

CHAPTER VII

GOVERNMENT AND NON-GOVERNMENT PUBLIC SECTOR

1. CONSOLIDATED ACCOUNT¹

PUBLIC SECTOR operations in 1972 were influenced by the restrictive fiscal measures introduced by the Government. The sector's overall demand surplus rose 5.6 percent at current prices, and at 1971 prices it probably declined; the domestic demand surplus was down 5.5 percent at current prices, after swelling 39.4 percent in 1971; the net credit inflow from the public in 1972 was ten times greater than in the previous year; the amount of liquidity pumped into the economy was slashed by 90 percent; and for the first time in many years there was hardly any increase in public sector liabilities to the banking system.

These indicators, which measure the sector's influence on aggregate demand and the level of economic activity, are based on the reports and direct budgetary operations of the various authorities of the sector. It should be borne in mind, however, that the Government's influence on economic activity is reflected not only in its fiscal policy measures but also in its control over public sector companies and financial institutions, the authorizing of capital imports, and the like. If the Government's extrabudgetary operations, which expanded in 1972, are also taken into account, the contractionary effect of the sector's activities in the year reviewed was not as strong as indicated above, but was still substantial in comparison with 1971.

A detailed discussion of the significance of the public sector's influence on aggregate domestic demand appears in section 2, which deals with the Gov-

¹ This sector comprises the Government (including the National Insurance Institute), local authorities (including religious councils and the municipal expenditure of cooperative agricultural settlements), and a number of voluntary institutions (the Jewish Agency, World Zionist Organization, Jewish National Fund, and Keren Hayesod) engaged principally in welfare and cultural activities for the general public.

Current income and expenditure of business-type enterprises (e.g. the Post Office, Israel Railways, and municipal waterworks) are not included except for their surpluses or deficits. The data in this chapter are for calendar years, and are based chiefly on the financial reports of the various public sector authorities and partly on data from the Central Bureau of Statistics. Some of the data for 1972 are based on provisional summaries, as the financial reports for 1972/73 had not yet been published when this chapter was prepared. Data for 1971 have been revised.

ernment and the National Institutions. It will be noted that, in the face of the rapid monetary expansion in 1971 and 1972, the accelerated increase in disposable private income, private consumption, and investment, and the accompanying decline in the unemployment rate to an all-time low, the public sector should have taken steps in 1971, and certainly in 1972, to significantly trim the overall and domestic demand surpluses, and not merely to stabilize them at the high level reached in the past three years.

The enormous increase in credit from the public and the much smaller liquidity injection in 1972 were due mainly to the boom in the securities market (bonds and stocks alike). The latter enabled the sector to grant much more credit; only part of it came directly from the Government, the bulk being provided through financial institutions.

The sector's payments rose less in 1972 than in the two preceding years. The deceleration was reflected both in public consumption spending and in subsidy and transfer payments to other sectors. At the same time, the uptrend in tax revenue and other domestic income also slackened.

Public consumption was up 14.4 percent at current prices, as opposed to 19.1 percent in 1971. At 1971 prices, the level contracted by 3.6 percent owing to developments in noncivilian consumption, the most flexible component of the sector's expenditure. The changes in public consumption and expenditure and in the sector's demand surplus are the main determinants of changes in noncivilian consumption in general, and in defense imports in particular. The more sluggish rise in public consumption during the past two years may be ascribed to a cutback in defense imports; domestic defense spending and noncivilian public consumption rose in nominal terms.

Total noncivilian consumption went up 11 percent at current prices, as against 16.3 percent the year before. This depressed its share in total public consumption from 69 percent in 1971 to 66.9 percent, and in GNP from 25.5 percent in 1970 and 23.7 percent in 1971 to 21.2 percent. Nevertheless, it was still higher than in any year prior to 1970.

These changes in defense spending brought down the share of total public consumption in GNP from 34.3 percent in 1971 to 31.7 percent, and its share in total domestic uses from 27.6 to 26 percent.

Tax revenue was up 25.8 percent in 1972, following a 38.1 percent gain the year before. If compulsory loans are included, the slowdown was even more pronounced—from 42.5 to 24.5 percent. The factor most responsible for this downturn in the growth rate was the cutting of taxes—both direct and indirect—following a substantial hike in 1970 and 1971. This reduction countered the effect of a number of factors working in the opposite direction: the growth of GNP, national income, and imports; the devaluation of the Israeli pound in August 1971 (which was only partially reflected in 1971); and the rise in import prices.

Total revenue in 1972 amounted to 37.3 percent of GNP, compared with

Table VII-1
INDICATORS OF PUBLIC SECTOR OPERATIONS, 1968-72

(IL million, at current prices)

	1968	1969	1970	1971	1972	Percent annual increase or decrease (-)			
						1969	1970	1971	1972
1. Public sector consumption	4,093	4,919	6,728	8,015	9,172	20.2	36.8	19.1	14.4
Civilian	1,590	1,712	1,973	2,483	3,033	7.7	15.2	25.8	22.1
Noncivilian	2,503	3,207	4,755	5,532	6,139	28.1	48.3	16.3	11.0
2. Revenue from taxes	3,932	4,909	6,222	8,595	10,813	24.8	26.7	38.1	25.8
Direct taxes	1,807	2,237	3,057	4,010	4,816	23.8	36.7	31.2	20.1
Indirect taxes									
On imports	692	1,007	1,188	2,160	3,043	45.5	17.9	81.8	40.8
On domestic production ^a	1,433	1,665	1,977	2,425	2,954	16.2	18.7	22.6	21.8
3. Compulsory loan receipts	82	22	538	1,041	1,185	^b	^b	93.5	13.8
4. Net transfers from the public ^c	2,310	2,868	3,831	4,953	6,272	24.1	33.5	29.3	26.6
5. Public sector saving	-1,684	-1,873	-2,757	-2,821	-2,617	-11.2	-47.2	-2.3	7.3
6. Demand surplus	2,271	2,559	3,539	3,812	4,026	12.7	38.3	7.7	5.6

7. Liquidity injected into the economy ^d	672	894	975	1,133	119	33.0	9.0	16.2	-89.5
8. Outstanding Government loans on March 31 ^e	8,566	10,328	13,989	17,970	24,947	20.6	35.4	28.4	38.8
Domestic									
Linked ^f	2,520	3,361	5,384	7,227	10,289	33.3	60.2	34.2	42.4
Nonlinked	878	1,242	1,915	1,913	1,906	41.4	54.2	-0.1	-0.4
Foreign	5,168	5,725	6,690	8,830	12,752	10.8	16.9	32.0	44.4
						Percentages			
Weight of public sector consumption in total domestic uses	25.0	25.3	28.6	27.6	26.0				
Weight of public sector consumption in GNP	29.8	31.1	36.0	34.3	31.7				
Weight of public sector consumption expenditure on defense in GNP	18.2	20.3	25.5	23.7	21.2				
Weight of public sector tax revenue in GNP	28.6	31.1	33.3	36.8	37.3				
Weight of public sector revenue from taxes and compulsory loans in GNP	29.2	31.2	36.2	41.3	41.4				
Weight of net transfer receipts ^g in total private income from economic activity	18.9	19.7	25.3	28.4	28.1				
Weight of public sector demand surplus in GNP	16.5	16.2	18.9	16.3	13.9				

^a Including licenses, fees, and property tax.

^b Insignificant.

^c Taxes and other compulsory payments, less transfers, domestic interest payments, and subsidies.

^d Surplus of total domestic expenditure over domestic revenue.

^e Excluding loans from the National Insurance Institute, Development Authority, and the War Risks (Arnona) Fund.

^f Excluding revaluation increments.

^g Including compulsory loan receipts (less the value of certificates distributed).

Table VII-2
PUBLIC SECTOR OPERATIONS, 1970-72
(IL million, at current prices)

	1970	1971	1972	Percent annual increase or decrease (-)	
				1971	1972
Demand surplus					
1. Current expenditure	9,917	12,667	14,921	27.7	17.8
Public consumption	6,728	8,015	9,173	19.1	14.4
Transfers	1,447	2,102	2,495	45.3	18.7
Interest paid	904	1,166	1,631	29.0	39.9
Subsidies and transfers to business	838	1,384	1,622	65.2	17.2
2. Revenue	7,160	9,846	12,304	37.5	25.0
Taxes	6,222	8,595	10,813	38.1	25.8
Other domestic revenue	938	1,251	1,491	33.4	19.2
3. Saving (2-1)	-2,757	-2,821	-2,617	-2.3	7.2
4. Purchases on capital account	782	991	1,409	26.7	42.2
5. Demand surplus (4-3)	3,539	3,812	4,026	7.7	5.6
Net domestic credit granted					
6. Net loans granted	1,222	1,411	1,468	15.5	4.0
7. Net credit received	1,137	1,512	2,519	33.0	66.6
Compulsory loans ^a	471	967	1,082	105.3	11.9
Other credit	666	545	1,437	-18.2	163.7
8. Net domestic credit granted (6-7)	85	-101	-1,051

Public sector "deficit" and its financing

9. Balance to be financed (5+8)	3,624	3,711	2,975	2.4	-19.8
10. Financing					
Net credit from banking system	1,128	1,273	25	12.9	-98.0
Unilateral transfers and net credit from abroad	2,496	2,438	2,950	-2.3	21.0

Influence of public sector operations on the money base**A. Liquidity infusions**

11. Domestic demand surplus	858	1,196	1,130	39.4	-5.5
Total demand surplus (5)	3,539	3,812	4,026	7.7	5.6
Less: Purchases and expenditure abroad ^b	2,681	2,616	2,896	-2.4	10.7
12. Net domestic credit granted (8)	85	-101	-1,051
13. Repayment of foreign loans	32	38	40	18.7	5.3
14. Total liquidity injected into the economy (11+12+13)	975	1,133	119	16.2	-89.5

B. Surplus of foreign currency expenditure over revenue

15. Purchases and expenditure abroad	2,681	2,616	2,896	-2.4	10.7
16. Less: Unilateral transfers and net credit from abroad	2,496	2,438	2,950	-2.3	21.0
Repayment of foreign loans	32	38	40	18.7	5.3
17. Surplus foreign currency expenditure	153	140	-94	-8.5	-167.1

C. Increase in public sector debt to banking system (A+B)

	1,128	1,273	25	12.9	-98.0
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^a Absorption, Compulsory Savings, and the compulsory Defense Loans, less the Defense Loan issues for banking institutions and voluntary Defense Loan issues.

^b Excluding the defense levy on imports.

36.8 percent in 1971 (in 1965–68 the ratio stood at 26–27 percent). The weight of tax revenue and compulsory loan receipts combined in GNP was, at 41.4 percent, hardly changed in 1972; it is therefore obvious that the tax burden did not increase in 1972, following a steady rise begun in 1967.

Some of the indirect taxes on imports were introduced in lieu of an official devaluation and not for fiscal reasons. Excluding import levies, tax revenue in 1972 amounted to 30.9 percent of GNP, as against 32 percent in 1971.²

As already noted, the growth of the public sector demand surplus slowed in 1972, when it reached IL 4,026 million as against IL 3,812 million in 1971. Excluded from the computation are net compulsory loan receipts, the financing of housing, and various development budget investments, all of which are included under financial transactions.

The sector's transactions on financial account show a net credit inflow of IL 1,051 million, compared with IL 101 million in 1971.

The sector's domestic transactions resulted in a net liquidity infusion of only IL 119 million, as opposed to IL 1,133 million the year before; this implies a significant reduction in the sector's contribution to the expansion of the money base and the money supply. Actually, only the local authorities and the National Institutions pumped liquidity into the economy; the Government mopped up considerable funds. The liquidity infusion by the National Institutions was due to their financing structure, which is based preponderantly on foreign sources; in the case of the local authorities the reason was the rapid expansion of their activities in the last two years, which was largely financed by credit from the banking system.

Along with this relatively small liquidity infusion, the sector's transactions in foreign currency resulted in a surplus, so that the debt to the banking system rose only IL 25 million, as contrasted with IL 1,273 million in 1971 and IL 1,128 million in 1970.³ The picture here is similar to that of the liquidity infusion: the local authorities and the National Institutions increased their indebtedness to the banking system, while the Government sharply pared its liabilities. The growth of the Institutions' indebtedness stemmed mainly from a loan provided by the Bank of Israel for the purpose of repaying a number of foreign loans. This credit, in fact, replaced that from foreign sources, and therefore had no influence whatsoever on the Institutions' liquidity infusion.

² With GNP calculated at the effective rate of exchange.

³ The data on the growth of the public sector's debt to the banking system and other financial sectors do not include changes stemming from revaluation differentials; consequently, caution must be exercised when comparing these data with the figures on the Government's and public sector's debt given in Chapter XIII—"Money Supply, Credit, and the Banking Institutions"—and in Chapter XV—"Financial Institutions". The incremental public sector indebtedness to the banking system in 1972 includes the aforementioned Bank of Israel loan to the National Institutions. In Chapter XIII this loan is not treated as credit extended to the public sector, but is included in the nongovernmental sectors' foreign currency transactions.

In view of the reduction of the sector's debt to the banking system, its "deficit" (the demand surplus, less net credit from domestic sectors) was overwhelmingly financed by unilateral transfers and net borrowing from abroad. Capital imports totalled IL 2,950 million in 1972, as against IL 2,438 million the year before (in dollar terms, \$ 702 million and \$ 650 million respectively). There was a change in the capital import mix: unilateral transfers (National Institution proceeds from the fund-raising campaigns) and intergovernmental transfers rose, while net foreign credit declined.

The "balance of payments" of the public sector is presented in the appendix to this chapter (in Hebrew only). A detailed breakdown of the changes in this statement appears separately for the various authorities—for the Government and the National Institutions combined in section 2, and for the local authorities in section 3.

2. THE GOVERNMENT AND THE NATIONAL INSTITUTIONS

(a) *Influence on domestic demand*

The Government dominates the public sector, accounting for 90 percent of total expenditure. The influence exerted by the Government and the National Institutions on the demand level is estimated below in terms of their demand surplus, net credit flows to and from other sectors, contribution to the money base, etc. These indicators, as well as the other data cited in this chapter, are based on the reports and budgets of the Government and the National Institutions and, at the most, show the direct impact of their operations as reflected therein. It must be stressed, however, that the Government's influence on economic activity is often greater than indicated by its budgets. First of all, various Government ministries sometimes undertake projects involving a larger outlay than that allocated in the current budget; the extra sum constitutes, in fact, an advance on future budgets and influences economic activity during the period reviewed even though it is not reflected in the Government's reports.

Secondly, the Government's influence on economic activity is not confined solely to the direct fiscal measures carried out within the framework of the budget. It exerts a weighty influence through its power to control and direct activities by means of laws, regulations, ordinances, and the like; but of hardly less importance are the direct economic activities which, though not included in its budget, are carried out on its full or partial responsibility. The financial institutions' operations are largely directed by the Government as regards both the mobilization of funds and their allocation; the Government also controls the new issue market for bonds and completely or partially controls dozens of public sector companies. In addition, it subsidizes various branches of the economy by means of low-interest credit and the insuring of foreign loans against changes in the exchange rate; this enables it to control the

provision of directed credit, a fact that does not immediately find expression in the budget. The Government's influence is also reflected in the granting of foreign loan permits to public institutions and various other bodies. Therefore, the discussion here must be regarded as mirroring only part—admittedly the greater part—of the influence wielded by the Government and the National Institutions.

The various indicators mentioned above show that in 1972 the Government adopted a contractionary policy as compared with the previous year.

The overall demand surplus of the Government and the National Institutions rose at current prices, but declined at constant prices; there was an absolute drop in their domestic demand surplus. In 1972 the Government had a sizable credit inflow from the public, whereas in 1971 it received only a negligible amount of net credit and in previous years it was a net lender. The year reviewed wound up with a liquidity absorption, which, of course, had a contractionary effect on the money base; the opposite was true of earlier years.

These changes must be assessed against the backdrop of developments in the various spheres of economic activity and the influence of the nongovernmental sectors in 1972 and earlier.

The overall demand surplus of the Government and the National Institutions remained at a high annual level of IL 3,400–3,600 million during the past three years, compared with IL 2,000–2,500 million during the period of economic recovery (1967–69) and IL 300–400 million in 1965–66. The domestic demand surplus of these two authorities reveals a similar picture. Although it was subject to sharper fluctuations than the overall demand surplus, it still ranged between IL 700 million and IL 900 million in the past three years, compared with IL 500–600 million in 1967–69 and a supply surplus in 1965–66.

If to the domestic demand surplus is added the effect of those Government activities that are not included in the calculation of the demand surplus but whose influence on final demands is similar to that of the aggregates included in the calculation (the financing of investment in housing and in certain public sector companies, less compulsory loan receipts), the picture remains unchanged. But if we also add the expansionary effect on the demand level of the operations of public sector companies and of financial institutions which obtained Government permits to mobilize funds abroad and to convert them into local currency in order to finance various domestic activities,⁴ the above trends become more pronounced.

In 1967–69—when the economy was moving from recession to a more vigorous level of activity, there was a reserve of idle factors of production, and the stimulative forces at work in the nongovernmental sectors were not strong—the creation of a sizable Government surplus demand actually constituted a re-

⁴ The long-term credit received by the public sector abroad (excluding that to shipping and aviation companies in connection with imports) rose from \$ 215 million in 1971 to \$ 253 million in 1972. See Chapter III, "The Balance of Payments", section 5.

flationary measure which greatly contributed to the upturn of GNP and economic activity. In 1970 the demand surplus of the Government and the National Institutions continued to grow, but the expansionary forces in the nongovernmental sectors were still comparatively weak, both because of the Government's incomes policy, which checked the expansion of private demand and consumption, and also because of balance of payments developments, which averted an increase in the money base and money supply. The 1970 growth of public consumption and the public sector's domestic and overall demand surpluses was at the expense of alternative final uses, thereby weakening somewhat the inflationary pressures latent in the former. The Government's operations in 1971 and 1972 must be viewed against the backdrop of the large-scale monetary expansion, which stemmed chiefly from balance of payments developments. Disposable private income, private consumption, and investment all moved up at a faster rate, accompanied by a dip in the unemployment rate to an extremely low level. In the light of these developments, the counteraction called for in 1971, and more so in 1972, was a significant contraction of the demand surplus and not its stabilization at the high level reached in the past three years.

The sector's credit inflow, as already noted, expanded greatly in 1972; however, from the aspect of final demands, the effectiveness of a reduction of the demand surplus generally outweighs that of an increase in domestic borrowing.

Net credit from the public reached an unprecedented level in 1972, and constituted the principal counterweight to the expansionary impact of the other domestic sectors' operations on the money base.

The credit inflow is explained primarily by the boom in the bond and stock markets, which was fueled by the wage and salary hikes awarded during the year, the growth of disposable income and the rate of saving, the larger capital import and rapid monetary expansion, the rise in prices, and the absence of devaluation expectations. In addition, the accumulation of institutional investors swelled, and voluntary purchases of Government and other bonds rose strongly, augmenting the Government's revenue.

The amount of credit received was much greater than projected at the beginning of 1972/73. This enabled the Government to reduce income tax and compulsory loan rates and even to forgo, at the end of the 1972/73 fiscal year, a budgeted Bank of Israel advance. On the other hand, it should be noted that much of the incremental credit funded the bulk of the supplementary budget tabled in the Knesset in November 1972, thereby helping to increase the demand surplus.

The much larger volume of credit provided by the Government to the public either directly or through financial institutions should also be noted. While the amount extended directly to the public by the Government and the National Institutions went up more slowly than in the previous year (see Table VII-10), total credit made available by the public sector—directly by the Government and the National Institutions and indirectly through financial institutions—for

Table VII-3
GOVERNMENT AND NATIONAL INSTITUTION OPERATIONS, 1970-72
 (IL million, at current prices)

	1970	1971	1972	Percent annual increase or decrease (-)	
				1971	1972
Demand surplus					
1. Expenditure	9,441	12,107	14,325	28.2	18.3
Consumption	6,082	7,222	8,187	18.7	13.4
Transfers to households and nonprofit institutions	1,300	1,889	2,255	45.3	19.4
Net transfers to local authorities	401	538	731	34.2	35.9
Interest paid	820	1,074	1,530	31.0	42.5
Subsidies and transfers to business	838	1,384	1,622	65.2	17.2
2. Revenue	6,588	9,162	11,479	39.1	25.3
Taxes	5,909	8,230	10,361	39.3	25.9
Other domestic revenue	679	932	1,118	37.3	20.0
3. Saving (2-1)	-2,853	-2,945	-2,846	-3.2	3.4
4. Purchases on capital account	493	605	819	22.7	35.4
5. Overall demand surplus (4-3)	3,346	3,550	3,665	6.1	3.2
Net domestic credit granted					
6. Net loans granted	1,246	1,439	1,546	15.5	7.4
7. Net credit received	1,035	1,448	2,451	39.9	69.3
Compulsory loans ^a	471	967	1,082	105.3	11.9

Other credit	564	481	1,369	-14.7	184.6
8. Net domestic credit granted (6-7)	211	-9	-905	-104.3	..
Govt. and National Institution "deficit"					
9. Balance to be financed (5+8)	3,557	3,541	2,760	-0.4	-22.1
10. Financing	3,557	3,541	2,760	-0.4	-22.1
Net credit from the banking system	1,061	1,103	-190	4.0	-117.2
Unilateral transfers and net credit from abroad	2,496	2,438	2,950	-2.3	21.0
Influence of Govt. and National Institution operations on the money base					
A. Liquidity infusion					
11. Domestic demand surplus	665	934	769	40.5	-17.7
Total demand surplus (5)	3,346	3,550	3,665	6.1	3.2
Less: Purchases and expenditure abroad ^b	2,681	2,616	2,896	-2.4	10.7
12. Net domestic credit granted (8)	211	-9	-905	-104.3	..
13. Repayment of foreign loans	32	38	40	18.8	5.3
14. Total liquidity injected into the economy (11+12+13)	908	963	-96	6.0	-110.0
B. Surplus of foreign currency expenditure over revenue					
15. Purchases and expenditure abroad	2,681	2,616	2,896	-2.4	10.7
16. Less: Unilateral transfers and net credit from abroad	2,496	2,438	2,950	-2.3	21.0
Repayment of foreign loans	32	38	40	18.8	5.3
17. Surplus foreign currency expenditure	153	140	-94	-8.5	-167.1
C. Increase in public sector debt to banking system (A+B)	1,061	1,103	-190	4.0	-117.2

^a Absorption, Compulsory Savings, and compulsory Defense Loans, less the Defense Loan issue for banking institutions and voluntary Defense Loan issues.

^b Excluding the defence levy on imports.

financing the other sectors of the economy expanded more rapidly in 1972. The financial institutions augmented their resources chiefly by floating new issues with Treasury approval, and to a lesser extent by way of foreign credit obtained either directly or in the form of deposits of foreign transfer receipts.⁵

In some branches the increase in cheap long-term credit exceeded the incremental investment. The considerations underlying the volume of capital spending in these branches were only partly influenced by the much larger amount of available credit, part of which was used not to finance investment but for saving (repayment of debts to other sectors or the purchase of securities), thereby preventing the generation of further pressure on the demand level.

For the first time in many years, the net indebtedness of the Government and the National Institutions to the banking system declined in 1972, and there was a net absorption of liquidity from the public. The latter totalled IL 96 million, compared with a liquidity infusion of IL 963 million in 1972 and IL 908 million in 1970.

National Institution operations resulted in a sizable infusion in 1972; these institutions have hardly any domestic income, and most of their domestic expenditure is financed by the conversion of foreign currency. The total amount of liquidity pumped into the economy by the National Institutions was IL 930 million, while the Government siphoned off about IL 1,030 million (in 1971 the Institutions injected IL 600 million, and the Government IL 350 million). The Government's large-scale liquidity absorption began in September 1971, and continued through 1972, reaching its peak in March. In the first quarter of the year reviewed the Government mopped up 45 percent of the total annual sum—a development that generally repeats itself every year owing to the seasonality in tax collections, which rise strongly at the end of the fiscal year (or the beginning of the calendar year). In the second quarter—the beginning of the 1972/73 fiscal year—tax revenue fell off sharply, chiefly because of the seasonality of tax collections and also because of the cutting of various taxes. As regards expenditure, in the early part of 1972/73 there was the usual yearly phenomenon of disbursements being made on both items still outstanding from the old budget and on newly budgeted items, which have generally been increased. Despite this, the usual second-quarter infusion was absent in 1972; instead there was a small-scale absorption, which increased from July onward.

The Government's budget for 1972/73 was characterized by the continuation of the contractionary policy adopted in 1970–71. The fiscal measures embodied in the new budget, were as follows:⁶

⁵ See Chapter XV, "Financial Institutions", section 2.

⁶ See the Minister of Finance's Budget Message of February 2, 1972, *Divrei ha-Knesset* (Knesset Proceedings), Vol. 63, p. 1489 (Hebrew); and the Bank of Israel Research Department and Economic Advisory Bureau of the Ministry of Finance, National Budget for 1972, p. 18 (Hebrew).

1. Stress was placed on restraining expenditure, whereas in the previous two budgets the emphasis was on revenue restraint.
2. The defense budget was also curtailed after the imposition of the 20 percent levy on defense imports in August 1971. The paring of the defense budget was intended to dampen total real domestic spending (excluding principal and interest payments).
3. The development budget was increased to a lesser extent than in the previous year.
4. No indirect tax increases were projected, and certain concessions were made in the case of direct taxes with a view to improving productivity and enlarging the labor supply. The defense levy collected from individual taxpayers was reduced and the Compulsory Savings Loan was abolished.

The original Government budget estimates presented to the Knesset in February 1972 called for the absorption of some IL 700 million (the reference is solely to the Government and not to the National Institutions, for which, as already noted, a IL 1,350 million infusion had been planned).

It was clear when the budget proposal was tabled that it contained some hidden reserves: the budgeted receipts from taxes, new bond issues, and loans from the public were far below the expected actual collections. On the other hand, some appropriations were on the low side, and free reserves were smaller than in previous budgets.

Even before the budget had been approved, the Treasury submitted a supplementary budget, to be financed chiefly by an increase in domestic revenue.

By August Government sales of new bond issues were already running ahead of the amount budgeted for the entire fiscal year; the receipts from this source constituted the principal component in its net credit inflow from the public during this period.

In November a second supplementary budget was tabled which called for the absorption of another IL 300 million. The bulk of the revenue was to come from new issues of bonds and loans to the public. However, by the end of November 1972 the Government realized most of the receipts provided for in the original and supplementary budgets, and it continued to absorb funds by this means.

The devaluation of the dollar and the upward revaluation of various currencies in relation to the dollar and the Israeli pound contributed to the increased absorption. The growth of revenue from ad valorem import taxes resulting from the alteration of the rate of exchange exceeded the surplus of expenditure over revenue in foreign currency due to the aforementioned realignment of exchange rates, since the lion's share of the Government's foreign currency transactions was in dollars.

Table VII-3 shows that the demand surplus of the Government and the National Institutions, calculated according to their budgetary performance, rose slightly in the year reviewed, from IL 3,550 million in 1971 to IL 3,665

million at current prices. Net borrowing from the public amounted to IL 905 million, as against a mere IL 9 million in 1971. The sum needed to finance the demand surplus and net credit outflow therefore came to IL 2,760 million, as against IL 3,541 million in 1971 and IL 3,557 million in 1970. This was obtained by borrowing from the domestic banking system and through capital imports.

The larger demand surplus in 1972 was the resultant of two contrasting developments: (1) the more sluggish growth of current revenue—25.3 as against 39.1 percent in 1971, which brought total income from taxes, compulsory payments, and other domestic receipts up to IL 11,500 million; (2) a further slackening of the uptrend in expenditure—from 28 percent in 1971 to 19.1 percent, bringing the level up to IL 15,100 million.

The dominant factor in these changes in the demand surplus of the Government and National Institutions was the volume of noncivilian consumption spending, or, more precisely, the proportion of direct purchases and outlays abroad in total noncivilian consumption. Nominal civilian consumption and domestic defense spending apparently display a rigidity toward a downward movement; this is especially true of domestic defense outlays, which were not cut back in 1972 even after completion of the fortifications and other works erected during the war of attrition in 1971, although their growth slackened noticeably.

Total defense outlays rose 11 percent at current prices and net of the defense import levy, by 5.8 percent; this compares with 13.6 percent in 1971 and 48.3 percent in 1970. Defense imports went up 6.7 percent, following a decline in the previous year, and domestic defense spending rose 5.3 percent, as against 31 percent in 1971. Civilian consumption grew by 21.2 percent, as against 27.4 percent the year before.

Direct overseas purchases and expenditure of the Government and the National Institutions rose by IL 280 million, as contrasted with an increase of IL 115 million in the overall demand surplus. The domestic demand surplus (excluding receipts from the import levy) was therefore whittled down from IL 934 million in 1971 to IL 769 million, or by IL 165 million.

The above data are in nominal terms; in real terms, as mentioned above, there was a decrease probably in the domestic, and certainly in the overall, demand surplus. If the growth of the indirect import component of Government and National Institution purchases is added, it turns out that there was a significant decline in the real domestic demand surplus.

It should be noted that the demand surplus is an aggregate of a number of payments and receipts flows with dissimilar stimulative or restrictive influence on final demands in the economy. In the absence of detailed and up-to-date data on the demand surplus components (such as the characteristics of taxpayers, recipients of transfer payments and subsidies, wage and salary earners, etc.), it is difficult to quantify the influence of the demand surplus and the changes therein on the national product.

Excluded from the above computations are two items that are treated as financial transactions but whose stimulative or restrictive effects on final demands are very similar to those of the demand surplus components. The first is the compulsory loan receipts, the liquidity of which is very low, especially in the period immediately after collection. The contractionary effect of compulsory loans exceeds that of any other form of credit received, and for a large percentage of the purchasers they have a tax-like effect. The second is the granting of development budget loans by the Government and the Jewish Agency, which are directly connected with the implementation of investments, notably in housing and in projects of the public sector companies, which would not have been carried out but for this credit. In terms of its impact on demand, there is very little difference between such credit and direct Government investment.

If the receipts and payments in these two items are included in the calculation, the surplus expenditure in 1972 comes to IL 711 million and that in 1971 to IL 620 million. The structural changes in the deficit are then as follows: development budget loans granted by the Government and the National Institutions (including those to local authorities) rose from IL 1,661 million in 1971 to IL 1,896 million, while net compulsory loan receipts advanced from IL 1,041 million to IL 1,185 million (not counting the series purchased by the banking institutions).

Total domestic financial transactions of the Government and the National Institutions—including compulsory loans and development budget loans, but excluding transactions with the banking system—netted IL 905 million, as against only IL 9 million in 1971.⁷ There was a particularly striking gain in domestic long-term loan receipts (see Table VII-9).

Government and National Institution indebtedness to the banking system was trimmed by IL 190 million, compared with an increase of IL 1,103 million in 1971; all of the decline was in liabilities to the Bank of Israel, while those to other banking institutions rose. In addition to the paring of the debt to the banking system, the deficit in the Government's and National Institutions' foreign currency transactions helped to reduce the money base.

As noted above, the Government and the National Institutions required IL 2,760 million to fund their demand surplus and net credit outflow; this was obtained from foreign sources and from the domestic banking system. In 1972 net borrowed receipts and net unilateral transfers from abroad totalled IL 2,950 million—21 percent more than in 1971. These sums are in Israeli pounds calculated at the official rates of exchange prevailing at the time the foreign currency transactions were executed; in dollar terms, the increase was smaller (\$ 702 million in 1972, as against \$ 650 million in 1971—a rise of 8 percent).

Table VII-4 presents the "balance of payments" of the Government and the

⁷ Net compulsory loan proceeds consist of loans less redemptions, and are to be distinguished from the data appearing in Chapter II, "Resources, Uses, and Income", where compulsory loan certificates distributed during the year reviewed are also deducted.

Table VII-4
"BALANCE OF PAYMENTS" OF THE GOVERNMENT AND NATIONAL INSTITUTIONS, 1970-72
 (IL million)

Receipts	1970	1971	1972	Annual increase or decrease (-)		Payments	1970	1971	1972	Annual increase or decrease (-)	
				1971	1972					1971	1972
Transfers and transactions in goods and services											
Taxes ^a	5,909	8,230	10,361	39.3	25.9	Consumption	6,082	7,222	8,187	18.7	13.4
Other receipts						Purchases on					
Transfers from						capital account	493	605	819	22.7	35.4
the public	229	303	340	32.3	12.2	Interest paid	820	1,074	1,530	31.0	42.5
Interest received	332	414	568	24.7	37.2	Transfers	1,300	1,889	2,255	45.3	19.4
Income from property	118	215	210	82.2	-2.3	Subsidies and transfers					
Unilateral receipts						to business	838	1,384	1,622	65.2	17.2
from abroad ^b	757	609	1,385	-19.6	127.4						
Total	7,345	9,771	12,864	33.0	31.7	Total	9,553	12,174	14,413	27.7	18.4
Transactions in financial claims											
Collections on						Long-term loans and					
long-term loans	153	200	329	30.7	64.5	participation in					

Long-term loans						share capital	1,367	1,603	1,789	17.3	11.6
received						Repayments on					
Foreign	2,445	2,519	3,062	3.0	21.6	long-term loans					
Domestic ^c	1,052	1,787	3,290	69.9	84.1	Foreign	726	726	1,264	—	74.1
Short-term credit, net						Domestic	355	387	912	9.0	135.7
Foreign	20	36	-233	80.0	..						
Domestic ^c	338	48	73	-85.8	52.1						
Credit from the											
banking system ^d	1,061	1,103	-190	4.0	-117.2						
Total	5,069	5,693	6,331	12.3	11.2	Total	2,448	2,716	3,965	10.9	46.0

Transactions with the rest of the public sector

						To local authorities					
						(net)	433	574	817	32.6	42.3
Total receipts	12,414	15,464	19,195	24.6	24.1	Total payments	12,414	15,464	19,195	24.6	24.1

^a Including collections on account of National Insurance.

^b Unilateral receipts from abroad, less the National Institutions' overseas expenditure and net participation in the budgets of the administered areas.

^c Excluding credit from the banking system.

^d Including changes in deposit balances, long-term loans, and purchases of Government bonds.

National Institutions for the years 1970–72. The table distinguishes between transfers and transactions in goods and services on the one hand and financial transactions on the other; transactions with the local authorities have been recorded separately.

Total payments of the Government and National Institutions, including long-term debt repayments, added up to IL 19,195 million at current prices—24.1 percent over the 1971 level. Details of the changes in the operations of these two authorities, as reflected in their “balance of payments”, follow in sections (b), (c), and (d).

(b) Receipts

1. Taxes

Government tax revenue was up 25.9 percent; this consists of direct taxes—including National Insurance receipts, indirect tax collections, and fees—and the levy on defense imports. Excluding the levy,⁸ the increase was 22.7 percent.

The growth of tax revenue sagged compared with the two preceding years, and exclusive of the levy on defense imports, it was the lowest recorded in the past five years.

The deceleration was due chiefly to the reduction of average tax rates, both direct and indirect, after being hiked substantially in 1970 and 1971. The paring of the taxes actually countered the influence of certain factors working in the opposite direction: the expansion of the product, national income, and imports; the devaluation of the Israeli pound in August 1971 (which was only partly reflected in the data for that year); the rise in import prices due to the realignment of exchange rates in 1972 and the exacerbation of inflation in a number of countries during the year; and fluctuations in world trade in foodstuffs and other basic products. The influence of these factors will be discussed in sections 2 and 3.

Of the IL 2,131 million incremental tax revenue in 1972, about 38 percent (IL 806 million) constituted direct tax collections; these rose 20.1 percent as against 31.2 percent in 1971 and 36.7 percent in 1970. Total direct tax revenue came to IL 4,816 million. Together with compulsory loans,⁹ the level went up to 18.8 percent in 1972, compared with 40.5 percent in 1971 and 59.2 percent in 1970, and reached IL 6,001 million.

⁸ In discussing the absorptive effect of tax revenue the levy on defense imports will be excluded, since it does not constitute an absorption of funds from the public, but represents a change in the official rate for the Israeli pound in respect to the Government's overseas defense procurements. As regards the other implications of tax revenue, the levy does not differ from any other tax on imports.

⁹ The reference is to compulsory loans levied on employees' earnings and on other income—namely the Compulsory Savings Loan, the Compulsory Defense Loan, and the Absorption Loans. In this chapter compulsory loans are classified under Government receipts on financial account, and the proceeds are itemized in section (d) below. Nevertheless, there is good reason to discuss these loans together with direct taxes.

Table VII-5
GOVERNMENT TAX REVENUE, 1970-72
(IL million)

	1970	1971	1972	Annual increase or decrease (-)		Percentage distribution		
				1971	1972	1970	1971	1972
Direct taxes	3,057	4,010	4,816	31.2	20.1	51.7	48.7	46.5
Income tax	2,232	2,768	3,311	24.0	19.6			
National Insurance	825	1,242	1,505	50.5	21.2			
Taxes on property	253	294	346	16.2	17.7	4.3	3.6	3.3
Property tax	233	257	284	10.3	10.5			
Land registry fees	20	37	62	85.0	67.6			
Indirect taxes on expenditure								
Imports	1,188	2,160	3,043	81.8	40.9	20.1	26.2	29.4
Customs and levy on civilian imports	890	1,556	1,990	74.8	27.9			
Purchase tax	247	376	535	52.2	42.3			
Foreign travel tax	51	70	80	37.3	14.3			
Surtax on stocks	—	28	15	..	-46.4			
Subtotal	1,188	2,030	2,620	70.9	29.1			
Levy on defense imports	—	130	423	..	225.4			
Domestic production	1,087	1,371	1,686	26.1	23.0	18.4	16.7	16.3
Purchase tax	419	519	644	23.9	24.1			
Fuel tax	252	355	488	40.9	37.5			
Tobacco excise	134	162	199	20.9	22.8			
Cement excise	60	57	60	-5.0	5.3			
Excise on beverages	29	32	34	10.3	6.3			
Defense stamp tax	73	99	109	35.6	10.1			
Current surplus of Govt. enterprises and misc.	120	147	152	22.5	3.4			
Total indirect taxes on expenditure								
Incl. the defense import levy	2,275	3,531	4,729	55.2	33.9			
Excl. the defense import levy	2,275	3,401	4,306	49.5	26.6			
Licenses and fees	324	395	470	21.9	19.0	5.5	4.8	4.5
Revenue stamp tax	123	157	204	27.6	29.9			
Defense stamp tax	28	44	51	57.1	15.9			
Vehicle license fees	65	77	91	18.5	18.2			
Other fees and misc.	108	117	124	8.3	0.6			
Total tax revenue								
Incl. the defense import levy	5,909	8,230	10,361	39.3	25.9	100.0	100.0	100.0
Excl. the defense import levy	5,909	8,100	9,938	37.1	22.7			

Indirect tax revenue, including property taxes, fees, and the levy on defense imports, rose 31.4 percent (48 percent in 1971) to stand at IL 5,545 million. Of this sum, IL 3,043 million represented import taxes, where a 40.9 percent gain was posted, as compared with 81.8 percent the year before.

Import taxes accounted for two-thirds of the incremental indirect tax revenue in 1972. This item was also responsible for most of the 1971 gain; as a result, its weight in total tax revenue moved up from 20.1 percent in 1970 to 26.2 percent in 1971 and 29.4 percent in 1972. It is therefore clear that import taxes are a dynamic component in total Government tax revenue, reflecting more the changes in exchange-rate policy than fiscal policy.

The weight of taxes on domestic production in total tax revenue edged down from 18.4 percent in 1970 to 16.3 percent in 1972. Its weight in GNP declined in 1972, after holding steady in 1967–71.

The share of taxes on income in total tax revenue continued downward, from 51.7 percent in 1970 and 48.7 percent in 1971 to 46.5 percent in 1972; if compulsory loan receipts are included in the calculation, the level declined from 55.8 percent in 1970 and 54.5 percent in 1971 to 51.9 percent in the year reviewed.

2. *Direct taxes*

Receipts from income tax and compulsory loans went up 18.1 percent to reach IL 4,496 million. Excluding compulsory loans, the figure came to IL 3,311 million—a 19.6 percent gain. This was somewhat slower than the growth of national income (24.2 percent) and gross private income from economic activity (24.3 percent).¹⁰ The elasticity of income tax revenue in relation to national income is greater than unity,¹¹ and the fact that income tax receipts moved up at a lower rate than national income may be explained by the following factors: (1) part of the incremental national income was tax-free or subject to relatively low rates; (2) income tax rates were reduced; (3) an increase in national income is not immediately reflected in current income tax collections; the lag is longer the higher the proportion of nonwage income in national income.

Average tax rates were higher in 1971, mainly because of their upward revision in 1970 (not fully reflected in the data for that year); as there were

¹⁰ For a more precise comparison of income tax collections in relation to national income we shall also present the 1972 percentage increase in national income, less depreciation (which as a rule is not taxable) and the imputed rental value of owner-occupied dwellings (for the same reason).

The changes are as follows:

a. Net national product (net national product at factor cost)—23.7 percent.

b. Net private income from economic activity—23.9 percent.

c. Net private income from economic activity, less imputed residential rents—22.5 percent.

¹¹ This finding is from an econometric model of the Israeli economy prepared by the Bank of Israel Research Department.

no further changes in 1971, the average rates held steady in the year reviewed. Even the raising, in April 1971, of the rate of Savings Loan collections from employers from 4 to 6 percent of their gross wage bill contributed only IL 50 million (1.3 percent) to the incremental receipts from income tax and compulsory loans in 1972.

At the same time, a number of concessions went into force in April 1972: the defense levy was reduced from 15 to 10 percent of the total income tax payment; the range of reliefs was broadened to include working mothers, approved overtime pay, wage incentive payments, and premiums for night shift work; and collection of the Savings Loan from employees and of the compulsory loans on overtime pay was discontinued. These concessions deprived the Government of an estimated IL 280-IL290 million of tax revenue in 1972. On the other hand, in August a tougher attitude toward business expenses was adopted, but the additional income produced by this change was negligible.

If the income tax and compulsory loan collections which the Government "lost" in 1972 are added to actual collections, the theoretical growth of income tax revenue came to 23 percent, and together with compulsory loans to 25 percent.

The reduction of income tax and compulsory loan rates therefore accounted for much of the difference in the growth rates of national income and private income from economic activity on the one hand and actual income tax collections on the other; but given the flexibility of income tax in relation to national income, this can offer only a partial explanation.

Income tax collected from employees (including company directors listed as salaried employees and members of cooperatives) was up 17.1 percent to stand at IL 1,540 million. The number of Israeli employees in the economy rose 3.9 percent, and average earnings (including fringe benefits) per employee 16.4 percent.¹²

Average taxable earnings went up less, since the cost-of-living allowance increment paid in January 1972 was tax-free and added about 5 percent to the average earnings per Israeli employee post (14.4 percent according to National Insurance Institute data, which do not include fringe benefits). The raising of the minimum wage brought the level up by another 1-1.5 percent (this was probably tax-exempt in most cases).

The reduction of the Defense Loan collection rates in April 1972 was immediately reflected in employees' returns; as regards the self-employed, it was partly reflected in the data for 1972 but will make its full impact felt only when the final assessments for 1972/73 are drawn up. This, together with the fact that the various reliefs introduced in April were intended for wage and salary earners only, justifies ascribing most of the resulting loss of tax revenue

¹² The data on compensation of employees are from the Central Bureau of Statistics national accounts. The change in the number of employees was estimated on the basis of the number of employee posts according to the National Insurance Institute.

to employees. After adjusting for this, the theoretical increase in income tax collections from employees reached 24 percent.

The growth of Israeli employees' wage income (including fringe benefits) came to 19.9 percent in 1972, while net private income from other sources, exclusive of imputed residential rents, reached 28 percent; these increases compare with 21.5 and 33.4 percent respectively in 1971. It will therefore be seen that during the past two years at least, nonwage income grew relatively faster. Since it is easier to collect income tax on employees' earnings than on nonwage income, the lag in tax collections on current nonwage income was greater in the year reviewed.

The year reviewed probably saw a further erosion of the tax base. Some of the benefits awarded wage and salary earners in the new labor agreements consisted of income that was either tax-free or subject to a relatively low tax.¹³

Company profits tax brought in IL 828 million—a gain of 24.9 percent, compared with 20.8 percent in 1971. Tax receipts from the self-employed¹⁴ totalled IL 599 million—an increase of 15 percent, as against 17.1 percent in 1971.

It should be noted that the data on tax revenue from companies and self-employed presented here (Table VII-6) do not include the total amount collected; the sums withheld at source from payments to Government and other public sector suppliers and subcontractors must be added; moreover, a large percentage of the tax withheld at source on interest and dividend payments should also be attributed to the self-employed and companies. At-source deductions in 1972 added up to IL 348 million, compared with IL 276 million the year before—an increase of 26 percent.

The amount of tax collected from individuals on nonwage income totalled IL 1,775 million—a gain of 21.6 percent; the figure remains unchanged if receipts from members of cooperatives and directors listed as salaried employees are included. The increase here trailed far behind that of net private nonwage income, excluding the imputed rental value of owner-occupied dwellings (28 percent).

The gap is explained partly by the lag in tax collection, due to the aforementioned changes in the distribution of income, and also because part of the income tax from the self-employed and companies is collected in the form of prepayments, with the balance being paid after the final assessment is made. In general, the prepayments are estimated conservatively on the basis of the taxpayer's income in previous years, so that if there is a large growth of income in the current year, this is not usually reflected in the prepayment but will result in a larger collection in the future.

¹³ Some of the benefits were granted in nontaxable forms (see Chapter IX, section 4).

¹⁴ Excluding company directors listed as salaried employees and members of cooperatives. Their earnings are treated as wage income in the national accounts.

Table VII-6
GOVERNMENT REVENUE FROM INCOME TAX AND COMPULSORY LOANS, 1970-72
(IL million)

	1970	1971	1972	Percent annual increase		Percentage distribution		
				1971	1972	1970	1971	1972
Income tax^a								
Self-employed	445	521	599	17.1	15.0	19.8	18.8	18.1
Companies	549	663	828	20.8	24.9	24.4	23.9	25.0
Wage and salary earners	989	1,220	1,424	23.4	16.7	44.0	44.0	42.9
Directors of companies listed as salaried employees and members of cooperatives ^b	64	95	116	48.4	22.1	2.9	3.4	3.5
Deductions at source	200	276	348	38.0	26.0	8.9	9.9	10.5
Thereof: From suppliers of goods and services	43	87	110	102.3	26.4	1.9	3.1	3.3
Total	2,247	2,775	3,315	23.5	19.4	100.0	100.0	100.0
Thereof: Absorption Loan collections	15	7	4					
Compulsory Defense Loan^c								
Self-employed	27	46	81	70.4	76.0	10.9	10.3	13.8
Companies	53	89	125	67.9	40.4	21.5	19.9	21.2
Wage and salary earners	152	291	355	91.4	22.0	61.5	64.9	60.4
Directors of companies listed as salaried employees and members of cooperatives ^b	15	22	27	46.7	22.7	6.1	4.9	4.6
Total	247	448	588	81.4	31.2	100.0	100.0	100.0
Compulsory Savings Loan								
Employers	173	399	503	130.6	26.0	62.7	68.2	84.8
Employees	94	173	86	84.0	-50.3	34.0	29.6	14.6
Directors of companies listed as salaried employees and members of cooperatives ^b	9	13	4	44.4	-69.3	3.3	2.2	0.7
Total	276	585	593	112.0	1.4	100.0	100.0	100.0
Total income tax and compulsory loans	2,770	3,808	4,496	37.5	18.1			

^a Net collections (i.e. after tax rebates).

^b Tax revenue from company directors listed as salaried employees and from members of cooperatives was apportioned to income tax and the compulsory Defense and Savings Loans according to partial data and Bank of Israel estimates.

^c Excluding the Defense Loan issues for banking institutions.

There was apparently some erosion of the tax base of the self-employed and companies as well. The self-employed are also exempt from tax on their cost-of-living allowance; furthermore, with the broadening of the scope of the Law for the Encouragement of Capital Investments and the Law for the Encouragement of Industry, the number of companies eligible for concessions and partial or full tax exemptions presumably increased in 1972. In addition, at-source deductions from payments to Government suppliers were reduced.¹⁵

The foregoing deals with income tax collections only. If the compulsory Defense Loans—where the tax element is high¹⁶—are added to the figures, the share of wage and salary earners in total revenue from these two sources inched down from 50.5 percent in 1971 to 49.3 percent, and plus the Compulsory Savings Loan—from 47.6 to 44.8 percent. The elimination of members of cooperatives and company directors listed as salaried employees does not change the results.

National Insurance collections rose 21.7 percent to reach IL 1,505 million. In 1971 the level jumped 50.5 percent, mainly because of changes in the contribution rates in 1970 and 1971. The rates were not raised in 1971; the growth in collections stemmed from the gain in income from employment.

3. *Indirect taxes*

Indirect tax revenue in 1972 totalled IL 5,545 million—up 31.4 percent, as against the previous year's 48 percent. Excluding the levy on defense imports, the increases were 25.2 and 43.4 percent respectively.

Whereas in 1971 there was a significant rise in the annual average tax rates due to the hiking of various taxes in 1970 and the revision of the fuel tax in August 1971, there was no significant increase in 1971 in the average rates, apart from the change in the fuel tax, which made its full impact felt in 1972. On the other hand, a number of taxes were pared, depriving the Treasury of an estimated IL 100 million in 1972. Two-thirds of this sum was accounted for by the cutting, in January 1972, of customs duties on meat and sugar imports following a rise in their foreign prices; the balance can be ascribed to the additional two rounds of tariff cuts made under the import liberalization program (a limited reduction in April 1972 and a more extensive one in June 1972), the trimming of various taxes in August and October 1971 (which were also reflected in the data for 1972), and the reduction of the excise on cement in March 1972. These revenue losses were, however, fully compensated for by the increased receipts from the fuel tax after its upward revision in July 1971.

The devaluation of the Israeli pound added some IL 200 million to indirect

¹⁵ See State Comptroller, *Annual Report*, No. 23, pp. 235–36 (Hebrew).

¹⁶ Due to the terms of the loan; see Bank of Israel, *Annual Report 1971*, p. 154.

tax revenue, most of it deriving from customs and levies on civilian imports, and the remainder from surcharges, purchase tax on imports, and the tobacco excise. With the IL 293 million gain in revenue from the defense import levy, the increase in tax receipts totalled IL 1,325 million, of which IL 830 million (a rise of 19.7 percent) stemmed from the expansion of economic activity—chiefly the growth of private consumption and imports and the rise in prices.

Following are the principal changes in tax revenue:

Customs and the levy on civilian imports yielded 27.9 percent more in 1972 and totalled IL 1,990 million. More than a third of the incremental customs revenue can be credited to the devaluation of the Israeli pound in August 1971; the balance stemmed from the greater volume of imports and to price rises abroad (which increased the ad valorem receipts), less the various tax reductions mentioned above. Imports of consumer goods rose 19 percent; a 39 percent increase was posted for durables, headed by dutiable passenger cars, with a 75 percent rise.

Changes in the import product mix and the growth of private consumption—especially of durables—affected purchase tax receipts; those on imported goods soared 42.3 percent to reach IL 535 million, while the tax on domestic production brought in IL 644 million, a rise of 24.1 percent.

Fuel tax revenue came to IL 488 million, up 37.5 percent; three quarters of the gain is explained by the changes in the rates introduced in July 1971.

Property tax collections were, at IL 284 million, up 10.5 percent; in April 1972 the collection of these taxes was reformed, involving the loss of more than IL 10 million.

The remaining indirect taxes yielded a larger revenue in 1971. A breakdown appears in Table VII-5.

4. *Miscellaneous revenue*

These receipts—which consist of domestic transfers, income from property, interest, and dividends—went up from IL 932 million in 1971 to IL 1,118 million in 1972. The biggest increase was in Government and National Institution income from interest and dividends, which added up to IL 568 million.

Income from property fell off in 1972 and totalled IL 210 million; most of the decline is explained by the shrinkage of Bank of Israel profits (which are transferred to the Treasury) from IL 101 million in 1971 to IL 64 million.

Transfers from the public amounted to IL 340 million; of this, IL 180 million was on capital account (in the main Government receipts from its enterprises on account of depreciation, as well as revenue from the land betterment tax and the inheritance tax), while IL 160 million represented current transfers for services supplied by public health and educational institutions, as well as drivers license fees, fines, and donations.

Unilateral transfers from abroad went up from IL 609 million in 1971¹⁷ to IL 1,385 million. This item consists of several components: the National Institutions' receipts from fund-raising campaigns abroad, which jumped from IL 762 million in 1971 to IL 1,289 million; intergovernmental transfers, which totalled IL 240 million in 1972 (grants for the absorption of immigrants and for a binational research fund), less the National Institutions' overseas outlays; and the deficit (or surplus) in the budget of the administered areas.

(c) *Payments*

Total expenditure by the Government and the National Institutions, as reflected in their "balance of payments" (see Table VII-4) totalled IL 19,195 million at current prices, compared with IL 15,464 million in 1971—a rise of 24.1 percent. The most striking change was the much larger expenditure on financial account (the repayment and granting of long-term loans), which soared 46 percent compared with 10.9 percent in 1971. There was also a respectable 42.3 percent rise in net transfers to local authorities, following a 32.6 percent increase the year before. These two items accounted for one quarter of total payments. The lion's share of the payments was made on real account—i.e. consumption, investment, transfers (excluding those to local authorities), and subsidies. The uptrend in these payments sagged for the third consecutive year, the nominal growth rate being 18.4 percent, compared with 27.7 percent in 1971 and 32 percent in 1970. The changes in the component items were not uniform, as explained below.

1. *Purchases on current and capital account*

Government and National Institution consumption (current purchases less sales)¹⁸ rose 13.4 percent to stand at IL 8,187 million at current prices, or IL 6,862 at 1971 prices—a decline of 5 percent.

A breakdown of consumption between domestic and overseas purchases shows that the latter was up 7.1 percent at current prices, following a decline in the previous year. Domestic purchases reveal a different trend, rising 10.5 percent at current prices, as against 30.1 percent in 1971. As mentioned above, these changes were chiefly influenced by developments in noncivilian consumption, which was three times as great as civilian consumption (see Table

¹⁷ This amount differs from that cited in the section "Capital imports" in Chapter III, "The Balance of Payments", where foreign unilateral transfer receipts are recorded net of the National Institutions' interest payments and other expenditure abroad and the changes in their financial transactions with the foreign sector.

¹⁸ Excluding interest paid locally and abroad, overseas outlays of the National Institutions, and net participation in the budgets of the administered areas. The overseas expenditures mentioned here are treated in the national accounts not as consumption but as transfers to the rest of the world.

VII-7). In 1972 the former was up 11 percent at current prices, with the import component rising 6.7 percent. At 1971 prices, however, there was an 8.5 percent drop, while Government and National Institution consumption increased 6.5 percent.

Payroll outlay, excluding Ministry of Defense enterprises, moved up 18.8 percent—less than in the two preceding years. Of this increase, 4.3 percent was due to the growth of personnel and 13.8 percent to a higher average expenditure per employee. The percentage increase in average earn-

Table VII-7

GOVERNMENT AND NATIONAL INSTITUTION PURCHASES ON CURRENT AND CAPITAL ACCOUNT, 1970-72

(IL million)

	1970	1971	1972	Percent annual increase	
				1971	1972
Noncivilian consumption					
Payroll and domestic purchases	2,574	3,371	3,549	31.0	5.3
Foreign purchases	2,181	2,031	2,167	-6.9	6.7
Levy on defense imports	—	130	423	..	225.4
Total noncivilian consumption	4,755	5,532	6,139	16.3	11.0
Civilian consumption					
Payroll—civilian employees	947	1,221	1,450	28.9	18.8
Domestic purchases (net of sales)	290	368	482	26.9	31.0
Foreign purchases	90	101	116	12.2	14.9
Total civilian consumption	1,327	1,690	2,048	27.4	21.2
Total consumption	6,082	7,222	8,187	18.7	13.4
Purchases on capital account					
Economic services	388	509	704	21.2	38.3
Transportation and communications	303	395	534	30.4	35.2
Agriculture and irrigation	56	78	64	39.3	-17.9
Other ^a	29	36	106	24.1	194.4
Public buildings and social services	105	96	115	-8.6	19.8
Total purchases on capital account	493	605	819	22.7	35.4
Thereof:					
Domestic purchases	373	490	679	31.4	38.6
Foreign purchases	120	115	140	-4.2	21.7
Total purchases					
Domestic purchases	4,184	5,450	6,160	30.3	13.0
Foreign purchases	2,391	2,247	2,423	-6.0	7.8
Levy on defense imports	—	130	423	..	225.4
Total purchases	6,575	7,827	9,006	19.0	15.1

^a Minerals, tourism, and industry, including changes in stocks in Ministry of Commerce and Industry warehouses.

ings per employee post in the civil service and the entire public sector was among the lowest in the entire economy in 1972.¹⁹ This was due to two reasons: first, in 1971 wage and salary differentials were paid for previous years; and second, most of the new labor agreements covering the various groups of Government and other public sector personnel had not yet been signed or implemented by year's end, but were postponed to 1973.²⁰ Substantial retro-active differentials will be paid in 1973 on account of this year.

Government and National Institution purchases on capital account²¹ were, at IL 819 million, up 35.4 percent. Approximately two-thirds of this sum (IL 534 million) was invested in transportation and communications (roads, postal services, the railway, and airports). Capital outlays on agriculture and irrigation declined, after advancing the year before, while outlays in other economic spheres rose, mainly because of an increase in stocks in Ministry of Commerce and Industry warehouses. Investment in public buildings and social services was up 19.8 percent to total IL 115 million.

2. *Subsidies and transfer payments*

Subsidies and transfers paid by the Government and the National Institutions came to IL 5,636 million, an increase of 25.6 percent. Subsidies rose 16.4 percent to IL 1,503 million. This item consists of direct price supports, participation in or rebates of expenditure of producers and other enterprises, outlays of Government departments to encourage production and exports, the subsidizing of imported foodstuffs, and the covering of deficits incurred by Government business-type enterprises.

Export subsidies were up 12.5 percent to IL 866 million; this compares with a huge 83.8 percent rise in the previous year, due to the much larger incentives granted to exporters (these had been revised in August 1970 and January 1971). Rebates of indirect taxes were reduced upon the devaluation of the Israeli pound in August 1971. In August 1972 the incentives were increased slightly following the replacement of branchwide indirect subsidies (such as the financing of market research) by direct export subsidies;²² the larger volume of export subsidy payments can therefore be ascribed primarily to the strong headway made in exports during the year reviewed.

The subsidization of local production, including the covering of deficits of Government enterprises, was stepped up 20.4 percent to IL 478 million.

¹⁹ See Chapter IX, "The Labor Force and Wages", Table IX-10.

²⁰ See Chapter IX, section 4.

²¹ These purchases are not identical with the share of the Government and National Institutions in gross domestic investment, since they include purchases of existing assets and purchases of equipment and investments not included under the head of domestic investment.

²² On the changes in incentives and on the effective exchange rates for industrial exports, see Chapter III "The Balance of Payments", Table III-14.

The biggest rise was in transportation subsidies. Agricultural factor subsidies were reduced, after an increase in 1971.

Import subsidies rose 28.2 percent to IL 159 million. These are granted mainly on essential foodstuffs (imported under the control of the Ministry of Commerce and Industry) and to a lesser extent on agricultural inputs. The increase in these subsidies was due chiefly to the higher prices paid abroad.

Transfer payments to households went up 17.8 percent to IL 1,627 million. Of this amount, IL 770 million represented statutory National Insurance benefit payments, and IL 179 million represented Government and National Institution payments through the National Insurance Institute for social benefits, nonstatutory old-age and survivors pensions, low-income supplements, and benefit payments to victims of enemy action. Total benefit and transfer payments made through the National Insurance Institute went up 24.7 percent, reflecting an average rise of 6.3 percent in the number of beneficiaries and of 17.3 percent in the average payment. The latter increase is attributable to the upward revision of benefit rates in most National Insurance schemes in September 1971 and October 1972.

Table VII-8

TRANSFER PAYMENTS, GRANTS, AND SUBSIDIES BY THE GOVERNMENT AND NATIONAL INSTITUTIONS, 1970-72

(IL million)

	1970	1971	1972	Percent annual increase	
				1971	1972
Transfer payments and grants to households	938	1,381	1,627	47.2	17.8
From the National Insurance Institute					
Benefits	458	593	770	29.5	29.8
Other transfer payments ^a	84	171	179	103.6	4.7
Provident and pension payments	155	204	248	31.6	21.6
Other transfers	241	413	430	71.3	4.1
Transfer payments to nonprofit institutions	362	508	628	40.3	23.6
Transfer payments on capital account to business	74	93	119	25.7	28.0
Subsidies	764	1,291	1,503	69.0	16.4
On locally produced goods and services	317	397	478	25.2	20.4
On imported goods	28	124	159	342.8	28.2
On exports	419	770	866	83.8	12.5
Domestic interest payments	505	678	1,028	34.3	51.6
Net transfer payments to local authorities	401	538	731	34.2	35.9
Total transfer payments and subsidies	3,044	4,489	5,636	47.5	25.6

^a Government and National Institution transfers through the National Insurance Institute, such as supplementary old-age pensions, cost-of-living grants, and benefit payments to casualties of hostile action.

Provident and pension payments added up to IL 248 million. These include compensation payments to victims of Nazi persecution and war invalids and pensions paid to retired Government and National Institution employees.

Other transfer payments to households rose moderately. These consist of Government participation in graded secondary school fees, expenditure on food in health, educational, and welfare institutions of the Government and National Institutions, participation in hospitalization fees, various relief allotments to needy families and others, as well as the cost of initial immigrant absorption (financial aid to new arrivals in the country, employment and housing assistance, etc.). Such transfers increased by 4.1 percent to reach IL 430 million.

Allocations to nonprofit institutions, including participation in the investments of such institutions, rose 23.6 percent to IL 628 million, with most of the increment going to educational institutions.²³

Transfer payments to business on capital account went up 28 percent to stand at IL 119 million. These payments are made through the Government's development budget as subsidies to industrial investors. Of this sum, about IL 100 million consisted of grants to industrial concerns under the Law for the Encouragement of Capital Investments, while the balance consisted of other grants.

Total interest outlays by the Government and the National Institutions (excluding that paid to the National Insurance Institute and the War Risks Insurance Fund) were, at IL 1,028 million, up 51.6 percent.

Net Government transfers to local authorities increased 36 percent and totalled IL 731 million. The bulk of the increment was in Government tax revenue shared with the local authorities, which is determined by the amount of tax collected.²⁴ With the increase in tax revenue, these transfers rose to IL 262 million. Ordinary and extraordinary budget grants to local authorities were also enlarged considerably and reached a similar level. Another transfer item—participations of various Government departments in local authority expenditure (mostly those of the Ministries of Social Welfare, Education, and Religion on social services) and grants from the Government's budget and from the Israel Education Fund—increased to IL 208 million.

(d) *Financial transactions*

Net long-term loan receipts of the Government and National Institutions from foreign and domestic sources (excluding long-term loans from the banking system) soared 29.8 percent to reach IL 5,126 million. Net long-term domestic loans (including those from the banking system) went up by an even faster 54.4 percent—the highest rate recorded since 1969, when the Government borrowed heavily from the Bank of Israel.

²³ See Chapter VIII, "Nonprofit Institutions", Table VIII-5.

²⁴ Details are presented in section 3 (b).

By contrast, there was a sharp fall in net short-term receipts, especially from the banking system; and whereas in 1971 the Government and the National Institutions were net recipients of short-term credit, in the year reviewed they became net lenders (through the receipt of deposits, repayment of current liabilities, the granting of new loans, etc.).

Net foreign borrowed receipts continued downward for the second consecutive year, and their share in total net loan receipts inched down from 47 percent in 1970 and 41.8 percent in 1971 to 40.9 percent in the year reviewed.

1. Foreign loans

Long-term foreign loan receipts amounted to IL 3,062 million, while foreign debt repayment came to IL 1,264 million. Together with the decline in short-term credit, net foreign borrowing totalled IL 1,565 million (or \$ 372 million), as against IL 1,829 million (\$ 488 million) in 1971. Most of the decline was in short-term credit. Net long-term borrowing was down from \$ 479 million in 1971 to \$ 428 million (calculated in Israeli pounds at the exchange rates prevailing at the time of the transactions, the level was unchanged in 1972).

The contraction of net long-term credit was chiefly due to the sizable foreign debt repayments by the Government and the National Institutions, which totalled \$ 301 million (including payments ahead of maturity), as against \$ 195 million in 1971.

The decline in long-term credit encompassed all component items, except the Independence and Development Loans (these receipts rose 5 percent to \$ 185 million).

The National Institutions were responsible for most of the decline in foreign short-term credit; they also cut down their foreign long-term borrowing in 1972. These changes stemmed from a deliberate effort to reduce the Institutions' foreign indebtedness by the receipt of a special loan from the Bank of Israel to repay various foreign liabilities. Similar action had been taken in 1968 and 1969.

2. Domestic loans

Long- and medium-term domestic borrowing was on a much larger scale in 1972. Long-term loans, excluding those from the banking system, rose from IL 1,787 million in 1971 to IL 3,290 million. Less repayments, receipts from this source were 70 percent up on the previous year—IL 2,378 million as against IL 1,400 million.

The increase in wages and salaries, disposable income, rate of saving, capital imports, monetary expansion, and prices, along with the absence of devaluation expectations—all these contributed to the precipitous rise in domestic borrowed

Table VII-9
CHANGES IN GOVERNMENT AND NATIONAL INSTITUTION LIABILITIES, 1971-72
(IL million)

	1971	1972			Change in net re- ceipts in 1972
	Net re- ceipts	Loans re- ceived	Loans re- paid	Net re- ceipts	
A. Foreign loans and credit					
1. Long- and medium-term loans					
Independence and Development Loans ^a	677	1,262	487	775	98
U.S. Government loans ^b	889	1,261	433	828	-61
Loans from the West German Govt.	168	163	6	157	-11
Other loans	59	376	338	38	-21
Total	1,793	3,062	1,264	1,798	5
2. Short-term credit (net)					
Total foreign loans and credit	1,829	2,829	1,264	1,565	-264
B. Domestic loans and credit					
1. Long- and medium-term loans					
Compulsory Defense Loan	448	589	—	589	141
Compulsory Savings Loan	586	592	—	592	6
Absorption Loan	-67	4	103	-99	-32
1967 Defense Loan	—	—	377	-377	-377
Bond issues ^c	220	817	234	583	363
Proceeds of issues deposited with the Treasury and loans from financial institutions	213	1,288	198	1,090	877
Total	1,400	3,290	912	2,378	978
2. Net short-term credit					
Total domestic loans and credit	1,448	3,363	912	2,451	1,003
C. Net credit from the banking system					
1. Long- and medium-term loans					
From the Bank of Israel	650	883	—	883	233
Bonds purchased by banking institutions	106	67	—	67	-39
Total long- and medium-term loans	756	950	—	950	194
2. Short-term credit					
Changes in deposits with and credit from Bank of Israel	411	-1,183	—	-1,183	-1,594
Changes in deposits with and credit from banking institutions	-64	43	—	43	107
Total short-term credit	347	-1,140	—	-1,140	-1,487
Total credit from banking system	1,103	-190	—	-190	-1,293
D. Total loans and credit					
1. Long- and medium-term					
Total	3,949	7,302	2,176	5,126	1,177
2. Short-term (net)					
Total	431	-1,300	—	-1,300	-1,731
Grand total	4,380	6,002	2,176	3,826	-554

^a Before deducting distribution costs.

^b Including Export-Import Bank loans.

^c Excluding bonds purchased by the banking system; including the Insurance Companies Loan.

receipts. Institutional investors reported a greatly increased accumulation in the year reviewed, and voluntary purchases of Government and other bonds were up strongly.

It should be pointed out that the market for new bond issues is controlled by the Government. Since it approves all domestic issues, it is in a position to regulate the volume of its own and other flotations and is also able to divert the issue proceeds to finance various extrabudgetary projects. Consequently, changes in the volume of Government issues do not always reflect fluctuations in the demand for these bonds, and changes in the volume of proceeds deposited with the Treasury do not necessarily reflect changes in the volume of new flotations.

To illustrate, the volume of noncompulsory bond flotations in 1972 rose by more than 80 percent (from IL 1,560 million in 1971 to IL 2,860 million), but the amount of issue proceeds used for directly financing the Government budget almost tripled—from IL 640 million to IL 1,890 million. Whereas in 1971 some 43 percent of total noncompulsory bond issues was used for this purpose, in 1972 the ratio jumped to 65 percent; the Government diverted most of the increase in these issues to finance its budget.

Direct Government and National Institution bond sales grossed IL 817 million in 1972, of which IL 496 million was in option-type development loan issues, IL 242 million in 6.5 percent interest-bearing index-linked bonds (which were offered to the public at the beginning of the 1972/73 fiscal year), IL 58 million in long-term bonds purchased by social insurance funds and insurance companies (including the Insurance Companies Loans to the Government), and IL 21 million in Hollis bonds (traded in foreign currency and sold by the Jewish Agency to domestic investors).

Net deposits of the proceeds of bond issues floated by various financial institutions and the State Lottery rose from IL 213 million in 1971 to IL 1,090 million; of the latter sum, IL 890 million was deposited with the Treasury.

Following are the changes that took place in the Government's compulsory loan receipts in 1972:

Proceeds from the compulsory Defense Loan went up from IL 448 million in 1971 to IL 589 million;²⁵ collections on account of this loan are at a flat rate of 7 percent of taxable income, and the 1972 increase in receipts stemmed predominantly from the growth of private income from economic activity. There was hardly any change in the Compulsory Savings Loan, the figure coming to IL 592 million compared with IL 586 million in 1971.²⁶ This loan was imposed at the rate of 4 percent of total earnings in the case of wage earners and the self-employed and 2 percent for companies and cooperative societies; on top of this, employers had to purchase an amount equivalent to

²⁵ See Table VII-6 for a breakdown of the increment.

²⁶ The debt repayment data in this chapter include linkage differentials on the principal.

6 percent of their gross wage and salary payments. In April 1972 collections from employees were discontinued, but the loan imposed on employers remained in force. For this reason, receipts from this loan rose only slightly.

Along with the increased revenue from the Defense Loan and Compulsory Savings Loan in 1972, there was a heavier net redemption of the Absorption Loan—IL 99 million as against IL 67 million in 1971. To this should be added the redemption of the 1967 Defense Loan (although it is not essentially a compulsory loan), which amounted to IL 377 million.

The debt to the banking system declined by IL 190 million, compared with an increase of IL 1,103 million in 1971. Liabilities to the Bank of Israel were cut by IL 300 million; this was the net outcome of an IL 883 million growth in net long-term borrowing (IL 265 million by the National Institutions and IL 618 million by the Government within the framework of its budget for 1971/72) and a IL 1,183 million decrease in short-term credit from the Bank, reflecting a decline in current advances to the Government and an increase in Government foreign currency deposits.

Credit from other banking institutions rose from IL 42 million in 1971 to IL 110 million in the year reviewed; this sum consists of IL 43 million in loans from the institutions and IL 67 million in net purchases of Government bonds by the latter. In 1972 the banks took up IL 129 million of the Defense Loan issue floated specifically for them; however, they in turn sold part of this issue to other sectors of the economy.

3. *Credit outflow*

In 1972 the Government and the National Institutions provided the rest of the economy (including the local authorities) with IL 1,896 million in long-term loans—14.1 percent more than in the previous year. These loans were granted from the Government's and National Institutions' development budgets and do not include loans granted by financial institutions from their bond issue proceeds or from other independent resources. The distribution of these loans by sector of final destination shows that the largest component went for housing, which rose by IL 206 million to IL 1,126 million.²⁷

The importance of these direct development budget loans in financing investment in the rest of the economy has been diminishing, while the role of the financial and banking institutions, social insurance funds, and insurance companies has risen correspondingly. A decline in direct Government lending to a particular sector does not mean that the public sector granted less financing, but rather that in most cases the direct source of financing has shifted from the development budget to financial institutions.

²⁷ Credit for financing housing is treated as credit to the public even if part of the publicly sponsored housing has not yet been handed over to buyers or to public housing companies but is being held temporarily by the Government.

Table VII-10

**DEVELOPMENT BUDGET LOANS^a GRANTED BY THE GOVERNMENT AND
NATIONAL INSTITUTIONS, BY ECONOMIC SECTOR, 1970-72**

(IL million)

	1970	1971	1972	Percent annual increase or decrease (-)	
				1971	1972
Housing ^b	829	920	1,126	11.0	22.4
Agriculture and irrigation	150	190	206	26.7	8.4
Mining, quarrying, electricity	72	42	36	-41.7	-14.3
Industry and crafts	80	212	153	165.0	-27.8
Transportation and communications	94	54	17	-42.6	-68.5
Tourism	45	63	72	40.0	14.3
Services and misc.	97	122	179	25.8	46.7
Total ^c	1,367	1,603	1,789	17.3	11.6
To local authorities	56	58	107	3.6	84.5
Grand total	1,423	1,661	1,896	16.7	14.1

^a Including participation in company share capital; excluding Government and National Institution investments. Most of the loans are granted through financial institutions, with the distribution here being by sector of final destination.

^b The entire amount of financing provided for housing is treated as loans to the public, even if part of the public housing has not yet been actually handed over to the buyers or to the public housing companies but is being held temporarily by the Government.

^c Excluding loans to local authorities.

The sectoral distribution of Government and National Institution loans is presented in Table VII-10.²⁸

Collections of Government and National Institution loans totalled IL 329 million, compared with IL 200 million in 1971; this includes IL 291 million in Government development budget loans. The Government's outstanding claims arising out of development budget operations added up to IL 7,430 million at the end of March 1972.²⁹ Of this sum, some IL 1,750 million represented investment in shares and bonds (including amounts originally granted as loans but

²⁸ The sectoral distribution relates to the final destination of loans. Most were given through financial intermediaries (see Chapter XVI for the destination of credit channelled through the financial institutions).

²⁹ Excluding loans to the National Institutions, Israel Ports Authority, and local authorities, as well as the amount charged to the National Water Carrier, concerning which it has not yet been decided whether to treat it as a loan to the Mekorot Water Company. In this chapter expenditure on the National Water Carrier and ports development has been treated as direct Government investment.

later converted into share capital), while as regards a further IL 1,140 million no decision has yet been taken whether to treat it as a loan or an equity investment. The balance of loans to be collected thus totalled IL 4,540 million at the end of March 1971. Loan collections (excluding the sale of shares) were equal in 1972 to 6.4 percent of total Government loans outstanding at the end of March 1972; this compares with 4.6 percent in the previous year. It should be noted in this connection that a sizable part of the balance consisted of loans on which only interest is collected or whose redemption date either had not been fixed or had been deferred.

3. LOCAL AUTHORITIES

(a) *Operations of the local authorities*³⁰

Local authority operations expanded rapidly in 1972: consumption and investments shot up 24.3 and 52.8 percent respectively, compared with 22.8 and 33.6 percent respectively in 1971. These growth rates are particularly striking in comparison with those of the Government and the National Institutions, where the uptrend in civilian consumption slackened and purchases on capital account went up by 35.4 percent.

This strong expansion of the local authorities' operations resulted in a notable IL 361 million growth of their demand surplus (compared with IL 262 million in 1971); to finance this they had to borrow from banking and financial institutions on an unprecedented scale.

The rapid upsurge of the authorities' operations began in fiscal 1971/72, when the Government acknowledged the need to enlarge and improve services to the growing population, to finance the wage and price rises facing the authorities, and to service their mounting indebtedness (the repayment of principal and linkage differentials).

The Government approved an increase of more than 20 percent in the authorities' current budgets for 1971/72, a high rate compared with the three preceding years. In 1971/72 the authorities' current expenditure outpaced the growth of their revenue, which went up by a mere 12 percent.³¹

This low rate of increase was forced upon the authorities by the "package deal" on prices, taxes, and wages, one of the conditions of which expressly required the freezing of municipal tax rates. The Government did not cover all of the difference between the authorities' expenditure and revenue estimates,

³⁰ Municipalities, local, regional, and religious councils, and regional authorities. Also included are the municipal expenditure of kibbutzim and moshavim (cooperative agricultural settlements).

³¹ Including loans for the consolidation of Government-directed credit and Government grants and participations. See explanatory notes to the budget proposal of the Ministry of the Interior for 1973, p. 73 (Hebrew).

instead approving deficit budgets, with the average deficit exceeding 10 percent of the total budgeted expenditure.

For 1972/73 the Government again approved an increase of some 20 percent in the authorities' current budgets; this allowed for the estimated rise in prices and the authorities' payroll outlays, the growth of population, and a mild expansion of services. Municipal taxes were unfrozen in the year reviewed, and a 26 percent increase was projected; however, the authorities' expenditure again exceeded the revenue estimates, and so deficit budgets, with the average deficit exceeding 6 percent of total budgeted expenditure, were again approved.

The authorities therefore had to resort to borrowing—estimated at approximately IL 120 million for 1972—to finance their current deficits, in addition to the credit required for covering their development budgets.

There is no effective constraint whatsoever on the authorities' development

Table VII-11

DEMAND SURPLUS OF THE LOCAL AUTHORITIES AND ITS FINANCING, 1970-72

(IL million)

	1970	1971	1972	Percent annual increase	
				1971	1972
A. Expenditure	877	1,098	1,327	25.2	20.9
Consumption	646	793	986	22.8	24.3
Transfers to households and nonprofit institutions	147	213	240	44.9	12.7
Interest paid ^a	84	92	101	9.5	9.8
B. Revenue	973	1,222	1,556	25.6	27.3
Taxes	313	365	452	16.6	23.8
Other domestic revenue	259	319	373	23.2	16.9
Net transfers from the Government and National Institutions	401	538	731	34.2	35.9
C. Saving (B-A)	96	124	229	29.2	84.7
D. Purchases on capital account (less sales)	289	386	590	33.6	52.8
E. Demand surplus (D-C)	193	262	361	35.8	37.8
Sources financing the demand surplus					
F. Credit (net)					
Government and National Institutions	32	36	86	12.5	138.9
Banking system	67	170	215	153.7	26.5
Other domestic sectors	94	56	60	-40.4	7.1
Total	193	262	361	35.8	37.8

^a Excluding interest paid to the Government.

budgets, other than their ability to mobilize the requisite funds to finance their investments. About 80 percent of the development budgets is financed by loans and credits, while the remaining 20 percent is obtained through the participation of property owners and institutions in various outlays, Government participations, the sale of property, etc.

Loan repayment is included in the ordinary budgets of the authorities, and the more their investments expand the more this is reflected in their ordinary budgets, a growing proportion of which is earmarked for the repayment of loans.

Since deficit budgets were approved in recent years, with the deficits arising largely from debt repayment, and since the increase in other ordinary expenditures was in some degree controlled by the Ministry of the Interior, a breach was in fact made, permitting the appreciable expansion of development budgets. Once deficit budgets have been authorized, the size of the deficit becomes a secondary problem, as evidenced by the rapid growth of the authorities' capital spending.

The authorities' heavy investment demand made them one of the prime sources of upward pressure on investment prices on the one hand, and the foremost cause of pressure in the credit market on the other. The authorities tended to swallow the precipitate rise in investment prices and the considerable hardening of the terms of their investment credit.³²

The growth of their demand surplus stemmed predominantly from a stepped-up capital expenditure. Excluding purchases on capital account, they enjoyed a much higher saving, the result of revenue outpacing the rise in current expenditure.

The authorities' revenue on real account, including net transfers from the Government and National Institutions, advanced 27.3 percent—the highest rate reached during the past decade. Two factors contributed to this growth: a larger volume of transfers from the Government and the National Institutions (including special grants-in-aid for the balancing of their budgets and to compensate them for not hiking taxes in fiscal 1971/72), and a larger tax revenue.

In 1972/73 the freeze on municipal taxes, in force since 1967/68, was lifted. This helped to boost the authorities' tax receipts in 1972, but only slightly. Tax revenue and other transfer payments from the public (including fees for various services and owners' participation in local authority expenditure) rose 20.6 percent, as against 19.6 percent in 1971. Considering the expansion of those economic activities which constitute the municipal tax base, this increase seems fairly low. It should be pointed out that part of the incremental revenue from service fees was earmarked for financing the increased expenditure of the authorities' enterprises. Since the outlays of these enterprises are not included in public sector expenditure, except for their surpluses or deficits, the incremental income from these fees (e.g. water rates) was not included in the calculation

³² Many of the authorities obtained index-linked loans at an annual interest of 11 percent.

of the growth of the authorities' receipts. But even if these receipts are added to the authorities' total revenue, the 1972 increase in revenue still appears to be less than what might have been expected given the rise in municipal tax rates.

One item whose weight in the authorities' total receipts has been moving up from year to year is transfers from the Government. Net transfers from the Government and the National Institutions (including net loans) soared 42.3 percent in 1972, and their weight in the authorities' total revenue, as presented in their "balance of payments" (Table VII-12), reached 40 percent, as against 36.1 percent in 1971 and 35.1 percent in 1970.

Government transfers, as calculated above, include the authorities' share in Government tax collections (see section [b]1). Part of these transfers may be regarded as municipal taxes which are formally collected by the Government, and do not differ essentially from other autonomous municipal taxes. Even if these are excluded from Government transfers, there was still a rise in the weight of Government and National Institution transfers in the authorities' total receipts, which implies an increased Government participation in the authorities' activities.

The authorities financed their demand surplus by borrowing more heavily from other domestic (mainly financial) sectors. Their debt to the banking system rose in 1972 by IL 215 million, most of it in medium- and long-term loans. They borrowed IL 86 million from the Government (more than double the previous year's figure) and IL 60 million from other sectors, including financial institutions and the State Lottery. This differentiation of net credit from other sectors is merely a formal one, since most of the credit received from financial institutions is directed by the Government, and the fluctuations in net credit extended directly by the Government do not indicate any change in Government financing, direct or indirect, to local authorities.

Since the authorities have run a demand surplus for many years, their outstanding indebtedness has grown appreciably. As of March 31, 1972, this was estimated to have reached approximately IL 1,400 million on account of principal⁸³ and another IL 1,150 million in linkage differentials and accumulated interest. About 15 percent of these sums originated in the accumulated deficits in their current budgets, and they consist mostly of Government-directed loans for the consolidation of debts. The balance of principal, linkage differentials, and accumulated interest at the end of 1972 is estimated at IL 3,000 million; this is more than double the authorities' total ordinary budget receipts for 1972/73.

(b) *The "balance of payments" of the local authorities*

The "balance of payments" of the local authorities is presented in Table VII-12, which distinguishes between transactions in goods and services, financial transactions, and transactions with the rest of the public sector.

⁸³ On a total some 26,000 loan contracts.

Table VII-12
"BALANCE OF PAYMENTS" OF THE LOCAL AUTHORITIES, 1970-72
 (IL million)

Receipts	1970	1971	1972	Increase or decrease (-)		Payments	1970	1971	1972	Increase or decrease (-)	
				1971	1972					1971	1972
Transfers and transactions in goods and services											
Taxes	313	365	452	16.6	23.8	Consumption	646	793	986	22.8	24.3
Misc. revenue	259	319	373	23.2	16.9	Purchases on capital account	289	386	590	33.6	52.8
						Interest paid	84	92	101	9.5	9.8
						Transfers	147	213	240	44.9	12.7
Total	572	684	825	19.6	20.6	Total	1,166	1,484	1,917	27.3	29.2
Transactions in financial claims											
Long-term loans	143	173	188	21.0	8.7	Participation in share capital	5	8	8	60.0	—
Loans and credit from the banking system	67	170	215	153.7	26.5	Repayments on long-term loans	63	100	115	58.7	15.0
Short-term credit	19	-9	-5	..	44.4						
Total	229	334	398	45.9	19.2	Total	68	108	123	58.8	13.9
Transactions with the rest of the public sector											
From the Government and National Institutions											
Net participations	401	538	731	34.2	35.9						
Net loans	32	36	86	12.5	138.9						
Total	433	574	817	32.6	42.3						
Total receipts	1,234	1,592	2,040	29.0	28.1	Total payments	1,234	1,592	2,040	29.0	28.1

1. Receipts

Autonomous municipal tax revenue—taxes collected directly by the local authorities, not counting their participation in Government tax collections—went up 23.8 percent in 1971 to total IL 452 million. For fiscal 1972/73 increases of 25–40 percent were authorized in the general rates and of 40–50 percent in the business tax, terminating the freeze on municipal taxes which had been in force for many years.

In 1971 tax revenue was up 16.6 percent, even though rates had not been revised; this is explained by the expansion of the municipal tax base, i.e. the growth of economic activity on which municipal taxes are collected, especially residential construction. Given the strong uptrend in such economic activity in 1972, the incremental tax revenue deriving from the expansion of the tax base this year presumably was at least as large as in 1971; thus the growth of tax revenue attributable to the upward revision of rates was at the most 6–7 percent, much less than what might have been expected.

There are several reasons for this: first, the increases in rates were approved after the beginning of the 1972/73 fiscal year and went into effect later in the year; second, there are several constraints on the growth of revenue from property and business taxes—such as a statutory ceiling in the case of the business tax, the granting of exemptions or concessions to low-income families in the case of general rates, and so forth. In addition, there was apparently an increase in 1972 in arrears in municipal tax payments.³⁴

Nontax revenue added up to IL 373 million in 1972. Approximately 60 percent of this sum represented the participation of various institutions and property owners in development costs and current outlays, while the balance represented participations in the cost of services provided, including service charges in primary schools and tuition fees in other educational institutions, and the authorities' income from property.

The net participation of the Government and the National Institutions in local authority budgets³⁵ was stepped up by 42.3 percent to IL 817 million. This participation consists of four items:

(a) General grant-in-aid, consisting of ordinary and extraordinary grants. The former are allocated through the Ministry of the Interior and are equal to 21 percent of the Government's income from vehicle license fees and 5 percent of its purchase tax receipts. These grants are allocated to local author-

³⁴ See Jerusalem Municipality, Report of the Controller for 1971/72, p. 22 (Hebrew). In addition to the lag in tax collections, many property owners were in arrears in the payment of their participation in development budget outlays (p. 23).

³⁵ Allocations, grants, participation in various local authority activities, and net loans granted to the authorities, less interest paid to the Government by the authorities and their participation in various Government outlays.

ities according to various criteria: per capita receipts from taxes, average per capita expenditure on social welfare, the number of inhabitants, and the age structure of the population. The extraordinary grants are provided by the Ministry of the Interior to supplement the authorities' budgets and compensate them for forgoing tax hikes, or as special participation in various services. Total transfers under this head rose from IL 191 million in 1971 to IL 261 million in 1972.

(b) "Shared revenue"—comprising 21 percent of the Government's income from vehicle license fees (identical to the sum appearing under the general grant-in-aid) and about 4.8 percent of its total revenue from taxes and license fees—in return for relinquishing the collection of the municipal property tax. With the growth of Government tax revenue, these allocations went up from IL 183 million in 1971 to IL 262 million. The shared revenue was allocated to the authorities in proportion to their weight in municipal tax collections before the Government assumed responsibility for collection and to the number of vehicles owned by their residents.

(c) The participation of the Government and the National Institutions in the financing of the local authorities' current operations, mainly the participation of the Ministries of Social Welfare, Education, and Religious Affairs in the financing of various services. In 1972 these transfers (less various local authority participations in Government expenditure, including interest paid to the Government) amounted to IL 128 million, compared with IL 106 million in 1971.

(d) Loans and grants from the Government development budget and from the Education Fund of the National Institutions. Net loan receipts rose from IL 36 million in 1971 to IL 86 million, while total grants received went up from IL 58 million to IL 80 million.

2. *Payments*

Local authority expenditure on real account—i.e. consumption, investment, and transfers—increased 29.2 percent at current prices, following a 27.3 percent rise the year before, and totalled IL 1,917 million.

The authorities' consumption spending was up 24.3 percent to IL 986 million, of which IL 652 million was payroll outlay. This item rose 20.5 percent in 1972, following a growth of 5.4 percent in personnel and of 14.4 percent in average pay per employee. At 1971 prices, the increase in consumption came to 9.1 percent, compared with 4.6 percent in 1971.

Transfer payments added up to IL 240 million in 1972, of which IL 55 million went to nonprofit institutions (education, health, and social welfare) and IL 185 million to households.

A functional breakdown of the authorities' expenditure reveals that more than

60 percent of the incremental consumption spending and transfer payments was in the social field—education, health, and social welfare; this represents approximately half of the total disbursements in this category.

Local authority investments soared 52.8 percent at current prices and totalled IL 590 million. All component items shared in the growth, with the biggest increases being in education—which accounted for over half of the authorities' total capital spending—and transportation (roads, sidewalks, and traffic regulation), which accounted for 20 percent of the total.