

CHAPTER XI

GOVERNMENT AND NONGOVERNMENT PUBLIC SECTOR¹

1. MAIN DEVELOPMENTS²

The activities of the public sector, which declined slightly in 1976, stabilized in 1977, and may even have increased somewhat. This development contrasts with the rapid expansion that followed the Yom Kippur War. The stability this year was a product of a slight decline in both the sector's direct demands and the absorption of purchasing power from the public. The rate of reduction in domestic defense expenditures slowed down this year, while a considerable increase in the level of real wages in all of the public sector had a strong expansionary influence on the non-defense component of the public sector. Direct investments of the sector declined this year at a slower rate than last year – 6 percent compared to 16 percent – while public housing construction fell at a much faster rate than in 1976: 48 percent compared to a decline of 25 percent last year. At the same time, the expansionary trend of the taxation system and transfer payments slowed in 1977: taxes and compulsory loans, which had risen by 16 percent in 1976, increased by 4 percent this year, i.e. less than the rise in private income³. Net transfer payments to the public rose by 5 percent, following an annual growth of about 12 percent for each of the previous two years and the still more rapid growth of 1972–1974.

Attempts to estimate the cumulative effect of fiscal activity on aggregate demand in 1977 rely on domestic demand surplus. This surplus is defined as the gap between the sector's expenditures on direct domestic demands and the amount absorbed by the sector from the public in tax and property revenues, less transfer payments to the public. The basic drawback of this indicator is its inability to distinguish between the influences

¹ The public sector includes the government, the local authorities and the National Institutions. The chapter deals with the real activities of the sector, while the discussion of monetary developments is concentrated in Chapters XVII–XX below. The sources of data contained in this chapter are estimates of the Central Bureau of Statistics, unless otherwise stated.

² Data in this section are from Tables XI-2, XI-3 and XI-4. Discussion in this chapter is in real terms, unless otherwise stated.

³ Private income increased by 6 percent in 1977.

TABLE XI-1

INDICATORS OF PUBLIC SECTOR OPERATIONS, 1972-1977
(percent, at current prices)

	1972	1973	1974	1975	1976	1977
A. GNP share of direct domestic demands of the public sector a b						
Total public consumption	18.0	21.2	22.5	22.2	21.3	22.0
Civilian public consumption	9.3	9.8	9.7	9.6	10.0	11.2
Defense public consumption	8.7	11.4	12.8	12.6	11.3	10.8
Direct investments	3.2	3.3	3.6	3.9	3.2	3.0
Housing construction (public sector)	3.1	3.6	4.2	3.9	2.0	1.1
Total direct demands	24.3	28.0	30.3	29.9	26.4	26.1
B. GNP share of total direct demands and nonprofit institutions^b						
Civilian public consumption and nonprofit institutions	15.4	15.9	15.6	15.4	16.0	17.7
C. Weight of employed in public services in total of employed in economy^c						
	24.3	24.7	26.1	27.1	27.5	27.8
D. Weight of revenue and transfer payments of public sector in the product^d						
Revenue of public sector, less subsidies ^e	36.2	33.6	38.6	37.9	44.7	43.6
Net transfer payments ^f	11.7	13.2	16.4	18.2	20.4	20.3
Absorption ^g	24.5	20.4	22.2	19.7	24.3	23.3

^a The share of public consumption components in uses is presented in Chapter II, Table II-2.

^b These shares were estimated in relation to the various direct demands in items A and B, as follows: in the ratio, the GNP component of direct demand is in the numerator, and the GNP in production factor prices is in the denominator. The product components of the various demands provide an estimate of the amount of GNP that they absorb. To calculate the product components, the direct and indirect import components were deducted from the various direct demands, as were taxes on import components and on domestic production. These calculations were made with the help of an input-output system for the year 1968/69, with correction for changes which occurred in various periods in relative prices and in the various taxation rates.

TABLE XI-1 (cont'd.)

- c The definition of public services is according to manpower surveys of the Central Bureau of Statistics, which does not coincide with the definition of the public sector in the National Accounts. The definition of manpower surveys also includes those employed in the nonprofit institutions, as well as those privately employed in the education and health branches, but on the other hand does not include some government, local authority, and National Institution employed, who are classified according to their branch activity, and who are included in the National Accounts definition. Therefore, the definition of employed in public services according to manpower surveys is broader.
- d The product at market prices.
- e Revenue from taxes, from compulsory loans and revenue from property, less subsidies to domestic production, to import and export, and without taxes on defense imports.
- f The structure of this item – in Table XI-9.
- g Revenue of the public sector, less net transfer payments.

which the various components of sector activity exert (see the discussion below).

Domestic demand surplus stabilized in 1977, after a sharp drop of 44 percent last year. In light of the controversy surrounding the effect of public housing construction on aggregate demand (see discussion below), a second calculation of direct demand was made, subtracting out the change in housing construction. Using this definition, the domestic demand surplus experienced a steep 30 percent increase.

Domestic public consumption remained stable in 1977 in real terms, after dropping by 4 percent in 1976. This, however, masks contradictory trends in the various components: domestic defense purchases continued their decline, decreasing by 7 percent, after a 10 percent drop in 1976, while the long-term upward trend in the sector's employment, both in absolute numbers and proportional to the total Israeli labor force, continued. In 1977 the number of employees increased by about 4 percent, which was comparable to last year. In addition, the wage hikes and considerable retroactive payments granted this year raised the wage level in the public sector, in terms of purchasing power, by about 17 percent. This created additional indirect demand⁴ of approximately IL 2.6 billion (in 1977 prices), which was tantamount to a reduction of 2 percent in the absorption of pur-

⁴ National Accounting methodology is based on the assumption that the productivity of public services has remained stable. Accordingly, the increase in the level of real wages is assumed to have an indirect demand effect similar to that of transfer payments. The growth of purchasing power is defined here as the wage increase above that required by the growth of labor input and by the increase of private consumption prices, as well as the Value Added Tax on wages.

TABLE
DOMESTIC DEMAND

	Current		
	1972	1973	1974
			(IL
A. Direct demands			
1. Domestic public consumption	6,498	9,407	14,795
2. Domestic investments of the public sector	1,241	1,589	2,430
3. Housing construction initiated by the public sector	1,168	1,629	2,754
4. Total domestic direct demands	8,907	12,625	19,979
5. Total domestic demands, excluding housing construction initiated by the public sector (4-3)	7,739	10,996	17,225
B. Absorption			
6. Net revenue from taxes and compulsory loans ^b	10,086	12,203	19,541
7. Revenue of the public sector from property	675	390	906
8. Net transfer payments	3,475	4,942	8,681
9. Absorption (6+7-8)	7,286	7,651	11,766
10. Absorption including impact of changes in the wage level in the public sector ^c			
C. 11. Domestic demand surplus, including housing construction (4-10)			
	1,621	4,974	8,213
Weight in GNP of domestic demand surplus (at current prices, percent)	5.5	13.3	15.5
Domestic demand surplus without housing construction (5-10)	453	3,345	5,459

^a Estimates of the changes in fixed prices were calculated as follows: components of the direct demands at fixed prices were taken from Central Bureau of Statistics data. The various absorption components were discounted by private consumption prices.

^b Taxes and compulsory loans less subsidies to domestic production, to import and export, excluding taxes imposed on defense imports.

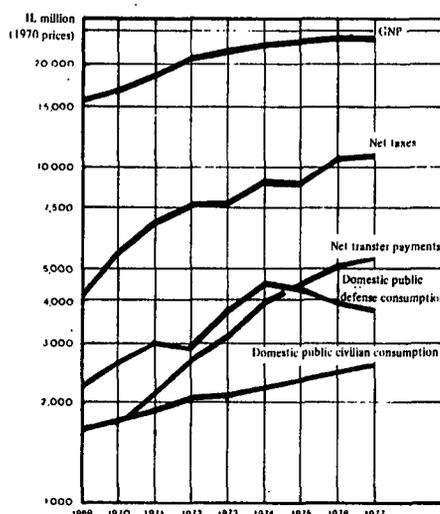
SURPLUS, 1972-1977

prices			Increase or (-) decrease from previous year ^a				
1975	1976	1977	1973	1974	1975	1976	1977
million)			(percent, fixed prices)				
20,330	25,499	37,526	17.6	15.0	0.4	-3.7	-1.0
3,723	4,055	5,542	5.1	9.3	8.6	-13.2	-0.9
3,631	3,153	2,147	10.8	16.9	7.9	-24.8	-47.7
27,684	32,707	45,215	15.0	14.5	1.8	-7.8	-6.0
24,053	29,554	43,068	15.6	14.2	0.8	-5.2	-1.0
27,087	40,824	56,875	1.2	15.5	-1.0	17.2	2.6
1,438	2,493	3,664	-51.7	67.6	13.4	34.8	8.1
13,727	19,782	28,133	19.0	26.7	12.9	12.1	4.7
14,798	23,535	32,406	-12.2	10.9	-10.2	23.7	1.4
			2.9	20.7	-13.6	22.5	-8.2
12,886	9,172	12,809	43.0	4.3	31.4	-43.7	-0.3
17.1	9.5	9.2					
9,255	6,019	10,662	68.0	-2.1	45.7	-51.4	29.3

^c In the National Accounting there is stability in public services productivity. Accordingly, the impact of indirect demand, stemming from an increase in purchasing power, is attributed to the increase of the real wage level.

chasing power from the public. When this effect is combined with the influence of other changes that occurred in the sector's revenues, i.e. in transfer payments and subsidies, it appears that a decrease of about 8 percent took place this year in total absorption of purchasing power from the public. The number of employees in the public sector has grown and transfer payments have increased continually, both at annual rates exceeding the rate of population growth. This phenomenon reflects a social policy designed to increase welfare services, a policy whose foundations were laid at the beginning of the decade. This policy has in recent years conflicted with the economic targets, which after 1973 focused on the balance of payments problem, and sought to achieve a structural change in the economy that would stimulate exports while reducing the relative weight of public services and other nontradable branches. The substantial rise this year in the real wage level of public employees, resulting from pressures exerted by the workers, signifies a retreat from the wage policy of previous years. This policy sought to restrain the inflationary pressure of wages and promote the desired structural changes in the economy by lowering relative wages in public services.

FIGURE XI-1
DEVELOPMENT OF GNP, PUBLIC
CONSUMPTION, TAXES, AND
TRANSFER PAYMENTS
1969/1977
(at fixed prices)



Semi-logarithmic calibration
DEFINITIONS:

Net taxes: total direct and indirect taxes, and compulsory loan, less domestic incentives to domestic production, import and export.

Net transfer payments: total transfer payments from the public.

In estimating the overall influence of the public sector's activities on aggregate demand, the individual activities must be examined separately since they have a differential impact. Public consumption expenditures, particularly wages, and domestic direct investment expenditures exert a much stronger marginal effect on demand than do taxes and transfer payments. This occurs for a number of reasons: changes in consumption and investments create a direct one-for-one change of demand in the commodity and factor markets. Changes in purchasing power, which stem from taxes and transfer payments, possess only an indirect delayed effect, occurring after public behavior adapts itself. Furthermore, this

TABLE XI-3

FINANCING OF DEMAND SURPLUS, 1974-1977

(IL million, at current prices)

	1974	1975	1976	1977
1. Domestic demand surplus	8,213	12,886	9,172	12,809
2. Net purchases abroad ^a	6,146	12,577	13,728	12,634
3. Total demands	14,359	25,463	22,900	25,443
4. Financial remainder (3-5) ^b	4,868	7,426	1,030	1,711
5. Deficit to be financed	9,491	18,037	21,870	23,732
Financing				
6. Net financing from abroad ^c	6,832	14,568	16,895	17,109
7. Credit from Bank of Israel ^d (8-6-2)	2,659	3,469	4,975	6,623
8. Injection ^e	3,345	5,460	8,142	11,098
Injection, compared to the money base at the end of the previous year.	50.4	68.6	95.0	93.6

^a Government imports n.e.s. + direct defense import without taxes and levy + direct imports in investments.

^b This section is a remainder, taken from data appearing in this table; these data were received from various sources, and they must be treated accordingly.

^c The estimate in this section was received by adding sizes, (net purchases abroad (item 2 in the table) + conversion of foreign currency + correction of food imports) and not through direct measurement.

^d The change in the government debt to the Bank of Israel, less the changes in the debt which are not included in injection, whose principal component is the payment of interest to the Bank of Israel.

^e The injection is measured directly, and is the result of (6+7-2).

influence is only partial since the additional income is not, as we know, consumed in its entirety⁵.

The definition of direct demand includes public construction for housing. It can be assumed that the effect of fluctuations in this area upon aggregate demand is smaller than that exerted by other direct demands, given the reciprocal relationship in the housing construction market between private and public construction.

⁵ This difference in effects appears to exist despite the differences in the size of various components of indirect imports.

The corresponding long-run trends of growth in the taxation system and in the transfer payment and subsidy system have an expansionary effect on aggregate demand: in view of the fact that both systems are progressive, and since the marginal propensity to consume decreases with the growth of income level, a marginal growth in transfer payments will expand aggregate demand more than an identical rise of taxes will reduce it⁶. In addition, tax increases, particularly of indirect taxes, accelerate inflation considerably, while a reduction of direct government demand exerts a moderating influence on prices. Hence, it can be concluded that a reduction of direct expenditures by the public sector, especially in public consumption, restrains aggregate consumption more effectively than increased taxation. It can be further stated that a parallel increase of direct expenditure and taxation has an expansionary effect on aggregate demand, especially when a parallel growth of taxes and transfer payments exists.

The amount of liquidity injected into the economy by the public sector was IL 11 billion⁷, up 36 percent from 1976. This was a slightly slower increase than that which occurred in the GNP deflator. The government injection totalled IL 8.6 billion and was the main factor enlarging the money base. As in previous years, the injection was not uniformly distributed over the year. But whereas in the past it had intensified towards the end of the year, in 1977 it was concentrated almost entirely in the first ten months. This was largely due to the big wage increases awarded in the middle of the year, including the payment of big retroactive adjustments. As in 1976, the net financial transactions of the public made a very modest contribution to the financing of the domestic demand surplus⁸: IL 1.7 billion compared to IL 1 billion in 1976, and IL 7.5 and IL 5 billion for 1975 and 1974 respectively (for a detailed discussion of the subject, see Chapter XVIII).

2. PUBLIC CONSUMPTION

Domestic public consumption stabilized this year in quantitative terms, after it had decreased by 4 percent in 1976. At the same time, total public consumption decreased at a rate higher than last year – 14 percent compared to 9 percent. The difference between these trends is explained by the accelerated decline in direct defense imports: 37 percent in 1977 compared with 17 percent in 1976.

In estimating the effect of changes in public consumption on the economy, both wage

⁶ Assuming that the progressiveness of marginal changes is identical to average progressiveness in each of the two components.

⁷ Data on the size of injection and financial transactions below are given at current prices.

⁸ See line 4 in Table XI-3.

increases and the considerable retroactive payments that were made this year in the public sector should be included. These payments increased the purchasing power of public employees by about 17 percent and created additional indirect demand of about IL 2.6 billion. Public consumption's share of GNP increased in 1977 at a rate of 3 percent, and reached 22 percent, after a 4 percent decline last year⁹.

The stabilization of domestic public consumption reflects contradictory trends in domestic defense and civilian consumption. Domestic civilian consumption continued to expand, while domestic defense consumption was reduced, although at a pace slower than last year. The previous trend of rapid growth in domestic defense consumption after the Yom Kippur War was reversed in 1975. The decline that began in 1975 gathered momentum in 1976 and reached 8 percent. This year, the decline decreased to 5 percent: domestic purchases by the Defense System decreased by 7 percent as against 10 percent last year, while employment input rose slightly after having dropped by 4 percent in 1976. The domestic defense consumption share of GNP decreased from a level of 11.3 percent in 1976 to 10.8 percent this year.

Domestic civilian public consumption grew by 4.5 percent this year, exactly the same as last year's growth. The long-run upward trend in the number of employees in public consumption continued this year, at a rate of about 4 percent¹⁰, comparable to last year's. It is worth mentioning that social services employees, who constitute the majority of employees in the sector, accounted for the great majority of the increase, whereas government office workers increased only slightly¹¹. A stable trend can be discerned in the growth of public civilian consumption in the last decade. This growth was only slightly

⁹ For an estimate of the part of GNP inherent in the various direct demands of the sector, see Table XI-1.

¹⁰ The real growth of the labor input was only 1.9 percent (see Table XI-4), but this takes into account the 2 percent reduction in the number of available work days in 1977. This latter effect is not relevant to the analysis of the development that has occurred in the course of time in public sector manpower, since a reduction of available work days generally brings with it a parallel reduction in demand for the services of the sector and does not justify an adjustment of the number of jobs. The 4 percent increase in the number of civilian employees in the public sector includes a 5 percent increase in the number of government employees, a 3 percent increase in employment by local authorities, and a 5 percent decrease in the number of employees in National Institutions.

¹¹ According to the report of the committee that examined the increase in employees in public services (October 1977), the number of state employees in government offices grew in the period 1972-1977 at an annual average rate of about 2.5 percent.

TABLE

DIRECT DEMANDS,

	1974	1975	1976
	(IL million, current)		
A. Public consumption			
Civilian public consumption			
1. Wages	3,928	5,479	7,460
2. Purchases	1,782	2,562	3,579
3. Total	5,710	8,041	11,039
4. Of which: government imports n.e.s.	455	646	1,000
Public Defense consumption			
5. Wages	2,740	3,845	4,645
6. Domestic purchases	6,800	9,090	10,815
7. Purchases abroad	6,823	12,959	14,645
8. Of which: taxes and levy on defense imports	(1,386)	(1,688)	(2,553)
9. Total	16,363	25,894	30,105
10. Total public consumption (3+9)	22,073	33,935	41,144
Domestic public consumption			
11. Domestic defense consumption (5+6)	9,540	12,935	15,460
12. Domestic civilian consumption (3-4)	5,255	7,395	10,039
Of which: government	3,111	4,417	5,931
Local authorities	1,885	2,650	3,670
National Institutions	259	328	438
13. Total domestic public consumption	14,795	20,330	25,499
B. Public sector investments in economic sectors	2,684	4,383	4,691
14. Investments less direct import component	2,430	3,723	4,055
C. Housing construction initiated by public sector	2,754	3,631	3,153
D. Total direct demands of the public sector (10+B+C)	27,511	41,949	48,988
Of which: direct domestic demands (13+14+C)	19,979	27,684	32,707
E. Total direct demands of the public sector, without housing construction (10+B)	24,757	38,318	45,835
Of which: direct domestic demands (13+14)	17,225	24,053	29,554

XI-4.

1974-1977

1977	Increase or (-) decrease from previous year			
	1974	1975	1976	1977
prices)	(percent, fixed prices)			
12,490	4.8	5.6	4.5	1.9
5,021	2.5	2.7	6.2	4.1
17,511	4.0	5.1	5.0	2.6
1,195	-5.2	-10.7	12.9	-18.2
7,405	5.9	-2.5	-4.2	1.4
13,805	28.9	-4.4	-10.2	-7.4
13,262	-17.2	34.0	-17.5	-37.2
(2,432)				
34,472	1.5	11.8	-12.9	-20.1
51,983	2.1	10.0	-8.7	-13.9
21,210	20.7	-3.8	-8.4	-4.7
16,316	5.2	6.9	4.4	4.5
9,968	5.7	8.1	4.6	5.1
5,665	4.8	5.7	4.4	3.6
683	3.7	-7.1	1.5	3.6
37,526	15.0	-0.4	-3.7	-1.0
6,151	0.3	18.7	-15.5	-5.6
5,542	10.3	8.6	-13.2	-0.9
2,147	16.9	7.9	-24.8	-47.7
60,281	3.2	10.6	-10.8	-15.6
45,215	14.5	1.8	-7.8	-6.0
58,134	1.9	10.9	-9.4	-13.0
43,068	14.2	0.8	-5.2	-1.0

TABLE XI-5
INDICATORS FOR ANALYSIS OF GROWTH IN THE CIVILIAN PUBLIC SERVICES, 1969-1977

	1969	1972	1974	1977	Annual average increase or (-) decrease		
					1969-72	1972-74	1974-77
	(IL million, at current prices)				(percent, fixed prices)		
1. Civilian public consumption ^a	1,652	2,962	5,594	17,251	5.7	5.4	4.4
2. Nonprofit institution consumption	969	1,831	3,256	9,540	8.9	5.3	3.6
3. Civilian public services (1+ 2)	2,621	4,793	8,850	26,791	7.0	5.4	4.1
4. National Insurance benefits and welfare payments	449	913	2,726	9,798	14.1	34.2	13.7
5. Gross National Product	15,865	29,735	52,979	138,920	10.4	4.5	2.0
6. Private consumption ^b	9,374	15,224	29,981	78,608	5.9	8.8	1.1
7. Population (thousands)	2,930	3,225	3,422	3,651	3.2	3.0	2.2
RATIOS							
Civilian public consumption/GNP (1/5)					-4.3	0.9	2.4
Civilian public consumption/ private consumption ^b (1/6)					-0.2	-3.1	3.3
Civilian public consumption per capita (1/7)					2.4	2.3	2.2
Civilian public services/GNP (3/5)					-3.1	0.9	2.1
Civilian public services/ private consumption ^b (3/6)					1.0	-3.1	3.0
Civilian public services per capita (3/7)					3.7	2.3	1.9

a Without expenditure for the bond issues.

b Without nonprofit institutions consumption.

adversely affected by general economic factors at work after 1973, including the standstill in economic growth, the growing-defense burden, and the decline in immigration and population growth.

We have preferred to examine the development of civilian public consumption as part of a "unified sector" of civilian public services, which includes both civilian public consumption and the consumption of nonprofit institutions. We have chosen to do so for two reasons. First, most services provided by nonprofit institutions bear the nature of public services, and are thus complementary to the services of the public sector in various fields. In addition, they are generally managed according to governmental specifications and depend on extensive governmental budgetary support. Their activities as public services are only slightly affected by market forces, as apparent from the minor role which revenues from the competitive sale of these services play in the financing of sector activities.

To the extent that nonprofit institutions are self financed, it is mainly via the sale of services, not necessarily on a competitive basis. Self-financing of all nonprofit institutions excluding health services amounted to 28 percent in 1977¹². The rate of self-financing in health services amounted to 62 percent. However, about half of this amount represents employers' matching premiums collected from employers and the self-employed, which are taxes for all practical purposes and therefore constitute, in effect, financing by the public sector. It should be emphasized that the almost universal membership in the health insurance system (Kupat Holim)¹³ results from a lack of any serious medical insurance alternative in the private market.

In the past decade, the consumption of civilian public services has grown at a faster rate than population growth. The population grew at average annual rates of 3.3, 3.0 and 2.2 percent in the periods 1969–1972, 1972–1974, and 1974–1977 respectively, while civilian services during those periods increased by 7.0, 5.4 and 4.1 percent respectively.

Due to the recession in recent years, the GNP share of civilian public services increased continuously, from 15.4 percent in 1972 to 17.7 percent in 1977. Consumption of public

¹² Data on self-financing sources for nonprofit organization activities are estimates of the Bank of Israel (see also Chapter XII). The other estimates on the activities of nonprofit institutions mentioned in this chapter are taken from data of the Central Bureau of Statistics. These two sources of information are based on different samples, and data derived from them are therefore not comparable.

¹³ In 1956, 92 percent of the population, aged 18 and above, were insured by the Sick Funds (Kupat Holim).

TABLE XI-6

**CIVILIAN PUBLIC SERVICES CONSUMPTION (CIVILIAN PUBLIC CONSUMPTION
AND NONPROFIT INSTITUTION CONSUMPTION), 1969-1977^a**
(percent, fixed prices)

	Annual average increase or (-) decrease			Distribution by destinations			
	1969- 1972	1972- 1974	1974- 1977	1969	1972	1974	1977
Education services	8.9	6.5	4.8	33.3	35.2	35.9	36.4
Health services	10.1	6.1	5.1	21.5	23.4	23.7	24.2
Other welfare and social services	6.2	5.5	4.4	19.0	18.6	18.6	18.6
Total welfare services consumption	8.6	6.2	4.9	73.8	77.2	78.3	79.2
Economic and other services	2.1	2.8	2.9	26.2	22.8	21.7	20.8
Total of civilian public consumption and nonprofit institution consumption	7.0	5.4	4.1	100.0	100.0	100.0	100.0

^a The estimates of total public consumption and nonprofit institution consumption are based on Central Bureau of Statistics data. The calculation of the growth rates in the components of civilian public services was based for the period 1969-1974 on Central Bureau of Statistics data on civilian public expenditure by destinations, whereas for the period 1974-1977 the calculation was based on the growth rates of the number of positions in the appropriate economic sectors (from Central Bureau of Statistics data coming from the National Insurance Institute). It must be pointed out that these estimates are approximate and they must be considered accordingly.

social services increased even more rapidly than the growth rate of overall civilian public services, and their weight in the latter increased from 74 percent in 1969 to 79 percent in 1977. This rapid growth is attributable chiefly to the development of education and health services, which constitute about three-quarters of the social services. The expansion of education services reflects the increase in enrollment rates over the course of the decade. A partial explanation for the growth of health services can be found in the change in the age structure of the population - the past decade has been marked by an increase in the weight of the elderly groups, who require more health services.

Paralleling the rapid growth of public services, there was an accelerated growth of the system for income maintenance: National Insurance and social welfare payments increased especially rapidly in the years 1972–1974, at an annual average rate of 34 percent, while in the two other periods, the rate of increase was about 14 percent. These findings mirror a vigorous social policy of expanding the infrastructure of social services and income maintenance. The foundations of this policy were formulated at the beginning of the decade. Until 1973 the rate of expansion of the social services coincided with the growth rates of the economy and of private consumption. The stagnation of the GNP and the extensive growth of the defense burden following the Yom Kippur War apparently had only a slight deflationary effect on the rate of expansion of social services, in contrast to its much larger effect on private consumption. Hence, the share of social services in GNP rose rapidly, and the ratio between the consumption of social services and private consumption changed. This development constituted a heavy burden for the post-Yom Kippur War economic policy, which focused on the balance of payments problem and sought to achieve structural change in the economy. The question arises whether changes in economic conditions following 1973 should have called for increased restraint upon the development of social services as well.

3. DIRECT INVESTMENTS OF THE PUBLIC SECTOR AND PUBLIC HOUSING CONSTRUCTION

1977 was the second consecutive year of reduced direct investments by the public sector, although the rate of reduction dropped to 6 percent following a decrease of 16 percent in 1976. Direct investments less equipment imports stabilized, after dropping by about 13 percent last year. A policy of restraint has been in effect for three years on the investments in roads and communications, which are areas of infrastructure important to most branches of the economy. Public construction for housing continued to shrink, at an even higher rate: a reduction of 48 percent as against 25 percent last year. This reduction in the volume of public construction coincides with the policy of demand restraint in the present, but it also has a delayed effect on the apartment market due to the long duration of construction. At the beginning of 1977 there were 12,500 finished apartments of this type. These surpluses exerted a downward pressure on new construction starts in both the public and the private sectors. With the renewal of public demand for apartments in 1977, the accumulated stock retained by public construction was utilized to partially alleviate this demand. It thereby moderated the pressure for increased housing starts in the second half of 1977. When examining the effect of public housing construction policy on domestic demand, it should be borne in mind that there is substitution between private and public construction. The greater the sensitivity of private construction to changes in public housing construction, and the more it adjusts its volume of activities to the anti-

TABLE XI-7

TAXES, COMPULSORY LOANS, TRANSFER PAYMENTS AND SUBSIDIES, 1974-1977

	1974	1975	1976	1977	Increase or (-) decrease from previous year			Real increase or (-) de- crease from previous year ^a		
					1975	1976	1977	1975	1976	1977
	(IL million)				(percent)			(percent)		
1. Taxes	20,390	29,861	47,018	66,880	46.4	57.5	42.2	4.6	22.5	4.6
Direct	9,106	14,228	23,272	33,054	56.2	63.6	42.0	11.6	27.2	4.5
Indirect taxes on domestic production	5,243	8,721	13,404	19,697	66.3	53.7	46.9	18.8	19.5	8.1
Indirect taxes on civilian imports	6,041	6,912	10,342	14,129	14.4	49.6	36.6	-18.3	16.3	0.5
2. Taxes and compulsory loans	23,050	32,476	48,590	68,815	40.9	49.6	41.6	0.6	16.3	4.2
Of which: compulsory loans	2,660	2,615	1,572	1,935	-1.7	-39.9	23.1	-29.8	-53.3	-9.4
3. Total transfer payments and subsidies	12,190	19,116	27,548	40,075	56.8	44.1	45.5	12.0	12.1	7.1
Net transfer payments	8,681	13,727	19,782	28,135	58.1	44.1	42.2	12.9	12.1	4.6
Of which: net nonprofit institutions	(2,270)	(3,599)	(4,506)	(5,991)	58.5	25.2	33.0	13.2	-2.6	-2.2
Subsidies to domestic production	1,133	2,137	4,035	6,320	88.6	88.8	56.6	34.7	46.8	15.2
Subsidies to imports	426	950	278	720	123.0	-70.7	159.0			
Subsidies to exports	1,950	2,302	3,453	4,900	18.1	50.0	41.9			
4. Net tax burden ^b (2-3)	10,860	13,360	21,042	28,740	23.0	57.5	36.6	-12.1	22.5	0.5

^a Discounted for the increase of private consumption prices.

^b The net tax burden is defined here as the difference between taxes plus compulsory loans and transfer payments plus subsidies.

pated delayed effects of public construction on the housing market, the smaller will be the effect of public construction policy on aggregate demand, in the short as well as the long run. Thus it can be assumed that the effect of changes in public construction on aggregate demand is smaller than that of other direct demands upon the public sector. (For a more extensive discussion of investments and construction, see Chapter IX.)

4. PUBLIC SECTOR REVENUES FROM TAXES, COMPULSORY LOANS AND TRANSFER PAYMENTS

The taxation, compulsory loans and transfer payments systems constitute a main policy tool in the hands of the public sector, and of the government in particular, for influencing the economic activities of other sectors of the economy. In 1977, the government continued to expand this system as it had in 1976, although at a much lower intensity: the total of taxes and compulsory loans increased by 4 percent in real terms¹⁴ as against 16 percent in the previous year, transfer payments increased by 5 percent compared with 12 percent. Only in subsidies did the high rate of growth of the previous year continue: 13 percent in 1977 following 12 percent in 1976 (see Table XI-7).

Through the taxation system, the government requisitions part of the resources of the economy¹⁵. Most are returned to the public through the system of subsidies and transfer payments, and the rest — being an indicator of the net tax burden — serves to finance public services and investments in infrastructure. Since the beginning of the decade, the weight of taxes and compulsory loans in GNP and in resources increased considerably. This increase was used for the financing of a parallel expansion of the subsidy and transfer payments system, while the net tax burden did not increase beyond the growth of GNP and of resources. In 1977 the weight of taxes and compulsory loans in GNP and in resources stabilized at the high level attained in 1976, reaching about 50 percent in the GNP and 43 percent in the resources at the disposal of the economy. This high level is one of the striking expressions of the measure of the government's and of the public sector's involvement in the economy. The net tax burden declined slightly in 1977, and its weight was 21 percent in the GNP and 18 percent in the resources. This decline was mainly caused by the rapid growth of subsidies, which also continued in 1977, compared to the slow-down of the rate of growth in taxes and in transfer payments.

¹⁴ Discounted by the increase in the private consumption price index; all rates of change mentioned below were calculated accordingly unless otherwise stated.

¹⁵ This is not the only way in which the government mobilizes resources: deficit financing of expenditure, for instance, and the mobilization of voluntary loans also constitute ways of financing expenditure.

TABLE XI-8

**WEIGHT OF TAXES AND COMPULSORY LOANS, WEIGHT OF NET TAX
BURDEN IN GNP AND DOMESTIC RESOURCES, 1972-1977**
(percent)

	1972	1973	1974	1975	1976	1977
Weight of taxes and compulsory loans						
In GNP	38.8	39.1	43.5	43.1	50.1	49.5
In domestic resources	34.4	32.5	34.8	35.1	41.7	42.7
Weight of net taxes and compulsory loans						
In GNP	21.9	18.0	20.5	17.7	21.7	20.7
In domestic resources	19.4	15.0	16.4	14.5	18.1	17.8

DEFINITIONS:

Taxes and compulsory loans – government taxes (excluding levy and VAT on defense imports) and local authority taxes, as defined in this chapter (see Tables XI-10, XI-11, XI-12).

Net burden of taxes and compulsory loans – taxes and compulsory loans, less net transfer payments, subsidies to domestic production, to import and export, less redemption of compulsory loans and issue of negotiable loan certificates.

Gross National Product – at effective exchange rate.

Domestic resources – Gross National Product, plus import surplus (imports CIF and exports FOB) at effective exchange rate, including imports from the administered areas. Direct defense imports and interest payments of the public sector are not included here.

NOTE:

In calculating the indicators in this table, we considered the compulsory loans as taxes. An alternative calculation, deducting the compulsory loans, gives a similar picture of progress over the years.

A. DIRECT TAXES, COMPULSORY LOANS AND TRANSFER PAYMENTS

Direct taxes and the transfer payments constitute an important tool in the hands of the government for influencing disposable private income¹⁶ directly. Direct taxes are

¹⁶ In addition, the public sector influences private income through the volume of its direct demands. This type of influence, through wage payments of the public sector, was granted special significance in 1977. A discussion of this can be found above. Indirect taxation also has an effect on real private income.

collected by the government and the National Insurance Institute, and transfer payments to households and nonprofit organizations are transferred through the government, the National Insurance Institute, the Local Authorities and the National Institutions.

Direct taxes and compulsory loans grew by 4 percent in 1977, after an exceptional growth of 15 percent in 1976, a year in which the reform in direct taxation, initiated in 1975/76, was fully expressed. The tax base – private income¹⁷ – increased in 1977 by about 6 percent, following a decline of 3 percent in 1976; this means that the average tax rate on private income declined in 1977, after increasing considerably in 1976.

Net transfer payments to the public increased at a pace similar to the rate of growth of direct taxation: about 5 percent in 1977, after an annual growth of 12 percent in the previous two years. This slowdown expresses the completion of the expansion stage of the

FIGURE XI-2

DISTRIBUTION OF TRANSFER PAYMENTS AND DIRECT TAXES PER MONTH PER STANDARD ADULT, 1976/76

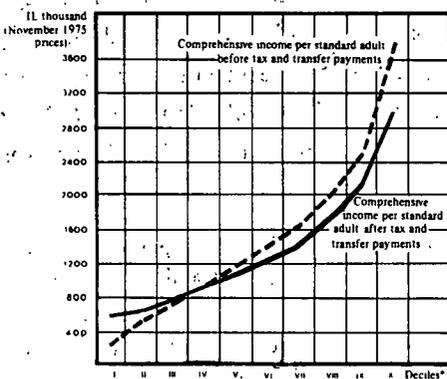
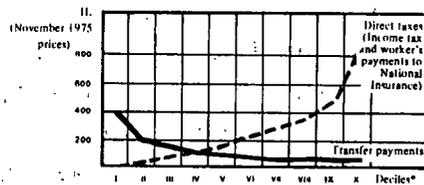


FIGURE XI-3

DISTRIBUTION OF MONTHLY INCOME PER STANDARD ADULT, 1975/76



system of income maintenance started in 1975, and some of its segments, such as children's allowances, constituted part of the reform in direct taxation.

The direct taxation and transfer payments system has a considerable influence on the distribution of income in the economy. Such an influence can also be exerted on the composition of public services through their differential incidence on families with different

¹⁷ Defined for this purpose as net private income from economic activity, except for debiting of housing services.

income, but this is difficult to measure. A preliminary examination of the effect of direct taxation and transfer payments on the distribution of income was carried out on the basis of a survey of family expenditure in 1975-76. This examination revealed that direct taxation (defined here as income tax and employee national insurance contributions) and transfer payments reduce inequality in the distribution of income by about 20 percent¹⁸. This effect was measured *a posteriori*, and the original distribution of measured income should not be considered identical to the distribution that would have existed were it not for the development of progressive systems of direct taxation and transfer payments.

The influence of transfer payments was found to be stronger than that of direct taxation. A comparison of the findings of this examination to those of similar examinations, based on data from a survey of family expenditure in 1968/69, reveals that the effect of transfer payments on inequality in the distribution of income has increased considerably. It is impossible to conclude on a change in the effect of direct taxation, since it was calculated on the basis of tax rates and not measured as an actual payment¹⁹. In Figure XI-2 the distribution of income is given before and after the payment of taxes and receipt of transfer payments.

Income tax on wages and employer and employee national insurance contributions increased in 1977 by 14 percent, a rate that slightly exceeds the growth rate of real wages (see Table XI-10). Taxes collected on income from sources other than wages declined by 6 percent, while the tax base – income other than wages²⁰ – declined this year by 9 percent. This development is contrary to the development of tax collection in 1976, when collections increased at a considerable rate, particularly on income other than wages,

¹⁸ Inequality is measured here in terms of the Lawrence Index. The index inequality, equal to 0.39 before taxes and transfer payments, declines to 0.31 in disposable income. The effect of transfer payments alone reduces the index to 0.34. The effect of direct taxes alone reduces the index to 0.36. These figures are not comparable to the Lawrence indexes, which were calculated on a different data basis. Inequality is measured by dividing the population into deciles arranged according to total income, not including receipt of transfer payments, per standard adult. For an explanation of the term "standard adult" and the scale defining it, see, for instance, G. Haviv, Yossi Tawil: "The Standard of Living and Family Size", *Economic Quarterly* 82 (Hebrew).

¹⁹ It can be assumed that this fact deflects the power of the effect of direct taxes on income distribution upward.

²⁰ Income from sources other than wages was calculated for this purpose as the difference between the net private income from economic activity, excluding housing services, and the total payment of wages in the economy.

despite the decline in the tax base, which has been continuing for a number of years.

The decline in the collection of income tax from companies is particularly striking. Together with a drop in capital return, special factors were at work this year, intensifying this decline:

a) Since the introduction of the reform in direct taxation in 1975/76, profitability of withdrawing profits in the form of managerial salaries has increased, due to the difference in the tax rate on income of individuals and distributed profits.

As a result, the collection of taxes from company managers and cooperative members increased (nominally) by a factor of 2.8 in 1976, and doubled once again in 1977. After deducting the effect of this factor, there was a nominal increase of 21 percent as against an actual increase of 8 percent in collections from companies.

b) From the year 1975/76, industrial companies (under the Law for the Encouragement of Capital Investments) were permitted to depreciate within two years such equipment which had not yet been depreciated, as well as any new equipment for which the law applies. The depreciation rate on buildings was also doubled. It is difficult to gauge the effect of this factor on tax collections; however, its main effect on tax collections was felt in the years 1976/77 and 1977/78.

c) From the 1976/77 fiscal year advanced income tax payments, collected on profits during the current year, were increased at a more rapid pace, in order to reduce that part of the tax paid late, with the preparation of the final assessment. This led to a considerable increase in the level of collection in 1976. The increase of advance payments continued in 1977, but the collection of taxes for preceding years decreased nominally.

The collection of taxes from the self-employed increased in 1977 by 7 percent, as against a real increase of about 62 percent in 1976. The huge increase in 1976 stemmed from a number of factors: the effect of the considerable growth in payment arrangements in 1975 and the effect of the reform in direct taxation: compulsory loans were replaced by income tax, and collection was broadened as a result of the enforcement of bookkeeping and the linking of the payment of arrear debts for income tax²¹. The effect of these factors ran down in 1976, and as a result collection slowed down in 1977. This development is also related to the reform: one of the basic changes introduced by the reform was the acceptance of assessee's declarations based on account books as final assessments – with the exception of a sample of assessees whose declarations were thoroughly checked. The introduction of bookkeeping in 1976 led to a growth of 80 percent (nominally) in the average declaration for the fiscal 1975/76. At the same time, in the sample declarations the final assessment was on the average twice as high as the declared income

²¹ For a discussion of these factors, see the Bank of Israel Annual Report 1976, page 238.

TABLE XI-9
INCOME TAX AND NATIONAL INSURANCE, BY TYPE OF ASSESSEE, 1974-1977

	1974	1975	1976	1977	Increase or (-) decrease from previous year			Real increase or (-) decrease from previous year ^a		
					1975	1976	1977	1975	1976	1977
	(IL million)				(percent)			(percent)		
On wages	5,295	7,617	11,918	18,432	43.9	56.5	54.7	2.8	21.7	13.8
Income tax on wage earners ^b	2,659	3,820	6,242	9,554	43.7	63.4	53.1	2.6	27.1	12.6
National Insurance	2,636	3,797	5,676	8,878	44.0	49.5	56.4	2.9	16.3	15.1
On income not from wages	3,626	5,931	11,069	14,182	63.6	86.6	28.1	16.9	45.1	-5.7
Income tax ^b : companies	1,883	3,150	5,581	6,007	67.3	77.2	7.6	19.5	37.8	-20.8
self-employed	738	933	2,048	2,944	26.4	119.5	43.8	-9.7	70.7	5.8
company managers and cooperative members	170	292	810	1,700	71.8	177.4	109.9	22.7	115.7	54.4
deduction at source	665	1,276	2,159	2,800	91.9	69.2	29.7	37.1	31.6	-4.6
National Insurance	170	280	471	731	64.7	68.2	55.2	17.6	30.8	14.2

^a Discounted by the rise in the private consumption price index.

^b Net of the growth in the loan balance to tax debtors.

SOURCE: Income tax – Bank of Israel computations based on Income and Property Tax Commission, the Accountant General, and reports of the banks on loan grants to tax debtors. National Insurance – National Insurance Institute.

assessments²². The slowdown in collections in 1977, in which the average declaration increased by only about 33 percent, apparently stems from the size of the examined sample, which is too small for use as a factor in enforcing truthful declarations. It can be assumed that it will be difficult to broaden collection from the self-employed, or even to prevent an erosion of collections, without a revision in this field.

Transfer payments of the public sector to households are mostly (about two-thirds) effected through the National Insurance Institute. Payments of the Institute increased by only 2 percent in 1977 following an annual increase of more than 20 percent in the two preceding years. This rapid growth reflected the expansion of the income maintenance system, as well as the transfer of fields of activity from other bodies to the National Insurance. This development also reflects the reinforcement of the universal character of the Israeli transfer payments system. Besides the growth of children's allowances, old age pensions, invalid allowances, etc., there has been a decline in welfare payments effected by the government and the Local Authorities and even in the field of activity of the National Insurance Institute, there has been a decline in the percentage of those receiving social benefits, which are the selective component of pensions. This stage in the expansion of the system, initiated in 1975, has been completed, and its completion is expressed by a curtailment in the increase of National Insurance Institute payments this year.

Transfer payments to nonprofit institutions have declined in the last two years. The 12 percent decrease in grants earmarked for investment financing in this sector stood out in 1977. The current transfers to nonprofit institutions are given mainly to educational institutions (in particular in higher education), as well as health and religious institutions.

The rapid growth of capital transfers to business has been continuing for the third year in a row. Grants are given by the government in the framework of the Law for the Encouragement of Capital Investments, the advancement of industries in development areas and the Industrial Research and Development Fund. A considerable increase took place in government transfers to research and development and the search for oil.

Interest payments of the public sector (mainly the government) increased by about 9 percent in 1977, after rising by 18 percent in the previous year. Data this year do not include linkage and exchange rate insurance for directed credit, mainly to industry. These have been transferred to the item of subsidies to domestic production. The growth of interest payments stems mostly from the financing policy of the sector in the past, and cannot be changed significantly in the short range.

²² Data of the State Revenue Administration. It should be pointed out that the sampling was not incidental, and centered in those sectors where it could be assumed that this gap is wide.

B. INDIRECT TAXES AND SUBSIDIES TO DOMESTIC PRODUCTION

The net indirect taxes²³ on the domestic production rose in 1977 by 5 percent. Most of the increase stems from the growth of the tax base, so that the average tax rate on the GNP, or on private consumption, remained approximately constant; this stability followed the considerable growth of average tax rates in the past two years. Thus, the effect of taxes and subsidies on the rise of prices was very small in 1977.

At the same time, considerable changes occurred in the composition of taxes and subsidies: indirect taxes increased by 8 percent, mainly due to the imposition of Value Added Tax in the middle of 1976, the raising of its rate in October 1977, a rapid growth in the collection of employers' matching contributions, related to the increase in wage payments, and an increase in the operating surplus of communications operations and the Port Authority – resulting from the increase of telephone and postal tariffs, etc. The remaining indirect taxes – among them purchase tax, gasoline tax, excise and property tax – declined in real terms due to the abolition of taxes (defense procurement tax, part of the stamp tax) and a reduction in other tax rates (purchase tax).

Subsidies increased by 15 percent after two years of steeper rises. The composition of subsidies has also changed: subsidies to basic commodities increased by only 3 percent (an increase that seems entirely from the subsidy to public transportation; subsidies to other basic commodities decreased by 3 percent), while other components of the subsidies—among them payments for linkage and exchange rate insurance on directed loans—increased at a rapid pace. As a result, the share of subsidies to basic commodities has declined to 50 percent of the total subsidies in this item has declined to 50 percent of the total subsidies in this item. The low increase of subsidies to basic commodities was attained by lowering the percentage of subsidies in consumer prices of basic commodities, although at a lower rate than the one planned in the budget.

A preliminary examination of the effect of subsidies to basic commodities on the distribution of income in the economy was carried out, based on data of a 1975/76 survey of family expenditure²⁴. The examination points to a considerable difference between the effect of transfer payments and that of subsidies on the distribution of income: it was found that the per capita subsidy in the lowest decile of the population²⁵ is the

²³ Indirect taxes on domestic production less subsidies to domestic production.

²⁴ Consumption baskets by levels of income were taken from the survey's data. The rates of subsidies in force in July 1977 and in February 1978 were adjusted to these data. Similar results were obtained in both cases.

²⁵ The population being arranged according to total income per standard adult.

lowest – while transfer payments per person in this decile are considerably higher than in the other deciles. The average per capita subsidy in the low-income half of the population constitutes about 90 percent of the average per capita subsidy in the other half²⁶; at the same time, subsidies reduce the inequality in the distribution of disposable income (after receipt of transfer payments) by approximately 3 percent²⁷.

The effect of indirect taxes on the distribution of income has not yet been examined in the light of the data of the 1975/76 survey, but with the gradual replacement of taxes imposed at varying rates on various products (assuming for instance, that the rates of purchase tax on the consumption basket of high income families are higher) by the Value Added Tax, imposed at a uniform rate on private consumption – the regressivity of the indirect taxation system increases. The advantage of VAT is that it does not lead to a distortion of prices, resulting in distortions in allocation, in production and in consumption. Subsidies given to a limited number of products, at varying rates bring about distortions of prices and allocations in production and in consumption. At the same time, their effect on price increases is apparently greater than that of indirect taxes, and the reduction of subsidy rates therefore accelerates the increase of prices.

Apart from subsidies included in the item of subsidies to domestic production, extensive subsidy, along with indirect taxation at a considerable rate through the “equalization fund,” is given to fuel, and through the “equilibration fund,” to water. The fuel fund constitutes a tax mainly on gasoline and to a smaller extent on heating oil and kerosene and a subsidy to crude oil used in electricity production and industry.

The water fund imposes a tax on private consumption and a subsidy to water for agriculture and industry, and fixes a uniform price for water in the whole country, despite the fact that the cost of water is different in different areas. Taxes and subsidies in the framework of these funds influence the relative prices, and through them, allocations, and most of them are not included in the subsidy item, except a deficit in those funds in the years when there was one.

²⁶ The average subsidy per standard adult is similar in the low income half of the population to the average subsidy in the other half.

²⁷ A preliminary close estimate, made on the assumption that the entire subsidy reaches the consumer. In products for which demand is not entirely rigid, part of the subsidy reaches the producer.

TABLE XI-10

DIRECT TAXES, COMPULSORY LOANS AND TRANSFER PAYMENTS, 1974-1977

	1974	1975	1976	1977	Increase or (-) decrease from previous year ^a			Real increase or (-) decrease from previous year		
					1975	1976	1977	1975	1976	1977
	(IL million)				(percent)			(percent)		
1. Total direct taxes	9,106	14,228	23,272	33,054	56.2	63.6	42.0	11.6	27.2	4.5
Income tax	6,115	9,471	16,840	23,005	54.9	77.8	36.6	10.6	38.3	0.5
National Insurance ^b	2,806	4,077	6,147	9,609	45.3	50.8	56.3	3.8	17.3	15.0
Inventory surtax	185	680	285	440	267.6	-58.1	54.4			
2. Compulsory loans	2,660	2,615	1,572	1,935	-1.7	-39.9	23.1	-29.8	-53.3	-9.4
Employers' savings loan	615	888	1,144	1,807	44.4	28.8	58.0	3.1	0.2	16.3
Other compulsory loans ^c	2,045	1,727	428	128	-15.6	-75.2	-70.1	-39.7	-80.7	..
3. Total direct taxes and compulsory loans (1+2)	11,766	16,843	24,844	34,989	43.1	47.5	40.8	2.2	14.7	3.7
4. Transfer payments to households	4,442	6,714	9,714	13,358	51.1	45.1	37.2	7.9	12.8	1.0
Through the National Insurance Institute	2,393	4,101	6,337	8,800	71.4	54.5	38.9	22.4	30.1	2.2
Provident funds and pensions	904	1,149	1,608	2,297	27.1	39.9	42.8	-9.2	8.8	5.1
Other transfers	1,145	1,646	1,794	2,261	27.9	22.5	26.0	-8.6	-4.7	-7.3

5.	Net transfer payments to nonprofit institutions	2,270	3,599	4,506	5,991	58.5	25.2	33.0	13.2	-2.6	-2.2
	Net current transfers ^d	1,987	3,259	4,045	5,437	64.0	24.1	34.4	17.1	-3.5	-1.2
	Of which: Employers' matching payments	(449)	(677)	(1,030)	(1,627)	50.8	52.1	58.0	7.7	18.3	16.3
	Transfers in the current account	283	340	461	554	20.1	35.6	20.2	-14.2	5.4	-11.6
6.	Transfer of capital to businesses	414	176	1,111	1,747	72.9	55.2	57.2	23.5	20.7	15.7
7.	Interest payments in IL	2,286	3,410	5,183	7,696	49.2	52.0	48.5	6.6	18.2	9.3
8.	Redemption of nonnegotiable compulsory loans	185	732	1,352	2,037	295.7	84.7	50.7	182.6	43.6	10.9
9.	Total transfer payments to the public (4 to 8)	9,597	15,171	21,891	30,829	58.1	44.3	40.8	12.9	12.2	3.6
10.	Transfer payments to the public	916	1,444	2,109	2,694	57.6	46.1	27.7	12.6	13.6	-6.0
	In the current account	372	514	1,082	1,474	38.2	110.5	36.2	-1.3	63.7	0.2
	In the capital account	544	930	1,027	1,220	71.0	10.4	18.8	22.1	-14.2	-12.6
11.	Total net transfer payments (9-10)	8,681	13,727	19,782	28,135	58.1	44.1	42.2	12.9	12.1	4.6
12.	Direct taxes and compulsory loans, less net transfer payments (3-11)	3,085	3,116	5,062	6,854	1.0	62.5	35.4	-27.9	26.4	-0.4
13.	Direct taxes and compulsory loans, less transfer payments to households and businesses ^e	5,355	6,715	9,568	12,845	25.4	42.5	34.2	-10.4	10.8	-1.3

^a Discounted by the rise in the private consumption price index.

^b Including collection of Employers' matching contribution.

^c Defense loans and COL loans.

^d Current transfer payments to nonprofit institutions, less transfer payments from them.

^e Less net transfer payments to nonprofit institutions. In this system, in which nonprofit institutions are defined as part of public consumption, transfer payments from the public to the nonprofit institutions must be added to this figure, including payments for higher education and membership fees to Sick Funds.

SOURCE: Income and Property Tax Commission, Central Bureau of Statistics, and Bank of Israel estimates.

C. INDIRECT TAXES AND SUBSIDIES TO IMPORTS, EXPORT INCENTIVES

The indirect taxes on imports increased nominally by 37 percent in 1977²⁸. Most of the increase (about 17 percent) stems from the increase in collections of the Value Added Tax imposed in 1976. The growth rate of taxes necessitated by the increase of taxable imports and the devaluation of the Israeli pound is about 45 percent. The gap between the calculated growth and the actual growth in collections is mostly explained by the abolition of the import levy and foreign travel tax, and by the reduction of customs duties, in the framework of the policy measures adopted in October 1977. The rest of the difference stems from a change in the composition of imports: the import of consumption assets – in which the small increase in the value of imported vehicles and the sharp drop (about 16 percent) in that of other durables is striking – rose by only about 7 percent. Particularly high rates of customs duties and purchase tax are imposed on those products.

The subsidies to imports rose this year by 159 percent, following a decline of about 71 percent in 1976. The decrease of subsidies in 1976 reflected a transfer from subsidies for imported raw materials to subsidies for final products, and subsequently subsidies were defined as subsidies to domestic production, instead of subsidies to imports (the difference is inherent in the definition more than it reflects effects on product prices)²⁹. Subsidies included in this item are mostly given as payments for exchange rate insurance related to import transactions. Furthermore, in some of the basic commodities the tax imposed on the imported products is transferred as subsidy to the substitute product manufactured in Israel. Thus, a tax is imposed on frozen meat and transferred as subsidy to frozen chicken, and the tax on imported sugar covers the budget of subsidies to locally manufactured sugar.

Tax refunds to exporters increased by 35 percent in 1977. This increase stems from a 22 percent rise in the value of exports entitled to these refunds, and from the 9 percent growth of the average incentive per export dollar. The given increase of the incentive per export dollar refers to a whole year: in the first ten months, the increase of the incentive was higher until its abolition in the framework of the policy measures of October 1977.

The weight of indirect taxes as a means to implement the exchange rate policy continued to decline in 1977; this process had started with the introduction of creeping

²⁸The discussion in this paragraph is in nominal growth rates, unless otherwise stated.

²⁹In this way they moved from subsidies on grain, soy beans, and fodder (defined as subsidies to imports) to subsidies on bread, edible oil and milk (defined as subsidies to domestic production).

TABLE XI-11
INDIRECT TAXES AND SUBSIDIES TO DOMESTIC PRODUCTION, 1974-1977

	1974	1975	1976	1977	Increase or (-) decrease from previous year			Real increase or (-) decrease from previous year ^a		
					1975	1976	1977	1975	1976	1977
	(IL million)				(percent)			(percent)		
Total indirect taxes on domestic production	5,243	8,721	13,404	19,697	66.3	53.7	46.9	18.8	19.5	8.1
VAT ^b	55	123	1,417	5,036						
Purchase tax	1,352	1,998	3,119	3,173						
Gasoline tax ^c	676	1,581	1,565	1,702						
Employers' tax	-	560	1,173	2,017						
Excise tax	473	685	876	952						
Other indirect taxes ^d	1,343	1,875	2,546	3,435						
Property tax	749	1,149	1,525	1,587						
Taxes of local authorities	595	750	1,183	1,795						
Subsidies to domestic production ^e	1,133	2,137	4,035	6,320	88.6	88.8	56.6	34.7	46.8	15.1
Net taxes on domestic production	4,110	6,584	9,369	13,377	60.2	42.3	42.8	14.4	10.7	5.1
Tax rate on GNP (percent)	11.0	13.1	16.1	16.5						
Tax rate, net of subsidies, on GNP (percent)	8.4	9.6	10.7	10.7						

^a Discounted by the rise in the private consumption price index.

^b Including service tax on financial institutions, which was collected until the imposition of VAT, which contains it.

^c Excluding the petroleum levy imposed in November 1974 and cancelled in October 1977. The import levy is included in indirect import taxes.

^d Stamp tax, defense stamp, vehicle licenses, Ministry of Justice fees and various services. Broadcasting Authority fees, current surplus of communications and port authorities, and miscellaneous.

^e The definition of this item was changed this year; it now includes part of the linkage insurance which was previously included in interest payments. The amounts added to this item as a result are as follows: 1974 - IL 25 million; 1975 - IL 100 million; 1976 - IL 735 million; 1977 - IL 1,789 million. For previous years the figures have been left.

SOURCE: Central Bureau of Statistics data.

TABLE XI-12

INDIRECT TAXES AND IMPORT SUBSIDIES, EXPORT INCENTIVES, 1974-1977

	1974	1975	1976	1975	Increase or (-) decrease from previous year		
					1975	1976	1977
	(IL million)				(percent)		
1. Indirect taxes on civilian imports	6,041	6,912	10,342	14,129	14.4	49.6	36.6
VAT	—	—	1,001	2,985			
Customs and levy on imports	4,468	4,209	4,946	6,026			
Purchase tax	1,385	1,901	2,854	3,582			
Other indirect taxes ^a	188	802	1,541	1,536			
2. Import subsidies	426	950	278	720	123.0	-70.8	159.0
3. Net taxes on civilian imports	5,615	5,962	10,064	13,409	6.2	68.8	33.2
4. Taxes on defense imports	1,447	1,753	2,553	2,432			
Import levy	1,447	1,753	1,902	1,260			
VAT	—	—	651	1,172			
5. Export incentives	1,950	2,302	3,453	4,900	18.1	50.0	41.9

^a Foreign travel tax, levy on service imports and levy on petroleum imports (see also footnote c in Table XI-11).

SOURCE: Central Bureau of Statistics.