

## CHAPTER X

# GOVERNMENT AND NONGOVERNMENT PUBLIC SECTOR

### 1. CONSOLIDATED ACCOUNT<sup>1</sup>

In 1975 the domestic demand surplus of the public sector settled at the peak reached in 1974 following two years (1973 and 1974) in which it rose considerably, due to the security situation. Whereas the public sector's domestic demand surplus constituted approximately 5 percent of GNP in 1972, it accounted for about 14 percent in 1975. Despite the real freeze in the 1975 demand surplus, in nominal terms it grew nearly 36 percent due to rapid price inflation and amounted to approximately IL10.4 billion. Financial

1. The public sector includes the government, the local authorities, and the National Institutions. The influence of the government on economic activity in general and on the public sector in particular is decisive. In the absence of a financial report on the government's activities for April-December, 1974, which would serve as a basis for calculating its activities both inside and outside the budgetary framework during the 1974 and 1975 calendar years, the data in our possession on the execution of the government budget and its financial transactions are incomplete. Accordingly, it is impossible to express overall government activity quantitatively at a sufficiently high level of reliability. Despite these limitations, an attempt has been made to estimate the public sector's impact on the level of domestic demand and domestic economic activity in 1975 in comparison with 1974.

The source of the data for the estimate of the domestic demand surplus is the Central Bureau of Statistics' figures for those items which are currently estimated, namely: public consumption; investment (that sponsored by the public sector and capital outlays of the sector's authorities and the government's commercial enterprises); current subsidies to domestic production and imports and indirect tax rebates to exporters; and indirect taxes. The remaining components needed to calculate the domestic demand surplus were estimated by the Bank of Israel. On the expenditure side these consist of: current transfer payments to households and nonprofit institutions; transfer payments on capital account to nonprofit institutions and businesses; and domestic interest payments; and on the revenue side: transfers received from households by the public sector on capital and current account; income from property; and interest received in Israel. Direct taxes were estimated on the basis of data of the Income and Property Tax Department of the Ministry of Finance after deducting the increase in outstanding balances of loans given to tax debtors. The source of the data on liquidity injection by the public sector is Bank of Israel estimates. Care should be taken in comparing the domestic demand surplus received here with that calculated up to 1972 due to the change in the basis of the calculations; until 1972 the calculation was based mainly on the government system of accounts.

Table X-1  
INDICATORS OF PUBLIC SECTOR OPERATIONS, 1970-75

(IL million, at current prices)

	1970	1971	1972	1973	1974	1975	Percent annual increase				
							1971	1972	1973	1974	1975
1. Public sector consumption	6,728	7,940	9,242	16,396	22,281	34,727	18.0	16.4	77.4	35.9	55.9
Civilian	1,973	2,483	3,046	4,145	5,800	8,257	25.8	22.7	36.1	39.9	42.4
Noncivilian	4,755	5,457	6,196	12,251	16,481	26,470	14.8	13.5	97.7	34.5	60.6
2. Revenue from taxes	6,222	8,605	10,786	14,363	21,367	30,683	38.3	25.3	33.2	48.8	43.6
Direct taxes <sup>a</sup>	3,057	4,010	4,764	6,136	8,451	12,887	31.2	18.5	29.2	37.7	52.5
Indirect taxes											
On imports	1,188	2,160	3,036	4,644	7,661	9,046	81.8	40.6	53.0	65.0	18.1
On domestic production <sup>b</sup>	1,977	2,435	2,986	3,583	5,255	8,750	23.2	22.6	20.0	46.7	66.5
3. Compulsory loan receipts	538	1,040	1,185	1,426	2,660	2,608	93.3	13.9	20.3	86.5	-2.0
4. Compulsory loan repayments <sup>c</sup>	67	74	103	138	376	966	10.5	39.2	34.0	172.5	156.9
5. Domestic demand surplus	858	1,196	1,466	4,728	7,700	10,430	39.4	22.6	222.5	62.9	35.5
6. Total absorption through net credit operations <sup>d</sup>	-117	63	1,727	3,898	4,198	4,969			125.7	7.7	18.4
7. Liquidity injected into the economy (5-6)	975	1,133	-261	830	3,502	5,461					
8. Outstanding govt. loans on March 31 <sup>e</sup>	14,593	19,082	26,742	33,904	47,903	82,593	30.8	40.1	26.8	41.3	72.4
Domestic											
Linked <sup>f</sup>	5,384	7,227	10,289	12,758	19,251	28,049	34.2	42.4	24.0	50.9	45.7
Index-linkage increments <sup>g</sup>	212	497	950	3,119	7,890	19,377	134.4	91.1	228.3	153.0	145.6
Unlinked	1,915	1,913	1,906	2,535	2,199	2,353	-0.1	-0.4	33.0	-13.3	7.0
Accrued interest <sup>f</sup>	392	615	845	640	865	1,266	56.9	37.4	-24.3	35.2	46.4
Foreign	6,690	8,830	12,752	14,852	17,698	31,548	32.0	44.4	16.5	19.2	78.3
	<b>Percentages</b>										
Weight of public sector consumption in total domestic uses	28.5	27.7	25.9	31.7	30.0	32.9					
Weight of public sector consumption in GNP	36.0	34.4	31.3	43.7	41.1	46.4					
Weight of noncivilian public sector consumption in GNP	25.3	23.7	21.0	32.6	30.4	35.4					
Weight of public sector tax revenue in GNP	33.1	37.3	36.6	38.3	39.4	41.0					
Weight of public sector revenue from taxes and compulsory loans in GNP	36.0	41.8	40.6	42.1	44.3	44.5					

<sup>a</sup> Excludes the increase in outstanding credit granted through the commercial banks under the tax debt payment arrangement.<sup>b</sup> Includes licenses, fees, and property tax.<sup>c</sup> Principal and linkage differentials.<sup>d</sup> Credit received, less repayment of credit received in previous years and credit granted net of collections on account of credit provided in the past.<sup>e</sup> Excludes loans from the National Insurance Institute, Development Authority, and the War Risks (Arnona) Fund.<sup>f</sup> Excludes revaluation increments.<sup>g</sup> Excludes the increase in government liabilities on account of items with index-linkage insurance coverage and which are not included in the government's debt; also excludes the writing up of liabilities to the National Insurance Institute for index-linkage.

absorption by the public sector from the domestic sectors (net credit flow including compulsory loans), which finances part of this demand surplus, increased, moreover, at a rather sluggish rate, approximately 18 percent, and amounted to only IL4.9 billion. As a result, the sector's liquidity injection shot up by approximately 56 percent, from about IL3.5 billion in 1974 to a peak of IL5.5 billion this year. This injection, the external infusion generated by the public sector's operations, equalled 79 percent of the money base at the beginning of the year.<sup>2</sup>

The large domestic demand surplus and liquidity injection curtailed any further restraint on economic activity and made it possible for private consumption to resume its growth in the second half of the year. In order to solve the economy's balance of payments problem in the long run, crucial importance attaches to the reduction of the public sector's domestic demand surplus and liquidity injection. To increase the share of exports in uses necessitates trimming the relative weight of those domestic uses influenced, directly or indirectly, by the government. The level and composition of the public sector's outlay determine the direction of the economic activity of the other sectors. Thus, the volume of the public sector's expenditures in 1975 prevented the emergence of unemployment, but they did not lead to conditions conducive to the structural change needed by the economy and necessary for a solution of the balance of payments problem; nor did they release factors of production from activity for the domestic market to that aimed at export.

The government's activities directly prevented the emergence of unemployment in 1975, both by increasing employment in the public sector and in nonprofit institutions and by making large-scale transfer payments to households. These transfers enabled some of the potential job seekers to leave the labor force or not work at all and live on public support.

**WEIGHT OF DOMESTIC DEMAND SURPLUS IN GNP AND LIQUIDITY INJECTION RELATIVE TO  
MONEY BASE,<sup>a</sup> 1972-75**  
(percentages)

	1972	1973	1974	1975
Weight of public sector domestic demand surplus in GNP	5.0	12.6	14.2	13.9
Liquidity injection or absorption (-) relative to money base	-7.4	16.6	55.6	79.3

<sup>a</sup> The amount of liquidity pumped into the economy during the year by the public sector compared with the beginning-of-year money base.

2. For a detailed discussion of the money base see Chapter XVII, "Money Supply, Credit, and the Banking Institutions".

The extensive domestic demand surplus of the public sector occurred despite various policy measures taken to reduce it beginning in the second half of 1974. This surplus demand stemmed from the high level of domestic public consumption, accompanied by rapid increases in current transfer payments to households and nonprofit institutions and in interest payments. These hikes in demand were not offset by a sufficient rise in the sector's domestic income from taxes and transfers; nor did investments initiated by the public sector fall sufficiently in real terms to decrease the domestic demand surplus.

The sector's domestic demand surplus and extensive liquidity injection are due to the continued increase in employment in the sector itself and in institutions supported by it; they also reflect the consequences of various rigid institutional arrangements. The latter include: the system linking wages to prices by means of the cost-of-living allowance; the linking of pensions and allowances to average wages and prices; the fixed level of government participation in investments required by the Law for the Encouragement of Capital Investment; the extensive provision of free services as required by law;<sup>3</sup> the provision of services at prices lower than cost; and the mobilization of capital at interest rates linked to the price level, while the credit provided from this source remains unlinked.

The inflexible institutional framework makes it difficult for the public sector to reduce its real expenditures in the face of heavy public pressures. Likewise, the interest which must be paid each year is fairly inflexible in size; it is largely exogenous to the government's activity in the current year and stems from the way in which government expenditures were financed in the past. Nor is the public sector's revenue system sufficiently flexible to raise government income rapidly in real terms in order to contract the domestic demand surplus and liquidity injection.<sup>4</sup>

The total financial absorption of the public sector's net credit activities grew at a relatively moderate rate of approximately 18 percent at current prices. One of the reasons for this moderate rise was the abolition of the compulsory War Loan from April, 1975 and the redemption of earlier compulsory loans on a considerable scale. Because the War Loan was cancelled, the collection of compulsory loans stabilized at last year's nominal level. In addition, capital mobilization through new bond issues rose relatively slowly, by 20 percent, while considerably greater public credit was granted for investment and dwelling

3. Such as compulsory education, municipal services, health services, etc.

4. A certain improvement has taken place in one area of government income, i.e. the income tax has been imposed on the cost-of-living allowance increment which previously had been exempt. The linking of allowances and tax thresholds to the price index, however, operated in the opposite direction.

**Table X-2**  
**DOMESTIC DEMAND SURPLUS OF THE PUBLIC SECTOR, 1972-75**

(IL million, at current prices)

	1972	1973	1974	1975	Percent annual increase					
					At current prices			At constant prices		
					1973	1974	1975	1973	1974	1975
1. Current expenditure	11,973	17,597	27,010	38,683	47.0	53.5	43.2	21.0	11.0	2.7
Domestic public consumption <sup>a</sup>	6,498	9,407	14,705	20,398	44.8	56.3	38.7	17.4	13.4	-0.2
Transfers to households and nonprofit institutions	2,675	3,810	6,190	9,410	42.4	62.5	52.0	19.1	17.3	8.3
Interest paid	1,170	1,550	2,300	3,435	32.5	48.4	49.3	10.7	7.2	6.5
Subsidies and transfers to business <sup>b</sup>	1,630	2,830	3,815	5,440	73.6	34.8	42.6	45.3	-7.2	1.6
2. Revenue	11,709	14,498	21,731	31,483	23.8	49.9	44.9	3.5	8.2	3.3
Taxes <sup>c</sup>	10,439	13,223	19,981	28,988	26.7	51.1	45.1	5.9	9.1	3.4
Other domestic revenue	1,270	1,275	1,750	2,495	0.4	37.3	42.6	-16.0	-0.8	1.6
3. Domestic saving (2-1)	-264	-3,099	-5,279	-7,200		70.3	36.4		27.0	0.0
4. Nondwelling investment initiated by public sector	1,202	1,629	2,421	3,230	35.5	48.6	33.4	8.8	-1.4	-1.0
5. Domestic demand surplus (1+4-2)	<b>1,466</b>	<b>4,728</b>	<b>7,700</b>	<b>10,430</b>	<b>222.5</b>	<b>62.9</b>	<b>35.5</b>	<b>169.8</b>	<b>16.3</b>	<b>-0.4</b>
6. Publicly sponsored residential construction	1,169	1,693	2,797	3,566	44.8	65.2	27.5	16.7	11.5	6.7

<sup>a</sup> Public consumption, less direct defense imports and government imports n.e.s.

<sup>b</sup> Transfers, subsidies on domestic production and imports, and indirect tax rebates to exporters.

<sup>c</sup> Excludes the defense import levy (which is included in public consumption), but includes import taxes.

SOURCE: Central Bureau of Statistics and Bank of Israel estimates.

construction. By enabling this considerable rise in directed credit, the government substantially limited its ability to absorb financial sources through the financial intermediaries.

A study of the liquidity injection during the course of the calendar year reveals that as early as the first quarter of 1975 (the last one of the 1974/75 financial year), the amount of money pumped into the economy amounted to IL136 million. Last year too the public sector injected liquidity during the first quarter, whereas in former years the first quarter was one of monetary absorption on the part of the government. In the remaining quarters the injection was considerable: IL1.4 billion in the second, IL1.7 billion in the third and IL2.2 billion in the fourth quarter. A peak was reached in October with the large-scale redemption of compulsory loans.

Domestic public consumption did not fall in real terms in 1975, despite a drop of 3.5 percent in domestic defense consumption. Real civilian public consumption rose 5.4 percent--an increase of 3 percent per capita while per capita private consumption fell

approximately 3 percent. The rise in civilian public consumption was accompanied by a 6.3 percent hike in the number of employees in the civilian public sector. These trends were inconsistent with the economic policy aims laid down in the 1975 national budget. The public sector's transfer payments, grants, and subsidies jumped in 1975 at an accelerated rate of approximately 49 percent at current prices. If this rise is deflated by the price index for private consumption, the increase is still 6 percent at fixed prices. These transfers were 2.2 times as high as civilian public consumption, equalling approximately 90 percent of entire domestic public consumption. The substantial increase stemmed from most of the items included under transfer payments and subsidies, excluding indirect tax rebates to exporters and transfers on capital account to nonprofit institutions. The domestic investment of the public sector (excluding public sector companies) fell by about one percent, which did not contribute much to reducing the domestic demand surplus.

Public sector revenues from taxes, together with gross receipts from compulsory loans, amounted to IL33.3 billion in 1975, an increase of approximately 39 percent, similar to that for GNP at current prices. Accordingly, the weight of taxes and compulsory loans in GNP remained stable this year at approximately 44.5 percent. In April, 1975 compulsory loans on income were cancelled and, consequently, gross collection of total compulsory loans (the annual amount) dropped by some 2 percent in nominal terms. Revenue from taxes and compulsory loans rose no more quickly than did private consumption prices so that monetary absorption hardly advanced in real terms despite the series of policy measures undertaken. Replacing compulsory loans by taxes, which left the weight of compulsory payments in national product unchanged, was equivalent to raising the tax burden (since the tax element contained in compulsory loans is smaller than that in the tax itself), but the hike in transfer payments to households and nonprofit institutions at an even higher rate than that of the increase in tax and compulsory loan collection offset part of the increased burden. (For a detailed discussion, see section 3a of this chapter.)

Public sector income from taxes totalled IL30.7 billion in 1975, growing at a rate of about 44 percent, slightly slower than last year's pace. Tax revenues, however, rose faster this year than did the tax base: GNP, national income, and private consumption. As a result, taxes as a share of GNP increased by approximately 1.5 percent to reach 41 percent. The weight of municipal taxes in total tax collections continued to decline, constituting in 1975 only 2.3 percent of the public sector's tax revenues, as opposed to 3.3 percent in 1973. (For a detailed discussion of government tax revenues, see section 3a of this chapter.)

In the second half of 1975, the income tax reform was put into effect. The reform

cancelled compulsory loans (except for the employers' loan), expanded the income tax base by including the cost-of-living allowance and various payments claimed as expenses, and abolished personal exemptions, replacing them by a system of tax credits and national insurance allowances. The total collection of direct taxes rose by 53 percent in 1975, compared with 38 percent the year before, while total taxes and compulsory loans rose by only 39 percent. These figures reflect a number of factors which operated in different directions. On the one hand, national income increased by only 33 percent compared with 43 percent in 1974. On the other hand, tax collections from the self-employed and companies were based on assessments of past years, when nominal incomes rose significantly but the tax rates remained unchanged.

Following the cancellation of compulsory loans on income, collections from self-employed and companies for the current year were all registered as revenue from income tax. (It should be noted that the rise in revenue was also accompanied by an increase in expenditures by the National Insurance Institute on allowances that replaced the personal exemptions that had been in effect prior to the reform.)

Indirect taxes on domestic production shot up 67 percent in 1975, the main elements being the hike in the excise tax on fuel in November, 1974, which was fully felt in the course of 1975; the imposition of an employers' tax starting in April, 1975; and the increase in purchase taxes in November, 1974, February, 1975 and November, 1975. The indirect taxes on imports rose at a moderate rate of 18 percent, as a result of the slowdown in taxable imports in general and in highly taxable imports (durable consumer goods and other consumption assets) in particular, as well as the reduction in the import levy in November, 1974.

Net capital imports by the public sector amounted to \$2,415 million in 1975,<sup>5</sup> approximately 70 percent above that of the previous year and higher than the average for the years preceding the Yom Kippur War. (A considerable part of the public sector's capital imports was connected with the financing of defense imports from the United States.)

Unilateral transfers to the public sector amounted to \$1,032 million, some 43 percent of the capital imports. Slightly more than a third of the unilateral transfers consisted of transfers of the National Institutions, the rest consisting of government transfers. The increase in unilateral transfers this year reflects the rise in those received by the National Institutions.

Net long-term loans received by the public sector increased by \$925 million to reach

5. According to balance of payments data.

\$1,383 million this year; their weight in the total capital imports of the public sector rose. U.S. government loans increased considerably, whereas net income from the Independence and Development Loans and other sources dropped. The size of capital imports from U.S. government sources is to a large extent connected with the financing of defense imports and is subject to political considerations. The external debt of the government of Israel grew rapidly; the outstanding balance of the government's foreign loans stood at \$5.1 billion on March 31, 1975 as compared with approximately \$4.1 billion on March 31, 1974--a 26 percent increase. In addition to increasing its direct debts abroad, the government also expanded its obligations in the form of exchange rate guarantees.

## 2. DOMESTIC DEMAND OF THE PUBLIC SECTOR

### (a) Consumption

Overall public consumption in 1975 rose 56 percent at current prices--a real increase of 11 percent over 1974. It reached 46.4 percent of GNP, higher than in 1973 and 1974. Public consumption, excluding direct defense imports, fell by about half a percent in real terms; its weight in GNP and total domestic uses remained stable at the high level reached the year before.<sup>6</sup>

The freeze on domestic public consumption was accompanied by a change in its composition. Noncivilian consumption dropped 3.5 percent due to the reduction in the number of reservists (which depressed real wages by 4.6 percent) and a 3 percent decline in purchases. On the other hand, domestic civilian consumption rose 5.4 percent.<sup>7</sup> The fall in domestic noncivilian consumption must be viewed against its high level in the first quarter of 1974, while the rise in civilian consumption is particularly marked when viewed against the government's achievement in reducing private consumption for the first time in many years.

The composition of civilian consumption also changed: the number of employees grew by 6.3 percent, while domestic purchases rose by only 3.4 percent. The increase in employment in the public sector clearly contradicts the declared policy of the government which is to freeze and even reduce the number of those employed in the services. This increase is destined to influence the size of public consumption in the long term, making it even more

6. The data on defense consumption are based on temporary figures. The slight changes reflected in the updated data do not alter the trends described above.

7. Civilian public consumption, excluding government imports not elsewhere specified.

difficult to change the composition of employment in the economy, a structural change which is necessary in order to improve the balance of payments.

The rise in the average number of employees in the public sector began in the second half of 1974. Just when extensive economic policy measures were adopted to dampen economic activity, the number of civilian employees rose for the first time above the figure prior to the Yom Kippur War. Since the first quarter of 1975, the number of those employed directly in the public sector has been stabilized. On the other hand, civilian purchases have continued to expand, growing by 4.5 percent in real terms in the course of 1975. Civilian public consumption by the government and local authorities grew by 6 percent, while the domestic consumption of the National Institutions dropped by 6 percent, mainly as a result of reduced immigration. It should be recalled that part of the public consumption of the government and local authorities is connected with the number of immigrants; the slump in immigration should have been reflected by a drop in consumption

**Table X-3**  
**PUBLIC CONSUMPTION, BY COMPONENT, 1972-75<sup>a</sup>**

(IL million, at current prices)

	1972	1973	1974	1975	Percent annual increase					
					At current prices			At constant prices		
					1973	1974	1975	1973	1974	1975
1. Civilian public consumption	<b>3,046</b>	<b>4,145</b>	<b>5,800</b>	<b>8,257</b>	<b>36.1</b>	<b>39.9</b>	<b>42.4</b>	<b>6.9</b>	<b>4.0</b>	<b>4.8</b>
Payroll	2,107	2,893	4,018	5,711	37.3	38.9	42.1	3.9	4.8	6.3
Purchases	939	1,252	1,782	2,546	33.3	42.3	42.9	12.8	2.5	2.0
Thereof: Government imports, n.e.s.	231	399	450	651	72.7	12.8	44.7	62.3	-3.8	-7.3
2. Noncivilian public consumption	<b>6,196</b>	<b>12,251</b>	<b>16,481</b>	<b>26,470</b>	<b>97.7</b>	<b>34.5</b>	<b>60.6</b>	<b>66.2</b>	<b>2.2</b>	<b>12.9</b>
Payroll	1,138	2,128	2,855	3,975	87.0	34.2	39.2	56.7	6.5	-4.6
Domestic purchases	2,545	3,533	6,500	8,817	38.8	84.0	35.6	16.2	25.1	-2.9
Foreign purchases	2,119	5,448	5,740	11,983	157.1	5.4	108.8	132.9	-13.4	34.8
Defense import levy	394	1,142	1,386	1,695	189.8	21.4	22.3			
3. Total public consumption	<b>9,242</b>	<b>16,396</b>	<b>22,281</b>	<b>34,727</b>	<b>77.4</b>	<b>35.9</b>	<b>55.9</b>	<b>46.4</b>	<b>2.6</b>	<b>10.9</b>
Government	8,120	14,880	20,137	31,716	83.3	35.3	57.5	51.8	2.4	11.6
National Institutions	136	186	259	331	36.8	39.2	27.8	12.4	3.7	-6.2
Local authorities	986	1,330	1,885	2,680	34.9	41.7	42.2	7.8	4.8	6.0
4. Total domestic public consumption <sup>b</sup>	<b>6,498</b>	<b>9,407</b>	<b>14,705</b>	<b>20,398</b>	<b>44.8</b>	<b>56.3</b>	<b>38.7</b>	<b>17.4</b>	<b>13.4</b>	<b>-0.2</b>

<sup>a</sup> The noncivilian consumption data for 1974 and 1975 were revised slightly, but the changes were not made in this chapter, which conforms to the national accounts data. These changes would not alter the trends shown in the table.

<sup>b</sup> Total public consumption, less defense procurements abroad, defense import levy, and government imports n.e.s.

(b) *Transfer Payments, Grants and Subsidies*

The public sector's transfer payments, grants, and subsidies on capital and current account continued to climb rapidly, reaching IL18.3 billion in 1975. This notable expansion--about 49 percent at current prices-- followed two years of approximately 50 percent growth per annum. These growth rates are higher than those for both consumption prices and population. Total payments, which keep going up, are 2.3 times as high as the volume of domestic civilian consumption. In 1969 they were only 1.5 times as high. The size of these sums and their accelerated rate of growth make them the principal factor leading to the public sector's domestic demand surplus. These payments, besides their direct influence on the distribution of income and the labor supply, are central to any attempt to influence the demand surplus and the resulting liquidity injection.

Transfer payments to households in 1975 amounted to IL6.4 billion, up 54 percent from 1974. These payments include benefits from the National Insurance Institute, pensions and compensation, and other transfers including welfare payments. The rapid increase in transfer payments to households--the result of government social policy--reduces the effective tax burden on the population. Thus, for example, the ratio between transfer payments to households and total direct taxes reached 50 percent in 1975 as compared to only 40 percent in 1973. The relationship is similar between the weight of transfer payments and total taxes in GNP. Thus the rise in taxes as a share of GNP by approximately 1 percent this year does not necessarily indicate an increase in the effective tax burden.

Transfer payments under the National Insurance Law shot up 67 percent this year, growing to nearly IL3.0 billion. Other payments made through the National Insurance Institute soared at an even higher rate--82 percent; they amounted to IL1.1 billion. This year's increase in total National Insurance payments followed a sizable rise last year. It stemmed from a number of factors, such as the full impact of increases in transfer payments made to compensate beneficiaries for price increases as part of the economic policy of July and November, 1974; this compensation affected the 1974 average in part, but it was expressed fully, as mentioned, only this year. Other factors were the rise in the average wage per wage-earner, to which pensions are linked, and the application of the income tax reform, which led to an increase in transfer payments and altered the system of direct tax collection.

The main changes in benefits resulting from the reform were as follows:

1. Old-age pensions were raised from 15 to 16 percent of the average wage for an individual recipient and from 22.5 to 24.0 percent for a couple, following the abolition of old-age deductions in the income tax system.

2. The large families' insurance benefits and workers' children allowances were merged into a single child allowance system.

3. The granting of the children's allowance for the first child onwards was extended to the entire population.

4. Children's and discharged soldiers' allowances were raised.

5. Income tax deductions for children were abolished.

Together with the increase in transfer payments made by virtue of these arrangements, income tax collections also rose to some extent, as child and old-age deductions were abolished; National Insurance collections also expanded slightly with the entry of non-wage income earners into the cycle of national insurance contributors due to the existence of universal children's insurance.

Pensions and other benefits, including those to the war-injured, victims of Nazi persecution, and employees who retired from the civil service and National Institutions, jumped by 41 percent to reach IL990 million this year (excluding pensions to employees who retired from local authorities). A relatively moderate increase--23 percent--occurred in other transfer payments to households. These included participation in graded school fees and hospitalization, expenditures on food in public sector health, educational, and welfare institutions, welfare payments made through the local authorities, and primary immigrant absorption services (financial assistance to immigrants, basic equipment, wage complementation, and aid in employment). The laggard increase in those items this year reflects the drop in immigration; other transfer components expanded at a faster pace.

Transfer payments to nonprofit institutions increased 49 percent this year,<sup>8</sup> Current transfers--which constitute the majority--rose 62 percent, whereas those on capital--which are earmarked for investments of nonprofit institutions--fell 13 percent. The decline in capital transfers to those institutions is consistent with the policy of curtailing investments which do not contribute to improving the balance of payments. Most transfer payments to nonprofit institutions are destined for educational (including vocational and higher educational) institutions and health facilities. These transfers do not include here the collections of the "parallel tax" (employers' contributions to health insurance schemes) by the National Insurance Institute, which are then transferred to the various Sick Funds.

In 1972-75, the weight of total public sector transfers to nonprofit institutions on

8. About 5 percent originated in the compensation paid to nonprofit institutions for the employers' tax and indirect taxes imposed in February, 1975.

capital and current account inched up from 3 to 4 percent of GNP compared with some 2.4 percent in 1969. The increase in these transfers has enabled such institutions to expand rapidly without necessitating a parallel rise in income from autonomous sources. Establishing nonprofit institutions on the basis of large scale transfers from the public sector actually turns them into a part of that sector without their being directly bound by its limitations and policy considerations.<sup>9</sup>

Transfer payments on capital account to businesses include grants from the development budgets of the government and the local authorities, those made to cover losses, and other capital grants. They do not include capital grants reflecting the difference between the interest rate paid on credit provided by the public sector and the interest, including linkage differentials, paid by the public sector itself. The share of the government in all these payments is decisive--over 93 percent. Transfers on capital account grew 72 percent in 1975. Most of the increase was due to the government's obligations under the Law for the Encouragement of Capital Investments and in connection with other investments which are not eligible for the concessions provided in the Law but enjoy government encouragement. It is sometimes difficult to distinguish between transfers on capital account to businesses and the provision of credit to businesses, since with respect to part of the sums there is no prior decision as to whether they constitute a definite outlay or a credit outlay creating a monetary asset. The high growth rates of capital transfers are consistent with the accelerated upswing of long- and medium-term credit to industry as shown by analyses of the financial intermediaries. Capital grants to industry constituted approximately 70 percent of total capital grants in 1975. This component of government expenditure is relatively inflexible in the short term, because of the government's ongoing commitment to finance investments once it approves projects under the Law for the Encouragement of Capital Investments.

Public sector subsidies on commodities and services together with indirect tax rebates to exporters rose 39 percent this year, compared with 43 percent in 1974. These subsidies include direct ones on locally produced goods, participation in costs and refund of costs to producers and firms, and expenditures to promote production for export and subsidies on imported foodstuffs. This item also includes deficit finance for the government's commercial enterprises. Subsidies on locally produced goods and services increased this year 63 percent, compared with only 25 percent last year; they amounted to IL1,785 million

9. The transfers to nonprofit institutions in this chapter are not the same as those described in Chapter XI, "Nonprofit Institutions", since the institutions covered in the two chapters differ.

**Table X-4**  
**PUBLIC SECTOR TRANSFERS, GRANTS, AND SUBSIDY PAYMENTS, 1972-75**  
(IL million)

	1972	1973	1974	1975	Percent annual increase		
					1973	1974	1975
Transfer payments to households	1,735	2,445	4,180	6,415	40.9	71.0	53.5
National Insurance Institute							
Pensions	765	1,125	1,785	2,980	47.1	58.7	66.9
Other transfers <sup>a</sup>	175	245	610	1,110	40.0	149.0	82.0
Compensation and pension payments <sup>b</sup>	280	395	700	990	41.1	77.2	41.4
Other transfers	515	680	1,085	1,335	32.0	59.6	23.0
Transfers to nonprofit institutions	940	1,365	2,010	2,995	45.2	47.3	49.0
Capital-account transfers to business	165	415	365	630	151.5	-12.0	72.6
Subsidies and indirect tax rebates to							
exporters	1,465	2,415	3,450	4,810	64.8	42.9	39.4
Domestic products and services	495	875	1,095	1,785	76.8	25.1	63.0
Commodity imports	145	505	405	645	248.3	-19.8	59.3
Indirect tax rebates to exporters	825	1,035	1,950	2,380	25.5	88.4	22.1
Interest paid in Israel	1,170	1,550	2,300	3,435	32.5	48.4	49.3
Total transfers, subsidies, and indirect tax rebates	<b>5,475</b>	<b>8,190</b>	<b>12,305</b>	<b>18,285</b>	<b>49.6</b>	<b>50.2</b>	<b>48.6</b>

<sup>a</sup> Government and National Institution transfers made through the National Insurance Institute, such as special old-age pensions, hostile action casualty benefits, special large family allowances, etc.

<sup>b</sup> Excludes compensation and pension payments by local authorities, which are included under "other transfers".

SOURCE: Central Bureau of Statistics, National Insurance Institute, and Bank of Israel.

in 1975. This underestimates the subsidies granted, since large additional subsidies were given by means of the fuel equalization fund. This fund collects hundreds of millions of pounds each year<sup>10</sup> on certain types of fuel which are then transferred as subsidies on other fuel products as a way of supporting the production of goods and services. The above-mentioned data on subsidies to local production include only the deficit (where one exists) of the equalization fund. Imputing the latter's sums as subsidies to local production requires making a parallel increase in the figure showing the imputed tax collections on fuel, so that the total domestic demand surplus and liquidity injection would not change, but the size of the components and the extent of intervention in production attributed to the government would change.

A slightly different type of subsidy, which is not defined as such, is given by means of the water adjustment fund. The subsidy and the tax are on the same product as consumed in different places; yet here too only the fund's deficit appears as a subsidy.

10. IL677 million in 1974/75.

The considerable expansion of subsidies this year took place despite the increase in the prices of basic products in November, 1974; it stemmed from the freeze on the prices of basic products and transportation during 1975, despite the continuous rise in production costs, exchange rates, and fuel prices. Every cost increase which is not fully reflected in the prices of the subsidized products raises the amount of subsidies paid and the rate of subsidy per unit of product. The freeze on the prices of subsidized goods in 1975 led to a situation in March, 1976--on the eve of a hike in these prices--where subsidies equalled between 50 and 100 percent of the product's consumer price. Public transportation subsidies increased much faster than did total subsidies, and their weight in total subsidies went up.

Subsidies on imported products<sup>11</sup> in 1975 amounted to IL645 million--59 percent above the figures for 1974, when they dropped approximately 20 percent. The fall in subsidies in 1974 was caused by the considerable price rises for the basic commodities in November, 1973, January, 1974, and November, 1974, whereas in 1975 the prices of subsidized products were maintained despite the creeping devaluations and the rise in local costs. Any increase in the prices of goods abroad or any change in exchange rates which is not accompanied by an immediate rise in the local price enlarges the amount of the subsidy and raises the latter's weight in the product price.

Indirect tax rebates to exporters rose 22 percent this year compared with 88 percent in 1974. The slack rate of growth reflects the government's preferring to directly encourage exports by means of changes in the official rate of exchange. It rose about 41 percent on the average in 1975 above that of the previous year, the result of a 43 percent devaluation in November, 1974, a 10 percent devaluation in September, 1975 and four smaller "creeping" devaluations that took place from June, 1975 to the end of the year. The slow rise in indirect tax rebates to exporters also reflected the low 10 percent growth in the dollar value of exports entitled to support compared with 1974. The average support per dollar of export in the maximum value-added group increased approximately 15 percent; in the second half of 1975, it did not rise at all. The average effective exchange rate for exports reached IL8.07 per dollar in 1975 compared with an average official rate of IL6.33.

Domestic interest payments by the public sector, excluding interest payments to the National Insurance Institute and the War Risks (Arnona) Fund, increased 49 percent in 1975

11. The subsidy on imported products as stated here is the difference between the sale price to the consumer and the cost price, the purchase being calculated by the LIFO method (last in--first out).

to IL3.4 billion, 90 percent of which constituted the government's interest payments. These payments include both interest and interest linkage, while the linkage of the principal is included together with the latter's repayment in net credit operations. The notable increase in interest payments was due to the formidable expansion of the outstanding domestic debts of the public sector. If interest payments are deflated by the rise in consumer prices, their real rate of increase in 1975 was 6 percent, a rate that must be taken into consideration in any discussion of the distribution of national income. The interest payments presented above are on a cash basis--i.e. those interest payments actually made by the government during the year.<sup>12</sup>

The considerable rise in transfer payments to households, based on the adoption of an almost automatic system of adaptation to price and wage levels, and the increase--necessitated by the state's indebtedness--in the public sector's interest payments--an increase connected with financing the sector's structural demand surplus over a long period--reduce both the flexibility of the budget on the one hand and the efficiency of economic policy on the other. Whereas the sector's outlays on these components are developing rapidly, its receipts from interest (on credit provided to the other sectors) and other transfers from the public are not linked, a phenomenon that tends, during a period of inflation, to expand the public sector's structural demand surplus in the present and also in the future. The rise in transfer payments on the one hand and the provision of public services according to various means tests, on the other, suggest that willingness to participate in the labor force will be affected if the disposable income of non-workers rises relative to that of workers. Transfer payments to nonprofit institutions are also related in practice to their increased outlays on payrolls and purchases; to reduce transfer payments to nonprofit institutions is no easier than to reduce the direct consumption of the public sector.

(c) *Investment*<sup>13</sup>

The real direct investment of the public sector in buildings and equipment inched up 1.6 percent in 1975. The previous year investments fell at a similar rate. Investments by the government, local authorities, and National Institutions in public construction and

12. Part of the interest the government owes for a certain year is not paid in that year. This interest is mostly linked and accumulates the price increases to the full extent. In 1974/75, the increase in the amount of unpaid interest was estimated at IL400 million.

13. The public sector's investments are defined here as direct investments made by the government, local authorities, and National Institutions as well as investments made by the government's commercial enterprises according to national accounts data.

the investments of the government's commercial enterprises in equipment contributed to the expansion of public investment, whereas investments in interurban roads declined sharply. The remaining investment components--construction and equipment for government services, urban roads, and construction by commercial enterprises--remained at their 1974 real level. A considerable part of the incremental investment was used for the direct import of equipment for government enterprises. Without these imports real domestic investment would have edged down 1 percent.

According to these data the public sector's investments did not contribute to reducing the domestic demand surplus in 1975. Moreover, the freeze on domestic investment was accompanied by pressure on the balance of payments from the public sector via its equipment imports. The 18 percent increase in public sector equipment imports occurred after two years of moderate decline by 2 and 11 percent respectively, despite the government's policy to reduce investments. Investments of public sector companies, which are largely financed by the public sector, expanded 33 percent in 1975, after falling 18 percent the year before. Although the behavior of public sector companies is presumably based on business considerations, the government can influence the level of investment through its representatives on the boards of directors and by the finance it provides in the form of capital transfers and long-term loans. Transfer payments on capital account to business, which are part of the investment finance placed by the public sector at the disposal of private sector and public sector companies, grew in nominal terms by 73 percent. This rate of growth clearly indicates that the policy of reducing investments was not efficiently applied; it testifies, moreover, that the government was unable to reduce investments in the short-term, including investments of bodies that benefit directly from government financial sources under the Law for the Encouragement of Capital Investments or other long-term arrangements. Investments of nonprofit institutions that were not connected with capital grants according to the Law did not increase.

(d) *Publicly Sponsored Construction*

The outlay on publicly sponsored construction rose 6.7 percent in real terms in 1975. The number of apartment construction starts fell 19 percent--a sharp decline concentrated mainly in the second quarter of the year following record starts in the first quarter. The number of apartment completions rose 10 percent in 1975. The stock of dwellings built by the public sector did not continue to expand in 1975, but as a result of the decline in purchases and increase in completions, the stock of such units plateaued at an extremely high level--approximately 55,000 in the process of construction compared with 31,000 in

1971 and 41,000 in 1972. The stock of apartments completed similarly increased. (For a more detailed discussion, see Chapter VIII, Investment and Construction.)

Public sector spending on housing in the government development budget and those of the National Institutions is defined in this chapter as the public sector credit granted to other economic sectors, and not as the sector's direct investments. This definition suited the situation in the past when there was a surplus demand for publicly sponsored apartments and residents with their own sources and construction firms with the aid of securities issues and other credit participated in the construction costs. Public housing budgets helped to finance buildings in the process of construction and extended credit to households for the purchase of apartments; at the same time, the credit recipients owed money to the public sector. In recent years, however, the market for publicly sponsored apartments has changed. There is now a stock of unsold apartments; construction is continuing in places where demand for apartments is extremely low; and new construction is starting despite the large stock on hand. These phenomena have been accompanied by a renewed expansion of public finance provided on easy terms and by reductions in apartment prices. The change in the market situation leads one to think that a large part of public expenditure on housing should probably be regarded as a definite expenditure; if it were so regarded, the sector's domestic demand surplus would increase as would net credit absorption, but the total liquidity injection would not change.

### 3. THE PUBLIC SECTOR'S DOMESTIC REVENUE ON CAPITAL ACCOUNT

#### (a) *Tax and Compulsory Loan Receipts*

Taxes are defined in this section in accordance with the national accounts definitions, which differ from those generally used in the government's publications. National insurance contributions are treated here as direct taxes, except for the matching contributions of employers to the National Insurance Institute that are transferred to the Sick Funds. Also included are the Broadcasting Authority's license fees and the current surplus of the government's business-type enterprises, particularly communications and ports (the deficits of these enterprises are included in subsidies). On the other hand, certain compulsory payments, such as the land betterment tax, inheritance tax, fines, and certain license and service fees (e.g. driving license and passport fees) are defined as transfers from the public to the government<sup>14</sup> and not as taxes.

14. For an explanation and discussion of transfer payments, see section 2(b) of this chapter.

**Table X-5**  
**GOVERNMENT TAX REVENUE, 1973-75**  
(IL million)

	1973	1974	1975	Percent increase		Percentage distribution <sup>a</sup>		
				1974	1975	1973	1974	1975
<b>Direct taxes</b>								
Income tax <sup>b</sup>	4,385	6,102	9,473	39.2	55.2			
National insurance <sup>c</sup>	1,751	2,349	3,414	34.2	45.3			
<b>Total</b>	<b>6,136</b>	<b>8,451</b>	<b>12,887</b>	<b>37.7</b>	<b>52.5</b>	<b>44.2</b>	<b>40.7</b>	<b>43.0</b>
						<b>(48.2)</b>	<b>(43.7)</b>	<b>(45.7)</b>
<b>Taxes on property</b>								
Property tax	347	616	936	77.5	51.9			
Land registry fees <sup>d</sup>	84	133	182	58.3	36.8			
<b>Total</b>	<b>431</b>	<b>749</b>	<b>1,118</b>	<b>73.8</b>	<b>49.3</b>	<b>3.1</b>	<b>3.6</b>	<b>3.7</b>
						<b>(3.4)</b>	<b>(3.9)</b>	<b>(4.0)</b>
<b>Indirect taxes</b>								
<b>Imports</b>	<b>4,646</b>	<b>7,661</b>	<b>9,046</b>	<b>64.9</b>	<b>18.1</b>	<b>33.4</b>	<b>36.9</b>	<b>30.2</b>
Customs and levy on civilian imports <sup>e</sup>	2,627	4,528	4,558	72.4	0.7			
Purchase tax	754	1,385	1,901	83.7	37.3			
Foreign travel tax	88	116	205	31.8	76.7			
Surtax on stocks	7	185	629	—	—			
<b>Subtotal</b>	<b>3,476</b>	<b>6,214</b>	<b>7,293</b>	<b>78.8</b>	<b>17.4</b>	<b>(27.3)</b>	<b>(32.2)</b>	<b>(25.9)</b>
Levy on defense imports	1,170	1,447	1,753	23.7	21.1			
<b>Domestic production, fees, licenses</b>	<b>2,682</b>	<b>3,911</b>	<b>6,912</b>	<b>45.8</b>	<b>76.7</b>	<b>19.3</b>	<b>18.8</b>	<b>23.1</b>
Purchase tax	778	1,326	1,943	70.4	46.5			
Fuel tax <sup>e</sup>	584	688	1,829	17.8	165.8			
Tobacco excise	262	306	452	16.8	47.7			
Cement excise	75	167	233	122.7	39.5			
Excise on beverages	22	26	22	18.2	-15.4			
Defense stamp tax	201	262	293	30.3	11.8			
Revenue stamp tax	253	353	469	39.5	32.9			
Vehicle license fees	92	101	117	9.8	15.8			
Other fees (incl. current surplus of govt. enterprises) <sup>f</sup>	388	627	871	61.6	38.9			
Financial services tax	27	55	123	103.7	123.6			
Payroll tax	—	—	560					
<b>Total indirect taxes on expenditure</b>								
Incl. the defense import levy	<b>7,328</b>	<b>11,572</b>	<b>15,958</b>	<b>57.9</b>	<b>37.9</b>	<b>(21.1)</b>	<b>(20.2)</b>	<b>(24.5)</b>
Excl. the defense import levy	<b>6,158</b>	<b>10,125</b>	<b>14,205</b>	<b>64.4</b>	<b>40.3</b>			
<b>Total tax revenue</b>								
Incl. the defense import levy	<b>13,895</b>	<b>20,772</b>	<b>29,963</b>	<b>49.5</b>	<b>44.2</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Excl. the defense import levy	<b>12,725</b>	<b>19,325</b>	<b>28,210</b>	<b>51.9</b>	<b>46.0</b>	<b>(100.0)</b>	<b>(100.0)</b>	<b>(100.0)</b>

<sup>a</sup> The figures in parentheses denote the distribution excluding the defense levy.

<sup>b</sup> Excludes the increase in outstanding credit granted through the commercial banks under the tax debt payment arrangement.

<sup>c</sup> Excludes the matching tax paid by employees and transferred to the Sick Funds.

<sup>d</sup> Includes the tax paid in lieu of the land registry fee.

<sup>e</sup> The estimated imputed import levy on fuel is included in revenue from customs and the import levy.

<sup>f</sup> Consists of the current surplus of government business-type enterprises (Post Office, ports, etc.), radio and TV fees paid to the Broadcasting Service, and entertainment tax.

SOURCE: Income and property tax — Ministry of Finance; national insurance collections — National Insurance Institute; indirect taxes — Central Bureau of Statistics.

Government tax revenue<sup>15</sup> rose 46 percent in 1975 as compared with 52 percent in 1974. Indirect taxes on imports were responsible for the more sluggish increase; indirect taxes on local production<sup>16</sup> and direct taxes moved up more rapidly this year, as compulsory loan collections declined.

Direct taxes soared 53 percent in 1975, compared with 38 percent in 1974, but revenue from compulsory payments on income rose more slowly this year; direct taxes and compulsory loans levied on income (Defense and War Loans) and the cost-of-living allowance increment paid in the form of a loan increased 37 percent in 1975, compared with 55 percent in the previous year. Part of this slowdown stemmed from the deceleration in the growth of gross private income from economic activity (which rose 35 percent in 1975 and 44 percent in 1974). The other part arose from the reform in direct taxation which abolished the Defense and War Loan on individuals and companies; expanded the income tax base considerably by including the accumulated cost-of-living allowance and various benefits such as payments for vehicle maintenance, telephone, etc. in taxable income; replaced personal deductions by a system of allowances; and linked allowances and tax thresholds to the consumer price index. The reform was introduced in July, with effect retroactive from April. Its impact was only partly felt in 1975, mainly in a much slower growth of revenue from compulsory payments on wage income, the reduction of the share of loans in total compulsory payments on non-wage incomes, and a notable change in the structure of National Insurance payments and receipts. Further effects will become manifest in 1976.

Indirect taxes on imports (excluding the levy on defense imports) rose only 17 percent in 1975 compared with 79 percent in 1974. This sharp slowdown stemmed from two factors: first, commodity imports, which are the main basis for the imposition of these taxes, hardly increased in 1975, and the weight of highly taxed commodities fell. Secondly, the method used to carry out balance of payments policy was changed. In 1974, the government used indirect taxes--particularly the defense levy on imports--in its efforts to influence the balance of payments. As from November, 1974 and in the course of 1975, the government acted directly on the official rate of exchange while lowering the import levy. As a result, the average official exchange rate went up from IL4.5 per dollar in 1974 to IL6.3 in 1975, and, parallel to this, the rate of the import levy went down from 27.2 percent to 15 percent on the average.

15. Excluding the defense import levy.

16. Indirect taxes on local production cover property taxes and taxes on local production, including the fuel tax, licenses and fees, and the current surplus of the government's commercial enterprises (mainly communications and ports).

Indirect taxes on local production<sup>17</sup> increased 72 percent in 1975 compared with 50 percent in 1974. This acceleration occurred despite the more moderate nominal growth of GNP--38 percent in 1975 compared with 44 percent in 1974. It stemmed from the hikes in tax rates in 1974, which were fully reflected in the 1975 tax collections, and the further increases in the tax rates put into effect in the course of 1975. The principal changes leading to the higher tax collections were: the fuel tax hike of November, 1974; the imposition of the employers' tax in April, 1975; and the raising of purchase tax rates in July and November, 1974 and February and September, 1975.

**WEIGHT OF TAXES AND COMPULSORY PAYMENTS IN GNP AND  
RESOURCES AVAILABLE TO THE ECONOMY, 1971-75**  
(percentages)

	1971	1972	1973	1974	1975
<b>Gross taxes</b>					
GNP	36.3	35.2	35.1	36.7	38.6
Available resources	31.6	31.2	28.5	31.1	30.5
<b>Gross compulsory payments</b>					
GNP	40.8	39.2	38.9	41.6	42.1
Available resources	35.5	34.8	31.6	35.2	33.3
<b>Net taxes</b>					
GNP	22.3	20.6	17.5	18.3	18.8
Available resources	19.4	18.3	14.2	15.5	14.8
<b>Net compulsory payments</b>					
GNP	26.5	24.0	20.9	22.9	21.3
Available resources	23.0	21.4	17.0	19.3	16.8

NOTE: The items are defined as follows:

Gross taxes — Government taxes (excluding the defense import levy) and local authority taxes as defined in this chapter.

Net taxes — The above less transfer payments to households, nonprofit institutions, and businesses, and subsidies.

Gross compulsory payments — Gross taxes and compulsory loans.

Net compulsory payments — Net taxes and compulsory loans, less compulsory loan repayments and tradable loan certificates distributed.

Gross national product — valued at the effective rates of exchange.

Resources available to the economy — GNP plus the import surplus (imports valued c.i.f. and exports f.o.b.), at the effective rates of exchange and including imports from the administered areas. Excludes direct defense imports and interest paid by the public sector.

The employers' tax and the tax on financial services and insurance companies are defined here and in the system of national accounts as indirect taxes on local production. In their present form, however, they more closely resemble direct taxes. Like employer payments to national insurance, they are imposed at a fixed rate on the total payroll of the financial services, insurance companies,<sup>18</sup> and other employers.

17. Indirect taxes on domestic production, fees and licenses, surpluses of the government's business-type enterprises, and property taxes.

18. The tax on financial services and insurance companies is imposed on their profits as well.

Direct taxes, together with these other two taxes, increased 60 percent in 1975 compared with 38 percent in 1974. Indirect taxes on local production (less the employer tax and the tax on financial services and insurance companies) went up 60 percent in 1975 compared with 49 percent in 1974.

The weight of taxes and compulsory payments in total resources at the disposal of the economy indicates the degree of government intervention in the allocation of resources via taxes and compulsory payments. This intervention declined between 1971 and 1973 and then again increased until 1975. The weight of net taxes and net compulsory payments in the sources at the disposal of the economy is an approximation of the tax burden. These indicators clearly point to a decreasing tax burden between 1971 and 1973, which was connected with tax policy, a rise in the burden in 1974 also connected with tax policy, and a decline in 1975 due to the rise in transfer payments. In order to obtain a better approximation of the tax burden, the share of taxes and the tax component in compulsory loans should have been calculated, but due to the difficulty of an exact quantitative identification of this component, it was decided to present the share of taxes only and the share of taxes and compulsory loans after netting out the relevant items in both cases; the development over the years was similar under both calculations.

It would also have been desirable, when calculating the tax burden, to deduct part of the taxes on imports which substitute for an exchange rate policy and to adjust the calculation of total resources accordingly. The identification of this part is difficult, however, and therefore its deduction was not attempted. All the indicators are calculated also in relation to GNP, although conceptually total resources at the disposal of the economy provide a more meaningful basis.

Another characteristic of the tax structure is the multiplicity of taxes as opposed to the concentration of revenues from a few taxes. The bulk of the government's revenue comes from four or five main taxes: income tax, national insurance, customs duty and the levy on civilian imports, purchase taxes, and in recent years the fuel tax. This is shown in the following table.

**WEIGHT OF MAIN TAXES IN TOTAL TAX REVENUE, 1973-75**  
(IL million)

	1973	1974	1975
Total tax revenue <sup>a</sup>	12,725	19,325	28,210
Four main taxes			
IL million	10,295	15,690	21,289
Percent of total	80.9	81.2	75.5
Five main taxes			
IL million	10,879	16,378	23,118
Percent of total	85.5	84.8	81.9

<sup>a</sup> Excludes the defense import levy. Its inclusion would pull up the figures, since revenue from customs and the import levy is included in the main taxes.

There are, of course, taxes slated to serve other purposes apart from transferring resources from the public to the government, such as the surtax on inventories, the aim of which is to absorb importers' profits arising from devaluations; excise taxes on beverages and tobacco, which represent to a certain extent a fine that society imposes on their consumption; and other taxes and fees (fuel tax, for instance) which are imposed in order to collect from the consumer the difference between the cost of a commodity or service to him and that to the economy. But it seems that in order to reduce collection costs, the tax system should be re-examined with a view to abolishing or merging taxes yielding small sums and to centralize the collection machinery to a greater extent. The government has already moved in this direction: in 1974 it combined the tax levied on top of the land betterment tax and the land registry fee, which previously had been collected by different offices.<sup>19</sup> The value-added tax, when introduced, is supposed to eventually replace a number of indirect imposts. Another development brought out by the table is the decline in the share of the main taxes in total receipts in 1975; this indicates that the government had to resort this year to additional taxes, such as that levied on payrolls, in order to reach the revenue figure recorded. The reason for the downturn lay in the nongrowth of income from customs duties and the import levy, and this suggests the need for a flexible, broadly based tax where a slight revision of the rate would enable the Treasury to realize its revenue estimates. The value-added tax is expected to fulfill this role.

#### 1. Direct taxes

Direct taxes comprise income tax (including company tax and capital gains tax) and national insurance contributions, excluding employers' matching contributions transferred to the Sick Funds.

After a 28 percent rise in 1974, direct tax revenues increased 52.5 percent in the year reviewed, as compulsory loans levied on income dropped.<sup>20</sup> Direct taxes and compulsory loans together increased approximately 37 percent in 1975, compared with approximately 55 percent in 1974. The laggard rise stemmed from the real decrease in compulsory payments on income from wages, which offset the rise in compulsory payments on other incomes. The replacement of loans by taxes in itself constitutes a rise in tax rates since the tax component of the compulsory loans, though difficult to identify, is certainly below 100 percent.

19. Whether the imposition of this tax is at all justified should be examined, since the revenues from it are low, and it constitutes a tax on mobility which, on the contrary, should be encouraged.

20. The Defense and War Loans collected on income and the Cost-of-Living Allowance Loan.

In July, 1975, a reform of direct taxation was adopted, with its provisions to take effect retroactively from April, 1975; its main points were:

- (a) The abolition of the Defense and War Loans on individuals and companies.
- (b) The expansion of the tax base to include many forms of income which were formerly exempt from tax and loans: the accumulated cost-of-living allowance, payments for vehicle maintenance, telephone, vacation, etc.
- (c) The fixing of a table of marginal tax rates at different income levels, which is simple and less steep than was the case previously.
- (d) The fixing of tax allowance points and children's allowances instead of the former deductions from taxable income.
- (e) Partial linking of the system of tax rate thresholds to the consumer price index and complete linking of the tax allowance points and children's allowances.
- (f) The reduction of the rate of direct taxes (company and income tax) on ordinary companies and the reduction of the gap in tax rates between industrial and ordinary companies.
- (g) The extension of the obligation to keep books and records on income.
- (h) The reduction of the differences between wage earners and non-wage earners with regard to payment of income tax: the new system of allowances does not distinguish between them as opposed to the former situation in which wage earners were favored by the deduction system. On the other hand, it was decided that tax payments on account of previous years for which assessments have been drawn up would be linked.
- (i) A reform of the land betterment and capital gains taxes aimed at unifying the principles of taxation for profits from the sale of lands and buildings with those for capital gains from other assets.

(j) Special directives for the 1975/76 financial year, making it a transition year between the old and new tax systems. The directives were: the sums collected on account of loans between April, 1975 and the start of the reform in July of the same year would be converted into advances of income tax payments on account; a special levy of 3 percent was imposed on all incomes in 1975/76 and a guarantee was made to maintain the level of income from wages, after taxes and loans are deducted, that the individual would have received had it not been for the reform.

The influence of the reform on taxes collected in 1975 was only partial, since it was put into operation gradually in the course of the year. In the first quarter, still part of the 1974/75 financial year, income tax and compulsory loans were collected from employees and advances were collected from the self-employed and companies at the previous

**Table X-6**  
**INCOME TAX AND COMPULSORY LOAN COLLECTIONS, 1973-75**

(IL million, at current prices)

	1973	1974	1975	Percent annual increase		Percentage distribution <sup>a</sup>		
				1974	1975	1973	1974	1975
<b>Income tax on:</b>								
Wages and salaries <sup>b</sup>	2,066	2,833	4,100	37.1	44.7	47.1	46.4	43.3
Receipts <sup>c</sup>	2,076	2,865	4,150	38.0	44.9	(45.9)	(44.5)	(40.1)
Less: Income tax debt payment arrangement <sup>d</sup>	10	32	50	220.0	56.3			
Nonwage income	2,319	3,269	5,373	41.0	64.4	52.9	53.6	56.7
Receipts <sup>c</sup>	2,443	3,570	6,209	46.1	73.9	(54.1)	(55.5)	(59.9)
Less: Income tax debt payment arrangement <sup>d</sup>	124	301	836	142.7	177.7			
<b>Total income tax</b>	<b>4,385</b>	<b>6,102</b>	<b>9,473</b>	<b>39.2</b>	<b>55.2</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Receipts <sup>c</sup>	4,519	6,435	10,359	42.4	61.0	(100.0)	(100.0)	(100.0)
Less: Income tax debt payment arrangement <sup>d</sup>	134	333	886	148.5	166.1			
<b>Defense and War Loans on:</b>								
Wages and salaries	486	1,014	562	108.6	-44.6			
Nonwage income	400	1,027	1,068	156.8	4.0			
Appreciation of real estate values	—	4	21	—	—			
<b>Total</b>	<b>886</b>	<b>2,045</b>	<b>1,651</b>	<b>130.8</b>	<b>-19.3</b>			
<b>Employers Saving Loan</b>	540	615	881	13.9	43.3			
<b>Cost-of-Living Increment Loan<sup>e</sup></b>	—	—	76	—	—			
<b>Total income tax and compulsory loan receipts</b>	<b>5,811</b>	<b>8,762</b>	<b>12,081</b>	<b>50.8</b>	<b>37.9</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Thereof: compulsory loans	1,426	2,660	2,608	86.5	-2.0	24.5	30.4	21.6

<sup>a</sup> Figures in parentheses denote the distribution of income tax receipts.

<sup>b</sup> Includes members of cooperatives and owner-directors of companies listed as salaried employees.

<sup>c</sup> Less tax rebates, etc.

<sup>d</sup> The increase in outstanding credit granted through commercial banks for the payment of tax debts.

<sup>e</sup> The reference is to that part of the c-o-l allowance increment paid in January-June 1975 in the form of a loan instead of cash.

SOURCE: Ministry of Finance and Bank of Israel.

rates. Even in the second quarter, income tax and loans were collected at the old rates except that the compulsory loans were abolished post factum and the sums collected were registered as payments on account of income tax. The adjustment of the accounts for this period--which included the imposition of a special 3 percent levy on incomes in 1975/76--was carried out with respect to most employees towards the end of the 1975/76 financial year; it therefore had no effect on incomes in 1975. In the third and fourth quarters, income tax was collected from employees at the new rates (without the special levy) so that their net income<sup>21</sup> increased at almost all income levels. Compensation was given to a small group of wage earners whose net income was supposed to decline due to the

21. After deduction of direct taxes and compulsory loans.

extension of the tax base. The advance payments of the self-employed and companies were recorded entirely as advances on account of income tax and company tax (the latter is included in the data on income tax collection).

In 1975, the use of payment arrangements through the banks for people owing taxes expanded remarkably; the balances jumped to IL900 million compared with IL350 million in 1974. The sums granted under the arrangements are recorded in the banks' books as loans to income tax debtors (and to a small extent to those owing back purchase taxes and surtaxes) and credited to the Treasury's earmarked deposits for the provision of loans to tax debtors in those banks.

The payment arrangements were made with the self-employed and companies mainly in connection with the tax payments for previous years and in a few cases payments of tax deductions from salaries and wages to which they had committed themselves, as employers, in the current year. The payment arrangements are not linked and were made for an average period of less than a year (and a maximum period of 22 months); they bore 13 percent interest. In November, 1975, the income tax commission ordered a reduction of the maximum period, a considerable increase in the interest rate on the amount involved, and a limitation on the use of such arrangements for paying taxes deducted from employee salaries.<sup>22</sup>

The payment arrangements through the banks make it easier for the tax authorities to collect taxes from assesseees to whom they apply; the rate of subsidy reflected by the interest rate has, moreover, recently been reduced. Nevertheless, it would appear that there is no room at all for such arrangements with regard to payroll deductions. As for debts from previous years, the arrangements constitute a certain avoidance of the rule linking these debts to price increases which was included in the recent reform of direct taxation. That part of the tax payments of the self-employed and companies which is, in fact, a payments arrangement, is included in the collection data for the current year of the Income and Property Tax Commission and of the State Revenue Administration. The Accountant General in his financial report deducts the rise in the outstanding balance of these loans from tax collections so that the sums are registered as actual collections when payments are made by the assesseees. This practice has also been followed in the tables in this chapter.<sup>23</sup> Data on collections of income tax and compulsory loans by type

22. For a description of the development of loans to tax debtors, see the 26th Annual Report of the State Comptroller, pp. 100-101 (Hebrew).

23. This definition conforms to registration on a cash basis or corrected cash basis as is the practice in the case of taxes.

of assessee exist only with regard to gross collection (including payment arrangements through the banks). Payment arrangements by type of assessee have indeed been estimated, but the range of error in these estimates prevents the publication of complete data on income tax collections by type of assessee (excluding payment arrangements) except for a distinction between collections from employees and other collections. It is possible, however, to draw a number of conclusions, presented below, which remain valid within this range of error.

Income tax collection from employees rose 45 percent in 1975 compared with 37 percent in 1974. The increase was entirely due to the decline in compulsory loans, since if the income-linked compulsory loans are added to the income tax,<sup>24</sup> an increase of 23 percent would result for 1975, a mild increase compared to that of 1974 (51 percent), even though the total wage bill of the economy rose 41 percent in 1975 compared with 38 percent in 1974. The growth in income tax receipts and in collections of income tax and compulsory loans from employees was moderate even in comparison with collections from income other than wages, so that the weight of collections from employees in total receipts dropped.

Income tax on the self-employed and companies, including deductions at the source, increased 64 percent in 1975, compared with 41 percent in 1974; if the income-linked compulsory loans are added, the increase was 50 percent in 1975 compared with 58 percent for 1974. According to the available estimates, collections from the self-employed and companies developed unevenly (without deductions at source which are difficult to classify by type of assessee): collections from the self-employed were up some 30 percent this year compared with less than 10 percent in 1974--a year in which mainly the income of the self-employed was affected by the Yom Kippur War at the end of 1973 and the mobilization of reservists in 1974. Collections from companies rose substantially--approximately 60 percent--a rate more or less similar to that prevailing for a number of years. This rate of increase reflects the considerable rise in corporate income in previous years for which final tax calculations are now being made. The advances made by companies for the current year went up 40 percent and those of the self-employed increased 28 percent.

The estimate of payments arrangements for deductions from wages and salaries is not presented here as tax collected, even though the amounts were actually deducted from the employees' incomes; nevertheless, they are not regarded as tax revenues from the

24. The Defense and War Loan and the Cost-of-Living Allowance Loan which were deducted from employees' incomes from January to June, 1975.

government's viewpoint. Additional deductions from employee income on account of compulsory payments on income are not recorded in state revenues from taxes in the same year due to the natural lag in the transfer of such deductions to the tax authorities.<sup>25</sup> A special phenomenon of 1975 was the great delay in transferring employer deductions on account of the Cost-of-Living Allowance Loan. The loan was deducted from employee income from January to June at a rate of up to IL100 per month. The employers, with government agreement, began to send in these deductions to the tax authorities in September. Up to the end of the year IL76 million were transferred; the balance is to be transferred in 1976.

National insurance contributions rose 45 percent--faster than the growth in the total wage bill of the economy. The increase stemmed from the fixing of a higher wage ceiling on which contributions are collected and a hike in the rates. In April, 1975 the wage ceiling for national insurance contributions was raised from IL2,500 to IL3,400 per month, while the rates hardly increased (insurance contributions were raised 0.1 percent due to the addition of a new insurance branch aimed at guaranteeing the payment of debts to employees in cases of liquidation and bankruptcy). In July, with the start of the reform, children's allowances were extended to all families in Israel (including the first and second children of the self-employed for whom such allowances had not been paid previously) and old-age pensions were increased parallel to the abolition of income tax deductions for the aged and for employees' children. Collections were adjusted to meet these additional payments by raising the ceiling, retroactively to April, 1975, to IL3,700 per month and increasing the contribution rates, particularly from the self-employed (from 9.6 to 13.5 percent of income above IL11,300 per annum) due to the extension of children's allowance payments.

## 2. Indirect taxes

Indirect taxes<sup>26</sup> (excluding the levy on defense imports<sup>27</sup>) jumped 41 percent in 1975 compared with a 65 percent rise in 1974. The increase in indirect taxes on local

25. Even though there is a natural lag every year and incomes are therefore transferred from one year to another--revenues from tax collections from employees are still less than the sums deducted from their wages due to the increase of taxes on wages from year to year.

26. Including property taxes, indirect taxes on imports and on local production as detailed in the table.

27. It is important to include the levy on defense imports in indirect taxes on imports when discussing these taxes as an instrument of balance of payments policy. In discussing government revenue from taxes, it is the flow of transfers from the public to the government that is interesting, and therefore the levy on defense imports, expressed in the government accounts as an outlay on defense imports and as income from the collection of the levy on this import, was not included here. For this reason this levy is treated separately in the tables and in the discussion.

production (excluding property taxes) accounts for a 28 percent rise in total indirect taxes in 1975. Import taxes caused a 10 percent increase in total indirect taxes, while property taxes contributed another 3 percent. Indirect taxes, excluding the levy on defense imports and after deducting subsidies on locally produced commodities and imported goods, grew 37.5 percent in 1975 compared with 80 percent in 1974.

The taxes defined as indirect taxes on imports are: the defense levy, which is imposed at a uniform rate on all imported commodities, including direct defense imports (up to the end of 1975 the levy was not imposed on imported services); customs duties which are imposed at different rates (ranging from a few percent to hundreds of percent) on various groups of imported commodities; the purchase tax which is also imposed at different rates on various groups of commodities and does not discriminate between imported and locally produced commodities; the foreign travel tax which is imposed on the price of a return journey abroad, but which up to the end of 1975 was not imposed on the outlays of Israelis abroad; the inventory surtax which is imposed on stocks of goods<sup>28</sup> and foreign currency in the possession of the banks at the time of any currency devaluation in order to absorb the value differentials created by the devaluation.

Indirect taxes on imports increased at a low rate this year both in comparison with the rise in total taxes and in comparison with previous years. The factors that operated to slow the growth in collections were:

(a) Commodity imports in terms of current dollars (excluding direct defense imports, diamonds, ships and aircraft), which is the main base for indirect tax collections, fell slightly.

(b) The share of highly taxed imports dropped: the import of consumer goods (excluding food) was down by 10 percent and that of durables fell 28 percent. The downswing is attributable partly to the administrative ban imposed at the end of 1974 on the import of certain durables for half a year.<sup>29</sup>

(c) The import levy in 1974 was 25 percent until July and 35 percent from July to November. With the devaluation of the IL in November, 1974 the levy was reduced to 15 percent and it remained at this level throughout 1975. The rate affects not only receipts from the import levy and the ad valorem customs duty but also collections of the purchase tax on imports which is imposed on the value of the import including the levy and the customs duty.

28. The inventory surtax is also imposed on stocks of locally produced goods when their prices are changed. It is difficult to estimate the size of this component.

29. For a detailed discussion of the factors in the decline see the chapter on Imports.

Alongside those factors were the offsetting effects of the devaluations and tax hikes:

(1) The devaluations at the end of 1974 and in the course of 1975 raised the tax base and increased the collections of the purchase tax and ad valorem customs duty accordingly.

(2) The November, 1974 hike of 10 percent in the purchase tax and customs duty rates on a list of commodities was fully felt in 1975.

(3) Purchase tax rates were jacked up twice in 1975: in February by 7.5 percent on all commodities subject to the tax, except for textiles; and in September by 7 to 12 percent, the increase in most cases being 10 percent. This last increase will be reflected mainly in 1976 tax collections.

Government indirect taxes on local production include property taxes, property tax proper and the defense procurement tax, and registry fees and the tax paid in lieu of the land betterment tax (their collection was combined in 1974); and taxes on local production; licenses; and fees.

Indirect taxes on local production, licenses, and fees soared 77 percent in 1975 compared with 46 percent in the previous year, causing a rise of some 2.5 percent in the average rate of these taxes on GNP.

Approximately one-third of this increase stemmed from the growth in fuel tax collections.<sup>30</sup> The consumer prices for fuel were raised considerably in November, 1974 and again in September, 1975. A fuel tax is imposed on all types of gasoline, kerosene, and solar oil at a fixed amount per liter. It is not imposed on the various types of mazout used in industry and for the production of electricity, which account for approximately 60 percent of the economy's total outlay on fuel (excluding taxes and subsidies). In November, 1974 the fuel tax was raised drastically (178 percent on 94 octane gasoline, 126 percent on 83 octane gasoline and 350 percent on solar oil). The rise in the consumption of the various types of gasoline in 1975 was mild--3.6 percent. Consumption of kerosene and solar oil dropped. The fuel tax was not raised with the price increase of September, 1975, and it remained steady in terms of tax per liter.

A further close-to-20-percent tax increase on local production stemmed from the imposition of the employer's tax, which earned the Treasury IL560 million up to the end of 1975.

30. Fuel tax collections here do not include the import levy on fuel, which is included in revenues from customs duties, and the levy on civilian imports. There is also an equalization component in the price of fuel, a form of tax on most types of fuel that is then returned as a subsidy on mazout. In principle, surpluses accumulating in the fund should be regarded as a fuel tax, but in 1974 and 1975 the fund had a deficit which is included under subsidies to local production.

Local authorities' taxes are also defined as indirect taxes on local production in the national accounts system. The discussion in this section and the data presented do not include them, but they are discussed in Section 5 of this chapter.

(b) *Other Domestic Revenues*

The other domestic revenues of the public sector include transfers from the public on capital and current account, income from property, and income from interest. These revenues amounted to IL2.5 billion in 1975, 43 percent up over the previous year in nominal terms, a 1.6 percent gain in real terms. Current transfers from the public constituted approximately one quarter of all other domestic revenues. The main item in these transfers is transfers to the sector's health and educational institutions as participation in or payment for the services they provide. The remaining items are fines, driver's license fees, and donations. In 1975, transfers from households grew moderately--by approximately 35 percent. This rate of increase did not even cover the average price rise in 1975; thus these receipts actually fell in real terms.

Transfers from the public on capital account include government revenues from its commercial enterprises on account of depreciation, the land betterment tax, and the estate tax.<sup>31</sup> Together they represent about half of the transfers on capital account; the second half comprises owners' participation in the development activities of local authorities. Transfers on capital account from the public rose at the relatively low rate of 31 percent in 1975, which was still higher than the rate in 1974.

The receipts of the local authorities and the revenues of the government on account of depreciation increased slowly, whereas land betterment tax and estate tax collections rose approximately 55 percent. The slack expansion in local authority income from owner participation was connected with the recession that began in construction and road building.

The public sector's domestic revenues from property include income from interest, profits of the Bank of Israel from its current activities,<sup>32</sup> and transfers from the Israel Lands Administration. The sector's interest receipts from abroad, amounting to IL0.7 billion (an increase of 25 percent), were deducted from these sums.

The sector's income from property rose 55 percent in 1975; income from interest--only 20 percent; the Bank of Israel's profits--90 percent; and transfers from the Israel Lands

31. The land betterment tax and the estate tax are defined in accordance with the national accounts as transfers and not as taxes. The additional tax which is collected together with the land betterment tax is defined as an indirect tax on local production.

32. Excluding revaluation activities.

Administration--to double their previous level.

The slow rise in the public sector's interest collections, compared with an increase of some 50 percent in domestic interest payments, stemmed from the sector's system of financing: on the one hand it mobilizes credit such as the voluntary and compulsory loans on a large scale bearing interest which is partially linked and, on the other hand, it provides finance in the form of grants, which do not constitute a monetary asset of the sector, or credit at low and unlinked interest rates. Some of this credit is not even repaid currently.

#### 4. THE NATIONAL INSTITUTIONS

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

In addition to their regular activities in the spheres of immigration, absorption of new immigrants, settlement, and land development, the National Institutions are also involved in the fields of higher education, health, and social services with the help of the emergency fund-raising campaigns. The share of the National Institutions in these services, which the state is not obliged to provide by law, has changed from time to time in accordance with the inflow of funds to Israel.

The greater part of the Institutions' operations results, by definition, in a demand surplus<sup>33</sup> since their domestic activity is financed principally by receipts from abroad, whereas their domestic income is very small. A large part of the Institutions' demand surplus stems from transfer payments and subsidies. In 1975 the amount transferred to households fell as immigration dropped, while the sums transferred to nonprofit institutions rose. The main component of the latter type of transfer is transfers to institutes of higher learning.

A mild increase occurred in investments, grants, and participation in investments in 1975 as a consequence of the decline in credit provided by the Institutions to housing and the rise in investments, primarily the expansion of land development. Interest payments grew approximately 80 percent in 1975.

The overall demand surplus of the National Institutions totalled IL2,643 million in 1975 compared with IL2,053 million in 1974--a 29 percent increase. These growth rates reflect a reduction in the real overall and domestic demand surpluses. One of the reasons

33. The demand surplus of the public sector as a whole is discussed in Section 1 of this chapter.

**Table X-7**  
**NATIONAL INSTITUTION OPERATIONS, 1972-75**

(IL million)

	1972	1973	1974	1975	Percent annual increase		
					1973	1974	1975
<b>1. Demand surplus</b>							
Domestic consumption and current expenditure abroad	254	357	494	627	40.6	38.4	26.9
Transfers and subsidies	745	956	1,278	1,357	28.3	33.7	6.2
Interest paid	104	140	133	238	34.6	-5.0	78.9
Investments, grants, and participation in investments <sup>a</sup>	477	602	475	542	26.2	-21.1	14.1
Less: Domestic revenue	55	65	81	181	18.2	24.6	123.5
Net transfers from rest of public sector	421	136	246	-60	-67.7	80.9	-124.4
Demand surplus	<b>1,104</b>	<b>1,854</b>	<b>2,053</b>	<b>2,643</b>	<b>67.9</b>	<b>10.7</b>	<b>28.7</b>
<b>2. Net domestic credit granted</b>							
Net loans granted to the public	166	205	310	502	23.5	51.2	61.9
Net credit received	34	-95	-81	70	-379.4	14.7	186.4
Net domestic credit granted	<b>132</b>	<b>300</b>	<b>391</b>	<b>432</b>	<b>127.3</b>	<b>30.3</b>	<b>10.5</b>
<b>3. Balance to be financed (1+2)</b>	1,236	2,154	2,444	3,075	74.3	13.5	25.8
Financing							
Unilateral transfers and net credit from abroad	1,048	2,772	1,703	3,198	164.5	-38.6	87.8
Net credit from the banking system	188	-618	741	-123	-428.7	219.9	-116.6
Total financing	<b>1,236</b>	<b>2,154</b>	<b>2,444</b>	<b>3,075</b>	<b>74.3</b>	<b>13.5</b>	<b>25.8</b>
<b>4. Domestic demand surplus</b>	<b>932</b>	<b>1,630</b>	<b>1,729</b>	<b>2,201</b>	<b>74.9</b>	<b>6.1</b>	<b>27.3</b>
Total demand surplus (1)	1,104	1,854	2,053	2,643	67.9	10.7	28.7
Less: Purchases and expenditure abroad	172	224	324	442	30.2	44.6	36.4

<sup>a</sup> Includes participations and credit for financing housing construction.

for the decline is the fall-off in immigration during the past two years; in 1975, some 21,000 immigrants came to Israel compared with 33,000 in 1974 and 56,000 in 1973.

In addition to the demand surplus, the Institutions provide credit to the rest of the economy, primarily through the land settlement budgets of the Jewish Agency and the World Zionist Organization. Net loans to the public (loans provided less collections) amounted to IL502 million in 1975, 62 percent over the previous year. The Institutions received net credit in Israel this year totalling IL70 million as opposed to the two previous years in which they had a net credit outflow.

The total credit operations of the National Institutions in 1975 resulted in the provision of net credit in the amount of IL432 million compared with IL391 million in 1974, an increase of only 10 percent.

That part of the Institutions' expenditures which was not financed from domestic sources (including transfers from the rest of the public sector) but was covered by

unilateral and net borrowed receipts from abroad amounted to IL3,075 million in 1975, compared with IL2,444 million the year before.

Unilateral transfers, that is receipts from the fund-raising campaigns in 1975, grew considerably in nominal terms compared with the previous year; they covered approximately 92 percent of the balance to be financed compared with 73 percent in 1974. The Institutions' net credit transactions abroad resulted this year in the receipt of some IL370 million net credit after four years in which there was a net credit outflow to the rest of the world. One reason for the outflow in the past was the deliberate effort made to gradually reduce the Institutions' foreign currency liabilities, an activity facilitated by the increase in the funds' incomes.

Part of the unilateral transfers received in 1973 went to finance the National Institutions' expenditures in 1974, which resulted in a decrease in the Institutions' deposits. This decrease appears as a net credit inflow from the banking system in the same year, 1974. In the current year, net credit transactions with the banking system resulted in an outflow.

The income of the Jewish National Fund--mainly from property, donations, and bequests--enables it to continue its own operations. In addition, the Jewish National Fund carries out land development activities for other bodies, mainly the government and the Jewish Agency, but to finance such activities it is compelled to resort to interim credit.

## 5. THE LOCAL AUTHORITIES

The operations of the local authorities, for the purpose of this discussion, include those of the religious councils and regional authorities as well as the municipal activities of the kibbutzim and cooperative agricultural settlements.<sup>34</sup> The activity carried out by the local authorities themselves is dominant, both in terms of volume and in terms of its share in the revenue sources of the religious councils and municipal unions.<sup>35</sup>

The demand surplus of the authorities declined 2 percent at current prices in 1975 after a jump of 83 percent in 1974. In other words, the average annual rise in the past two years was 34 percent at current prices. The lower demand surplus of the authorities in

34. Principally educational activity which is here charged to consumption on the one hand and income from taxes on the other.

35. The local authorities finance approximately two-thirds of the religious councils' activities and approximately half of the firefighting operations of the regional authorities.

1975 is attributable to the 83 percent rise in their income from government transfers. (The latter constitute almost 70 percent of their total revenues). The authorities' revenues from autonomous sources increased at a lower rate than their outlays did; this naturally had an expansionary effect on the demand surplus. The considerable difference in the development of the authorities' demand surplus during the past two years, despite the similarity in the development of their autonomous revenues and expenditures during the same period, emphasizes the great interdependence between the demand surplus and government transfers and stresses the need to examine the demand surplus of the public sector as a whole as a significant economic parameter.<sup>36</sup>

(a) *Local Authorities' Expenditures*

Local authority spending in 1975 exceeded that of 1974 by 43 percent at current prices and 2 percent at constant prices--a rise equivalent to that of the population in the same year; in other words, per capita real outlay remained constant. The composition of spending changed little: per capita consumption remained unchanged; transfer payments to household and nonprofit institutions increased 8 percent per capita; and, in contrast, purchases on capital account fell.<sup>37</sup>

Local authority consumption in 1975 grew 42 percent, an increase that is wholly explained by the rise in prices and the growth in population. The weight of wage payments in consumption was about two-thirds, while the remaining third consisted of purchases on current account.

The composition of the authorities' consumption has hardly changed in the past two years: approximately 40 percent is accounted for by educational services; 15 percent by cultural, welfare, health, and religious services; 35 percent by municipal services such as sanitation, maintenance of public assets, etc. and the remaining 20 percent--administrative expenses.

The authorities' transfer payments to households and nonprofit institutions rose 53 percent in 1975, compared with 37 percent in 1974, which was more than the general rise in expenditures. The real increase in transfers to nonprofit institutions was in step with population growth whereas per capita transfer payments to households rose 17 percent in real terms; their weight in total transfer payments on current account exceeded 50 percent this year for the first time. About 80 percent of the transfers to households consist of

36. The demand surplus of the whole sector does not change, of course, with a change in the volume of transfers between bodies within the sector.

37. Purchases on capital account are defined as net investments and purchases of buildings and land less the sale of assets.

Table X-8

## DEMAND SURPLUS OF THE LOCAL AUTHORITIES AND ITS FINANCING, 1973-75

(IL million)

	1973	1974	1975 <sup>a</sup>	Percent annual increase	
				1974	1975
<b>A. Demand surplus</b>					
1. Expenditure	<b>2,598</b>	<b>3,824</b>	<b>5,465</b>	<b>47.2</b>	<b>42.9</b>
Consumption	1,330	1,885	2,680	41.7	42.2
Transfers on current account	293	400	612	36.5	53.0
Interest paid	163	227	312	39.3	37.4
Purchases on capital account	765	1,252	1,783	63.7	42.4
Transfers on capital account	47	60	78	27.7	30.0
2. Revenue	<b>2,014</b>	<b>2,753</b>	<b>4,416</b>	<b>36.7</b>	<b>60.4</b>
Taxes	470	595	720	26.6	21.0
Other domestic revenue	355	475	610	33.8	28.4
Net transfers from rest of public sector	1,189	1,683	3,086	41.5	83.4
3. Demand surplus (1-2)	<b>584</b>	<b>1,071</b>	<b>1,049</b>	<b>83.4</b>	<b>-2.1</b>
<b>B. Financing of demand surplus</b>					
4. Credit (gross)	852	1,523	1,741	78.8	14.3
Less: Principal repayments	172	226	318	31.4	40.7
Linkage differentials	96	226	374	135.4	65.4
Total	<b>584</b>	<b>1,071</b>	<b>1,049</b>	<b>83.4</b>	<b>-2.1</b>

<sup>a</sup> Data for 1975 are from approved budgets and hence should be regarded as provisional

SOURCE: Taxes and consumption — Central Bureau of Statistics; other data — Bank of Israel estimates.

welfare payments of various types; another 15 percent are under the heading of education; and the rest are listed under various other headings. Transfer payments to nonprofit institutions are spread over a variety of items: 44 percent go to cultural and educational institutions; 26 percent to welfare institutions; 6 percent to health institutions; and the rest to various other institutions.

Purchases on capital account went up 42 percent in 1975 compared with 64 percent in 1974--a real increase of some 4 percent. Purchases on capital account are here defined as investments, plus purchases of buildings and land, less the sale of assets.<sup>38</sup> Almost half the authorities' investments are in elementary education and secondary school buildings; over 20 percent in shelters; approximately 10 percent in arterial roads; almost 10 percent in sewerage; some 5 percent in sport and cultural centers and day homes; and the remainder in drainage, piping, fire-fighting, and municipal development.

38. These data are based mainly on the development budget estimates for 1975/76; they are probably underestimates. Data on these budgets, which are based on consolidated financial reports, are received a year later and, accordingly, the estimates' reliability is low relative to the estimates of current costs which are based on the consolidated financial reports for 1974/75 and the budgets approved for 1975/76 as drawn up by the Central Bureau of Statistics and the Ministry of the Interior.

(b) *Local Authority Revenues*

The revenues of the local authorities soared 60 percent in 1975, compared with a 37 percent increase in 1974. Their autonomous revenue<sup>39</sup> rose by only 24 percent, however, compared with 30 percent the year before. The principal sources of this revenue are taxes--rates on residential buildings and lands, business tax and taxes on new construction, transfers from individuals and nonprofit institutions--mostly in the form of school fees--and participation of residents and institutions in development works carried out near their place of residence (roads, sewerage, and the like). Most of these revenues do not increase naturally with a price rise in the economy since they stem from taxes, licenses, and service fees which are imposed at a fixed amount and not as a percentage of the value of the goods or services. Decisions to raise taxes, licenses, and service fees in times of inflation lag behind the rise in prices, which is one of the main reasons for the sluggish rise in autonomous revenue. At the beginning of 1975/76 the authorities intended to hike their taxes approximately 40 percent, but the government withheld its consent and compensated the authorities instead with about IL150 million in 1975 for not raising their taxes.

Government transfers to the authorities are not uniform. They contain a component very similar to the authorities' autonomous revenue in which the government acts as an efficient "tax collector" who distributes the proceeds to the authorities. Another component stems from services whose level is dictated by the government which finances a large portion of the expenditures involved. A third component is the general grant-in-aid which is not connected with any specific activity but is meant to supplement the authorities' revenues in order to enable them to maintain their general level of activity.

The main components of the government's transfers are:

(1) Shared revenue--a fixed percentage of government revenue from certain taxes. The main component is the income transferred on account of property tax--4.8 percent of total government revenue from all annual taxes collected two years before the year in question. A fixed part of government revenue in the current year from the land betterment tax, the additional land betterment tax paid in lieu of the land registry fee, vehicle licensing fees and purchase taxes is also transferred to the local authorities. This component is similar to the authorities' autonomous revenue since it replaces municipal taxes, with the government serving as a "tax collector" for reasons of collection efficiency. Accordingly, the shared income is divided among the authorities, as far as possible, as it would have

39. Revenues less transfers from the rest of the public sector.

been had the authorities collected the taxes themselves, except for half the sum transferred on account of vehicle licenses and the entire sum transferred on account of the purchase tax which are combined with general grant-in-aid and divided together with it. Shared revenue constitutes about one-third of total government transfers to the authorities on current account.

(2) Earmarked participation of government ministries--designed to finance most of the services provided to citizens by law or those services that the government is interested in supplying at a uniform level to all residents. The main participation is in social services (education, health, and social welfare) and is funded from the budget of the ministry responsible for that sphere of activity; the services are actually provided by the local authorities. Likewise, the government ministries participate, to a lesser extent, in the provision of non-obligatory services which the government is interested in encouraging, such as fire-fighting, activities of the religious councils, etc. The total participation of the ministries constitutes over a third of total government transfers to the authorities on current account.

(3) The general grant-in-aid--its level is fixed in the government budget and it is allocated together with part of the shared revenues in accordance with a formula worked out by the Ministry of Interior. This formula fixes standard "service and revenue baskets" for each local authority according to the size of its population and other special factors affecting its revenue and expenditure. Part of the total grant--the standard grant--is aimed at complementing the "revenue basket" of each authority. The remainder is divided among the authorities as balancing or special grants in order to solve financing problems for which no solution is provided within the framework of the standard grant; they are allocated according to considerations of the Ministry of the Interior. Within the framework of the grant-in-aid, the authorities received in 1975 compensation for not raising taxes, as stated, and a special grant in the amount of the employer's tax to which the authorities were liable according to the law. Together with the special grants, the general grant-in-aid component amounts to a third of total government transfers to the authorities on current account.

(4) Transfers on capital account--in addition to the transfers on current account to the authorities, the government ministries participate through their development budgets in the authorities' development activities; the National Institutions also participate in the development of educational and welfare institutions by the authorities. The total amount of these transfers to the authorities on capital account is relatively low compared with that on current account, reaching IL260 million in 1975.

(c) *Deficits, Deficit Financing, and Indebtedness*

The local authorities' deficit stems from two sources: the deficit on current account and the deficit on capital account. The authorities have been operating for some years within a deficit framework on current account; that is, current revenues have been insufficient to finance current expenditures. Current expenditures are defined here as expenditures on wages and current purchases, current transfer payments to households and nonprofit institutions, and loan repayments (principal, interest, and linkage differentials). Current revenues are taxes and current transfers from households and nonprofit institutions and current transfers from the government.<sup>40</sup>

**CURRENT DEFICIT OF LOCAL AUTHORITIES, 1973-75**  
(IL million)

	1973	1974	1975	Percent annual increase	
				1974	1975
1. Total current expenditure	2,060	2,973	4,308	44.3	44.9
2. Total current revenue	1,714	2,302	3,823	34.3	66.1
3. Thereof: From own sources	634	804	997	26.8	24.0
4. Current deficit (1-2)	346	671	485	93.9	-27.7

The current deficit dropped in 1975 due to the considerable rise in government transfers to the authorities on current account. The government helped to finance part of those deficits through loans for balancing the ordinary budgets; the loans were granted on linked terms until March, 1975. Part of the money was given in the form of directed credit or was supplied by commercial banks (in approximately equal measure), and part carried a government guarantee. These loans totalled IL160 million in 1973/74 and IL215 million in 1974/75. In 1975/76, non-linked balancing loans for local authorities amounting to IL215 million were listed for the first time in the government budget. The remainder was financed by the authorities from loans obtained on the free market, generally linked and at high rates of interest.<sup>41</sup>

The deficit on capital account is structural: approximately 70 percent of the

40. Activity reflected in the ordinary budget is not identical with the current account. Investment activity and the purchase of buildings and land are carried out through the expenditure side of the ordinary budget. Part of the transfers on capital account (owners' participation) and part of the loans received are included in its revenue. On the other hand, there are small components of current expenditure in the development budget as well.

41. The maximum legal interest on linked loans is 9 percent. Together with commissions and other payments, the authorities paid up to 12 percent interest.

expenditures on investments and purchases of buildings and land are financed by borrowed funds. The greater part of these funds comes from government-directed sources; approximately half of them are given on easy terms and are not linked. In recent years, due to inflation, the actual expenditures involved in completing certain projects exceeded planned outlays by considerable sums. The government ministries financed these differences only partly and the authorities financed the remainder with free market loans. Due to delays in the execution of government transfers to the authorities, the latter needed, in addition to deficit finance, interim credit as well in order to finance current activity. The total overall deficit of the local authorities, that is, that part of the expenditures which is financed by loans, declined to 39 percent in 1975 after having reached a peak of 57 percent of total expenditures in 1974.

As a direct consequence of the deficit activity of the authorities over the years, they accumulated a debt which strained their budgets during the same period. The linked portion of the debt rose during the past two years due to the rapid price increases and the authorities' urgent need for loans which were obtained in the free market only on stiff terms. The debt grew very quickly, almost doubling between March, 1973 and March, 1975. This rapid rise slowed in the course of 1975; the additional credit which the authorities needed was relatively low compared with previous years and part of it was given for the first time from the government budget as balancing loans without linkage. The price rise in the course of 1975 was also moderate compared with that in 1974.

The need for credit, which had led to the acceptance of loans on stiff terms in 1974, contracted in 1975 and more efficient control was exercised over the loans received. At the initiative of the Ministry of Interior, the Examiner of the Banks ordered the banks and financial institutions not to execute any loans to local authorities without the written approval of the Minister of the Interior (who delegated this authority in practice to the district commissioners). This procedure enabled the Interior Ministry to examine the loans beforehand and not to authorize those offered on particularly harsh terms. Previously, loans had sometimes been submitted for Interior Ministry approval after they had in fact been disbursed.

The easing of the local authorities' pressure on the capital market was reflected in their share of total credit provided through this market this year. An indicator of this development can be found in the accounts of the intermediaries making up the capital market.<sup>42</sup> The credit given to the authorities through this system in 1975 expanded 15

42. For a definition of this system and the activity reflected in it, see Chapter XVIII.

percent compared with 57 percent in 1974. The share of the credit to authorities in the total credit provided by the system was 15 percent in 1973 and 1974; it rose to 16 percent in the first half of 1975 and then fell to 10 percent in the second half of the year, the average level for the whole of 1975 being 12 percent. It appears that 1975 saw a weakening of the influence the authorities had exercised on the free credit market, in the two previous years as a factor leading to a rise in interest and a deterioration of other credit terms, at least on the margin. This development is attributable mainly to the above-mentioned control exercised over the new loans.

The development of the debt is reflected by the authorities' outlay on loan repayments; in 1975 this outlay exceeded the authorities' entire autonomous revenues. The share of linkage differentials in the total outlay on loan repayment rose from 22 percent in 1973 to 33 percent in 1974 and to 37 percent in 1975.

A partial solution to the financing problems of the authorities was outlined by an inter-ministerial committee (consisting of representatives of the Ministry of the Interior, the Ministry of Finance, and the Local Authorities Center) which discussed the problem. It recommended coordination between the various ministries and the authorities with respect to the current account and with regard to the mobilization of funds for development purposes. The government is to establish an orderly line of credit to the authorities, and they are no longer to mobilize credit from the free market. This solution, however, can only be a partial one, since it does not deal with the debt already accumulated or with the burden of loan repayments deriving from it for the years to come.