5	-2.9
1989	-5.8	-0.2	-1.7	-1.8	-3.3
<i>6 percent</i>					
1990	-4.8	0.7	-0.8	-0.9	-2.3
<i>4 percent</i>					
1988	-1.7	0.6	-0.9	-1.0	-2.5
1989	-5.8	0.7	-0.8	-1.0	-2.4
<i>7 percent</i>					
1990	-4.8	2.0	0.5	0.3	-1.2

^a Does not include compulsory loan. The base-year tax/GNP ratio is based on the average tax rate in 1985–87 (variant A) or 1980–87, excl. 1984 (variant B).

Analysis of general government activities on the basis of the actual deficit is liable to be misleading, and it is therefore useful to adjust it for swings in economic activity. For this purpose it is assumed that outlays other than unemployment benefit are not affected by changes in GNP and that they are equal to actual outlays *plus* an unemployment benefit correction.

On the income side, it is assumed that the revenue is a constant proportion of potential GNP, assuming alternative growth rates, as shown in the table. It is also assumed that the average tax/GNP ratio for 1985–87 reflects the potential tax rate for the benchmark (the beginning of 1988). Accordingly, potential tax receipts in 1988–90 are estimated by netting out the legislative changes occurring during this period.