

Chapter 5

The Public Sector

1. MAIN DEVELOPMENTS

In 1991, as in 1990, the domestic budget deficit¹ amounted to 5.4 percent of GNP, and the total deficit to 2.6 percent. Real taxes and revenues rose, and real domestic expenditure increased at about the same rate.² When general government investment is deducted from expenditure, the saving rate is negative, and has been estimated at $\frac{1}{2}$ a percent of GNP.

While the large public deficit reflects the expansionary effect of government on economic activity, it is still an underestimate because of two factors specific to 1991. First, there were large extra-budgetary outlays in order to further immigrant absorption. Since the object of this—which will show up in the general government accounts in subsequent years—was to dispel business-sector uncertainty, it contributed to the expansion of economic activity in 1991. Second, since some of the tax increases were determined from the outset as being temporary, their contractionary effect was weakened. Expenditure on grants to immigrants is also temporary, and its duration depends on the integration of the immigrants into employment.

The 1991 deficit does not exceed the first-year level of the three-year deficit path set in the 1992 Budget. The tax receipts and expenditure which gave rise to this deficit were nonetheless higher than desired, particularly in view of the need to improve business-sector profitability and foster employment. In the course of 1991 it became clear that decisions regarding expenditure on immigrant absorption were based on optimistic estimates of the numbers arriving. Adjusting government expenditure—especially that part of it intended to accelerate dwelling investment—to the reduced number of immigrants would have made a reduction in tax receipts possible while adhering to the planned

¹ The deficit in this chapter differs from the one in Chapter 7 on two major (though not the only) counts. First, the data here are based on the national accounts, while those in the monetary chapter are on a cash basis. Second, the deficit here reflects the activity of general government whereas in the monetary chapter it reflects only that of the central government and the Jewish Agency. For further definitions, see Table 5.1.

² GDP prices rose faster than those of public consumption in 1991, so that a comparison between them in GDP terms underestimates the real change in the deficit.

Table 5.1
General Government: Receipts, Expenditure, and Deficit, 1980–91^a

	1980–84	1986–91	1984	1985	1986	1987	1988	1989	1990	1991	(percent of GNP)
Expenditure											
Domestic	59.80	50.97	58.73	55.56	52.89	51.59	50.25	50.81	50.68	49.62	
Foreign	11.59	7.91	13.28	14.19	11.39	9.50	7.70	6.61	6.29	5.95	
Total	71.39	58.88	72.01	69.75	64.28	61.09	57.95	57.42	56.97	55.57	
Receipts											
Domestic	48.56	47.51	42.70	49.23	51.72	50.35	48.80	44.79	45.17	44.24	
Foreign	12.36	10.31	17.46	22.23	15.90	10.76	8.81	8.59	9.11	8.69	
Total	60.92	57.82	60.16	71.46	67.62	61.11	57.60	53.38	54.28	52.93	
Deficit (-)											
Domestic	-11.25	-3.46	-16.03	-6.33	-1.17	-1.24	-1.45	-6.02	-5.51	-5.38	
Foreign	0.77	2.40	4.18	8.04	4.51	1.26	1.10	1.98	2.81	2.74	
Total	-10.48	-1.06	-11.85	1.71	3.35	0.02	-0.35	-4.04	-2.69	-2.64	
Public debt^b											
Domestic	108.62	92.96	106.90	117.60	110.60	100.50	88.90	89.80	88.90	79.10	
Foreign	39.25	26.21	48.73	52.91	40.33	31.22	25.51	23.55	20.13	16.49	

^a General government deficit—income less expenditure.

Domestic public debt—excludes the government's commitment under the bank shares Arrangement.

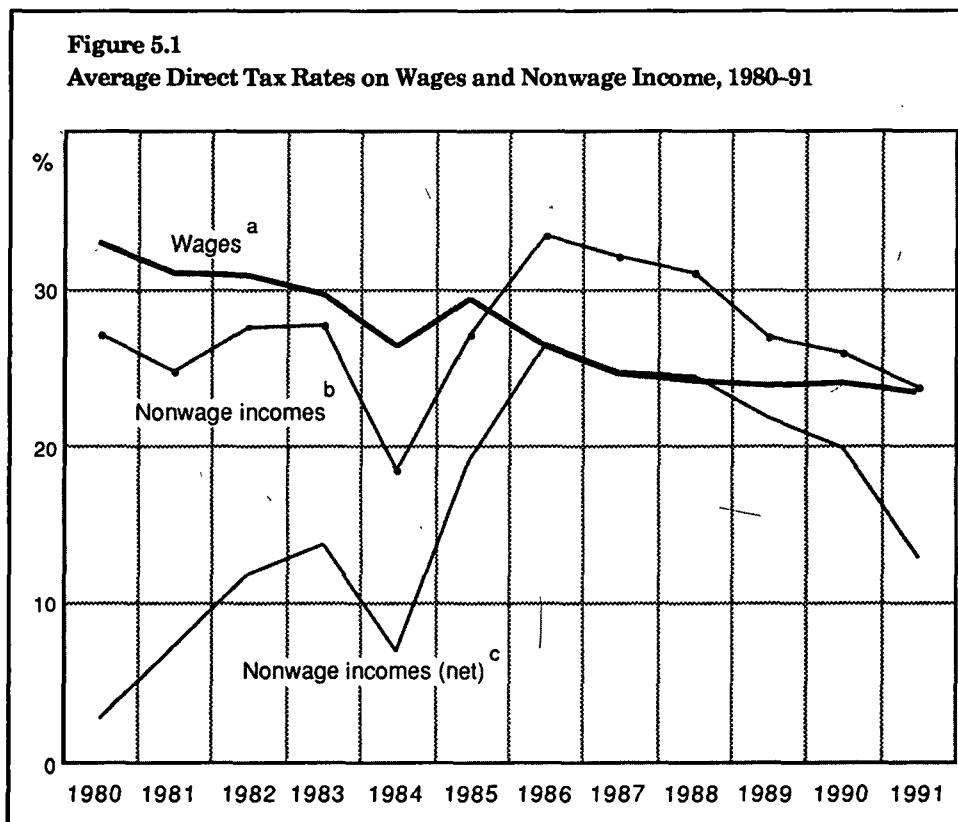
Foreign public debt—the annual estimate of the public debt, domestic and foreign, is calculated as the arithmetic mean of quarterly debt/GNP ratios.

^b For details, see Chapter 7 (domestic debt) and Chapter 6 (foreign debt).

SOURCE: Based on Central Bureau of Statistics data.

budget deficit. Tax reductions have a positive effect on present and future economic activity, and such steps would have helped to promote the economic growth target.

The absorption of immigrants was predominant in general government activity in 1990 and 1991. On the income side, additional taxes were raised, adding over NIS 2 billion to government income (principally because VAT was increased). In addition, the national institutions and the publicly-financed nonprofit institutions intensified their grant-raising



^a Excluding company managers' salaries.

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

^c Less credit subsidies and capital transfers to firms.

SOURCE: Based on Central Bureau of Statistics data.

activities abroad, thus increasing unilateral transfers by \$ 800 million over the 1988–90 average (Table 6.8). On the expenditure side, incentives were offered to speed up dwelling construction and provide accommodation for immigrants, while mortgages were subsidised to help immigrants buy apartments. Extra-budgetary commitments were made to contractors to buy back unsold housing units, and government-guaranteed loans were extended for investment in other industries.

The provision of accommodation for immigrants in effect headed national priorities, and considerable—chiefly extra-budgetary—efforts were made in this direction. The swift adjustment of the supply of apartments to the government's rapid-completion incentives, and the unexpected fall in the number of immigrants arriving, helped to ease the housing shortage, although the immigrants' employment problems have not yet been solved. Absorbing the additional manpower into production requires more capital formation, and this needs long-term planning and the reduction of uncertainty for investors. As part of its fiscal policy, the government can contribute to reducing business-sector uncertainty and increasing profitability, mainly by reducing the tax burden permanently and investing in the infrastructure. The alternative—direct government intervention, creating employment by establishing industries—is wasteful, inefficient, and possibly even harmful in the long run since it crowds out more efficient factors.

The task of absorbing immigrants has shifted the structure of government expenditure away from the trend of the last decade, increasing the proportion of direct intervention in outlays on business-sector activity. The share of expenditure devoted to welfare, which soared in the 1980s, continued to rise, while the proportion of public goods fell. The expenditure figures do not reflect the cost of intervention, since guarantees for housing and for business-sector activities will be honored only in 1992.

During the year the tax structure was amended, with some beneficial effects on factor allocation. The main improvements were the reduction of employers' tax and of employers' contribution to National Insurance, and further exposure to imports. Immigration makes it even more important to streamline the tax system. Employers' taxes on wages and protective taxes hamper the efficient allocation of the incremental labor force, and because of the prevalence of labor market imperfections—as well as social pressures—this process will persist, impairing the country's growth.

Infrastructure investment was only 2 percent of GDP in 1990 and 1991, in spite of its importance for economic growth. The proportion of GDP invested in infrastructure is now lower than in the period up to 1973, particularly in the road infrastructure.

2. LONG-TERM TRENDS

As a proportion of GNP, income and expenditure has declined in the last few years, and the pattern of government spending and the structure of the tax system have both been radically altered. Although the nature and timing of these changes resemble those in most western countries, immigrant-absorption needs deflected the trend of government expenditure and some principles of tax reform.

The functional composition of government expenditure shifted perceptibly in the 1980s (Table 5.3). The proportion of public goods fell slowly, administrative services and investment held steady, and cuts in defense expenditure led the decline in the share of this item in total outlay. The share of social services (education, health, welfare, and

Table 5.2
Principal Components of General Government Income and Expenditure, 1980-91^a

	1980-84	1986-91	1984	1985	1986	1987	1988	1989	1990	(percent of GNP) 1991
Expenditure										
Domestic										
Civilian	17.6	16.8	17.9	16.4	16.2	16.3	16.9	17.1	17.3	17.3
Defense, net	14.2	10.3	14.3	12.7	11.0	11.0	10.5	10.2	9.9	8.9
Investment	2.4	2.4	2.1	1.9	2.0	2.4	2.6	2.5	2.4	2.2
<i>subtotal:</i> Direct domestic demand	34.3	29.4	34.2	30.9	29.2	29.7	30.0	29.8	29.6	28.4
Subsidies	5.7	2.9	6.3	4.8	3.1	3.1	3.4	3.0	2.7	2.5
Transfer payments	11.2	12.5	10.2	10.4	11.3	11.1	12.4	13.0	12.8	14.2
Credit subsidies	4.5	0.9	3.2	2.0	1.5	1.4	1.0	0.7	0.6	0.4
Real interest payments	4.2	5.2	4.8	7.5	7.9	6.2	3.5	4.3	5.0	4.1
Total domestic expenditure	59.8	51.0	58.7	55.6	52.9	51.6	50.2	50.8	50.7	49.6
Expenditure abroad										
Direct defense imports	6.6	4.1	6.2	7.3	4.0	7.1	4.8	2.7	2.9	3.0
Advance payments on defense imports	0.2	0.0	1.0	0.3	2.2	-2.1	-1.1	0.4	0.3	0.3
Nominal interest payments	4.0	3.3	5.3	5.9	4.6	3.9	3.5	3.1	2.7	2.3
Other	0.7	0.5	0.7	0.7	0.5	0.6	0.5	0.4	0.4	0.4
Total expenditure abroad	11.6	7.9	13.3	14.2	11.4	9.5	9.7	6.6	6.3	5.9
Total expenditure	71.4	58.9	72.00	69.8	64.3	61.1	58.0	57.4	57.0	55.6

Receipts										
Domestic										
Taxes and transfers	43.2	43.9	38.4	45.3	48.1	47.0	45.1	41.0	41.3	40.6
Income from property	2.6	1.2	1.6	1.4	1.1	0.7	1.1	1.3	1.4	1.3
Other	2.8	2.5	2.8	2.6	2.6	2.6	2.5	2.5	2.4	2.3
Total domestic	48.6	47.5	42.7	49.2	51.7	50.3	48.8	44.8	45.2	44.2
From rest of the world										
Income from foreign investment	2.1	1.0	1.5	1.2	1.0	0.8	0.8	1.0	1.1	1.3
Unilateral transfers	9.8	8.9	15.5	20.5	14.5	9.5	7.7	7.2	7.6	7.1
Publicly-financed nonprofit institutions	0.5	0.4	0.5	0.5	0.4	0.4	0.3	0.3	0.3	0.3
Total from rest of world	12.4	10.3	17.5	22.2	15.9	10.8	8.8	8.6	9.1	8.7
Total income	60.9	57.8	60.2	71.5	67.6	61.1	57.6	53.4	54.3	52.9

* 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).

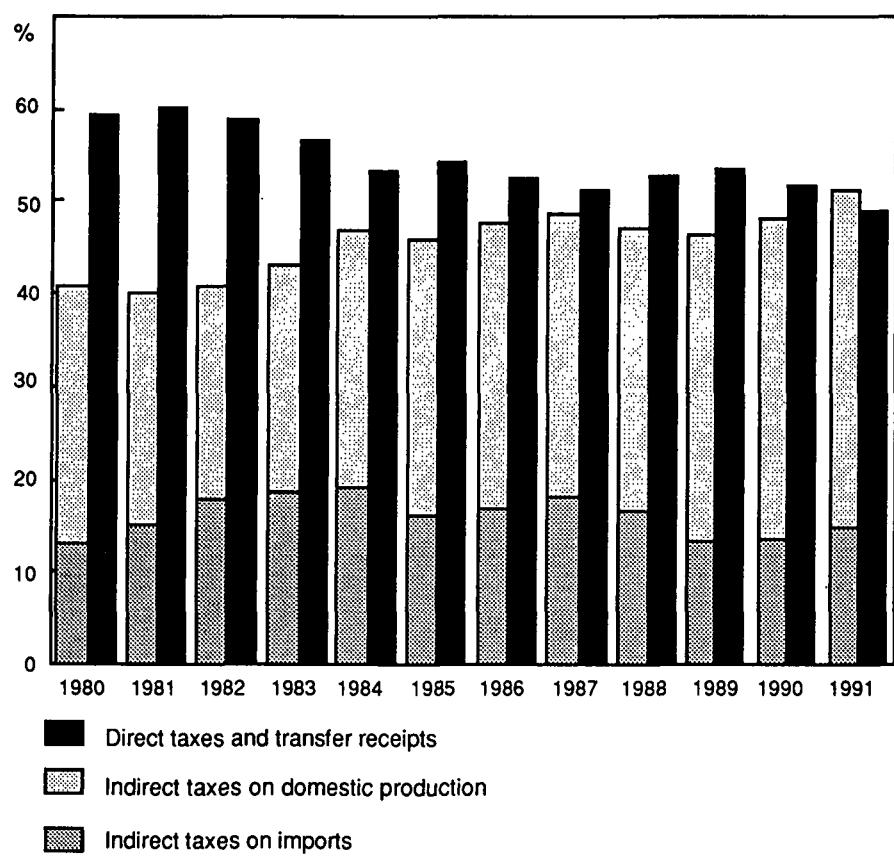
Other income—imputed pensions and depreciation.

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.

Figure 5.2
The Composition of Taxes, by Type of Tax, 1980-91



SOURCE: Based on Central Bureau of Statistics data.

current transfers to households) rose quite steeply in the late 1980s. Throughout the decade the share of expenditure on direct intervention in the business sector—and to credit subsidies in particular—declined. The share of financing costs, which peaked in 1986, declined until 1990.

The gradual reduction in the share of direct intervention, together with the increase in the share of social services, altered the character of the government's economic functions in the 1980s. The composition of social services outlays also changed during this period, with a relatively steep rise in transfer payments, which are given in cash and whose destination is decided by the recipients. The other components of social services expenditure rose less; since they are controlled by the government recipients they can benefit only by consuming goods supplied by the government. This indicates decreasing direct government involvement, through the budget, in the allocation of resources for social purposes.

Table 5.3
General Government Expenditure by Type of Intervention, 1980-91

	1980-84	1986-91	1984	1985	1986	1987	1988	1989	1990	(percent) 1991
Public goods										
Defense	29.5	24.3	29.9	29.1	26.8	26.1	24.5	23.2	23.0	22.0
Administrative services ^a	6.8	7.6	6.2	6.4	7.0	7.8	7.8	7.9	7.7	7.5
Investment	3.4	4.0	2.9	2.7	3.2	4.0	4.5	4.4	4.2	3.9
Total	39.7	35.9	38.9	38.1	36.9	37.9	36.8	35.5	34.9	33.4
Social services										
Merit goods ^a	18.9	21.9	19.7	18.0	19.0	19.9	22.2	22.6	23.5	24.2
Education	10.5	12.2	10.9	10.2	11.0	11.1	12.5	12.6	12.8	13.1
Health	5.1	5.7	5.1	4.8	4.9	5.2	5.6	5.7	6.3	6.4
Welfare	3.3	4.1	3.7	3.1	3.2	3.6	4.1	4.4	4.4	4.8
Current transfers	11.2	16.9	10.9	12.4	14.5	15.2	16.5	17.4	18.8	19.2
Total	30.1	38.8	30.5	30.4	33.5	35.1	38.7	40.0	42.2	43.5
Direct intervention (business sector)										
Subsidies ^b	6.1	3.3	6.5	5.0	3.2	3.1	3.7	3.1	3.0	3.5
Credit subsidy	6.2	1.6	4.5	2.9	2.3	2.4	1.8	1.2	1.0	0.8
Capital grants	3.5	3.0	2.2	1.9	1.9	2.3	2.4	2.1	2.9	6.2
Foreign trade subsidies	1.8	1.7	2.2	1.9	1.6	1.9	2.1	2.1	1.7	1.0
Total	17.7	9.5	15.4	11.7	9.0	9.7	10.0	8.5	8.5	11.5
Financing outlays										
Repayment of compulsory loan	1.0	1.4	1.1	0.5	1.2	0.7	2.4	3.1	0.8	0.1
Interest on public debt										
Domestic	5.9	8.7	6.7	10.7	12.3	10.1	6.0	7.6	8.8	7.4
Foreign	5.7	5.6	7.4	8.5	7.2	6.4	6.1	5.3	4.7	4.1
Total	12.5	15.7	15.2	19.7	20.6	17.3	14.5	16.0	14.3	11.6
Grand total			100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Percent of GNP	71.4	58.9	72.0	69.7	64.3	61.1	57.9	57.4	57.0	55.6

^a Estimated from the general government consumption figures; for 1988-91 provisional estimate based on change in 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.

Due to the steep decline in recent years in the ratio of government expenditure intended for direct intervention to GNP, by the late 1980s it had reached a level comparable with that in most OECD countries.³ In social services, the transfer payments/GNP ratio was similar to the average in developed countries. Nevertheless, large intercountry differences in GDP, population, demographic characteristics, and unemployment limit the value of this comparison. When allowance is made for differences in per capita GDP, the unemployment rate, and the old-age dependency ratio, the transfers to households/GDP ratio is lower in Israel than in most of the wealthier European countries (Austria, France, Germany, Italy, and Holland), is not significantly different from the Scandinavian countries, New Zealand, and the less wealthy European countries (Portugal, Spain, Ireland, and Greece), and is higher than in Australia, Japan, the United States, Switzerland, Canada, and Britain.

Table 5.4
Indicators of Civilian Public Services, 1980–91

(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	18.1	32.1	100.5	29.8	25.7	99.6
1982	17.7	30.1	100.0	29.8	24.3	99.1
1983	17.5	29.0	100.2	29.3	24.0	98.4
1984	18.2	32.0	100.0	29.3	25.0	98.5
1985	16.8	27.7	97.9	29.9	23.0	98.5
1986	16.5	25.5	96.2	29.7	21.8	98.5
1987	16.6	25.1	98.1	28.8	20.8	98.5
1988	17.1	26.5	100.6	29.0	21.7	98.5
1989	17.4	27.3	100.2	29.4	22.7	98.3
1990	17.6	27.7	102.5	29.4	23.3	98.3
1991	17.5	28.1	101.3	29.6	24.9	98.3

^a Excluding private nonprofit institutions.

^d General government as percent of total.

^b At 1986 prices.

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

^c Public services as percent of total.

SOURCE: Based on Central Bureau of Statistics data.

There was a steep rise in direct business-sector intervention in 1991, due mainly to the large increase in subsidies intended to encourage dwelling construction, as well as to the rise in subsidies to firms in order to create employment. The full budgetary effect of the

³ See Howard Oxley, Maria Maher, John P. Martin, Giuseppe Nicoletti, and Patricia Alonso-Gamo (1990), *The Public Sector, Issues for the 1990s* (OECD, Paris).

Table 5.5
Direct Demand of General Government, 1987-91^a

	NIS million			Annual change, percent							
				Price			Quantity				
	1989	1990	1991	1989	1990	1991	1987	1988	1989	1990	1991
Consumption (net)											
Civilian	14,530	17,994	23,185	21.7	18.5	22.6	3.7	4.2	2.3	4.5	5.1
Defense	11,351	13,819	16,866	25.8	15.7	20.6	32.6	-8.0	-18.6	5.2	1.2
Total	25,881	31,813	40,051	24.4	17.2	21.8	17.8	-2.5	-8.6	4.9	3.4
Domestic consumption (net)											
Civilian	14,292	17,731	22,858	21.7	18.5	22.7	3.6	4.5	2.2	4.7	5.1
Defense	8,543	10,121	11,837	21.6	17.5	21.9	4.3	0.1	-1.7	0.8	-4.1
Total	22,835	27,852	34,695	21.7	18.2	22.4	3.9	2.7	0.6	3.2	1.8
Investment	2,105	2,460	2,854	17.6	13.4	16.8	24.8	15.5	1.0	3.0	-0.7
Direct demand	27,986	34,273	42,905	23.8	17.0	21.3	18.3	-1.4	-7.9	4.7	3.2
Direct domestic demand	24,940	30,312	37,549	21.3	17.8	21.8	5.4	3.7	0.7	3.2	1.7
Government-guaranteed construction ^b	399	1,310	6,399	12.9	23.1	21.5	-5.9	-5.2	13.3	166.7	302.1

^a For more detailed information see Table 5.A1.

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

SOURCE: Based on Central Bureau of Statistics data.

purchase guarantees and the subsidization of mortgages undertaken in 1991 will begin to be felt only in 1992, when the stock of completed units is put up for sale—thereby increasing the number of purchase guarantees called in—and when new immigrants take out the subsidized mortgages.

The tax system has been gradually reformed in recent years in three important areas. The VAT was raised, thereby increasing the indirect tax component of consumption, and both corporate and personal income tax rates were reduced. While these measures improved the efficiency of tax collection, they made the tax system slightly less progressive. As a result, the share of direct taxes declined gradually and for the first time indirect taxes exceeded direct taxes. Israel's direct tax/GNP ratio is similar to that in the west, though the proportion of indirect taxes in total taxes is much higher. Thus, even though according to the indicators Israel's direct taxes are more progressive than in the west, the relatively high proportion of indirect taxes reduces the progressiveness, and this trend has been accentuated in recent years.

Table 5.6
Indicators of Defense Expenditure, 1980–91

Percent of: GNP plus unilateral transfers ^b	Defense consumption ^a as percent of GNP			Compensation of employees: defense ^a as percent of total
	Total (2)	Domestic ^c (3)	Domestic plus foreign funding ^d (4)	
1980	20.2	23.1	14.0	17.5
1981	21.7	24.5	14.1	17.7
1982	19.7	21.4	14.9	19.0
1983	16.9	18.7	14.0	17.8
1984	18.7	21.7	14.3	19.0
1985	17.7	21.5	12.7	17.7
1986	13.6	15.9	11.0	15.1
1987	17.3	19.4	11.0	14.6
1988	15.0	16.3	10.5	13.6
1989	12.3	13.6	10.2	12.9
1990	12.2	13.5	9.9	12.4
1991	11.7	12.7	8.9	11.0
				9.2

^a Excludes conscripts.

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

^c Local-currency expenditure net of domestic sales.

^d Budgeted foreign-currency outlay and principal and interest on U.S. government aid.

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

Because of predictions of larger expenditure on immigrant absorption in 1991, there was some departure from implementation of the long-term tax reform as personal income-tax rates were raised.

Table 5.7
Taxes, Subsidies, and Transfers, 1980–91

	1980–84	1986–91	1984	1985	1986	1987	1988	1989	1990	1991	(percent of GNP)
Taxes and transfers											
Taxes and transfer receipts	43.2	43.9	38.4	45.3	48.1	47.0	45.1	41.0	41.3	40.6	
<i>less</i> Subsidies and transfer payments	16.8	15.4	16.5	15.1	14.4	14.2	15.7	16.0	15.5	16.7	
<i>less</i> Credit subsidies	4.5	0.9	3.2	2.0	1.5	1.4	1.0	0.7	0.6	0.4	
Total	21.9	27.5	18.6	28.1	32.2	31.4	28.3	24.4	25.3	23.4	
Direct taxes											
Direct taxes and transfer receipts	24.9	22.7	20.3	24.5	25.3	24.1	23.7	21.9	21.3	19.8	
<i>of which</i> Income tax	15.9	14.6	13.0	15.9	16.5	16.0	15.8	13.9	13.1	12.1	
<i>less</i> Transfer payments	11.2	12.5	10.2	10.4	11.3	11.1	12.4	13.0	12.8	14.2	
Total	13.8	10.2	10.1	14.1	14.0	13.0	11.4	8.9	8.5	5.6	
Indirect taxes, domestic											
Taxes	11.0	14.3	10.7	13.5	14.7	14.3	13.8	13.6	14.3	14.8	
<i>less</i> Subsidies	4.4	1.9	4.7	3.5	2.0	1.9	2.2	1.8	1.7	1.9	
<i>less</i> Credit subsidies to firms	2.6	0.9	1.8	1.8	1.5	1.4	1.0	0.7	0.6	0.4	
Total	4.0	11.4	4.2	8.2	11.2	11.0	10.6	11.2	12.1	12.4	
Net foreign trade taxes											
Net import duties	7.2	7.1	7.6	7.6	8.4	8.7	7.7	5.5	5.6	6.0	
Direct export subsidies	1.1	1.1	1.8	1.6	1.3	1.3	1.3	1.2	0.9	0.6	
Export credit subsidies	1.5	0.0	1.3	0.2	0.0	0.0	0.0	0.0	0.0	0.0	
Total	4.5	5.9	4.5	5.7	7.1	7.4	6.3	4.3	4.7	5.4	
Tax burden^a	24.1	29.1	20.2	29.4	33.4	32.7	29.7	25.5	26.7	26.7	

^a Defined as net tax revenue *less* operating surplus of Post Office and Ports Authority and government earmarked income *plus* capital grants to firms.

SOURCE: Based on Central Bureau of Statistics data.

Table 5.8
Direct Taxes, Compulsory Loans, and Transfer Payments, 1985–91

	NIS million						Real annual change, percent ^a				
	1986	1987	1988	1989	1990	1991	1987	1988	1989	1990	1991
Income tax	7,092	8,815	10,795	11,597	13,404	15,989	3.7	5.3	-10.7	-1.4	0.2
Wages and salaries	2,528	3,393	4,499	5,287	6,313	7,430	12.0	14.0	-2.3	1.9	-1.1
Non-wage income	4,564	5,421	6,296	6,310	7,091	8,559	-0.9	-0.1	-16.7	-4.1	1.4
Companies	1,379	1,386	1,860	1,460	1,480	1,848	-16.1	15.4	-34.7	-13.5	4.9
Deduction at source	1,339	1,640	1,941	2,033	2,138	2,554	2.2	1.8	-12.9	-10.2	0.4
Cooperative members	815	1,188	1,288	1,483	1,770	2,117	21.6	-6.8	-4.2	1.9	0.5
Self-employed	1,031	1,207	1,207	1,334	1,703	2,040	-2.3	-14.0	-8.1	9.0	0.7
National insurance contributions	2,715	3,188	3,773	4,505	5,461	6,605	-2.0	1.8	-0.7	3.5	1.6
Wages and salaries ^b	2,338	2,680	3,176	3,777	4,678	5,660	-4.4	1.9	-1.1	5.7	1.7
Nonwage income	377	508	597	728	783	945	12.5	1.0	1.4	-8.2	1.4
Fees and fines	186	299	369	473	565	671	34.3	6.2	6.6	1.9	-0.2
Total direct taxes	9,992	12,302	14,937	16,575	19,430	23,265	2.7	4.4	-7.7	0.0	0.6
Current transfers to households	3,780	4,841	6,133	7,842	10,256	13,268	6.9	9.0	6.3	11.6	8.7
Through National Insurance	2,884	3,564	4,518	5,734	6,886	8,276	3.1	9.0	5.5	2.5	1.0
Other	896	1,277	1,615	2,108	3,370	4,992	18.9	8.8	8.5	36.4	24.5
To private nonprofit institutions	244	321	430	576	831	1,083	9.7	15.2	11.4	23.1	9.5
Current transfers	225	287	381	502	679	890	6.4	14.2	9.6	15.4	10.1
Capital transfers	19	34	49	74	152	193	47.4	24.0	25.6	75.3	6.7
Capital transfers to firms <i>of which</i> Housing	515	728	903	942	1,514	4,387	17.9	6.7	-13.2	37.2	143.5
500					500	3,000					404.2
Repayment of compulsory loans	321	252	955	1,511	488	99	-34.5	226.2	31.7	-72.4	-83.0
Total transfer and loan repayments	4,860	6,142	8,421	10,871	13,089	18,837	5.4	17.9	7.4	2.8	20.9

Transfers received	629	970	1,231	1,750	2,367	2,950	28.7	9.1	18.2	15.4	4.7
Current ^c	76	101	159	196	201	254	11.0	35.1	2.5	-12.5	6.2
Capital ^d	553	869	1,072	1,554	2,166	2,696	31.1	6.1	20.6	19.0	4.6
Net transfer payments	4,231	5,172	7,190	9,121	10,722	15,887	2.0	19.6	5.5	0.3	24.5
Direct taxes <i>plus</i> transfers received	10,621	13,272	16,168	18,325	21,797	26,215	4.3	4.8	-5.7	1.5	1.1
Net direct taxes and transfers	5,761	7,130	7,747	7,454	8,708	7,378	3.3	-6.5	-20.0	-0.3	-28.8

^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.

3. DIRECT GOVERNMENT INVOLVEMENT IN IMMIGRANT ABSORPTION

The government's involvement in immigrant absorption was confined to four areas—accommodation, employment, basic income support, and social services. Government involvement in the housing market led to a sharp increase in housing investment, and when the immigration rate fell, investment was in excess of requirements. Employment policy produced poor results since it was not pursued vigorously enough, in three areas in particular: reducing taxes on factors of production, chiefly labor; expanding infrastructure investment; and introducing structural reform, particularly in increasing labor-market flexibility, which progressed slowly. Current transfers to immigrants were adjusted several times in 1990–91, but remained constant in real terms. The level of per capita public consumption was not altered by the addition of the immigrants to the pool of social services recipients.

The object of the government's housing policy was to encourage the expansion of both supply and demand. The acceleration of immigration in 1990, and the belief that the housing market would respond too slowly, led the government to introduce a series of measures intended to expand and speed up dwelling construction. These included purchase guarantees given to contractors for units built and left unsold. At the end of 1990 the government also embarked on the own-account construction of 20,000 units. The remaining purchase guarantees are a potential burden on future budgets. Since fewer immigrants have come than were originally bargained for, and also because of the locations where the units were built, the gap between future supply and demand for them is widening and government expenditure on honoring the guarantees is expected to increase.

In addition, in 1990 the government began to offer inducements to contractors to speed up starts and completions of construction, also providing land at reduced prices in many parts of the country. This is reflected by the steep increase in government-initiated construction, which almost doubled in real terms in 1990 and tripled in 1991, as well as by the faster pace of construction.

On the demand side, through the mortgage banks the government offered immigrants subsidized mortgages and grants depending on duration of residence. Some 20,000 immigrant families took advantage of these benefits in 1991, and the subsidization of mortgages accounted for NIS 70 million—a relatively small amount, which will grow in the next few years as the number of home-buyers increases (see section on construction, Chapter 2).

In July 1991 the Knesset passed a law to encourage the absorption of immigrants in the business sector under which an employer who takes on a new employee is entitled to a subsidy of one third of his or her monthly wage, up to a ceiling of NIS 1,000 a month. The subsidy for the new employee is paid for up to ten months, and is brought into line with price-increases every quarter. The law was introduced at the end of 1991 and consequently does not greatly affect the 1991 budget. It is expected to cost about NIS 250 million in 1992, however. Since 1990 investment grants have also been linked with the

Table 5.9
Indirect Taxes and Subsidies on Domestic Production, 1984-91

	NIS million						Real annual change, percent ^a				
	1986	1987	1988	1989	1990	1991	1987	1988	1989	1990	1991
Indirect taxes											
Taxes on economic activity	4,847	5,828	6,993	8,454	10,904	14,865	0.3	3.2	0.5	10.1	14.6
Value added tax ^b	3,276	4,039	5,167	6,286	7,805	11,188	2.9	10.0	1.2	6.0	20.5
Purchase tax	344	388	419	454	452	470	-5.9	-7.0	-9.9	-15.0	-12.6
Fuel tax	356	375	501	618	1,036	1,494	-12.0	14.9	2.6	43.1	21.2
Employers' tax,	579	521	496	576	692	830	-24.9	-18.1	-3.4	2.5	0.8
Other ^c	292	505	410	520	919	883	44.1	-30.1	5.3	51.0	-19.2
Property taxes	65	87	131	191	272	337	10.5	30.0	21.2	21.5	4.1
Municipal taxes	1,075	1,518	1,794	2,226	2,865	3,623	17.8	1.7	3.2	9.8	6.3
Other taxes ^d	315	457	514	439	619	764	21.1	-3.3	-12.8	-1.9	3.7
Total indirect taxes	6,302	7,889	9,432	11,409	14,660	19,590	4.4	2.8	0.6	9.7	12.3
Subsidies											
Subsidies	872	1,051	1,479	1,470	1,741	2,552	0.6	21.0	-17.3	1.1	23.2
Imputed credit subsidies	626	790	702	568	569	583	5.2	-23.6	-32.7	-14.5	-13.9
Total subsidies	1,498	1,841	2,181	2,038	2,310	3,135	2.5	1.9	-22.3	-3.3	14.0
Net indirect taxes											
Excluding imputed credit subsidies	5,430	6,838	7,953	9,939	12,919	17,037	5.1	0.0	3.9	10.9	10.8
Including credit subsidies	4,804	6,048	7,251	9,371	12,350	16,454	5.1	3.1	7.5	12.5	12.08

^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.

absorption of new immigrants, one of the criteria for receiving such a grant being the number of employees in a firm. This criterion is currently more important than the export requirement which was the chief condition for receiving investment grants in the past.

Total annual aid per immigrant family, comprising the initial absorption grant plus health insurance and unemployment benefit (during the second half of the first year in Israel), came to NIS 31,000 at the end of 1991. Since the absorption grant was introduced, it has been adjusted several times (see note to Table 5.A3), but since the beginning of 1991 it has risen in nominal terms by 15 percent, slightly less than the annual inflation rate.

4. DIRECT DEMAND

Direct domestic government demand, which reached a trough in 1989, began to increase gradually as resources were allocated to the economic absorption of immigrants. Real direct domestic demand rose by 3 percent in 1990, with a similar expansion of general government consumption and investment. These trends did not recur in 1991 and, following a slight increase in public consumption and a decline in investment, real direct domestic demand rose by only 1 percent. A comparison of the increase in direct domestic demand and GDP shows that direct general government pressure on domestic resources moderated, causing economic activity to contract. However, when direct construction outlays, such as prefabricated units bought and purchase guarantees called in, are added to demand, the picture alters drastically, revealing the general government's direct effect on the expansion of economic activity in 1991.

Real domestic civilian consumption rose by 5 percent in 1991 due to the increase in employment and domestic purchases. Domestic defense consumption declined, however, since employment and domestic purchases fell.

5. TAXES AND TRANSFERS

An aggregate index of the indirect effect of government activities is the total tax burden, which reached a peak in 1986, declined gradually in 1987–89, and rose once again in 1990, remaining at the same level in 1991 (Table 5.7). This indicator seems to show that the indirect effect of government in 1990–91 was contractionary. However, it underestimates the effect in 1991, since it makes no allowance for the implicit contribution of purchase guarantees and future credit subsidies to stimulating business-sector activity, which will be recorded in the general government's accounts only in the future. Furthermore, some of the taxes and transfers are transient, and consequently have only a short-lived effect.

Real tax receipts increased by 7.4 percent, and their share of GNP declined slightly, reaching 39 percent. In the first quarter of 1991, following the contraction of economic

Table 5.10
Taxes and Subsidies on Imports, 1985–1991

	NIS million							Real annual change, percent ^a				
	1985	1986	1987	1988	1989	1990	1991	1987	1988	1989	1990	1991
Taxes on civilian imports	1,991	3,517	4,714	5,132	4,584	5,763	7,944	11.8	-6.4	-25.7	7.3	15.8
Value added tax	820	1,245	1,666	1,713	1,857	2,635	3,875	11.7	-11.6	-9.8	21.1	23.6
Customs ^b	392	774	791	796	421	518	708	-14.8	-13.4	-56.0	5.0	14.9
Purchase tax	541	1,268	1,950	2,245	1,986	2,388	3,155	28.3	-1.0	-26.4	2.6	11.0
Other taxes ^c	239	230	307	378	320	222	206	11.6	5.8	-29.6	-40.8	-22.0
Import subsidies	-82	-109	-88	-88	-25	17	-44	-32.9	-13.8	-76.4	-158.0	-317.5
Net taxes (civilian imports)	2,073	3,626	4,802	5,220	4,609	5,746	7,988	10.5	-6.5	-26.6	6.4	16.8
Taxes on defense imports	414	376	731	643	546	731	1,074	62.2	-24.3	-29.4	14.3	23.5
Exports	506	564	736	919	1,047	963	798	8.9	7.4	-5.3	-21.5	-30.4
Subsidies	438	560	732	916	1,044	960	794	9.1	7.6	-5.2	-21.5	-30.5
Imputed credit subsidies	68	4	4	3	3	3	4	-14.8	-30.6	-22.7	-14.7	12.0
Net foreign trade taxes												
Excl. credit subsidies	1,635	3,066	4,069	4,304	3,565	4,786	7,194	10.7	-9.0	-31.1	14.6	26.3
Incl. credit subsidies	1,567	3,062	4,065	4,301	3,562	4,783	7,190	10.8	-9.0	-31.1	14.6	26.3

^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 tariff on imports of services (from 1984); the tariff on foreign travel fares (from 1985).

SOURCE: Based on Central Bureau of Statistics data.

activity due to the Gulf War, real tax receipts fell, but with the recovery they soared in comparison with the corresponding quarter in previous years. In the last three quarters of 1991 tax receipts were higher than in any year since 1982, the peak year, when significant changes were made in tax legislation in order to finance the war in Lebanon. The increase in real tax receipts in 1991 was due chiefly to the increased volume of indirect taxes, which for the first time exceeded direct taxes.

During the last few years the tax system has been undergoing reform along the lines which have been introduced gradually in the OECD countries since the early 1980s. This reform includes expanding the corporate tax base and reducing its rate, expanding the base of tax on consumption through the shift to VAT, and reducing personal income tax rates. Because of the need to cover expenses associated with the absorption of immigrants, only the first two principles were applied in 1991, and the situation regressed with regard to the third.

Expectations of a steep increase in immigrant absorption expenditure aided the passage of tax legislation in 1990–91. These laws increased the tax burden and departed from the principles underlying the 1987 reform of direct taxes (Table 5.7).

The changes in tax structure nonetheless increased the efficiency of tax collection as the share of VAT rose and other taxes were abolished. Manpower allocation became more efficient, income tax rates were reduced, employers' share of National Insurance contributions was cut, the exposure policy was pursued through the removal of administrative controls on imported goods, income tax became more progressive, and real credit and export subsidies were reduced.

The legislative changes of 1991 helped to raise tax receipts by NIS 1,120 million, accounting for 0.8 percent of GNP. Legislation increased indirect taxes by NIS 2,280 million, while reducing direct taxation by NIS 1,060 million (Table 5.A3). The annual rate of increase of municipal taxes was 20.4 percent on average—2 percentage points higher than the rate at which the CPI rose.