

CHAPTER VII

PUBLIC SECTOR OPERATIONS

1. THE PUBLIC SECTOR—CONSOLIDATED ACCOUNT¹

THE INFLUENCE of the public sector on the level of aggregate domestic demand is measured below (Tables VII-1 and VII-3), in terms of the sector's demand surplus and the net volume of credit which it extended to the rest of the economy.²

The public sector's demand surplus is defined as the excess of its purchases on current and capital account over its total sales and receipts from domestic transfers. Total purchases represent the sector's direct demand for goods and services, domestic as well as imported, while total revenue from domestic transfers (taxes, other compulsory payments, and sales, less transfer payments) represents the amount by which the demand of the other sectors has been reduced. To the extent that the public sector expands its direct demand more than it decreases the demand of the rest of the economy, the sector's demand surplus rises, this being reflected by an increase in its influence on the level of economic activity, or on the import surplus, or both.³

In order to ascertain the total influence of the public sector on effective demand in the economy, its financial transactions also have to be taken into

¹ The Government (including the National Insurance Institute), the National Institutions (Jewish Agency, World Zionist Organization, Jewish National Fund, and Keren Hayesod), and local authorities (including religious councils and municipal outlays of cooperative agricultural settlements). Current income and expenses of trading enterprises (such as the Post Office, Israel Railways, and municipal waterworks) have been excluded, except for their surpluses or deficits.

The data in this chapter are based chiefly on financial reports of the public sector authorities, and in part on data from the Central Bureau of Statistics, and in all cases relate to calendar years. Some of the data for 1966 are based on provisional monthly summaries, since financial reports for fiscal 1966/67 have not yet been published. Data for 1965 have been revised.

² This is discussed in Chapter XVI, "Flow of Funds". The influence of the Government's outlays on the level of domestic demand is discussed below (see in particular Tables VII-5 and VII-7).

³ As regards the economy as a whole, the demand surplus is reflected in the balance of payments deficit on current account—i.e. an import surplus. As regards a specific sector of the economy, its contribution to the creation of a demand surplus and balance of payments pressure cannot be measured separately. Even were it possible to distinguish between domestic and foreign purchases, there is a considerable degree of substitution between them, and the substitution of local purchases for imports on the part of one sector may result in the expansion of imports by another.

account, for by granting credit to the other sectors, it enables them to expand their demand. Most of the credit goes to public sector companies, and since the Government and the Jewish Agency provide them with most or all of their funds and largely determine the volume of their investments and their operations, any distinction between the public sector's direct demand and the granting of credit to these companies lacks significance.

The sector's demand surplus¹ totalled IL 876 million in 1966, a rise of IL 208 million, as compared with IL 211 million in 1965. About one-third of the increase stemmed from purchases and expenditures abroad.² Part of the growth was in items with a low degree of substitutability with local purchases and whose influence was consequently felt mainly in the balance of payments. Thus it transpired that much of the rise in the demand surplus in 1966 did not affect the level of domestic economic activity at all. In contrast to the larger demand surplus, the amount of credit extended by the public sector to the rest of the economy—i.e. the excess of loans granted (mainly through the State's development budget and the Settlement Department of the Jewish Agency) over credit received (loans and credit from domestic sources, including the Absorption Loan but not bank credit)—declined by IL 250 million to stand at a mere IL 9 million. In 1965 the public sector granted net credit in the sum of IL 259 million and in 1964, IL 167 million.

The public sector's demand surplus and its net credit outflow are financed mainly from foreign sources and to a smaller extent by the banking system. In 1966 the total amount of financing came to IL 885 million, as against IL 927 million in 1965 and IL 624 million in 1964. This drop from the 1965 level does not mean that the sector's operations had a contractionary effect on aggregate domestic demand. And this not only because the increase in Government purchases was partly reflected in the import surplus, but mainly owing to the fact that, as the public sector's demand surplus and its net credit outflow developed in opposite directions in 1966, the one rising substantially and the other falling even more steeply, it is difficult to tell whether the net effect on the demand level was expansionary or contractionary, since the flow of credit affects demand only indirectly. Nevertheless, it is reasonable to assume that the reduction of net credit did not wholly offset the expansionary influence of the increased demand surplus, for the former largely resulted from the absorption of funds from the public in the form of short-term borrowing, the contractionary effect of which on demand is quite weak.

Both the Government and the local authorities contributed to the larger

¹ The demand surplus for 1966 has been calculated somewhat differently (see Table VII-3) than in previous Annual Reports. Collections on account of the Absorption Loan, which formerly were included in tax revenue, now appear under the head "loans from the public" (see section 2[d] below).

² Direct Government imports including equipment and commodity stocks, overseas expenditure of the National Institutions, and interest payments abroad.

Table VII-1

**DEMAND SURPLUS AND DOMESTIC CREDIT OUTFLOW OF THE PUBLIC
SECTOR AND SOURCES OF FINANCING, 1964-66**
(IL million, at current prices)

	1964	1965	1966	Change from 1965 to 1966
A. Demand surplus				
Purchases on current and capital account ^a and net interest	2,457	2,943	3,419	476
Less: Net taxes and transfers from the public ^b	2,000	2,275	2,543	268
Total	457	668	876	208
B. Net domestic credit granted				
Loans granted ^c	455	499	500	1
Less:				
Domestic loans and credit received ^d	187	113	320	207
Absorption Loan	101	127	171	44
Total	167	259	9	-250
Sources financing the demand surplus and net domestic credit				
C. Foreign sources				
Unilateral transfers	217	287	192	-95
Net loans and credits	298	546	437	-109
Total	515	833	629	-204
D. Banking system				
Total (C + D)	109	94	256	162
Of which:				
For the Government	346	626	620	-6
For the National Institutions	271	250	226	-24
For local authorities	7	51	39	-12

^a Purchases less sales.

^b Income from taxes and domestic transfers on current and capital account, less transfer payments, subsidies, and revenue from the Absorption Loan and compulsory saving (see Table VII-3).

^c Excluding transactions with the banking system.

^d Net of repayments, apart from collections on account of the Absorption Loan and compulsory saving.

demand surplus in 1966 by expanding their net purchases twice as much as their net local receipts. The slowdown in economic activity—the decelerated growth of GNP and private consumption, the stability in imports, and the decline in investment—was reflected by the “automatic stabilizers”, i.e. in the volume of Government and local authority tax revenue, which in 1966 rose at a rate far below the average for the five preceding years. The decline stands out all the more when compared with the anticipated revenue. The Government and local authority budgets for fiscal 1966/67, drawn up in conformity with the economic moderation policy, had envisaged a steep rise in direct and indirect tax receipts in order to obviate the need of inflationary financing.¹ Levies on a long list of goods were increased at the beginning of 1966, along with income tax rates, and local authorities were allowed to raise their rates for the first time since 1962. However, the recession resulted in revenue from taxes and other compulsory payments lagging far behind the budget estimates. In contrast to this, expenditure was almost as budgeted, both because the Government was reluctant to reduce the services it supplied, and also because of the inelasticity of the current expenditure items of the Government and local authorities.² On the other hand, the demand surplus of the National Institutions declined, owing to the smaller outlay on capital account (mainly development work by the Jewish National Fund) and in connection with immigration, which fell off sharply during the year. The rise in the public sector’s demand surplus in 1966 was therefore due primarily to the slower growth of revenue as a result of the operation of the automatic stabilizers, in contrast to the situation in 1965, when the expansion of the demand surplus could be traced mainly to a substantially higher level of Government and local authority expenditure.

The smaller volume of net credit extended by the public sector can be attributed chiefly to Government operations, since the Government is a net supplier of credit while the National Institutions and the local authorities are net recipients.³ The contraction of net credit did not result from a reduction in long-term lending by the Government and National Institutions—this totalled IL 500 million in both 1966 and 1965—but was due to a sharp rise in nonbank loans and credit, mainly proceeds from the sale of the Short-Term Loan to the public.

The public sector’s demand surplus and its net credit outflow were mostly financed, as stated, from foreign sources. However, the share of such funds (unilateral transfers and net borrowed receipts) fell from 90 percent in 1965 to 70 percent. Unilateral transfers were responsible for most of the decline. The rest of the financing was provided by the banking system, in the form of loans and drawings on deposits; this brought up the public sector’s indebtedness to

¹ See the “National Budget for 1966”, Bank of Israel Bulletin No. 26, June, 1966, p. 87.

² Mainly wage outlay and National Insurance benefit payments. This is discussed in the section on the influence of Government operations on demand.

³ Taking into account financial transactions between public sector authorities.

the banking system by IL 256 million, of which the Government alone accounted for IL 210 million.

(b) *The "balance of payments" of the public sector*

The "balance of payments" of the public sector for the years 1965 and 1966, by main type of receipt and payment, is set forth in Table VII-2. The table distinguishes between transfers and transactions in goods and services on the one hand (the "real account") and transactions in credit (the "financial account") on the other.¹

The volume of public sector payments, as reflected in the "balance of payments", rose by IL 794 million during the year reviewed to stand at nearly IL 5,790 million²—a growth of 16 percent, similar to the previous year's rate.

Payments on real account (purchases on current and capital account, interest, transfer payments, and subsidies) exceeded receipts (from taxes and other compulsory payments and transfers from domestic and foreign sources) by IL 684 million.³ This gap was balanced by a corresponding surplus in the financial account (net domestic and foreign borrowed receipts).

The Government's share in total public sector expenditure in 1966 came to 79 percent, that of the local authorities to 14 percent, and that of the National Institutions, which has been on the decline for the past several years, to 7 percent.

1. *Receipts*

Public sector tax revenue⁴ was up 15 percent in 1966, a lower growth rate than in any of the past six years (in 1961-65 it averaged 18.5 percent p.a.). The slower increase in 1966, the outcome of the economic recession, was reflected chiefly in indirect tax collections. The main influence here was the smaller purchases of homes, consumer durables, motor vehicles, and luxury items (which are taxed relatively heavily), and the decline in investment. The growth of the sector's tax revenue during the year is explained primarily by the raising of indirect and direct tax rates at the beginning of the year.

Unilateral receipts from abroad fell off by a third, following a rise in the previous year. This was mainly due to the termination of German reparations in 1965/66, and the poorer results of the National Institutions' fund-raising drives abroad, which was apparently connected with the decline in immigration. Net

¹ A breakdown of the items in Table VII-2 by public sector authority appears in the appendix to this chapter (in Hebrew only).

² With long-term loans granted and received recorded on a gross basis and short-term loans on a net basis. (If all loans granted and received had been recorded on a net basis, the volume of payments would have risen by IL 727 million to nearly IL 5,210 million.)

³ This figure is equal to the demand surplus of the public sector, less unilateral transfers from abroad.

⁴ Excluding receipts from the Absorption Loan.

Table VII-2

"BALANCE OF PAYMENTS" OF THE PUBLIC SECTOR, BY TYPE OF RECEIPT AND PAYMENT, 1965-66
(IL million)

Receipts	1965	1966	Increase or decrease (-)	Payments	1965	1966	Increase or decrease (-)
Transfers and transactions in goods and services							
Taxes ^a	2,839	3,271	432	Purchases			
Miscellaneous revenue	474	559	85	On current account	2,193	2,599	406
Total	3,313	3,830	517	On capital account	610	659	49
				Interest payments	338	381	43
Unilateral receipts from abroad	287	192	-95	Transfer payments and grants	583	742	159
Total	3,600	4,022	422	Subsidies	257	325	68
				Total	3,981	4,706	725
Transactions in financial claims							
Collections on account of long-term loans	95	90	-5	Long-term loans granted and participation in share capital	594	590	-4
Long-term loans received				Repayment of long-term loans			
Domestic ^b	318	385	67	Domestic	113	139	26
Absorption Loan	127	177	50	Foreign	306	353	47
Foreign	692	677	-15				
Short-term credit (net)							
Domestic ^c	-92	68	160				
Foreign	160	113	-47				
From the banking system ^d	94	256	162				
Total	1,394	1,766	372	Total	1,013	1,082	69
Total receipts	4,994	5,788	794	Total payments	4,994	5,788	794

^a Including collections on account of National Insurance but not on account of the Absorption Loan and compulsory saving.

^b Excluding the Absorption Loan.

^c Excluding credit from the banking system.

^d Including long-term loans and securities.

foreign borrowed receipts were down by nearly 20 percent. Net receipts from foreign sources aggregated about \$ 210 million in 1966, compared with \$ 275 in 1965. The weight of such receipts (unilateral transfers, gross long-term loans, and net short-term credit) in the sector's total receipts moved down from 23 percent in 1965 to 17 percent.

Domestic borrowed receipts showed a big gain. There were increases in long-term loans, including the Absorption Loan, and in short-term credit as a result of larger proceeds from the Government Short-Term Loan. The net debt to the banking system also went up, for the fourth year running.

2. *Payments*

Public sector purchases on current account amounted to 18.5 percent more in 1966, compared with a 24 percent rise in the previous year. As in 1965, most of the increment was in wage outlay, which increased by 28 percent to IL 1,070 million. This stemmed from a growth of 6 percent in the number of employees and an average rise of 20 percent in pay per employee. The latter was due almost entirely to the upping of basic wages and the payment of increments on account of retroactive pay rises. The reclassification of administrative workers in the National Institutions and some of the local authorities was virtually completed in 1966, and they were paid the wage increments due them on account of the years 1964 and 1965. The increments due academically-trained personnel, whose salaries were revised in December 1965 with effect retroactive to the beginning of fiscal 1964/65, were also paid at the beginning of 1966.

Current purchases other than wages rose by 12.5 percent; security expenditure and special budgets were higher, but Government imports hardly increased.

Purchases on capital account were up 8 percent. Virtually all of the growth was in Government stocks in warehouses. National Institution investments (mostly development work, land reclamation, and afforestation by the Jewish National Fund) declined. There was also a smaller investment by local authorities, by Government enterprises (the Post Office, Israel Railways, and the ports), and in the National Water Carrier. In contrast, Government expenditure on public buildings and highway construction was higher in 1966.

Transfer payments and subsidies were substantially larger in 1966. The former went up by 28 percent, with most of the increment being in National Insurance benefit payments following the raising of benefit rates and the increase in the number of recipients. Subsidies expanded by 27 percent; export benefited most from this, the volume of supports doubling as compared with 1965. Interest payments were 12.5 percent larger, with the Government and local authorities accounting for most of the rise. Interest payments of the National Institutions went up more slowly than in previous years, but the share of this item in the Institutions' total purchases and transfers advanced to 31 percent. About half of all interest paid by the public sector in 1966 went to the rest of the world.

Long-term lending by the public sector hardly changed between 1965 and 1966, and the weight of loans in total payments fell to 10 percent. There are several reasons for this decline, which has persisted for several years: the reduction of reparations funds, a large part of which has been channeled through the Government's development budget to public sector companies; the enabling of public sector companies to borrow from various domestic and foreign sources—mainly through the Government's guarantee—instead of borrowing directly from the Government; the obligating of social insurance funds to purchase bonds of various companies (by including the securities on the list of approved investments);¹ and the delegation of much of the financing function to public financial institutions operating under Government direction.

These changes have reduced the direct share of the public sector in financing the rest of the economy, but they are more of an institutional than a substantive nature.²

The stability in the volume of long-term lending by the public sector in 1966 followed several years of continuous growth, and was largely due, apart from the reasons listed above, to the decline in domestic capital formation, a considerable share of which is financed by the public sector.

(c) *Public sector saving*

The saving of the public sector, defined as the excess of current revenue (mainly taxes) over current expenditure (purchases, interest, transfer payments, and subsidies) is of a negative magnitude. The amount of dissaving increased from IL 156 million in 1965 to IL 310 million in the year reviewed.³ In arriving at the saving estimate, income from the Absorption Loan, which is classified under domestic loan receipts, has been omitted. But even if such revenue is included, it would not change the sign of the saving estimate but would only reduce the amount of dissaving.⁴

The growth of dissaving resulted from Government and local authority operations, whereas the National Institutions reduced their negative saving. Current Government outlays rose in 1966 by 22 percent, and current revenue (including that from property) by 16 percent. The difference between the corresponding rates for the local authorities was similar. It should be noted that local authority dissaving was smaller in 1966 than in the previous year, owing to the unfreezing of municipal tax rates at the beginning of fiscal 1966/67.

¹ The purchase of bonds recognized as an approved investment by social insurance funds entitles them to income tax concessions.

² The Government owns a controlling interest in the financial institutions, and it determines their loan policy. Moreover, it largely dictates the sectorial allocation of social insurance fund investments through its directives on approved investments.

³ These data relate to net public sector saving and differ from the figures cited in Chapter XIX, "Saving", which relate to gross saving.

⁴ Public sector dissaving, including revenue from the Absorption Loan, increased from IL 29 million in 1965 to IL 139 million in 1966 (see Table VII-3).

Table VII-3
PUBLIC SECTOR SAVING AND DEMAND SURPLUS, 1965-66
 (IL million, at current prices)

	1965				1966				Increase or decrease (-) from 1965 to 1966
	Government	Local authorities	National Institutions	Total	Government	Local authorities	National Institutions	Total	
A. Income on current account									
Taxes ^a	2,571	268	—	2,839	2,961	310	—	3,271	432
Transfers	48	61	6	115	63	70	4	137	22
Income from property	41	3	13	57	72	3	15	90	33
Total	2,660	332	19	3,011	3,096	383	19	3,498	487
B. Expenditure on current account									
Purchases (net of sales)	1,675	358	116	2,149	2,033	428	105	2,566	417
Transfers	455	78	31	564	593	90	35	718	154
Interest (net)	105	23	69	197	102	29	71	202	5
Subsidies	250	2	5	257	316	3	3	322	65
Intrasector transfers (net)	111	-113	2	—	124	-128	4	—	—
Total	2,596	348	223	3,167	3,168	422	218	3,808	641
C. Saving or dissaving (A-B)	64	-16	-204	-156	-72	-39	-199	-310	-154
Absorption Loan (net)	127	—	—	127	171	—	—	171	44
D. Saving incl. Absorption Loan	191	-16	-204	-29	99	-39	-199	-139	-110
E. Expenditure on capital account									
Purchases (net of sales)	337	221	39	597	413	204	34	651	54
Transfers (net) ^b	-27	-63	5	-85	-34	-57	6	-85	—
Intrasector transfers (net)	-11	-2	13	—	12	-8	-4	—	—
Total	299	156	57	512	391	139	36	566	54
F. Demand surplus (E-C)	235	172	261	668	463	178	235	876	208
G. Demand surplus incl. Absorption Loan (E-D)	108	172	261	541	292	178	235	705	164

^a Excluding collections on account of the Absorption Loan and compulsory saving.

^b Domestic transfers on capital account: to the Government—mainly land betterment tax and inheritance tax; to the local authorities—mainly participation of home-owners in development expenditure.

The drop in National Institution dissaving was due to smaller current expenditure—the Institutions do not collect taxes, and their current income from domestic sources covers only a fraction of their expenditure.¹

(d) *Functional composition of expenditure*

A breakdown of public sector expenditure for the years 1965 and 1966 by function and by public sector authority is shown in Table VII-4.²

Changes in the composition of public sector expenditure are mainly accounted for by the Government, as its proportion of total outlay comes to about 80 percent. Security, National Insurance, and the promotion of production and export are the exclusive province of the Government, which also plays a decisive role in other items.

The share in total expenditure of the National Institutions, which deal chiefly with immigration and agriculture, has been declining.

The main expenditure items of the local authorities are social services (chiefly education, health, and social welfare) and municipal services (sanitation, sewerage, fire protection, street lighting, supply of drinking water, etc.). Their weight in total public sector expenditure is moving upward.

In 1966 the relative share of social service continued to rise, outlay amounting to IL 1,910 million, or 33 percent of the total. The percentage spent on education, health, and social welfare (including National Insurance) went up, while that on housing declined, continuing the downtrend which began in the previous year with the reduction of immigrant housing construction.

The share of general services (general administration, community services, security, police, and justice) in total outlays declined in 1966 to IL 1,740 million, or 30 percent of the total. This item includes *inter alia* the municipal services supplied by local authorities and the immigration services supplied by the National Institutions. The absolute decline in outlay connected with immigration and the relatively moderate rise in that on security and special budgets explain most of the decrease in the weight of general services.

Outlay on economic services totalled IL 1,095 million in 1966, and their weight edged down to 19 percent. The percent spent on agriculture and water development declined, continuing the trend discernible since 1964 when investment in agriculture (including the National Water Carrier) fell off. The relative shares of industry, mining and quarrying, and transportation and communications held steady.

¹ The bulk of the Institutions' receipts originate in unilateral transfers from abroad. These receipts are not treated as current income in calculating saving.

² Table VII-4 is based on data from Tables VII-15, VII-18, and VII-21. Outlays have been recorded net of transfers between public sector authorities (Government, National Institutions, and local authorities), being regarded as expenditure of the executing authority and not of the financing authority. Hence Table VII-4 is not strictly comparable with the other tables mentioned.

Table VII-4

FUNCTIONAL COMPOSITION OF PUBLIC SECTOR EXPENDITURE,^a 1965-66
(IL million)

	1965	1966			Weight in total (%)		
	Total sector	Government	National Institutions	Local authorities	Total	1965	1966
General services							
General administration	286	187	27	85	299	5.7	5.2
Security and special budgets	952	1,069	—	—	1,069	19.1	18.5
Police and justice	106	130	—	—	130	2.1	2.2
Community services n.e.s. ^b	245	35	47	158	240	4.9	4.1
Total	1,589	1,421	74	243	1,738	31.8	30.0
Social services							
Education, culture, religion	678	539	40	303	882	13.6	15.2
National Insurance and social welfare	366	392	10	64	466	7.3	8.1
Health	188	211	2	39	252	3.8	4.4
Housing	311	300	7	4	311	6.2	5.4
Total	1,543	1,442	59	410	1,911	30.9	33.1
Economic services							
Agriculture and water development	395	273	121	9	403	7.9	7.0
Industry, mining and quarrying	142	148	1	7	156	2.8	2.7
Transportation and communications	368	350	—	75	425	7.4	7.3
Other economic services	73	109	3	—	112	1.5	1.9
Total	978	880	125	91	1,096	19.6	18.9
Unallocable services							
Interest payments	338	273	82	29	384	6.8	6.6
Debt redemption	419	377	64	51	492	8.4	8.5
Miscellaneous ^c	127	167	—	—	167	2.5	2.9
Total	884	817	146	80	1,043	17.7	18.0
Grand total	4,994	4,560	404	824	5,788	100.0	100.0

^a Excluding current outlays of public sector enterprises, such as the Post Office, Israel Railways, the ports, and municipal waterworks, but including the expenditure of the National Insurance Institute. Intrasector transfers have been disregarded—hence the difference between the data in this table and the corresponding data in Tables VII-15, VII-18, and VII-21.

^b Not elsewhere specified; mainly strictly municipal services (such as sanitation, sewerage, fire protection, and street lighting), general research, direct immigration services, and Jewish Agency expenditures abroad (incl. those on educational activities).

^c Mainly subsidies on imported commodities and on stocks in Government warehouses.

Interest payments and debt redemption totalled IL 875 million; the weight of these items did not change during the year, remaining at 15 percent.

2. THE GOVERNMENT

(a) *The influence of Government operations on demand*

The influence of the Government's fiscal operations and monetary expenditure on the level of domestic demand is measured below (Tables VII-5 and VII-7), in terms of its demand surplus and net credit outflow to other sectors.

In 1966 the demand surplus¹ amounted to a substantial IL 463 million, compared with IL 235 million in 1965 and IL 92 million in 1964. Government purchases on current and capital account² rose by 22 percent, while net domestic receipts³ rose by only 11.5 percent. On the other hand, its net credit outflow to other domestic sectors declined considerably. The surplus of credit granted by the Government to other sectors (mainly through long-term development budget loans) over credit received (loans and credit from domestic sources other than the banking system) amounted to IL 157 million in 1966. This was lower than in either of the two preceding years—IL 391 million in 1965 and IL 254 million in 1964.

To finance a demand surplus and credit outflow on such a scale, the Government had to borrow IL 620 million from abroad and from the banking system. In 1965 a similar amount was required—IL 626 million, as against IL 346 million in 1964 and IL 240 million in 1963. The stability in the volume of financing in 1966 gives no clear indication of the trend of change in the direct influence of Government operations on the level of domestic demand. And this because of the difficulty of determining the direction of the net effect of the two opposing movements—the rise in the demand surplus and the decline in the net credit outflow—since the credit outflow indirectly affects demand. Moreover, some of the Government's outlays were made abroad, and these affect the balance of payments deficit on current account (i.e. the import surplus) and not necessarily the level of domestic demand. Nevertheless, it can reasonably be assumed that the drop in net credit provided did not fully counteract the expansionary effect of the rise in the demand surplus, since much of the decline in credit was in short-term credits and loans, which do not have a strong contractionary effect.

¹ In calculating the demand surplus, collections on account of the Absorption Loan and compulsory saving were not included, being classified instead under loans to the Government. In past Annual Reports, the Absorption Loan was listed under tax revenue, and this should be taken into account when comparing the tables in this Report with corresponding tables in previous Reports.

² Net of sales and excluding interest.

³ Taxes and net transfers, including transfers to the rest of the public sector and net interest.

Table VII-5

SAVING AND DEMAND SURPLUS OF THE GOVERNMENT, 1964-66

(IL million, at current prices)

	1964	1965	1966	Change from 1965 to 1966
A. Income on current account				
Taxes ^a	2,179	2,571	2,961	390
Current transfers	46	48	63	15
Income from property	36	41	72	31
Total	2,261	2,660	3,096	436
B. Expenditure on current account				
Purchases (net of sales)	1,337	1,675	2,033	358
Transfer payments	338	455	593	138
Interest (net)	111	105	102	-3
Subsidies	242	250	316	66
Transfers to the rest of the public sector (net) ^b	72	111	124	13
Total	2,100	2,596	3,168	572
C. Saving (A-B)	161	64	-72	-136
Absorption Loan (net)	101	127	171	44
D. Saving incl. income from Absorption Loan	262	191	99	-92
E. Expenditure on capital account				
Purchases	310	337	413	76
Transfers (net) ^c	-36	-27	-34	-7
Transfers to the rest of the public sector (net)	-21	-11	12	23
Total	253	299	391	92
F. Demand surplus (E-C)	92	235	463	228
G. Demand surplus incl. income from Absorption Loan (E-D)	-9	108	292	184

^a Excluding revenue from the Absorption Loan, which is included under loans from the public to the Government. In previous Annual Reports, Absorption Loan and compulsory saving were treated as tax revenue. To render the data in this table comparable with those in corresponding tables in previous years, the Government's saving and demand surplus are presented in rows D and G inclusive of the Absorption Loan.

^b Net transfers to local authorities and the National Institutions.

^c Government transfers on capital account, less collections on account of the land betterment tax and the inheritance tax.

Table VII-6

INCREASE IN THE GOVERNMENT'S DEMAND SURPLUS, BY COMPONENT ITEM,
1964-66

(IL million, at current prices)

	Change from 1964 to 1965		Change from 1965 to 1966	
	Factors increasing demand surplus	Factors decreasing demand surplus	Factors increasing demand surplus	Factors decreasing demand surplus
A. Changes in Government expenditure				
Wages and salaries	136		166	
Security and special budgets	162		104	
Direct activities to regulate em- ployment	1		10	
Other purchases on current account	49		67	
Change in inventories		28	72	
Purchases on capital account (excl. change in inventories)	54			1
Transfers to households and nonprofit institutions	120		142	
Subsidies	8		66	
Interest payments (net)		6		3
Net transfers to the rest of the public sector ^a	49		36	
B. Changes in Government receipts				
Direct taxes		232		253
Indirect taxes		160		137
Transfers and other compulsory payments	4			26
Sales and income from property		14		15
Total	583	440	663	435
C. Increase in demand surplus				
Factors increasing the demand surplus	583		663	
Less: Factors decreasing the demand surplus	440		435	
Increase in demand surplus	143		228	
Of which:				
Increase in surplus of domestic expenditure over domestic revenue	83		141	
Increase in foreign purchases	60		87	

^a Net transfers to local authorities and the National Institutions.^b Estimated direct imports of the Government, including equipment and goods for Ministry of Commerce and Industry stores, other foreign purchases, and interest payments abroad.

About one-third of the IL 228 million demand surplus increment stemmed from the rise in purchases and expenditures abroad (direct Government imports, including equipment and commodity stocks, interest payments, and other foreign outlays). Part of the increase occurred in items for which local substitutes cannot readily be found, such as defense purchases and interest payments, and it is evident that some of the growth of the demand surplus had no effect at all on the expansion of economic activity.¹ The sharp decline in net credit from the Government to other sectors contrasted with the rise in the Government's demand surplus. The volume of net credit granted by the Government rose between 1962 and 1965, when the figure reached a new high. A large proportion of the credit was directly connected with investment activity—for example, that extended to Amidar or Mekorot, companies financed mainly by the Government. Credit to such firms directly influences the demand surplus. Other credit flows have an indirect influence on the demand surplus, depending on the volume of investment of the borrowing concerns, their current deficit, liabilities, and the alternative means of financing at their disposal. There are also some credit flows that have almost no effect on demand, such as the credit given to the Electric Corporation or to Zim for the purpose of importing ships, equipment, and various other investment goods.

The decrease in net lending in 1966 did not result from any reduction of long-term Government loans, but from the marked rise in loans and credit received by the Government from the public for financing its operations.

That net long-term loans by the Government did not rise in 1966 (after having increased continuously since 1959) is attributable to the policy of economic restraint, one aspect of which is the reduction of investment programs under the development budget—both those carried out directly by the Government and those implemented indirectly by the provision of long-term finance. In view of the decline in capital formation in 1966, it was to be expected that Government long-term loans, which constitute an important component of investment finance, would also decrease. However, this did not come about,² since investors resorted less to other sources of finance.³

Loans and credit from the public rose in 1966, mainly because of the larger net income from short-term loans, sales of which to the public expanded considerably following a sharp decline in the previous year. Net receipts from the Absorption Loan, bond issues, and other long-term loans also increased (see Table VII-7). The mobilizing of funds from the public through Government loans has a contractionary effect on aggregate domestic demand (though less

¹ As stated, the Government's contribution to the aggregate demand surplus and balance of payments pressure cannot be measured separately.

² The reference is to net long-term lending. There was a slight drop in gross lending (see the section below on development budget financing).

³ For this reason, the share of total investment financed by the public sector increased. See the section on public financing of investment in Chapter V, "Domestic Investment".

markedly than taxes). However, the contractionary effect of the different types of loans varies, depending on their liquidity¹ and on the sources of finance at the disposal of the lender.²

A comparison of the size of the Government's demand surplus and its net credit outflow to other sectors with their size as originally budgeted for 1966 suggests the change that took place in Government policy during the year.

The budget for fiscal 1966/67 was drawn up in conformity with the policy of economic restraint, aimed at slowing down the rate of economic growth. This included the moderation of Government consumption and investment through anti-inflationary measures, such as increased revenue from direct and indirect taxes (mainly by revising the rates), ensuring that the local authorities balanced their budgets by lifting the municipal tax freeze in force since 1962, curtailing development budget investments, and restraining the expansion of the civil service.³ The budget provided for a surplus, a considerable increase in Government saving⁴ and a corresponding drop in the demand surplus, and the provision of less net credit to other sectors.

The retrenchment reached unexpected proportions in 1966 and forced the Government to deviate from its surplus budget policy. The standstill in real national product and imports caused receipts from taxes and other compulsory levies to lag behind the estimates. However, expenditure remained as budgeted. This was because the Government did not reduce its services (mainly general and social services, such as defense, education, and health, which account for most of the budget outlays), and also because of the inelasticity of such ordinary budget expenditures as salaries (which rose in 1966 by about 30 percent, principally because of agreements made in 1965), and National Insurance benefits (which rose by 50 percent owing to the addition of a new type of insurance in August 1965 and an increase in benefit rates at the beginning of 1966).

A more elastic expenditure, and one easily regulated, is purchases on capital account. Direct Government investment did not rise in 1966—apart from that in stocks (mainly commodities in Ministry of Commerce and Industry stores), which apparently were enlarged for reasons unconnected with the Government's investment policy.

With the rapid growth of unemployment in the second half of 1966, the Government adopted several reflationary measures, mainly the stepping-up of subsidies and relief work.⁵

¹ Short-term loans have a weak contractionary effect, while the Absorption Loan, because of its low liquidity in the first few years after issue, has a strong effect.

² Some of the financial institution loans to the Government came out of funds mobilized abroad. Such financing has no contractionary effect whatever.

³ See the "National Budget for 1966", Bank of Israel Bulletin No. 26, June 1966.

⁴ See Explanatory Notes to the Budget Proposal for the Fiscal Year 1966/67, Vol. I. p. 27 (Hebrew).

⁵ About 45 percent of all subsidy payments in 1966 and 40 percent of the outlay on relief work were effected in the last quarter of the year.

Table VII-7

**DEMAND SURPLUS AND DOMESTIC CREDIT OUTFLOW OF THE GOVERNMENT
AND SOURCES OF FINANCING, 1964-66**

(IL million, at current prices)

	1964	1965	1966	Change from 1965 to 1966
A. Demand surplus^a	92	235	463	228
B. Net domestic credit granted^b				
1. Loans ^c				
To the rest of the public sector	16	57	54	-3
To public sector companies ^d	62	91	85	-6
For housing and public buildings	293	319	289	-30
To the rest of the economy	28	20	59	39
Total	399	487	487	—
2. Receipts from borrowing ^e				
Absorption Loan	101	127	171	44
Government bonds and other long-term loans	29	82	137	55
Short-term loans	34	-76	62	138
Other short-term credit	-19	-37	-40	-3
Total	145	96	330	234
Net domestic credit granted (1-2)	254	391	157	-234
Sources financing the demand surplus and net domestic credit granted				
C. Foreign sources				
Unilateral receipts	25	66	18	-48
Net loans and credit	226	505	392	-113
Total	251	571	410	-161
D. From the banking system	95	55	210	155
Total (C+D)	346	626	620	-6

^a Calculated minus receipts from the Absorption Loan (see Table VII-5).

^b Excluding transactions with the banking system.

^c Net of repayments.

^d Excluding financing for housing.

^e Net of repayments.

As a result of these measures, Government purchases rose twice as fast as net domestic receipts, so that there was a large increase in the demand surplus. This was mainly due to the influence of the automatic stabilizers, which tended to slow down the growth of tax revenue, and to the inelasticity of Government outlays. In 1965 the Government's demand surplus grew mainly because of a much larger expenditure. The pumping of purchasing power into the economy on a large scale that year raised the level of economic activity and for a while delayed the recession, whose first signs appeared at the time. At the end of 1965 the Government began to implement the retrenchment policy, and the expansionary effect of its operations apparently began to slacken in the first quarter of 1966.

The Government's demand surplus and net credit outflow were financed chiefly by receipts from abroad (grants and loans), with a minor share provided by the banking system. In 1966 receipts from abroad accounted for about two-thirds of the total—IL 410 million out of IL 620 million (in 1965 the proportion was over 90 percent). The remaining third was financed by drawing on deposits and borrowing from the banking system. In 1966 the Government increased its net debt to the banking system by IL 210 million, most of it to the Bank of Israel.

Table VII-8 shows the "balance of payments" of the Government in 1965 and 1966. The presentation distinguishes between transfers and transactions in goods and services on the one hand, and financial transactions on the other.¹

Total payments, including long-term debt redemption, amounted to IL 4,750 million in 1966, an increase of IL 733 million, or 18 percent, over 1965. A similar rise occurred in the previous year.

Current purchases rose by 20 percent in 1966, somewhat less than the 25 percent in 1965. However, the share of Government consumption in total uses rose.² Wage outlay was up 30 percent, owing to an increase in the number of employees and average salaries, and to the payment of retroactive increments.

There was a considerable rise in transfer payments and grants—mainly in National Insurance benefits and in subsidies (for keeping down the prices of goods destined for both the local and overseas markets).

Purchases on capital account were much larger in 1966, but all of the growth was in Government stocks, chiefly in Ministry of Commerce and Industry stores. Investment in postal and transport enterprises and in the National Water Carrier declined, while that in roads and public buildings rose.

Tax revenues were up 15 percent in 1966—the lowest growth rate in ten years. The recession was reflected in revenue from indirect taxes, which rose by

¹ Apart from transactions with the National Institutions and the local authorities, which are recorded separately.

² Private consumption slowed down to an even greater extent and gross investment actually declined. See the section on public consumption in Chapter II, "Resources, Uses, and Incomes".

Table VII-8

"BALANCE OF PAYMENTS" OF THE GOVERNMENT, BY TYPE OF RECEIPT AND PAYMENT, 1965-66
(IL million)

Receipts	1965	1966	Increase or decrease (-)	Payments	1965	1966	Increase or decrease (-)
Transfers and transactions in goods and services							
Taxes ^a	2,571	2,961	390	Purchases			
Miscellaneous revenue	301	383	82	On current account	1,717	2,064	347
Subtotal	2,872	3,344	472	On capital account	344	415	71
Unilateral receipts from abroad	66	18	-48	Interest payments	235	273	38
Total	2,938	3,362	424	Transfer payments and grants	461	603	142
				Subsidies	250	316	66
				Total	3,007	3,671	664
Transactions in financial claims							
Collections on long-term loans	87	79	-8	Long-term loans granted and participation in share capital			
Long-term loans received				For housing	309	280	-29
Foreign	662	605	-57	For other purposes	208	232	24
Domestic				Total long-term loans	517	512	-5
Absorption Loan	127	177	50				
Other loans	138	207	69	Redemption of long-term loans			
Short-term credit (net)				Foreign	280	301	21
Foreign	123	88	-35	Domestic	56	76	20
Domestic ^b	-113	22	135	Total	853	889	36
From the banking system ^c	55	210	155				
Total	1,079	1,388	309				
Transactions with the rest of the public sector							
				To National Institutions (net)	13	39	26
				To local authorities (net)	144	151	7
				Total	157	190	33
Total receipts	4,017	4,750	733	Total payments	4,017	4,750	733

^a Including collections on account of National Insurance and the War Risk Insurance Fund; excluding the Absorption Loan and compulsory saving.

^b Excluding credit from the banking system; including short-term securities.

^c Including long-term loans and securities.

only 10 percent. Most of this increase was in goods and services for which rates were raised; income from some taxes, such as customs and excise on cement, even declined. Direct tax revenue advanced 20 percent, mainly owing to the revision of rates and the collection of a considerable sum on wage increments paid the year before.

Income from abroad (loans, credit, and unilateral transfers) dropped. Net receipts from most types of foreign long-term loans were lower than in 1965; net receipts from Independence and Development Bonds fell off by about half owing to much larger redemption. Unilateral receipts declined with the termination of reparations from Germany in fiscal 1965/66.

Domestic loan receipts rose considerably; this applies in particular to short-term credit, most of the increase in which came from drawings on deposits, bank loans, and short-term loans from the public. Receipts from long-term loans and the Absorption Loan were also much higher in the year reviewed.

In previous Annual Reports revenue from the Absorption Loan was not included in loan receipts but under taxes; this practice took account of the attitude of the public, which was influenced by the fact that these loans were tied to income tax and that the lenders received no certificate attesting to the Government's obligation until three or four years after the date of collection. Once it became clear that the Government would honor the terms of the loan, a market for Absorption Loan certificates came into being in 1966; this enhanced the liquidity of the Absorption Loan and narrowed the difference between it and other Government bonds and loans from the public. The Absorption Loan was accordingly listed in 1966 under loans from the public instead of tax revenue. This accounting change increased the Government's demand surplus and reduced its saving, aggregates which conceptually are calculated net of loan receipts.¹

The volume of development budget loans granted by the Government in 1966 remained almost unchanged. Housing loans, which account for about half the total, dropped by 10 percent, and expenditure on the construction of immigrant housing by 40 percent; on the other hand, a larger amount was spent on construction in development areas and agricultural settlements and on slum-clearance projects. Collections on account of development budget loans declined, mainly because some borrowers were allowed to defer repayment.

(b) *Receipts*

1. *Taxes*

Government revenue from taxes² rose in 1966 by IL 390 million to IL 2,960 million. The growth rate—15 percent—was lower than in previous years (from 1961 to 1965 it averaged 20 percent per annum).

¹ See the section on household saving in Chapter XIX, "Saving".

² Excluding income from the Absorption Loan and compulsory saving (see the section below on domestic loans).

Table VII-9
GOVERNMENT TAX REVENUE, 1965-66
(IL million)

	1965	1966	Increase or decrease (-)	
			IL m.	% ^a
Direct taxes				
Income tax	993	1,146	153	15.4
National Insurance	234	334	100	42.7
Total	1,227	1,480	253	20.6
Indirect taxes				
Custom duties	398	375	-23	-5.7
Purchase tax	345	360	15	4.1
Fuel tax	117	170	53	44.2
Property taxes	126	137	11	8.6
Tobacco excise	60	85	25	41.7
Cement excise	48	39	-9	-19.5
Excise on beverages ^b	33	33	—	1.2
Stamp tax	40	57	17	40.4
Defense stamp tax	50	60	10	20.8
Vehicle license fees	33	44	11	34.9
Foreign travel tax	24	27	3	10.7
Licenses, fees, and misc. service charges	39	49	10	25.6
Current surplus of Post Office and ports	31	45	14	43.9
Total	1,344	1,481	137	10.2
Grand total	2,571	2,961	390	15.2

NOTE:

1. The definition of direct and indirect taxes in this table is based on conventional national accounting procedures and differs somewhat from that employed by the Accountant General. This table excludes compulsory payments which in the national accounts are defined as transfers—namely, the inheritance tax, the land betterment tax, fines, and certain fees and licenses (e.g. driving licenses and passport fees). On the other hand, this table includes the net profit of the Post Office and the ports (the deficits of Israel Railways and the Israel Lands Directorate are classified under subsidies).
2. Revenue from the Absorption Loan and compulsory saving has not been classified as direct tax revenue but under loans from the public. In previous Annual Reports it was treated as income from taxes. Net receipts from this source amounted to IL 127 million in 1965 and IL 171 million in 1966.

^a Percentage changes calculated from unrounded figures.

^b Including defense stamp tax on beer.

SOURCE: Accountant General and National Insurance Institute.

Direct taxes grew faster than national income—20.5 as against 8 percent. Net receipts from indirect taxes¹ levied on local production rose at about the same rate as the national product (roughly 9 percent). Government revenues most affected by the recession were indirect taxes, which were only 10 percent larger in 1966. Most of the increase was in those goods and services whose tax rates were revised—e.g. the fuel tax, stamp duty, and excise on tobacco. Other indirect tax revenue rose very little, and income from customs and excise on cement dropped.

Income from direct taxes was, as stated, 20.5 percent larger in 1966. Here too part of the increase stemmed from the revision of tax rates: new income tax rates came into force in April 1966, following a reduction in 1965. National Insurance contributions also averaged more than in 1965.

As a result of these developments, the weight of direct taxes (on income) in total tax revenue moved up from 47.5 percent in 1965 to 50 percent (see Table VII-10).

2. *Direct taxes*

Receipts from direct taxes, including income tax and National Insurance contributions, expanded by IL 255 million to IL 1,480 million.

Income tax receipts came to IL 1,146 million, a growth of 15.5 percent, compared with 22 percent in 1965 and 27 percent in 1964. Despite the slower rise, it was still faster than could be expected from the growth of national income.² There were several reasons for this: First, the amendment in 1965 of the Income Tax Ordinance, according to the recommendations of the Zadok Committee, reduced average tax rates retroactively, so that a substantial sum was rebated on account of the previous year's collections and therefore resulted in a slower growth of revenue in 1965. Were it not for the rebates, collections would have expanded more slowly in 1966. Second, the income tax rates were again raised at the beginning of fiscal 1966/67. Third, in 1966 tax was collected on retroactive wage adjustments, some of which had been paid in the previous year.³ In addition, income tax collections increased as a result of a wage rise. Despite the recession and mounting unemployment, the total wage bill was 19 percent higher, and the share of wage income in national income also went up. Since the tax is progressive, tax deductions were much larger, as can be seen from the composition of income tax by type of assessee: nearly all of the incremental receipts came from employees, who showed a 39 percent increase, compared with 6 percent for the self-employed and a decrease of 6 percent for companies. At the beginning of fiscal 1966/67 assessments on the self-employed

¹ Indirect taxes less subsidies.

² In 1960-65 the annual growth rate of income tax receipts exceeded that of national income by about one-quarter; in 1966 it was twice as big.

³ Mainly by local authorities and public institutions.

Table VII-10
GOVERNMENT TAX REVENUE, BY MAJOR CATEGORY, 1964-66

	1964	1965	1966	Increase or decrease (-) from 1965 to 1966	
				IL m.	%
IL million					
Taxes on income	995	1,227	1,480	253	20.6
Taxes on expenditure					
Imports	465	528	511	-17	-2.3
Local production	505	582	684	102	17.5
Taxes on property	110	126	137	11	8.7
Fees and licenses	104	108	149	41	38.0
Total	2,179	2,571	2,961	390	15.2
Percentages					
Taxes on income	45.7	47.7	50.0		
Taxes on expenditure					
Imports	21.3	20.5	17.3		
Local production	23.2	22.7	23.1		
Taxes on property	5.0	4.9	4.6		
Fees and licenses	4.8	4.2	5.0		
Total	100.0	100.0	100.0		

NOTE: Taxes on income include income tax and National Insurance contributions, but not the Absorption Loan and compulsory saving.

Taxes on imports include general customs duty and purchase tax on imports, surtax and tax on exchange rate differentials, and the foreign travel tax.

Taxes on local production include purchase tax on local products, excise, current surplus of the Post Office and ports, entertainment tax, defense stamp tax, and various other levies.

Taxes on property include the property tax and land registration fees.

Fees and licenses include the stamp tax, defense stamp on documents, and licenses, but exclude land registration fees.

and companies were revised upward, and they were asked to pay larger advances. However, owing to the fall in company profits and in the income of self-employed, the revenue estimates were not realized.

As a result of these developments, the share of wage earners¹ in total tax collections moved up to 52 percent, compared with 44 percent in 1965. The share of the self-employed edged down from 23 to 20 percent, and that of companies from 26 to 20 percent. The balance—7 percent in both years—came from at-source deductions of tax on income from interest and dividends.

¹ Including salaried directors of firms and enterprises and member of cooperatives (see Table VII-5 in the appendix to this chapter—in Hebrew only).

In 1966 National Insurance contributions rose by IL 100 million to IL 334 million. A large part of the increment stemmed from the introduction of a new type of insurance (for employees' children) in August 1965. In April 1965 the maximum income on which insurance was collected was raised, and this was another source of increase in 1966.

Despite a growth of 42 percent in National Insurance collections, deposits of the National Insurance Institute with the Government went up by only IL 5 million to IL 43 million. This was due to the large increase in payments,¹ which led to a worsening in the actuarial position of the National Insurance Institute's funds, in spite of the raising of contribution rates.

3. *Indirect taxes*

The slower growth of the national product and private consumption, the stability in imports, and the decline in investment were all reflected in the Government's indirect tax revenue, which came to IL1,480 million in 1966—a rise of 10 percent over 1965. This was a lower rate than during 1962–65, when it averaged 15 percent per annum.

The decline in the consumption of durable consumer goods and the smaller purchases of cars were the main reasons for the drop in revenue. Imports of these items, and of luxury goods (including cigarettes and beverages) subject to relatively high customs duties, also declined, as did investment. This was reflected primarily in decreased receipts from customs and other levies on construction materials such as wood, iron, and cement. The rise in tax rates at the beginning of 1966 explains most of the growth in indirect tax revenue. The following increases were particularly marked: excise on tobacco was raised by an average of 35 percent, and revenue rose to a similar extent, even though the consumption of tobacco did not increase; the fuel tax was revised from 55 to 70 percent, as a result of which revenue rose by 40 percent, in addition to the increment arising from larger fuel consumption; an increase in the purchase tax on alcoholic beverages resulted in the doubling of revenue.² The imposition of an additional levy on yarn (15 percent extra on the price) and on cloth (7.5 percent extra) as from July 1966 contributed to the 15 percent growth in purchase tax receipts from these items. The revision of stamp duty rates produced a much larger revenue, following a slower rise in 1965 as compared with 1964.

In addition, revenue from purchase tax on services jumped nearly 70 percent, and that from excise on cement declined as a result of the cutting of the rate and the slump in building.

Income from property taxes was up 9 percent in 1966, a much lower rate than in previous years. During fiscal 1966/67 assessments were raised on many

¹ See the section below on transfer payments and subsidies.

² The increase in the purchase tax on alcoholic beverages was partly offset by a reduction of the excise.

buildings which had been taxed on the basis of the 1962 assessment. This change, however, was not reflected in income in the year reviewed. Revenue from land registration fees fell in 1966; this continued the trend of the previous year, which can be ascribed to the decline in real estate transactions.

Revenue from indirect taxes on imports amounted to IL 511 million, compared with IL 528 million in 1965; as a result, its weight fell to 17.5 percent of total tax revenue, compared with 20.5 percent in 1965 (see Table VII-10). Customs receipts dropped—for the first time since 1948—by 6 percent and totalled IL 375 million. Income from indirect taxes on local output went up 17.5 percent to IL 684 million; its share in total revenue edged up slightly to 23 percent.

4. *Miscellaneous revenue*

Revenue from domestic transfers, interest, dividends, and property sales added up to IL 383 million in 1966. Of this, IL 171 million came from dividends and interest (other than interest from the rest of the public sector). This item expanded considerably, mainly because of larger interest receipts from Government enterprises (the Post Office, Israel Railways, and other economic units).

Bank of Israel profits transferred to the Government were, at IL 55 million, some IL 20 million higher than in 1965. Income from Government enterprises on account of depreciation also increased,¹ as did transfers from households (mainly to health and educational institutions for services supplied by them, driving license fees, and various fines). No marked changes took place in other revenue from property sales and transfers, including revenue from the land betterment tax and the inheritance tax.²

With the termination of German reparations in the year 1965/66, unilateral transfers from abroad dropped from IL 66 million in 1965 to IL 18 million; of this sum, IL 15 million was a U.S. Government grant.

(c) *Payments*

Government expenditure on current and capital account, excluding financial transactions, amounted to IL 3,670 million in 1966—an increase of IL 664 million, or 22 percent, over 1965. In the two preceding years the growth had been slower.

The components of the 1966 increase differed from those of the previous year. Current purchases, including wages and security outlay, rose by 20 percent, compared with 25.5 percent in the previous year. The other items (subsidies

¹ The reference is to transfers by Government enterprises on account of annual depreciation on Government investments therein (these transfers totalled IL 24 million in 1966).

² In accordance with conventional national accounting definitions, these receipts are included in transfers on capital account and not in taxes.

and transfers, including interest, and purchases on capital account) increased much more rapidly than in 1965: subsidies and transfers by 29 percent as against 15 percent in 1965, and purchases on capital account by 20.5 and 8 percent respectively.

1. Payments on current account

Current purchases of the Government, excluding interest, rose by 20 percent in 1966 to IL 2,064 million. Expenditure on security and special budgets accounted for IL 1,038 million of the total.

Table VII-11

GOVERNMENT PURCHASES ON CURRENT AND CAPITAL ACCOUNT, 1965-66
(IL million)

	1965	1966	Increase or decrease (-)
Purchases on current account			
Wages and salaries of civilian staff ^a	542	708	166
Security and special budgets	934	1,038	104
Other purchases	241	318	77
Total purchases on current account	1,717	2,064	347
Purchases on capital account			
Postal and transport enterprises ^b	213	201	-12
National Water Carrier	51	24	-27
Roadbuilding	44	48	4
Public buildings and misc.	51	85	34
Subtotal	359	358	-1
Change in inventories^b			
Ministry of Commerce and Industry stores ^c	-5	50	55
Other Government stores	-10	7	17
Total purchases on capital account	344	415	71
Grand total	2,061	2,479	418

^a According to the Central Bureau of Statistics.

^b Uninstalled equipment of the postal and transport enterprises is recorded in this table as investment in these enterprises and not as investment in inventories.

^c Mainly foodstuffs.

Outlay on wages and salaries (excluding the Ministry of Defense and trading enterprises) went up by 30 percent to IL 708 million. This increase was due to a rise of 6 percent in the number of employees and of 23 percent in average pay. The cost-of-living allowance contributed little to the increase in average pay, most of it being due to the revision of basic wages and the payment of retroactive adjustments on account of previous years. At the beginning of 1966 increments were paid to academically-qualified personnel, whose salaries were raised by about 18 percent in December 1965, with effect retroactive from the beginning of the 1964/65 fiscal year.

Other current purchases, i.e. excluding salaries and expenditure on security and special budgets, amounted to IL 318 million—up 32 percent from the 1965 figure (see Table VII-11).

2. *Subsidies and transfer payments*

In 1966 the Government subsidized local production and export to the tune of IL 316 million—an increase of 26 percent. This item includes direct price supports, participation in the costs of manufacturers and enterprises, outlays by various Government departments to stimulate production and export, Government participation in funds run jointly with producers with the object of promoting production and export, and the covering of deficits incurred by Government enterprises.¹

Export subsidies rose from IL 43 million in 1965 to IL 90 million in 1966. About a third of the increment went to producers in the form of rebates of taxes and various outlays, a third was in the form of outright grants, and the remainder reflected the increased expenditure of the Ministry of Commerce and Industry for furthering export.²

Subsidies on local production, including the covering of deficits of Government enterprises, amounted to IL 198 million—an increase of IL 30 million, most of which went to the latter. Farm price supports (i.e. other than on exports) came to about IL 120 million in both 1965 and 1966 (in 1965 there was a decline). Factor subsidies—on water, fodder, fertilizers, etc.—were enlarged, while direct supports on final products, such as eggs and milk, were reduced.³

Subsidies on imported foodstuffs decreased somewhat, as in 1965, owing to the drop in world prices.

Transfer payment to households and nonprofit institutions rose by 31 percent and reached IL 603 million. Of this, IL 274 million consisted of National In-

¹ Israel Railways and Israel Lands Directorate.

² See the section on export incentives in Chapter III, "The Balance of Payments". The figures shown here differ from those in Chapter III since they do not include subsidies given in the form of cheaper credit and through branch funds (other than Government participation in these funds).

³ See the section on incomes in Chapter XI, "Agriculture".

surance benefit payments—an increase of IL 91 million over 1965; two-thirds of the increment was in payments under the “insurance for employees’ children” scheme, which began operating in August 1965.¹ The rest of the increase stemmed from a 12.5 percent rise in the number of beneficiaries and a 11 percent rise in the average payment.

Benefit rates were raised for most classes of insurance. In the largest of these—old-age and survivors—the rates were revised upward in January 1966 by about 7 percent as compensation for the increase in the cost of living. In October 1966 the basic allowance was raised by 18 percent. In April 1966 the maternity grant was increased, and in July 1966, the large-family allowance.

Provident and pension payments by the Government came to IL 72 million. These include compensation to victims of Nazi persecution and war invalids and pensions to retired civil servants. Other transfer payments to households increased little and amounted to IL 87 million in 1966. Such payments include participation in graded secondary school fees, expenditure on food in Government health, educational, and welfare institutions, Government participation in hospitalization expenses, old-age grants to persons not eligible for National Insurance benefits, relief allotments to needy families not granted directly by the local social welfare offices, and grants to low-income families to compensate for the rise of prices.

Allocations to nonprofit institutions went up 25 percent to IL 170 million. Nearly all of the increment was accounted for by educational institutions; they received IL 120 million in 1966, and of this sum almost 60 percent went to institutes of higher education. Subsidies and contributions to health and welfare institutions rose slightly to IL 51 million.²

Interest payments³ (excluding interest to the National Insurance Institute and the War Risk Insurance Fund) increased by 16 percent to IL 273 million, of which IL 140 million was for foreign debts. Interest on short-term liabilities accounted for 28 percent of the total.

3. Purchases on capital account

Government purchases on capital account were, at IL 415 million, 20.5 percent larger than in 1965. The entire increment was in the value of stocks in Government warehouses,⁴ direct investment remaining constant. Most of the growth was in Ministry of Commerce and Industry stocks, and it was accom-

¹ Under this scheme the National Insurance Institute originally paid employees IL 9 monthly for each of the first three children under 18 years of age. The rate was raised to IL 10 in August 1966.

² See the section on “Transfers from the public sector” in Chapter VIII, “Nonprofit Institutions”.

³ In the national accounts Government interest payment are treated as transfers and not as consumption.

⁴ Stocks of Government departments; excludes stocks of Government enterprises, which are recorded as investment of the enterprises.

Table VII-12

GOVERNMENT TRANSFER PAYMENTS, GRANTS, AND SUBSIDIES, 1965-66
(IL million)

	1965	1966	Increase or decrease (-)
Transfer payments and grants			
To households			
National Insurance benefits	183	274	91
Pension and provident payments	59	72	13
Other transfer payments	83	87	4
Total	325	433	108
To nonprofit institutions			
Education and culture	89	119	30
Health	41	42	1
Social welfare and religion	6	9	3
Total	136	170	34
Total transfer payments and grants	461	603	142
Subsidies			
On locally produced goods and services	168	198	30
On imported goods	39	28	-11
On exports	43	90	47
Total subsidies	250	316	66
Total transfer payments, grants, and subsidies	711	919	208
Participation in ordinary budgets of local authorities	124	128	4
Grand total	835	1,047	212

panied by an increase, as from the second half of 1965, in purchases financed by short-term credit from foreign suppliers.¹

Government investment in postal and transport enterprises² and in the National Water Carrier declined, whereas other capital outlays were higher in 1966. Expenditure on roads rose by 9 percent, and that on public buildings went up by as much as 60 percent, after the growth rate had slowed down in 1965

¹ Stocks in the Ministry of Commerce and Industry warehouses were computed at cost values. The figures here thus differ somewhat from those in Chapter V, "Domestic Investment", which are based on average prices during the year.

² Including inventory changes in these enterprises.

owing to the Government's policy of restricting such construction during fiscal 1965/66.

4. Payments to the rest of the public sector

Grants and subsidies to local authorities¹ amounted to IL 150 million—an increase of 18 percent over 1965.

General grant-in-aid, provided through the Ministry of the Interior, hardly expanded in 1966. It was enlarged considerably in 1964 and 1965 with a view to covering part of the increased expenditure of local authorities and thus prevent a rise in municipal taxes. When the municipal rates freeze, in force for almost four years, was lifted and the rates were raised by most local authorities, the grant was not increased further.

Government grants to local authorities include transferred revenue, comprising 50 percent of the Government's revenue from vehicle licenses and 5 percent of its purchase tax receipts. These transfers rose by 28 percent, mainly owing to the increase in vehicle license fees. The growth of purchase tax collections slowed down, so that the share of this item in total transferred revenue fell. The participation of various Government departments in the authorities' outlays on educational, religious, and welfare services increased by 17 percent.

Government transfers to the local authorities—including net credit granted, less the authorities' transfers to the Government (participation in the financing of various services)—amounted to IL 151 million, a rise of 5 percent (compared with an annual average rise of 35 percent between 1962 and 1965).

Net payments to the National Institutions tripled to IL 39 million; Jewish Agency transfers for immigrant housing construction declined, while the Government allocation to the Agency's Settlement Department was considerably enlarged.²

(d) Financial transactions

Net Government receipts from loans³ and credits reached IL 932 million, of which IL 612 million was from long- and medium-term loans and IL 320 million from short-term credits (see Table VII-13); this was an increase of 56 percent over 1965.

The composition of the sources of credit underwent a marked change. Net foreign loan receipts were down IL 55 million, and their share in the total dropped from 74 percent in 1965 to 42 percent. The share of domestic loans expanded—those from the banking system from 9 to 23 percent of the total, and those from other local sectors from 17 to 35 percent.

¹ Including participation in the Fund for the Prevention of Road Accidents and in the War Risk Insurance Fund (firefighting services).

² Under an agreement between the Government and the Jewish Agency, Government participation in the Settlement Department's budget was raised from 50 to 75 percent in 1965/66.

³ Including the Absorption Loan and compulsory saving.

Table VII-13

CHANGE IN NET GOVERNMENT BORROWING, BY MATURITIES AND LENDING SECTOR, 1965-66

(IL million)

	1965	1966		Change in net receipts from 1965 to 1966	
	Net receipts	Loans received	Loans repaid		Net receipts
A. Foreign loans and credit					
(1) Long- and medium-term loans					
Independence and Development Loans ^a	101	300	247	53	-48
U.S. Government loans ^b	125	158	36	122	-3
World Bank loans	48	27	2	25	-23
Through the Industrial Development Bank	109	—	11	-11	-120
Miscellaneous ^c	-1	120	5	115	116
Total	382	605	301	304	-78
(2) Short-term credit (net)	123	88	—	88	-35
Total foreign loans and credit	505	693	301	392	-113

B. Domestic loans and credit

(1) Long- and medium-term loans

Absorption Loan and compulsory saving	127	177	6	171	44
Security issues ^d	41	44	36	8	-33
From financial institutions and social insurance funds	41	163	34	129	88
Total	209	384	76	308	99

(2) Short-term credit

Short-term loans ^d	-76	84	22	62	138
From the banking system (net)	55	210	—	210	155
Other net credit	-37	-40	—	-40	-3
Total	-58	254	22	232	290

Total domestic loans and credit

151	638	98	540	389
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C. Total loans and credit

(1) Long- and medium-term

591	989	377	612	21
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(2) Short-term (net)

65	320	—	320	255
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Grand total

656	1,309	377	932	276
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NOTE: Long- and medium-term loans are for three years or more, including the optional-type bonds, which may be cashed in before three years. Government securities purchased by the banking system are included in the Government's debt to the banking system. In contrast to previous Annual Reports, the Absorption Loan and compulsory saving are included with loans and not taxes.

^a Including cumulated interest on saving bonds of the Independence and Development Loans.

^b Including loans from the Export-Import Bank.

^c Receipts from a German loan; repayments on account of the French and Canadian loans.

^d Less securities purchased by the banking system.

1. Foreign loans

Proceeds from long-term foreign loans amounted to IL 605 million, and foreign debt repayment to IL 301 million. Together with the increase in short-term credit received, net foreign borrowing came to IL 392 million, compared with IL 505 million in 1965.

Net long-term proceeds declined in 1966 in most component items. Net income from the Independence and Development Loans was halved as the result of a much larger redemption. World Bank loans (for financing road-construction and Ashdod Port) and loans through the Industrial Development Bank were also much smaller in 1966. No change took place in net proceeds from U.S. Government loans (including those from the Export-Import Bank), which are the leading component in this income item (40 percent of net foreign loan receipts). Government liabilities were augmented in 1966 by the receipt of a IL 120 million loan from the Government of West Germany.

2. Domestic loans

Long-term domestic loan receipts amounted to IL 384 million and repayments to IL 76 million. Net receipts were thus IL 308 million, of which IL 171 million came from the Absorption Loan and compulsory saving.

The Government began to collect the Absorption Loan in October 1961. In fiscal 1962/63 a Compulsory Saving Loan was also introduced (receipts from the latter were deposited in the Bank of Israel), and a year later the two were combined.

Although the terms of these loans and repayment dates were announced from the start,¹ previous Bank of Israel Annual Reports treated them as taxes. This took account of the public's attitude, which was influenced by the fact that the loans are collected together with income tax (they are calculated as a fixed percentage of income tax—18 percent for employees and self-employed and 12 percent for companies). Moreover, the lenders at first received no document setting forth the Government's liability toward them. The first loan certificates were issued only three or four years later, and their liquidity was extremely slight.

The first repayments of the 1962 Compulsory Saving Loan, in April 1966, gave a fillip to the development of a market in Absorption Loan certificates (they even began to be traded on the Stock Exchange in April 1967). This narrowed the difference between the Absorption Loan and other Government loans from the public, and receipts from this loan were therefore included in 1966 in long-term domestic loan proceeds, rather than in tax revenue.²

¹ The Absorption Loan is linked to the cost-of-living index and bears annual interest of 4.5 percent. Redemption is after 15 years.

² Even today lenders receive Absorption Loan certificates only after several years; in this respect the loan differs from others received by the Government from the public.

In 1966 receipts from this loan amounted to about 16 percent of income tax collections, as against 13 percent in 1965.¹

Issues of long-term Government loans fell from IL 78 million in 1965 to IL 51 million in the year reviewed. Net of repayments of earlier issues, income from this source amounted to IL 15 million, compared with IL 41 million in 1965. Over half the receipts in 1966 came from net purchases by the banking system. Net sales to the public added up to only IL 8 million. Net receipts from long-term domestic loans of financial institutions (including social insurance funds and the State Lottery) totalled IL 129 million.

The net debt to the banking system continued upward for the fourth consecutive year; in 1966 the increase was IL 210 million, of which IL 177 million was owed to the Bank of Israel.²

Nonbank short-term credit rose by IL 22 million, compared with a drop of IL 113 million in 1965. The growth was largely due to increased income from short-term loans. Sales of such loans to the public went up considerably as a result of steps taken by the Bank of Israel to enhance their profitability and promote sales.³ Net revenue from this source amounted in 1966 to IL 62 million, compared with a net repayment of IL 76 million in 1965.

3. Development budget financing

The Government granted IL 512 million in credits to other economic sectors within the framework of the development budget. This was slightly less than in 1965. Another IL 54 million was lent to the National Institutions and local authorities. The share of long-term loans in total Government payments dropped in 1966, continuing a trend begun in 1962 with the transfer of the loan-granting function to public financial institutions operating under Government direction. The decrease in 1966 was also due in large measure to the reduction of domestic capital formation, which is financed to a considerable degree by Government loans.

Loans for financing housing accounted for over half the total, and amounted to about IL 280 million—down 10 percent from 1965. Expenditure on the construction of immigrant housing was off 40 percent. The decline began in 1965 with the contraction of immigration. Outlay on construction under the slum-clearance program and in development areas and farm settlements increased.

Loans for agriculture and irrigation also rose, to IL 64 million. There was

¹ This change was due to the large sum collected on account of 1965.

² The debt to the banking system also includes, as stated above, long-term loans and Government securities (including IL 11 million worth bought by the Bank of Israel as part of its open-market operations).

³ See the section on open-market operations of the Bank of Israel in Chapter XV, "Money Supply, Credit, and Banking Institutions".

Table VII-14
DEVELOPMENT BUDGET LOANS,^a BY ECONOMIC BRANCH
AND BORROWING SECTOR, 1965-66
(IL million)

	1965	1966	Increase or decrease (-)
Economic branch			
Housing	309	280	-29
Agriculture and irrigation ^b	48	64	16
Electric power	42	18	-24
Mining, quarrying, oil drilling	28	34	6
Industry and crafts	25	29	4
Transportation and communications	9	20	11
Services and misc.	56	67	11
Total, excl. public sector	517	512	-5
Borrowing sector			
Households	142	177	35
Public sector companies	314	246	-68
Private business enterprises	46	65	19
Public financial institutions	1	7	6
Nonprofit institutions	14	17	3
Total, excl. public sector	517	512	-5
National Institutions	28	30	2
Local authorities	29	24	-5
Total loans	574	566	-8

^a Including participation in company share capital, but excluding Government investments. Loans granted through banks and other financial institutions are classified by the sector of final destination and not as loans to the financial sector.

^b Excluding loans to the National Institutions for agricultural settlement and afforestation, as well as loans for rural housing.

an increase in credit to Mekorot Water Company, Tahal, and agricultural settlements for carrying out local and regional irrigation projects with the aim of expanding agricultural production (including the program for tying farms to a single bank).¹ A larger amount of financing was provided to industry and crafts (mainly by way of increased participation in industrial development fi-

¹ Instead of the prevailing practice of each farm depending on several banks for its financing.

nancial institutions), as well as to mining and quarrying (loans to public sector companies, mainly the Dead Sea Works), and to transportation and communications (mainly to Zim). Loans to the Electric Corporation declined.

The distribution of development budget financing by economic branch and borrowing sector is shown in Table VII-14.

4. Collection of loans

Collections on account of development budget loans and proceeds from the sale of shares decreased to IL 79 million in 1966. The Government's income from collections has developed in an opposite direction to what might be expected, considering the volume of loans which it has granted from year to year. Its credit balance arising out of development budget operations totalled IL 3,315 million at the end of March 1966.¹ Of this, IL 900 million was investment in shares (including sums originally given as loans but later converted into share capital), while as regards another IL 70 million it has not yet been decided whether it shall be regarded as a loan or as equity investment. Outstanding loans payable thus totalled IL 2,345 million at the end of March 1966. Income from collections on account of loans² amounted to only 3.2 percent of total Government loans outstanding at the end of March 1966, compared with 4.6 percent in 1965. A not insignificant part of this balance consists of loans on which only interest is collected, or loans whose redemption date has been deferred. This decline in collections in 1966 suggests that the Government increased its indirect subsidies by way of deferred debt redemption, which are granted mainly to public sector companies.

(e) Functional composition of expenditure

A breakdown of expenditure by function in 1965 and 1966 is presented in Table VII-15.³

The share of social services in total Government expenditure continued upward in 1966. Within this category, the weight of educational, cultural, health and welfare services rose. The proportion spent on housing fell, continuing the trend of the previous year, when construction was curtailed.

Most of the additional expenditure on education was on primary schooling—

¹ Excluding loans to the National Institutions, local authorities, and the Ports Authority, and the amount charged to the National Water Carrier about which it has not yet been decided whether it is to be regarded as a loan to Mekorot. In this chapter, the expenditures on the National Water Carrier and on port development have been treated as direct Government investment.

² Collections on account of development budget loans; excluding income from the sale of shares.

³ Expenditure in this table includes transfers to the local authorities and the National Institutions.

Table VII-15

FUNCTIONAL COMPOSITION OF GOVERNMENT, EXPENDITURE,^a 1965-66
(IL million)

	1966					1965	Percentage distribution of total outlay	
	Current outlay	Interest and debt redemption	Purchases on capital account	Credit granted	Total outlay	Total outlay	1966	1965
General services								
General administration	174	—	19	1	194	182	4.1	4.5
Security and special budgets	1,073	—	—	—	1,073	952	22.4	23.5
Police and justice	122	—	8	—	130	106	2.7	2.6
Community services n.e.s. ^b	28	—	1	13	42	35	0.9	0.9
Total	1,397	—	28	14	1,439	1,275	30.1	31.5
Social services								
Education, culture, religion	510	—	5	48	563	411	11.8	10.1
National Insurance and social welfare	428	—	2	1	431	322	9.0	7.9
Health	193	—	23	1	217	154	4.5	3.8
Housing	12	—	8	280	300	299	6.3	7.4
Total	1,143	—	38	330	1,511	1,186	31.6	29.2
Economic services								
Agriculture and water development	189	—	28	94	311	309	6.5	7.6
Industry, mining, electric power	67	—	—	81	148	136	3.1	3.3
Transportation and communications	71	—	262	24	357	312	7.5	7.7
Other economic services	72	—	17	20	109	68	2.3	1.7
Total	399	—	307	219	925	825	19.4	20.3
Unallocable services								
Debt redemption ^c	—	377	—	—	377	336	8.0	8.3
Interest payments	—	279	—	—	279	239	5.8	5.9
Miscellaneous ^d	202	—	42	2	246	195	5.1	4.8
Total	202	656	42	2	902	770	18.9	19.0
Grand total	3,141	656	415	565	4,777	4,056	100.0	100.0

^a Excluding current expenditure of the postal and transportation enterprises, but including transfers to local authorities and total expenditure of the National Insurance Institute.

^b Not elsewhere specified; mainly the broadcasting service and general research.

^c Redemption of long-term loans.

^d Mainly grants to local authorities, import subsidies, and stocks in Government warehouses.

largely because of the salary increases of teachers and other employees. Outlay on secondary and higher education was also higher in 1966. The rise in social welfare expenditure was mainly due to the substantial increase in National Insurance payments, while health expenditures grew because subsidies to medical institutions and Government hospitals were raised.

The share of general services dropped slightly; this is attributable to outlays on security and special budgets, the percentage spent on general administration and on police and justice remaining constant.

As to economic services, the weight of expenditure on agriculture and water development continued downward. The decline began in 1964 as investment in this branch—mainly in the National Water Carrier—contracted.

3. THE NATIONAL INSTITUTIONS

The National Institutions comprise the Jewish Agency, Jewish National Fund, Keren Hayesod, and the World Zionist Organization.¹

Total payments of the Institutions, including debt redemption, increased in 1966 by IL 13 million to reach IL 404 million.

Purchases on current and capital account declined—especially those connected with immigration, because of the smaller number of newcomers. The Institutions trimmed their staff; nevertheless, the wage bill increased considerably as a result of the reclassification of administrative personnel, which was almost completed in 1966 and resulted in the payment of retroactive increments.

Domestic loans, in the main granted by the Jewish Agency's Settlement Department to agricultural settlements, remained more or less constant, but principal and interest payments on foreign and domestic debts were appreciably higher than in 1965.

Unilateral transfers from abroad dropped—for the first time since 1960—by 21 percent. On the other hand, net foreign receipts from borrowing were up 10 percent. Net domestic borrowed receipts declined, except for bank credit.

(a) *Operations of the National Institutions*

Domestic nonborrowed receipts form only a small part of the Institutions' total income. Unlike other public sector authorities, the Institutions do not collect taxes, their main source of revenue being unrequited receipts from abroad. Consequently, their operations in Israel result in a considerable demand surplus.²

In 1966 the demand surplus of the Institutions fell by IL 26 million to IL 235 million. This was due primarily to smaller expenditure on capital account—

¹ Henceforth referred to simply as "the Institutions".

² Defined as the difference between purchases on current and capital account and domestic income on real account.

Table VII-16

**DEMAND SURPLUS AND CREDIT OUTFLOW OF THE NATIONAL
INSTITUTIONS AND SOURCES OF FINANCING, 1964-66**

(IL million, at current prices)

	1964	1965	1966	Change from 1965 to 1966
A. Saving				
Income on current account	17	19	19	—
Less: Expenditure on current account ^a	217	223	218	-5
Saving	-200	-204	-199	-5
B. Expenditure on capital account^b				
	54	57	36	-21
C. Demand surplus (B-A)				
	254	261	235	-26
Sources financing the demand surplus				
D. Foreign sources				
Unilateral receipts	192	221	174	-47
Net loans and credit	70	42	46	4
Total	262	263	220	-43
E. Banking system				
	9	-13	6	19
F. Net credit from other domestic sectors				
	-17	11	9	-2
Total (D+E+F)	254	261	235	-26

^a Purchases (net of sales), transfer payments and subsidies (including net transfers to the Government), and net interest.

^b Purchases and transfer payments on capital account (including net transfers to the Government).

transfers to the Government and development outlays of the Jewish National Fund—and to a lesser extent to reduced current expenditure (see Table VII-16).

As stated, in 1966 the demand surplus was almost entirely financed by foreign receipts (unilateral transfers and loans); domestic sources, including the banking system, contributed only 6 percent.

The "balance of payments" of the Institutions is shown in Table VII-17, which distinguishes between real flows (transfers and transactions in goods and services) and financial flows (transactions in loans and credit). Transactions with the Government are shown separately.

Table VII-17

"BALANCE OF PAYMENTS" OF THE NATIONAL INSTITUTIONS, BY TYPE OF RECEIPT AND PAYMENT, 1965-66
(IL million)

Receipts	1965	1966	Increase or decrease (-)	Payments	1965	1966	Increase or decrease (-)
Transfers and transactions in goods and services							
Unilateral receipts from abroad	221	174	-47	Purchases on current account			
Miscellaneous domestic receipts	31	30	-1	Domestic ^a	78	84	6
				Foreign	38	21	-17
				Purchases on capital account ^a	40	34	-6
				Interest payments	80	82	2
				Transfer payments, grants, and subsidies	41	44	3
Total	252	204	-48	Total	277	265	-12
Transactions in financial claims							
Collections on long-term loans	8	11	3	Long-term loans granted	74	75	1
Long-term loans received				Repayment of long-term loans			
Foreign	30	72	42	Foreign	25	51	26
Domestic ^b	73	46	-27	Domestic	15	13	-2
Short-term credit (net)							
Foreign	37	25	-12				
Domestic ^b	-9	6	15				
From the banking system	-13	6	19				
Total	126	166	40	Total	114	139	25
Transactions with the rest of the public sector							
From the Government and local authorities (net)	13	34	21				
Total receipts	391	404	13	Total payments	391	404	13

^a Excluding goods and services acquired for transfer to others as loans or grants.

^b Excluding the banking system.

SOURCE: Based on data of the Jewish Agency, World Zionist Organization, Jewish National Fund, and Keren Hayesod.

In the real account, payments exceeded receipts by IL 61 million. They include purchases on current and capital account, transfer payments, grants, subsidies, and interest outlay. Receipts consist of unilateral transfers from abroad and domestic sales and transfers. The financial account shows a surplus of IL 27 million in loans and credit received over loans granted. Net receipts from the rest of the public sector (including changes in outstanding loans) amounted to IL 34 million.

(b) *Receipts*

After rising steadily from 1960 to 1965, unilateral receipts from abroad fell off by IL 47 million in 1966 to reach IL 174 million. Most of the decline was in German reparations, which dwindled from IL 40 million in 1965 to IL 10 million. Other major sources of unilateral income were the United Jewish Appeal in the United States, the appeals in Europe and Canada, and contributions to the Jewish National Fund and Aliyat Hanoar (Youth Immigration). All these items except the last also contracted, probably because of the reduced domestic and foreign expenditure on immigration following the decline in immigration.

Domestic income, deriving from rent collected by the Jewish National Fund and from various local transfers and sales, practically held steady at IL 30 million.

Net receipts from loans and credit, including bank credit, rose from IL 76 million in 1965 to IL 91 million. IL 46 million was borrowed from abroad, including IL 21 million in medium- and long-term loans, mainly from financial institutions in the United States and Europe and from Ampal America-Israel Corporation.

Net domestic loans and credits rose from IL 36 million in 1965 to IL 45 million. Proceeds from the sale of bonds in local currency rose, net receipts totalling IL 13 million.¹ Practically all the bonds were purchased by social insurance funds as part of their approved investments. Proceeds from the sale of foreign currency bonds² went down from IL 64 million in 1965 to IL 19 million. Most of them were bought in Israel out of the foreign currency deposits of local residents.

Outstanding short-term credit from domestic sources expanded by IL 12 million, half of the increment being in bank credit

(c) *Payments*

Current expenditure of the Institutions (purchases, transfer payments, grants, subsidies, and interest payments) amounted to IL 231 million in 1966, or 4.5 percent less than in 1965.

¹ Net of redemptions and after deducting the increase in Government holdings of Jewish Agency bonds.

² Foreign currency bonds issued by the Jewish Agency subsidiary Hollis, which is registered abroad.

Table VII-18

**FUNCTIONAL COMPOSITION OF NATIONAL INSTITUTION
EXPENDITURE,^a 1964-66**
(percentages)

	1964	1965	1966
General services			
General administration	6.7	6.9	6.7
Immigration ^b	16.8	13.1	8.3
Other activities abroad ^c	3.0	3.4	2.5
Total	26.5	23.4	17.5
Social services			
Education and culture ^d	6.7	7.4	9.2
Social welfare and health	4.2	5.7	6.7
Housing	7.4	4.6	1.8
Total	18.3	17.7	17.7
Economic services			
Agriculture and water development	28.2	28.9	27.9
Other economic services	1.2	0.9	1.2
Total	29.4	29.8	29.1
Unallocable services			
Debt redemption	9.7	9.5	15.4
Interest payments	16.1	19.1	19.4
Miscellaneous	—	0.5	0.9
Total	25.8	29.1	35.7
Grand total	100.0	100.0	100.0
Grand total in IL million	404	419	434

^a Including gross payments to the Government.

^b Transport costs and costs of initial absorption of immigrants.

^c Outlay on offices and educational and cultural work.

^d In Israel only.

SOURCE: Based on data of the Jewish Agency, World Zionist Organization, Jewish National Fund, and Keren Hayesod.

Current purchases in Israel and abroad dropped by IL 11 million to IL 105 million. Wage outlay rose by 21 percent despite a staff reduction of over 4 percent.¹ The reclassification of administrative personnel according to a new scale, which involved the payment of increments retroactively to April 1964, was almost completed by the end of 1966. As a result, average wages rose by 28 percent,

¹ Chiefly because of the transfer of the agricultural training and guidance service from the Settlement Department of the Jewish Agency to the Government.

rather more than in the rest of the public sector. Other current purchases declined. Direct expenditure on immigration, including the transportation of newcomers, dropped by as much as 35 percent.

Interest outlay grew only slightly more than in recent years and came to IL 82 million, but its share in total purchases and transfers went up to 31 percent. There was also a moderate rise in transfer payments, consisting mainly of allocations to new immigrants and to nonprofit institutions.

Investments—chiefly in development projects, land reclamation, and afforestation by the Jewish National Fund—declined by IL 6 million to IL 34 million.

Long-term loans granted by the National Institutions remained virtually unchanged at IL 75 million. The majority are granted to agricultural settlements through the Settlement Department of the Jewish Agency. With the contraction of agricultural investment and the transfer to the Government of part of the responsibility for financing the settlements, the volume of such loans has declined steadily over the last few years.

(d) *Functional composition of expenditure*

Table VII-18 shows the breakdown of the Institutions' expenditure by function.¹

The weight of loan redemption and interest payments within total expenditure continued to rise and reached 35 percent in 1966. The share of general services dropped, especially expenditure on immigration (direct costs, including transportation and initial absorption), which came to only 8 percent of the total compared with 17 percent in 1964.

About 28 percent of the total outlay in the last three years was on agriculture, for land reclamation, afforestation, loans, and various services to agricultural settlements.

Among social services, the share of housing expenditure fell off with the contraction of immigrant residential construction, which is partly financed by the Jewish Agency. Outlay on education and cultural services,² on the other hand, increased. During the last three years the proportion spent on social services has remained constant at 18 percent.

4. THE LOCAL AUTHORITIES³

The local authorities' activities, as measured by their "balance of payments", rose by 11 percent to reach IL 824 million.⁴ The growth of current purchases

¹ Including transfers to the Government.

² Excluding educational and cultural expenditure abroad.

³ Municipalities, local councils, regional councils, religious councils, and regional authorities. Also included are the municipal expenditures of kibbutzim and moshavim.

⁴ With long-term loans recorded on a gross basis, and short-term loans and credit and loans from the Government on a net basis. (If all loans were recorded on a net basis, payments would rise to almost the same extent, to stand at IL 773 million.)

and investments slowed down, while that of tax revenue accelerated, thereby resulting in a smaller rise in the authorities' dissaving and demand surplus.

In 1966 the Government authorized the raising of most municipal taxes in order to reduce the authorities' budgetary deficits. For almost four years—since 1962/63—the Government had frozen tax rates, compensating the authorities by increased grants. With the revision of the rates, the Government sharply curtailed its share in financing the authorities' operations.

Purchases on current account rose by 19 percent, compared with 28 percent in 1965. In both years, most of the increment was due to larger payroll outlay, which reflected both an increase in personnel and higher wage scales. Purchases on capital account were down by 6 percent, compared with an annual increase of 26 percent between 1962 and 1965; the downturn was mainly the outcome of Government measures designed to trim the authorities' development expenditure.

(a) *Operations of the local authorities*

The demand surplus of the authorities (i.e. the surplus of expenditure on current and capital account over current income) came to IL 178 million, an increase of IL 6 million compared with IL 61 million in 1965. The slower rise can be attributed mainly to the growth of tax revenue following the revision of tax rates in 1966, and to the smaller volume of investment.

Transfers from the Government amounted to IL 135 million. This item, mainly intended to finance current operations, covered about 45 percent of the demand surplus (calculated without taking Government transfers into account.)¹

The remainder of the demand surplus was covered by net borrowed receipts from other domestic sectors, including the rest of the public sector. The weight of the other public sector authorities and the banks in financing the demand surplus declined, while that of other domestic sources (financial institutions, social insurance funds, the State Lottery, and contractors and suppliers) rose.

Table VII-20 shows the "balance of payments" of the local authorities for 1965 and 1966, by main type of receipt and payment.

(b) *Receipts*

1. Taxes and other compulsory levies

Tax revenue rose by 15.5 percent in 1966, to IL 310 million. Although rates were virtually frozen, tax revenue grew by about 24 percent per annum between 1962 and 1964. This can be ascribed to the widening of the tax base: the higher assessments on buildings and vacant plots whose value had risen as

¹ This is equivalent to the surplus of expenditure over income in the authorities' real account (see Table VII-20).

Table VII-19

**DEMAND SURPLUS OF THE LOCAL AUTHORITIES AND FINANCING
THEREOF, 1964-66**

(IL million, at current prices)

	1964	1965	1966	Change from 1965 to 1966
A. Revenue on current account				
Taxes	250	268	310	42
Other revenue ^a	54	64	73	9
Transfers from the Government	77	113	128	15
Total	381	445	511	66
B. Expenditure on current account				
Purchases (net of sales)	280	358	428	70
Transfer payments and subsidies	63	80	93	13
Interest (net)	18	23	29	6
Total	361	461	550	89
C. Saving (A-B)	20	-16	-39	-23
D. Expenditure on capital account				
Purchases (net of sales)	190	221	204	-17
Transfers (net) ^b	-59	-65	-65	—
Total	131	156	139	-17
E. Demand surplus (D-C)	111	172	178	6
Sources financing the demand surplus				
F. Credit (net)				
Rest of the public sector	11	29	20	-9
Banking system	5	52	40	-12
Other domestic sectors	93	92	119	27
Foreign	2	-1	-1	—
Total	111	172	178	6

^a Domestic transfers and income from property, exclusive of interest.

^b Mainly participation of home-owners in the financing of development expenditure.

a result of the real estate boom, and an increase in the number of rooms—the main basis for the collection of municipal taxes—particularly in new suburbs and in larger dwellings, which pay above-average rates.

In 1965 the slump in the real estate market and the decline in building starts resulted in a smaller revenue from property taxes and a much slower rise in total tax receipts—7 percent only. In 1966 most local authorities raised tax rates substantially, including the business tax and charges for various services,

Table VII-20

"BALANCE OF PAYMENTS" OF THE LOCAL AUTHORITIES, BY TYPE OF RECEIPT AND PAYMENT, 1965-66
(IL million)

Receipts	1965	1966	Increase or decrease (-)	Payments	1965	1966	Increase or decrease (-)
Transfers and transactions in goods and services							
Taxes ^a	268	310	42	Purchases			
Miscellaneous revenue	142	146	4	On current account	360	430	70
				On capital account	226	210	-16
				Interest payments	23	29	6
				Transfer payments and subsidies ^a	88	101	13
Total	410	456	46	Total	697	770	73
Transactions in financial claims							
Domestic long-term loans	107	132	25	Participation in share capital	3	3	—
Short-term credit (net)				Redemption of long-term loans			
From the banking system	52	40	-12	Domestic	42	50	8
From other domestic sources	30	40	10	Foreign	1	1	—
Total	189	212	23	Total	46	54	8
Transactions with the rest of the public sector							
Govt. participation (net)	115	136	21				
Loans (net)							
From the Government	29	15	-14				
From National Institutions	—	5	5				
Total	144	156	12				
Total receipts	743	824	81	Total payments	743	824	81

^a Including current deficits of waterworks and other enterprises.

and this explains the growth of tax revenue this year despite the sharp fall in new construction and the continued depressed state of the real estate market.

Receipts from other compulsory levies (i.e. other than taxes) totalled IL 146 million in 1966; the increase was slower than in previous years—3 percent as against 14 percent in 1965 and 22 percent in 1964. About half of the total revenue from this source (IL 65 million) came from assessments on home- and landowners for financing roads, sidewalks, sewage disposal, and the installation of water meters; as in previous years, they covered one-third of the cost. The decline in local authority investment also affected these receipts, which shrank by 16 percent.

The authorities collected approximately IL 70 million in transfer receipts for various services, including service charges in primary schools, tuition fees in other schools run by the authorities, hospitalization fees in municipal hospitals, and parents' participation in the cost of meals provided in schools and summer camps. These receipts grew by 15 percent, also largely because higher rates were charged. Income from municipal waterworks rose as a result of the revision of water tariffs; however, it failed to keep pace with the increased expenditure, so that for the first time waterworks and other municipal enterprises showed a deficit on current operations.¹

2. Government grants

Government allocations to the authorities were increased substantially after the devaluation as compensation for mounting costs and to enable them to expand municipal services without raising tax rates. With the revision of municipal rates at the start of fiscal 1966/67, the growth of Government allocations slowed down appreciably. The net amount allocated (i.e. less interest payments by the authorities and their participation in Government expenditure, including net loans granted) rose by IL 7 million to IL 151 million—an advance of 5 percent as against an annual increase of 37 percent during 1962–65.

The bulk of this income consisted of general grant-in-aid, allocated according to various criteria.² In addition, 5 percent of the Government's purchase tax receipts and 50 percent of its revenue from vehicle licenses were transferred to the authorities. The general grant and the transferred revenue together came to IL 78 million in 1966, 13 percent more than in 1965.

In addition, Government departments participate in various outlays of the authorities, such as the Ministry of Labor in unemployment relief projects, the Ministry of Transport in road safety projects (through the Fund for the

¹ The sums allocated to cover the current deficits of the municipal enterprises are included under local authority grants.

² Such as the number of inhabitants, the age structure of the population, the authorities' per capita receipts from various taxes, and per capita expenditure on social welfare. The authorities were classified into 10 groups according to these criteria, the size of the per capita grant varying from IL 0.50 to IL 75.

Prevention of Road accidents), the War Risk Insurance Fund in fire-protection services, and the Ministries of Education, Health, Religious Affairs, and Social Welfare in expenditure on social services. The amount of such aid increased by about 18 percent in 1966 to reach IL 63 million.

Net Government loans dropped from IL 28 million in 1965 to IL 15 million. Many of these loans were granted from the development budget for roads and pavements, sewers, street lighting, waterworks, public buildings, and educational institutions. In addition, the Government guaranteed local authority bond issues, taken up mainly by social insurance funds.

As part of the Government's policy of economic restraint, a number of measures were agreed upon with the Union of Local Authorities to help the authorities balance their budgets and cope with their accumulated deficits. While allowed to raise municipal taxes, the authorities were requested to reduce their staff and administrative expenses and to pare projected development budget outlays. The Government agreed to help the authorities defer debit redemption through a consolidation loan, and to cover 20 percent of their accumulated deficits for a period of four years beginning in fiscal 1966/67.

3 Change in indebtedness

Net proceeds from borrowing (excluding Government loans) rose from IL 143 million in 1965 to IL 158 million. About three-quarters of the sum was received from financial institutions, social insurance funds, and banks, while the remainder came from the State Lottery, contractors, suppliers, and households (parents of school children). Net loans from the State Lottery amounted to IL 22 million, in addition to IL 3 million in grants, while contractors, suppliers, and other creditors provided another IL 40 million. Bank credit was below the 1965 figure, coming to IL 40 million. It should be remembered that part of the rise in 1965 was due to the consolidation of debts: approximately IL 25 million of the authorities' debts to financial institutions were transferred to the banking system for collection. Excluding this amount, the authorities' liabilities to banks increased by IL 13 million in 1966. The debt to financial institutions and social insurance funds rose by IL 70 million, and stemmed mainly from the financing of development budgets.

Long-term loan repayments (including linkage increments) came to IL 50 million, or 9 percent of the authorities' outstanding liabilities on March 31, 1966.¹

(c) Payments

Local authority expenditure, excluding debt repayment and operating expenses of municipal enterprises, increased by IL 73 million to reach IL 770 million. Approximately two-thirds of these expenditures were current outlays, which

¹ The total indebtedness of the local authorities (excluding the revaluation of linked debts) stood at approximately IL 550 million at the end of March 1966.

rose by 19 percent to IL 560 million. Investments dropped by 6 percent to IL 210 million.

1. Current expenditure

Purchases on current account went up by 19 percent, compared with 28 percent in 1965, and amounted to IL 430 million. Approximately IL 314 million was spent on wages—22.5 percent more than last year. The number of employees rose by 7 percent and average wages by 15 percent. Most of the authorities which had not completed the reclassification of their administrative staff in 1965 did so in 1966 and paid them the balance of retroactive wage increments due them under the new pay scales. University graduates, whose salaries were raised in December 1965 in accordance with the national wage agreements, also received retroactive payments in 1966.

Transfer payments and grants totalled IL 101 million, including IL 28 million transferred to health and educational nonprofit institutions. The remainder consisted of social welfare allotments to needy families, participation in graded secondary-school fees, expenditure on food in schools and municipal institutions, and pension payments to retired employees of the local authorities.

2. Purchases on capital account

The year reviewed saw a decline in local authority investment, after a steady growth from 1962 to 1965. Purchases on capital account dropped from IL 226 million in 1965 to IL 210 million, or by 6 percent. This was mainly due to steps deliberately taken by the Government to reduce the authorities' development expenditure.¹

Investment in educational institutions, constituting 40 percent of total spending, fell somewhat, but slightly more was spent in 1966 on roads, pavements, and traffic facilities (about 25 percent of the total). On the other hand, less was spent on sanitation (sewage disposal, drainage, etc.) and on housing.

(d) Functional composition of expenditure

A functional breakdown of expenditure is presented in Table VII-21.

The local authorities' main fields of activity are education, social welfare, and municipal services such as sanitation and sewage disposal, street lighting, fire protection, public gardens, town planning, and supervision of building. In the economic sphere, their activities are confined to the transportation sector, including roads, pavements, bridges, and traffic regulation.

¹ For example, an agreement was concluded between the Government and the Union of Local Authorities which provided that during the four years from fiscal 1966/67 development expenditure should not exceed 50 percent of that in the preceding four years.

Table VII-21

FUNCTIONAL COMPOSITION OF LOCAL AUTHORITY EXPENDITURE,^a 1964-66
(percentages)

	1964	1965	1966
General services			
General administration	11.4	10.1	10.2
Municipal services	21.5	20.2	19.0
Total	32.9	30.3	29.2
Social services			
Education, culture, religion	33.5	35.5	36.4
Health	5.4	4.8	4.8
Social welfare	9.7	8.8	8.0
Housing	0.5	1.0	0.5
Total	49.1	50.1	49.7
Economic services			
Transportation and communications	7.6	8.9	9.5
Agriculture, industry, electricity	1.3	1.9	2.0
Total	8.9	10.8	11.5
Unallocable services			
Interest payments	3.6	3.1	3.5
Debt redemption ^b	5.5	5.7	6.1
Total	9.1	8.8	9.6
Grand total	100.0	100.0	100.0
Grand total in IL million	605	750	832

^a Excluding current expenditure of waterworks and transport enterprises. In the absence of detailed figures on the implementation of the budget for the calendar year, this table gives the functional composition of expenditure in the fiscal years 1963/64, 1964/65, and 1965/66.

^b Redemption of long-term loans.

SOURCE: Based on summary data prepared by the Central Bureau of Statistics.

Social services account for nearly half of total expenditure, with relatively more being spent on education and culture and less on social welfare and housing than in 1965.

The weight of outlay on municipal services has been declining since 1960, and in 1966 they accounted for 19 percent of total expenditure. The share of economic services rose somewhat as a result of the greater amount spent in 1966 on traffic facilities and roads.