

CHAPTER VII
GOVERNMENT AND NONGOVERNMENT
PUBLIC SECTOR

1. CONSOLIDATED ACCOUNT

NEARLY 80 PERCENT of the total financial transactions of the public sector—which comprises the Government, local authorities, and National Institutions¹—is accounted for by the Government, whose dominant influence is even greater than indicated by its budgetary operations.

In contrast to previous years, a financial report for the period April to December 1973 had not yet been prepared by the Accountant General when the Hebrew edition of the *Annual Report* went to press. Consequently, full data are not available on the Government's budget performance and its financial transactions, and therefore its operations—the volume of investment, transfer payments, saving, demand surplus, net credit, etc.—cannot be quantified with any reasonable degree of reliability. The partial data on Government operations presented in this and other chapters of the Report are based on information made available by other sources (such as the Central Bureau of Statistics, the State Revenue Administration and the Budgets Department of the Ministry of Finance, and the State Loans Administration of the Bank of Israel). But since the data from these sources are fairly specific, the accounts of the Government and the rest of the public sector cannot be presented in as comprehensive and detailed a manner as in previous years. However, we have no intention of departing from the usual degree of exactitude we have attempted to maintain in the past, and rather than use estimates based on partial information only, we have preferred to discuss only such activities for which reasonably accurate data are available: Government receipts from taxes and compulsory loans (section 3), National Institution operations (section 4), and local authority operations (section 5).²

Nevertheless, it is possible to broadly assess the sector's influence on aggregate demand and the level of economic activity for all of 1973 as compared with

¹ The local authorities include religious councils and the municipal expenditure of cooperative agricultural settlements; the National Institutions comprise the Jewish Agency, World Zionist Organization, Jewish National Fund, and Keren Hayesod.

² When the financial report for the period April-December 1973 appears, the data will be analyzed and the results published in a forthcoming issue of the Bank of Israel's *Economic Review*.

the previous year, since in the last quarter (during and after the October war) public consumption, the overall and domestic demand surpluses, and the amount of liquidity infused into the economy increased considerably, so that the strongly expansionary influence of the sector's operations is clearly evident even if the above indicators are not quantified. The position is different, however, with regard to the first three quarters of 1973. For this period the influence of the sector's operations on aggregate demand and the level of economic activity may be estimated, in only a general manner and with numerous reservations, with the help of only one reliable indicator, namely the volume of liquidity pumped into the economy by the public sector, or its contribution to the growth of the money base. Its limitations as an indicator of the overall impact of the public sector were discussed more than once in the past, and they certainly apply to the first nine months of 1973, when the latent inflationary influence of various financial assets which are not included in the money supply found expression. As long as the money base and the money supply are defined as they are,³ caution must be exercised in drawing conclusions about the expansionary or contractionary effect of the sector's operations from a comparison of changes in the magnitude of the liquidity infusion in the first three quarters of 1972 and 1973.

From the aspect of their influence, public sector operations in 1973 may be divided into three subperiods. In the first quarter the Government continued the restrictive fiscal measures introduced in the previous year. In the second quarter, which is also the start of the 1973/74 fiscal year, the sector's operations had an expansionary impact; this sharpened noticeably in the final quarter, after the October war.

The sector's demand surplus for the entire year is estimated at IL 9,500 million at current prices, compared with IL 4,100 million in 1972. While no data are available on the demand surplus in the first nine months of 1973, an examination of the budgets of the various public sector authorities suggests that the demand surplus increased moderately during this period as compared with the corresponding period of the previous year, with most of the growth occurring in the last quarter of the year. The same is true of the sector's domestic demand surplus, which shot up in the last quarter to reach an estimated IL 3,500 million by year's end, in contrast to IL 1,100 million at the end of 1972. Conditions in the financial assets market and the specific measures adopted by the Government in the last quarter of the year jacked up the net absorption of credit from the public in 1973 to IL 2,500 million—more than double the previous year's figure of IL 1,000 million. But this enormous absorption, about half of which occurred in the last quarter, only partly offset the significant growth of the domestic demand surplus; accordingly, in 1973 the

³ This is discussed in Chapter XIII, "Money Supply, Credit, and the Banking Institutions", section 1.

Table VII-1
INDICATORS OF PUBLIC SECTOR OPERATIONS, 1970-73
 (IL million, at current prices)

	1970	1971	1972		1973		Percent increase or decrease (-)			
			Jan.- Sept.	Entire year	Jan.- Sept.	Entire year	1971	1972	1973	
									Jan.- Sept. ^a	Entire year
1. Public sector consumption	6,728	7,940	6,795	9,242	8,018	16,627	18.0	16.4	18.0	79.9
Civilian	1,973	2,483	2,228	3,046	3,059	4,139	25.8	22.1	37.3	35.9
Noncivilian	4,755	5,457	4,567	6,196	4,959	12,488	14.8	13.5	8.6	101.5
2. Revenue from taxes	6,222	8,595	7,787	10,792	10,297	14,563	38.1	25.6	32.2	34.9
Direct taxes	3,057	4,010	3,471	4,790	4,670	6,306	31.2	19.5	34.5	31.6
Indirect taxes										
On imports	1,188	2,160	2,151	3,036	2,921	4,645	81.8	40.6	35.8	53.0
On domestic production ^b	1,977	2,425	2,165	2,966	2,706	3,612	22.7	22.3	25.0	21.8
3. Compulsory loan receipts	538	1,041	889	1,185	1,005	1,426	93.5	13.8	13.0	20.3
4. Demand surplus	3,539	3,672		4,102		9,500 ^c	3.8	11.7		119.5
5. Liquidity injected into the economy	975	1,112		-400		936				
6. Outstanding Government loans on March 31 ^d										
Domestic	13,989	17,970		24,947		30,144	28.5	38.8		20.8
Linked ^e	5,384	7,227		10,289		13,208	34.2	42.4		28.4
Nonlinked	1,915	1,913		1,906		2,084				9.3
Foreign	6,690	8,830		12,752		14,852	32.0	44.4		16.5
Percentages										
Weight of public sector consumption in total domestic uses	28.6	27.5	26.2	26.0	23.1	32.2				
Weight of public sector consumption in GNP	36.0	34.2	32.0	31.7	29.2	44.2				
Weight of noncivilian public sector consumption in GNP	25.5	23.5	21.5	21.2	18.1	33.2				
Weight of public sector tax revenue in GNP	33.3	37.0	36.7	37.0	37.6	38.7				
Weight of public sector revenue from taxes and compulsory loans in GNP	36.2	41.5	40.9	41.0	41.2	42.5				

^a Compared with January-September, 1972.

^b Including licenses, fees, and property tax.

^c Estimate.

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

^e Excluding revolving increments.

sector injected some IL 1,000 million of liquidity into the economy, mostly in the second and fourth quarters, while in the first quarter liquidity was still being mopped up.

The liquidity infusion was financed not by the banking system but through the conversion of part of the enormously larger volume of foreign credits and grants received in 1973. Moreover, the sector's debt to the banking system declined for the second consecutive year.

Net capital imports soared to an unprecedented IL 8,600 million (\$ 2,050 million), as compared with IL 2,700 million (\$ 650 million) in 1972. In the fourth quarter alone they reached \$ 1,550 million, as opposed to \$ 230 million in the corresponding period of 1972.

The sector's foreign currency expenditure increased substantially, both on defense imports—which shot up in the last quarter of 1973—and on other Government imports, which had already begun to swell at the beginning of the year following a rise in import prices. The sector's total transactions in foreign currency resulted in surplus receipts of about IL 2,000 million, of which IL 1,500 million was converted and pumped into the economy and the balance used to temporarily reduce the sector's obligations to the banking system.

As mentioned above, liquidity was siphoned off in the first quarter of 1973; this can be credited solely to the Government's operations, since the other authorities generally inject liquidity: the National Institutions obtain almost all their funds from overseas sources, while the local authorities are running ever-increasing current deficits, which are largely financed through bank credits.

The Government actually mopped up liquidity during all of 1972/73, with the inflow growing toward the end of the fiscal year to reach IL 500 million in the first quarter of 1973. In April 1973, the beginning of the new fiscal year, the Government again began to infuse liquidity.⁴ The amount injected by the entire sector totalled approximately IL 450 million in the second quarter of 1973 and IL 200 million in the third. During the first half of fiscal 1973/74, the sector therefore pumped in a total of some IL 650 million, thereby contributing to the rapid expansion of the money base, concurrently with the nongovernmental contribution through foreign currency conversions. In the last quarter, after the outbreak of hostilities, the sector stepped up its liquidity infusion. During this period various fiscal measures were introduced with the object of mopping up more money from the public, but these found only partial expression during this quarter, which ended with a IL 800 million liquidity infusion. In part this was a deliberate infusion, intended to restore normal economic activity, but *ex post facto* it blunted the absorptive influence of the nongovernmental sectors' large-scale purchase of foreign currency.

During the first nine months of 1973 nominal public consumption ran 18 per-

⁴ The size of the Government's liquidity infusion in 1973 is discussed in section 2 below.

cent higher than in the corresponding period of the previous year. But in constant prices, there was a miniscule increase of less than half a percent, after a 2 percent contraction in 1972. Noncivilian public consumption was down 4.5 percent at constant prices, with both domestic spending and defense imports falling off. Real civilian consumption was up 9.5 percent during this period. These changes in public consumption and its composition further depressed the share of defense spending in GNP, from 23.5 percent in 1971 and 21.2 percent in 1972 to 18.1 percent in the first nine months of 1973.

In the last quarter of 1973 public consumption exceeded the figure for the rest of the year; by the end of December it reached IL 16,627 million, up 80 percent at current and 48 percent at 1972 prices. Of this increment, 85 percent represented defense outlays (defense imports rose 55 percent). This brought up the weight of noncivilian public consumption in GNP for 1973 as a whole to 33.3 percent, compared with the previous record high of 25.5 percent in 1970.

These developments affected the share of public consumption in GNP and total domestic uses. Its weight in GNP edged down from 31.7 percent in 1972 to 29.2 percent in the first three quarters of 1973, but climbed to 44.3 percent by year's end. Its weight in total domestic uses declined from 26 percent in 1972 to 23.1 percent in the first three quarters of 1973, but rose to 32.3 percent for the year as a whole.

Public sector grants and subsidies went up 58.5 percent in 1973 and totalled IL 2,322 million; the increase between January and September was 55.5 percent. Export subsidies rose 39 percent during this period, with most of the increment stemming from the higher incentives paid to exporters. Rebates of indirect taxes on exports were raised three times in 1973: in January by 5-17 agorot per export dollar, according to the value-added group; in August by 3-7 agorot; and in November by 21 agorot.⁵

Subsidies on domestic production soared 73 percent in the first nine months of 1973, and those on imports by 88 percent. The enormous increase in these two categories was due primarily to the jump in world commodity prices. The price rises in the case of staple food imports in 1973 ranged from 30 to 100 percent, and they constituted a heavy burden on the Government budget as long as they were not reflected in the retail price.

Some of the commodity subsidies were pared during the year reviewed. In March the cuts raised the retail prices of several food products and fuel by a total of IL 260 million at annual rates; in October fuel prices were raised by IL 750 million so calculated, and in December by another IL 1,200 million. In October another round of subsidy cuts sent the prices of certain foodstuffs up by IL 180 million at annual rates. While these price hikes kept subsidy payments

⁵ For a discussion of export incentives and changes in the effective rate of exchange for exports see Chapter III, "The Balance of Payments", Table III-16.

from exceeding the actual increases, the subsidy rates in force at the end of 1973 still necessitated the spending of IL 2,000 million at annual rates. But this was slashed by IL 1,200 million at the end of January 1974, when the prices of all subsidized commodities and services were raised.

Public sector investment went up 46 percent at current and 17 percent at constant prices during the first nine months of the year surveyed. Capital spending on social and municipal services, which grew 13 percent at constant prices as against 23 percent in 1972, accounted for 60 percent of the sector total. The other capital expenditures were on economic services, through the trading enterprises of the Government and local authorities; these increased 24 percent at constant prices during this period, compared with 40 percent in 1972. In the last quarter of 1973 the sector's investments were virtually nil, so that the annual increment came to only an estimated 4.5 percent.⁶

Tax revenue was up 34.9 percent, following a gain of 25.6 percent in the previous year. Including compulsory loans, the increase came to 30.3 percent in the first nine months of 1973 and 33.5 percent for the entire year, compared with 24.3 percent in 1972. This acceleration must be viewed against the developments over the past three or four years. In 1970 and 1971 the Government adopted a policy of incomes restraint, reflected in higher tax rates and the imposition of compulsory loans on the public. In these years tax revenue advanced appreciably, bringing up its weight in GNP. In 1972 the Government discontinued this policy and even instituted an income tax reform. This led to a more sluggish growth of direct tax revenue, which for the first time in many years even lagged behind national income. The deceleration in 1972 is partly explained by the time-lag in income tax collections, since an increase in national income is not immediately reflected in current tax collections. Indirect tax rates were also trimmed somewhat in 1972 and this, together with the reduced propensity to consume that year, resulted in a smaller percentage increase in indirect tax collections. In 1972, therefore, several factors combined to retard tax collections, as reflected by the stabilization of the weight of tax revenue and compulsory loan receipts in GNP following an upswing in the two preceding years.

In 1973 as well the Government did not pursue a policy of incomes restraint and actually lowered direct tax rates. The acceleration of tax collections in the first three quarters of 1973 and the year as a whole stemmed from a change in direct tax revenue: after having slackened during 1972, it rose strongly in 1973 and outpaced the growth rate of national income. By contrast, the increase in direct taxes on domestic production during the first nine months of 1973 and for the entire year trailed behind the growth of GNP. Tax collections on imports decelerated if the levy on defense imports is included in the calculation, and accelerated if it is excluded. However, the growth of revenue

⁶ See Chapter V, "Domestic Investment and Construction", section 2 and Table V-3.

from this source, calculated either with or without the defense import levy, went up less than the total value of commodity imports (excluding ships, aircraft, and rough diamonds). The net outcome of all these changes was the steadying of the weight of receipts from taxes and compulsory loans in GNP at 41.2 percent in the first three quarters of 1973 (41 percent in 1972).

In November 1973 indirect tax rates were boosted and a compulsory War Loan imposed. But these were only slightly reflected in fourth-quarter receipts from taxes and compulsory loan receipts, except for revenue from the defense import levy, which was appreciably higher.

Total revenue from taxes and compulsory loans was equal to 42.5 percent of GNP in 1973. This is the highest rate ever recorded, but it must be remembered that it was achieved mainly because of the defense import levy. Excluding the levy, the figure was 39.4 percent, roughly the same as in the previous year.

The latter is a good indicator of the tax burden, since the defense import levy does not represent an absorption of funds from the public but constitutes an internal Government transaction. This indicator could be improved by eliminating additional taxes which the Government "pays itself" through its own purchases and which are not collected from the public, but exact data on such taxes are not available. However, they amount to a fairly small sum, and it may be assumed that they underwent no significant change in 1973, so that this does not affect the comparison of the tax burden between the two years. It should also be mentioned that some of the indirect import taxes were actually introduced in lieu of an official devaluation and not for fiscal considerations; to improve this indicator there is therefore cogent reason to omit this item too. But this was not done because of methodological difficulties involved in pinpointing this portion of the revenue. Presumably this would not affect a comparison between the two years, since the changes in the import tax rates were due to fiscal reasons.

The fact that the weight of tax revenue and compulsory loan receipts, excluding the levy on defense imports, held virtually steady between 1972 and 1973 indicates that the tax burden did not change in the year reviewed,⁷ after having increased steadily between 1967 and 1971 to reach 40.9 percent.

The above developments in direct tax collections in 1972/73 affected the growth of disposable income from domestic sources. If transfer payments to the private sector are included in the calculation, revenue from direct taxes and compulsory loans, less the transfers, increased by 26.8 percent in the first nine months of 1973, as against 5.8 percent in the previous year. As a result, disposable private income in 1972 and the first nine months of 1973 went up faster than gross private income from economic activity. By contrast, in 1970 and 1971 disposable private income had trailed behind the growth of private

⁷ The same conclusion emerges from a comparison of the weight of taxes and compulsory loans, exclusive of all import taxes, in GNP.

income, reflecting the policy of incomes restraint followed by the Government at the time.

2. THE GOVERNMENT BUDGET FOR 1973/74

The Government's budget proposal for 1973/74 was presented to the Knesset at the beginning of January 1973, and it provided for the continuation of the contractionary policy adopted in 1970/71. The fiscal measures embodied in the new budget were as follows:⁸

(a) Stress was placed on restraining expenditures, whereas in 1970 and 1971 the emphasis was on incomes restraint, with tax rates being upped and compulsory loans imposed.

(b) Government consumption was projected to rise by 3 percent at constant prices—similar to the growth of population. The lion's share of the increase was to be in Government civilian consumption, while real defense spending was to remain about the same as in the previous year.

(c) The development budget was enlarged to a lesser extent than in 1972/73 (the second successive deceleration), and at constant prices was even curtailed.

(d) No indirect taxes were projected, and the reform of direct taxation proceeded apace: the minimum income liable to income tax was raised and tax rates were reduced.

(e) The overall Government demand surplus, as computed from the budget estimates, was projected at about IL 3,100 million;⁹ this is an increase of less than 5 percent over the previous year at current prices and a decline at constant prices. The domestic surplus demand, at an estimated IL 250 million, was down in current-price terms.

(f) The budget proposal called for a liquidity absorption of about IL 700 million. The reference is solely to the Government and not to the National Institutions, which were to pump in an additional IL 1,250 million through their ordinary and extraordinary budgets.

(g) The projected absorption was to cover the anticipated deficit in foreign currency expenditure, so that the Government would not require any additional financing from the Bank of Israel, after having turned to it for advances for six consecutive years.

The attempt to follow a more stringent spending policy is reflected in the various indicators mentioned above. But the effort was not wholehearted, as evidenced by the following:

⁸ See the *Budget Proposal for Fiscal 1972/73*, p. 25 (Hebrew); and Bank of Israel Research Department and Economic Advisory Bureau of the Ministry of Finance, *National Budget for 1973*, published in Bank of Israel, *Economic Review*, No. 41, p. 103.

⁹ This and the other data cited in this chapter do not include the activities of the National Institutions and the emergency fund-raising campaigns, except insofar as they are reflected in the budget estimates presented to the Knesset for approval.

(a) Extrabudgetary Government development loans extended through financial intermediaries were stepped up. Included under this head are projects which have always been Government investments (e.g. in telecommunications).

(b) In several expenditure items, notably subsidies for holding the lid on prices and stimulating exports, the estimates were on the low side, as was the assessment of wage and price hikes. In these items the actual disbursements were not fully covered by the reserves allocated, especially since the latter were overstretched, a large percentage being earmarked for specific purposes besides those mentioned above; consequently the amount available for financing regular Government activity pales into insignificance compared with previous years.

The budget tabled in the Knesset in January 1973 totalled IL 19,800 million. In March the Minister of Finance presented a IL 217 million supplementary budget, designed primarily to adjust the aforementioned subsidy estimates. The supplementary budget was to be partly financed by deferring some of the original budget outlays to the following fiscal year.

Along with the supplementary budget, plans were drawn up to absorb more money from the public. A step already taken in this direction was the provision of hidden reserves in the original budget by projecting receipts from taxes, new bond issues, and loans to the public at less than their actual expected level. Another measure was the freezing of new bond issue proceeds earmarked for financing various projects in the form of extrabudgetary directed credits.

The Government wound up the year 1972/73 with a surplus of IL 470 million. This can chiefly be credited to the large-scale absorption of money from the public through bond issues and loans in the second half of 1972/73. Along with this sum, the Government carried over to fiscal 1973/74 a IL 750 million surplus arising from the nonimplementation of various expenditure items in the previous year. As a result of these surpluses, along with the newly budgeted expenditures and the seasonal revenue pattern, the Government began to pump liquidity into the economy at the start of fiscal 1973/74.

The Government's debt to the banking system grew by IL 860 million in the second quarter of 1973 (which is also the first quarter of the fiscal year), after being whittled down by IL 710 million in the previous quarter. In the second quarter the Government injected IL 290 million of liquidity into the economy, compared with an absorption of IL 800 million in the first quarter. It should be pointed out in this connection that the Government mopped up liquidity during the whole of 1972/73.

In early 1973/74 the need arose for tabling a supplementary budget, since the budgetary reserves proved to be too small to counteract the effect of the price hikes in the economy, including the rise in import prices. The Treasury began to draft a supplementary budget, which in August 1973 was projected at IL 1,500 million.

It was the revenue from taxes, new bond issues, and loans from the public in excess of the original estimates that enabled the Government to overspend the budget instead of absorbing it. What is more, the original plan to siphon off liquidity came to naught in the third quarter of 1973 as well, and in the first half of the fiscal year the Government pumped IL 310 million into the economy.

After the outbreak of war in October the Government introduced a number of contractionary fiscal measures in order to finance its mounting outlays. On October 9 the Minister of Finance submitted to the Ministerial Economic Committee a IL 500 million supplementary budget proposal. On October 17 it approved a total of IL 1,000 million. The additional budget provided for a IL 1,250 million increase in defense spending, to be financed by a IL 250 million cut in development budgets and by floating both a compulsory and a voluntary war loan.¹⁰

Although the supplementary budget provided the legal and formal framework for levying loans on the public, it was not sufficient to meet the growing defense needs with the prolongation of hostilities, and it was decided to introduce further absorptive fiscal measures in preparation for the submission of a second supplementary budget. At the beginning of November 1973 the Government decided on a series of tax hikes, the most prominent of which was the upping of the defense levy on imports from 20 to 25 percent and the purchase tax by 5 percent. In addition, subsidies on a number of food products were cut. These changes were designed to expand the Government's revenue, or to reduce its expenditure, at an annual rate of IL 1,400 million. A further step was the raising of fuel prices in October 1973 and January 1974, which saved the Government from having to cover anticipated losses of IL 2,000 million at annual rates in the fuel price equalization fund following the sharp rise in oil prices immediately before and after the war.

The second supplementary budget, presented to the Knesset in January 1974, totalled IL 11,324 million, of which IL 9,288 million was for the extra Ministry of Defense expenditures and the balance for other emergency outlays.¹¹ Part of these sums had already been expended when the budget was tabled.

Only one-third of the receipts projected in this supplementary budget were to come from domestic sources, mostly new bond issues and loans from the public, and to a lesser extent taxes. Two-thirds of the total represented loans and transfers from overseas.¹² Total foreign receipts were to exceed the estimated additional foreign currency expenditure by IL 1,850 million; this sum was

¹⁰ The terms of the war loans are discussed in section 3 below.

¹¹ See *Budget Proposal No. 3* for 1973, p. 1 (Hebrew).

¹² This does not include the National Institutions' foreign transfer receipts and proceeds of the emergency fund-raising campaigns, except insofar as they are reflected in the supplementary budget.

Table VII-2

THE GOVERNMENT BUDGET, 1972/73 and 1973/74

(IL million, at current prices)

	1972/73		1973/74			
	Final outturn	Proposed budget ^a	Supple- mentary budgets ^b	Total budget (2+3)	Estimated allocation of reserves	Adjusted budget (4+5)
	(1)	(2)	(3)	(4)	(5)	(6)
A. Demand Surplus						
1. Expenditure	14,594	17,080	11,653	28,733	-148	28,585
Consumption						
Civilian	1,908	2,332	254	2,586	160	2,746
Noncivilian	6,120	6,125	10,538	16,663	177	16,840
Transfers to households and nonprofit institutions	795	1,090	23	1,113	190	1,303
Interest paid	1,775	2,000	62	2,062		2,062
Transfers to rest of public sector	1,116	1,173	156	1,329	96	1,425
Price supports and export subsidies	1,662	2,023	519	2,542	153	2,695
Investments, grants, and participation in investments	1,042	1,288	-179	1,109	294	1,403
Reserves and miscellaneous	176	1,049	280	1,329	-1,218	111
2. Revenue	11,633	13,971	1,925	15,896		15,896
Taxes ^c	9,428	11,698	2,203	13,901		13,901
Other domestic revenue	2,205	2,273	-278	1,995		1,995
3. Total demand surplus (1-2)	2,961	3,109	9,728	12,837	-148	12,689

B. Net absorption of credit

4. Net loans granted to the public	1,656	1,411	65	1,476	148	1,624
5. Net credit received	2,787	2,379	3,048	5,427		5,427
Gross compulsory loan receipts	1,239	1,279	570	1,849		1,849
Other credit, gross	2,701	1,987	3,072	5,059		5,059
Less: Repayments	1,153	887	594	1,481		1,481
6. Net credit absorbed (5-4)	1,131	968	2,983	3,951	-148	3,803

C. "Government deficit"

7. Balance to be financed (3-6)	1,830	2,141	6,745	8,886		8,886
8. Financing	1,830	2,141	6,745	8,886		8,886
Unilateral transfers and net credit from abroad	2,333	2,180	6,745	8,925		8,925
From Bank of Israel, net	-32	-39		-39		-39
Budget surplus	-471					

D. Liquidity infusion

9. Domestic demand surplus	291	255	4,834	5,089	-148	4,941
Total demand surplus (3)	2,961	3,109	9,728	12,837	-148	12,689
Less: Purchases and expenditure abroad	2,670	2,854	4,894	7,748		7,748
10. Net absorption of credit (6)	1,131	968	2,983	3,951	-148	3,803
11. Total liquidity injected into the economy (9-10)	-840	-713	1,851	1,138		1,138

^a The budget proposal was presented in January 1973 and the supplementary budget in March.

^b Two additional supplementary budgets, presented in October 1973 and January 1974.

^c Excluding collections on account of National Insurance. National Insurance Institute deposits with the Ministry of Finance are included in "other domestic revenue".

to be pumped into the economy for financing part of the extra domestic spending.

It may be added in this connection that at the time of submitting the supplementary budget to the Knesset, an additional budget was drafted for the Jewish Agency, to be financed by the intensive emergency fund-raising campaigns conducted abroad after the October war. The incremental proceeds expected from this source, which are earmarked for financing National Institution budgetary domestic outlays on social services and settlement, involves the injection of an additional IL 700 million.

The supplementary budget constituted a potential source of very strong expansionary pressures: the Government's overall demand surplus was to exceed the IL 3,110 million projected in the original budget by IL 9,580 million, while the domestic demand surplus was to be IL 4,680 million above the original IL 260 million estimate.

The incremental receipts from compulsory and voluntary loans from the public (which shot up because of the special conditions prevailing in the financial assets market in the second half of fiscal 1973/74¹³) offset about 60 percent of the budgeted increase in the domestic demand surplus, while the remaining 40 percent was financed by foreign currency conversions, which involved the infusion of IL 1,850 million into the economy. (As mentioned, a IL 710 million absorption had been projected in the original budget.)

Such a huge planned growth in the overall and domestic demand surpluses, which was accompanied by partially compensatory operations through the sale of financial assets with a view to mopping up liquidity (whose restrictive influence is generally smaller than that of the hiking of taxes or the dampening of real demands in other ways), could not be realized in the period between the outbreak of the war in October 1973 and the end of fiscal 1973/74 without very severe inflationary effects, despite the temporary change of trend in the rate of private sector saving and shrinking investments, and even though some of these influences were reflected in the balance of payments. But as it turned out, after October 1973 the Government did not run as large a domestic demand surplus or infuse as much money as it would have done had the supplementary budget been fully implemented. Problems arose concerning the ability of the economy to immediately gear itself to filling military orders on the scale called for in the supplementary budget.

To sum up, part of the potential expansionary impact of the 1973/74 budget was deferred to the following year in the form of large budget surpluses, which will probably add to the inflationary pressures latent in the budget for 1974/75.

¹³ See Chapter XVI, "The Securities Market", section 1.

3. GOVERNMENT TAX AND COMPULSORY LOAN RECEIPTS

1. *Main developments*

The growth of Government tax revenue and compulsory loan receipts was influenced by economic developments during the first nine months of 1973, changes in tax and compulsory loan policy in 1972 and this part of 1973, and the impact of the October war as reflected in the changes in economic activity and tax and compulsory loan policy in the last quarter of 1973.

During the first three quarters of 1973 Government tax revenue soared 32.6 percent. This consists of direct taxes, including national insurance contributions, and indirect taxes and fees, including the levy on defense imports. Excluding the levy,¹⁴ the increase was 34.1 percent. For the year as a whole the figures were 35.4 percent including and 29.4 percent excluding the levy.

The growth of tax revenue between January and September 1973 was much higher than in the previous year. This is explained in section 1 above, and it must be viewed against the background of the Government's revenue policy in recent years, as well as the specific influences which operated between 1972 and 1973, such as the expansion of GNP, national income, and imports, which had a stimulative effect despite the paring of tax rates.

Direct tax revenue rose during the first nine months by 34.5 percent to IL 4,670 million, and for the year as a whole by 31.6 percent to IL 6,305 million. The inclusion of compulsory loans reduces the growth rates to 30.2 and 29.4 percent respectively, which are still significantly higher than in the previous year.

Indirect tax revenue, including property tax, fees, and the levy on defense imports, rose 31 percent to stand at IL 5,233 million in the first nine months of 1973; the figure for all of 1973 is IL 7,705 million, of which IL 4,645 million derived from import taxes, which spurted 53 percent as against 40.6 percent in the previous year. This appreciable increase was accounted for by the defense import levy, which brought in 35.8 percent more than in 1972.

Import taxes accounted for over 60 percent of the incremental indirect tax revenue in 1973. Their weight in total tax revenue continued upward, reaching 29.5 percent in the first three quarters of 1973 and 33.2 percent for the entire year; this compares with 17.6 percent in 1968 and 20.1 percent in 1970. It is obvious, therefore, that in recent years import taxes have been a dynamic component in the Government's tax revenue.

Taxes on domestic production (including property tax, fees, and license fees) rose 25.3 percent in the first three quarters of 1973. But their weight in total

¹⁴ In discussing the absorptive effect of tax revenue the levy on defense imports will be excluded, since it constitutes not an absorption of funds from the public but an internal Government transaction. As regards the other implications of tax revenue, the levy does not differ from any other tax on imports.

receipts continued to drift downward, standing at 23.3 percent in September 1973 and 21.8 percent at year's end. Their weight in GNP also continued to decline.

The weight of taxes on income in total revenue, which fell from 51.7 percent in 1970 to 46.3 percent in 1972, edged up a notch during the first three quarters of 1973 to reach 47.2 percent; however, by the end of December it had reversed direction and stood at 45 percent. The picture remains the same if compulsory loans are included in the calculation.

2. *Direct taxes and compulsory loans*

Receipts from income tax and compulsory loans went up 33 percent between January and September 1973. They outpaced the growth of private income from economic activity (29.5 percent), even though part of the incremental income was tax-free, tax rates were reduced, and reliefs were granted in the collection of compulsory loans. Over the year as a whole income from this source rose 33.1 percent to IL 5,982 million. Excluding compulsory loans, the gain was 40.1 percent in the first three quarters of 1973, compared with 19.4 percent the year before. This far eclipsed the growth of national income and private income from economic activity, and contrasts with the situation in 1972, when income tax revenue lagged behind the increase in national income.

This development does not accord with the findings of various studies which show the elasticity of income tax revenue in relation to national income to be greater than unity. It is explained chiefly by the trimming of income tax rates after the Government discontinued the policy of incomes restraint which it had pursued in the two preceding years, and also by the fact that part of the incremental national income in 1972 was either tax-exempt or subject to relatively low rates. An additional reason is the time-lag in income tax collections, since an increase in national income is not immediately reflected in current tax collections but only later on; the lag is longer the higher the proportion of nonwage income in national income.

Some of these reasons hold, in general, for 1973 too: that direct tax revenue expanded faster than current national income may be ascribed primarily to the national income gains in previous years, which were reflected in tax collections not in the years in which the income was produced but only in 1973. Collections of tax arrears were very large this year, as will be explained below.

The specific factors dampening the growth of tax collections were as follows:

(a) The payment of cost-of-living allowance increments (which are tax-free) in January and July 1973 added 9.2 percent to employees' earnings (including fringe benefits) and 5.2 percent to private income from economic activity (which rose by a total of 29.5 percent during this period). Another part of national income was either tax-free or subject to lower rates since it

constituted wage incentive payments, premiums for night shift work, and approved overtime pay. Still another part was subject to below-average rates of tax, being eligible for the various concessions granted under the Law for the Encouragement of Capital Investments and the Law for the Encouragement of Industry.

(b) In April 1973 tax rates were reduced, the defense levy discontinued, personal deductions increased, and an exemption granted on 25 percent of pension payments. These changes deprived the Treasury of IL 260 million on an annual basis. The tax concessions which came into force in April 1972 also depressed the average tax rates in 1973.

The raising of the at-source deductions from payments to contractors and Government suppliers from 5 to 7.5 percent in April 1973 and the tougher attitude toward business expenses adopted in August 1972 worked in the opposite direction; however, the estimated additional income produced by these changes had a negligible effect in the first three quarters of 1973.

In April 1973 the rate of Savings Loan collections from employers was reduced from 6 to 5 percent of their gross wage bill; it is estimated that the loss of revenue from this source will come to IL 100 million at annual rates. The discontinuation of collection of the Savings Loan from employees in 1972 deprived the Government of an additional IL 55 million in 1973.

On October 16 the War Loan Law, 5734-1973, was enacted by the Knesset, under which a compulsory loan was imposed on taxable income in the 1973 tax year. Those dividend payments which in the past had been exempted are now liable to the new loan, but interest received continues to enjoy a reduced low rate besides being exempt from this loan. Unlike the Defense Loans, the War Loan is also levied on approved overtime pay, productivity premiums, and premiums for night shift work. Loan rates on personal income in the 1973 tax year are 3.5 percent of the taxable income up to IL 40,000, 4.5 percent on sums of IL 40,000 to IL 60,000, and 6 percent on sums in excess of IL 60,000. Companies pay 4.5 percent of their taxable income. The 1973 War Loan is linked to the consumer price index of December 1973 and bears tax-free interest of 3 percent p.a. as of April 1, 1974. The principal will be redeemed in twelve monthly installments in the 1989 tax year, while the interest will be paid in three equal five-year installments. Collections from employees are made at source, while self-employed and companies are required to make larger tax prepayments; in addition, the at-source deduction has been increased.

The law also authorized the Government to raise a voluntary loan on the same terms as the compulsory loan. The latter yielded a total of IL 89 million by the end of December.

Income tax collections from employees, including company directors listed as salaried employees and members of cooperatives, was up 38.5 percent in 1973, and excluding the latter two by 41.3 percent. The number of Israeli employees

GOVERNMENT TAX

(IL

	1970	1971	1972		1973	
			Jan.- Sept.	Entire year	Jan.- Sept.	Entire year
			Direct taxes	3,057	4,010	3,471
Income tax	2,232	2,768	2,402	3,311	3,368	4,556
National Insurance	825	1,242	1,069	1,479	1,302	1,750
Taxes on property	253	294	234	345	306	398
Property tax	233	257	187	284	265	346
Land registry fees	20	37	47	61	41	52
Indirect taxes						
Imports	1,188	2,160	2,151	3,036	2,921	4,645
Customs and levy on civilian imports	890	1,556	1,409	1,987	1,955	2,627
Purchase tax	247	376	358	534	581	754
Foreign travel tax	51	70	66	80	77	88
Surtax on stocks	—	28	12	15	5	6
Subtotal	1,188	2,030	1,845	2,616	2,618	3,475
Levy on defense imports	—	130	306	420	303	1,170
Domestic production	1,411	1,766	1,603	2,175	1,996	2,662
Purchase tax	419	519	464	645	609	778
Fuel tax	252	355	360	488	428	584
Tobacco excise	134	162	150	199	180	262
Cement excise	60	57	45	60	51	75
Excise on beverages	29	32	28	35	18	22
Defense stamp tax	101	143	121	160	154	201
Other fees (incl. current surplus of Govt. enterprises)	228	264	223	297	266	335
Revenue stamp tax	123	157	149	204	199	253
Vehicle license fees	65	77	63	87	75	105
Financial services tax	—	—	—	—	16	27
Total indirect taxes on expenditure						
Incl. the defense import levy	2,599	3,926	3,754	5,211	4,917	7,307
Excl. the defense import levy	2,599	3,796	3,448	4,791	4,614	6,137
Total tax revenue						
Incl. the defense import levy	5,909	8,230	7,459	10,346	9,893	14,011
Excl. the defense import levy	5,909	8,100	7,153	9,926	9,590	12,841

^a Compared with January-September, 1972.

VII-3

REVENUE, 1970-73

million)

Percent annual increase or decrease (-)				Percentage distribution					
1971	1972	1973		1970	1971	1972		1973	
		Jan.-Sept. ^a	Entire year			Jan.-Sept.	Entire year	Jan.-Sept.	Entire year
31.2	19.5	34.5	31.6	51.7	48.7	46.5	46.3	47.2	45.0
24.0	19.6	40.2	37.6						
50.5	19.1	21.8	18.3						
16.2	17.3	30.8	15.4	4.3	3.6	3.1	3.3	3.1	2.8
10.3	10.5	41.7	21.8						
85.0	64.9	-12.8	-14.8						
81.8	40.6	35.8	53.0	20.1	26.2	28.8	29.4	29.5	33.2
14.8	27.7	38.8	32.2						
52.2	42.0	62.3	41.2						
37.3	14.3	16.7	10.0						
—	-46.4	58.3	60.0						
70.9	28.9	41.9	32.8						
—	223.1	-1.0	178.6						
25.2	23.2	24.5	22.4	23.9	21.5	21.5	21.0	20.2	19.0
23.9	24.3	31.3	20.6						
40.9	37.5	18.9	19.7						
20.9	22.8	20.0	31.7						
-5.0	5.3	13.3	25.0						
10.3	9.4	-35.7	-37.1						
41.6	11.6	27.3	25.6						
15.8	12.5	19.3	19.5						
27.6	29.9	33.6	24.0						
18.5	13.0	19.0	20.7						
—	—	—	—						
51.1	32.7	31.0	40.2						
46.1	26.2	33.8	28.1						
39.3	25.7	32.6	35.4	100.0	100.0	100.0	100.0	100.0	100.0
37.1	22.5	34.1	29.4						

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

in the economy rose 3.1 percent and compensation of employees (earnings plus fringe benefits) by 27.9 percent. The tax-free cost-of-living allowance increments paid in January and July 1973 added, as already mentioned, 9.2 percent to employees' compensation.

Income tax revenue from the self-employed and companies consists of prepayments on account of the current year and the balances due on final assessments for previous years.¹⁵ The prepayment rates were raised in April 1973: those made according to the assessment for 1970 or earlier were fixed at 140 percent of the assessment for the base year, while those made according to the assessment for 1971 or later were set at 120 percent of the assessment for the base year.

Income tax revenue from the self-employed was up 24.7 percent in the first three quarters of 1973; this was higher than in either 1971 or 1972, but lower than what might have been expected given the rise in net nonwage private income from economic activity during this period—31.6 percent including and 28.5 percent excluding imputed residential rents. Even if the sum withheld at source from payments to suppliers of goods and services and contractors (who paid higher rates this year) is added to collections from the self-employed (even though part of this was paid by companies), the growth rate came to only 27.4 percent.

Income tax and Defense Loan receipts from the self-employed may be divided into two components: prepayments and payments of balances due on final assessments. These rose at widely disparate rates: whereas aggregate receipts from income tax and loans were up 27.1 percent in the first three quarters of 1973, prepayments grew by only 13.6 percent while collections on account of previous years jumped 37.9 percent.

Income tax collections from companies soared 54.5 percent, a rate unmatched for a long time. A breakdown of the receipts by the same two components as for the self-employed shows that, in contrast to the latter case, there was no significant divergence between the two: both prepayments and balances collected on previous years' assessments rose to about the same appreciable degree. The growth of revenue from this source is explained by mounting company profits in the past several years.

National insurance collections were up 21.8 percent in the first nine months of 1973 and 18.3 percent for the entire year, and totalled IL 1,750 million at year's end. There was no change in contribution rates, the growth stemming solely from the gain in income from employment.

In 1973 collection of employers' contributions to a health insurance scheme through the National Insurance Institute was introduced. But these receipts are not included in the foregoing data or in Table VII-3.

¹⁵ On the method of collection from the self-employed and companies see Bank of Israel, *Annual Report 1972*, p. 174.

3. *Indirect taxes*

Indirect tax revenue (including property tax) was up 31 percent in the first nine months of 1973 (about the same rate as in the corresponding period of 1972), while for the entire year the level rose 38.7 percent to IL 7,705 million. The disparate rates of increase were due to the hiking of the defense import levy in the last quarter of 1973, which yielded IL 807 million during this period compared with IL 303 million for the rest of the year. Excluding the levy, the increase in the first nine months was 33.6 percent, as against 25.6 percent in the same period the year before, while for all of 1973 the gain came to only 27.2 percent because of a sharp decline in collections during the last quarter.

The growth of indirect tax revenue during the first three quarters of 1973, despite some reduction in rates, stemmed from the increased consumption of locally produced goods and services and a heavier volume of imports.

Import tax receipts rose 35.8 percent between January and September; excluding the levy on defense imports, the figure was 41.9 percent. This compares with 53 and 32.8 percent respectively in the previous year.

The import liberalization program was continued in 1973, with two rounds of tariff cuts (covering some 1,500 articles) being made in January and February. In addition, the duties on construction equipment, commercial vehicles, and iron were pared in March, April, and May. The effect of the tariff cuts made in 1972 was also felt in the year reviewed. These changes reduced the anticipated receipts from customs duty and purchase tax by about IL 110 million in the first nine months of 1973. In contrast, revenue from taxes on imported vehicles increased in 1973 owing to the revision of the method of levying purchase tax from a specific to an ad valorem basis and the raising of purchase tax and customs duty rates. The net effect of these changes was a "loss" of nearly IL 100 million in tax revenue; that import tax receipts nevertheless increased can be attributed to the higher value of imports. Excluding ships, aircraft, and rough diamonds, the import bill rose 44.7 percent during the first nine months of 1973, as against only 12.7 percent in the previous year.

At the beginning of November 1973 the general levy on imports was upped from 20 to 25 percent and the purchase tax by 5 percent; these increases were also imposed on imports coming within the scope of the Law for the Encouragement of Capital Investments. In addition, the tax on luxury goods was raised by more than 5 percent. These revisions, calculated to yield about IL 570 million at annual rates, were only partly reflected in the data for November and December 1973.

Following are the other principal changes in indirect tax revenue: Purchase tax on domestic production brought in 31.3 percent more in the first nine months of 1973, compared with a 24.3 percent rise in 1972. Most of the gain was due to the expansion of production and sales. The boosting of the purchase

GOVERNMENT REVENUE FROM INCOME

(IL

	1970	1971	1972		1973	
			Jan.- Sept.	Entire year	Jan.- Sept.	Entire year
Income tax^b						
Self-employed	445	521	423	599	528	713
Companies	549	663	598	828	924	1,274
Wage and salary earners	989	1,220	1,045	1,424	1,477	1,970
Directors of companies listed as salaried employees and members of cooperatives ^c	64	95	87	116	91	121
Deductions at source	200	276	252	348	350	478
Thereof: From suppliers of goods and services	43	87	80	112	113	154
Total	2,247	2,775	2,405	3,315	3,370	4,556
Thereof: Absorption Loan collections	15	7	4	4	—	—
Income tax	2,232	2,768	2,401	3,311	3,370	4,556
Compulsory Defense Loan						
Self-employed	27	46	52	81	78	108
Companies	53	89	85	125	161	227
Wage and salary earners	152	291	265	355	331	436
Directors of companies listed as salaried employees and members of cooperatives ^c	15	22	20	27	20	26
Total	247	448	422	588	590	797
Compulsory Savings Loan						
Employers	173	399	373	503	415	540
Employees	94	173	86	86	—	—
Directors of companies listed as salaried employees and members of cooperatives ^c	9	13	4	4	—	—
Total	276	585	463	593	415	540
Compulsory War Loan						
Self-employed	—	—	—	—	—	9
Companies	—	—	—	—	—	32
Wage and salary earners	—	—	—	—	—	43
Directors of companies listed as salaried employees and members of cooperatives	—	—	—	—	—	5
Total	—	—	—	—	—	89
Total income tax and compulsory loans	2,770	3,808	3,290	4,496	4,377	5,982

^a Compared with January-September, 1972.

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

^c Tax revenue from company directors listed as salaried employees and from members of

VII-4

TAX AND COMPULSORY LOANS, 1970-73

million)

Percent annual increase or decrease (-)		Percentage distribution							
1971	1972	1973		1970	1971	1972		1973	
		Jan.- Sept. ^a	Entire year			Jan.- Sept.	Entire year	Jan.- Sept.	Entire year
17.1	15.0	24.7	19.0	19.8	18.8	17.6	18.1	15.7	15.6
20.8	24.9	54.5	53.0	24.4	23.9	24.9	25.0	27.4	28.0
23.4	16.7	41.3	38.3	44.0	44.0	43.4	42.9	43.8	43.2
48.4	22.1	4.6	4.3	2.9	3.4	3.6	3.5	2.7	2.7
38.0	26.0	38.9	37.4	8.9	9.9	10.5	10.5	10.4	10.5
102.3	28.7	41.2	37.5	1.9	3.1	3.3	3.4	3.4	3.4
23.5	19.4	40.1	37.4	100.0	100.0	100.0	100.0	100.0	100.0
70.4	76.0	48.7	33.3	10.9	10.3	12.3	13.8	13.2	13.5
67.9	40.4	90.4	81.6	21.5	19.9	20.1	21.2	27.3	28.5
91.4	22.0	24.9	22.8	61.5	64.9	62.8	60.4	56.1	54.7
46.7	22.7	0.0	-3.7	6.1	4.9	4.7	4.6	3.4	3.3
81.4	31.2	39.8	35.5	100.0	100.0	100.0	100.0	100.0	100.0
130.6	26.1	11.3	7.4	62.7	68.2	80.5	84.8	100.0	100.0
84.0	-50.3	—	—	34.0	29.6	18.6	14.5	—	—
44.4	-69.3	—	—	3.3	2.2	0.9	0.7	—	—
112.0	1.4	-10.4	-8.9	100.0	100.0	100.0	100.0	100.0	100.0
									10.1
									36.0
									48.3
									5.6
									100.0
37.5	18.1	33.0	33.1						

cooperatives was apportioned to income tax and the compulsory Defense and Savings Loans according to partial data and Bank of Israel estimates.

SOURCE: Ministry of Finance.

tax on domestic production in November by 5 percent was expected to yield IL 155 million at an annual rate.

Fuel tax receipts increased 18.9 percent during the first nine months of the year. The adding of 5 agorot per liter of gasoline to the tax at the end of March explains about a third of the incremental revenue from this source.

Receipts from the cement excise increased 13.3 percent during this period. The excise was reduced in April, but in November it was raised from IL 40 to IL 100 per ton, which should have added some IL 100 million to the exchequer at an annual rate. However, owing to the slump in cement sales in November and December, the change was hardly reflected in the data for the year.

Revenue from the tobacco excise was up 20 percent by the end of September and 31.7 percent by the end of December. The fourth-quarter jump was due to heavier smoking during the emergency and the raising of the excise in March 1973.

In April a tax was imposed on financial services, to be collected by the income tax authorities. Also known as the bank tax, it is levied on banks and insurance companies at the rate of 3.5 percent of wages and profits and 3.5 percent on commissions paid to insurance agents.

4. THE NATIONAL INSTITUTIONS¹⁶

National Institution operations have expanded greatly since the inauguration of the special emergency fund-raising campaigns in 1967. These campaigns have enabled the Jewish Agency to extend its activities beyond the traditional fields of absorption and settlement and to help finance various social services. The extent of its participation in the financing of these activities has changed from year to year, depending on the flow of funds from overseas.

The greater part of the Institutions' operations results, by definition, in a demand surplus, since their domestic income is very small. In addition, they provide credit to the rest of the economy, primarily through the development budgets of the Jewish Agency and the World Zionist Organization. In recent years the Institutions have seldom resorted to domestic borrowing, and as long as they can obtain loans from abroad they prefer to do so rather than borrow from local sources on less favorable terms.

In each of the past three years, however, the National Institutions had a net credit outflow to the rest of the world. One reason for this was a deliberate effort to gradually reduce their foreign currency liabilities; another was the increase in Jewish Agency deposits abroad.

The Institutions' demand surplus totalled IL 1,854 million in 1973, compared

¹⁶ The Jewish Agency, World Zionist Organization, Jewish National Fund, and Keren Hayesod.

Table VII-5
NATIONAL INSTITUTION OPERATIONS, 1972-73
(IL million, at current prices)

	1972	1973	Percent increase or decrease (-)
1. Demand surplus			
Domestic consumption and current expenditure			
abroad	254	357	40.6
Transfers and subsidies	745	996	33.7
Interest paid	104	140	34.6
Investments, grants, and participation in investments ^a	477	602	26.2
Less: Domestic revenue	55	65	18.2
Net transfers from rest of public sector	421	176	-58.2
Demand surplus	1,104	1,854	67.9
2. Net domestic credit granted			
Net loans granted to the public	166	205	23.5
Net credit received	34	-95	-379.4
Net domestic credit granted	132	300	127.3
3. Balance to be financed (1+2)	1,236	2,154	74.3
Financing	1,236	2,154	74.3
Unilateral transfers and net credit from abroad	1,048	2,772	164.5
Net credit from the banking system	188	-618	-428.7
4. Liquidity infusion			
Domestic demand surplus	932	1,630	74.9
Total demand surplus (1)	1,104	1,854	67.9
Less: Purchases and expenditure abroad	172	224	30.2
Net domestic credit granted (2)	132	300	127.3
Total liquidity injected into the economy	1,064	1,930	81.4

^a Including participations and credit for financing housing construction.

with IL 1,104 million the year before.¹⁷ Before 1967 it came to IL 250-300 million a year at current prices.

The National Institutions provided IL 300 million net credit in 1973, as against IL 132 million the year before. Before 1967 they were net borrowers from the rest of the economy.

¹⁷ It should be pointed out that part of the National Institutions' operations is included in the Government's reports, so that part of their demand surplus as defined above has already been included in the Government's demand surplus as defined in section 2. Therefore, the demand surpluses of these two authorities should not be added together in order to estimate the combined demand surplus.

All told, they required IL 2,154 million for financing domestic operations in 1973, compared with IL 1,236 million in 1972—a staggering 75 percent rise. By far the greater part of this sum was financed by net capital imports. In 1972 part of the requisite financing was obtained by borrowing from the banking system.

Foreign unilateral transfer receipts—from regular and emergency fund-raising campaigns—reached \$ 686 million according to the Institutions' reports, as against \$ 334 million in 1972. Less transactions on financial account with the rest of the world, capital imports totalled \$ 607 million, as contrasted with \$ 210 million in 1972. Of the total 1973 capital import, fully some 80 percent (\$ 430 million) was received in the last quarter of the year, testifying in some measure to world Jewry's generous assistance to Israel during this trying period.

The inflow of emergency campaign proceeds in the postwar months affected the Jewish Agency's budgets in the following ways:

(a) The Jewish Agency succeeded in wiping out the deficit in its budget for social needs for 1973/74; this budget, drawn up at the beginning of the fiscal year, outlines the tasks which world Jewry is asked to fulfill. In previous years the budget performance fell short of the goals set forth in the budget, and upon the outbreak of war a big gap between the two was expected.

(b) The Jewish Agency took it upon itself to finance additional activities in the social services.

(c) The Government's participation in the Jewish Agency's budget, projected at more than IL 200 million in 1973/74, was cancelled.

Of its total capital import, the Jewish Agency converted approximately \$ 350 million in the last quarter of the year and \$ 460 million over the year as a whole, thereby injecting IL 1,930 million into the economy. The unconverted funds were used to temporarily reduce the Institutions' debt to the banking system.

5. THE LOCAL AUTHORITIES

(a) *Operations of the local authorities*¹⁸

The local authorities continued to expand their operations in 1973, their consumption swelling by 37.2 percent in the first nine months of 1973 and 34.7 percent for the year as a whole, following a rise of 24.3 percent in 1972. Even at constant prices, these rates were higher than in the previous year. Transfer payments also rose appreciably—27.4 percent as against 15.1 percent in 1972. On the other hand, the growth of investment slowed from 42.6 per-

¹⁸ Municipalities, local, regional, and religious councils, and regional authorities. Also included are the municipal expenditures of kibbutzim and moshavim (cooperative agricultural settlements).

Table VII-6

DEMAND SURPLUS OF THE LOCAL AUTHORITIES AND ITS FINANCING, 1971-73

(IL million)

	1971	1972	1973	Percent annual increase	
				1972	1973
A. Demand surplus					
1. Expenditure	1,450	1,839	2,421	26.8	31.6
Consumption	793	986	1,328	24.3	34.7
Transfers to households and nonprofit institutions	213	240	310	12.7	29.2
Interest paid ^a	92	111	137	20.7	23.4
Purchases on capital account (less sales)	352	502	646	42.6	28.7
2. Revenue	1,188	1,501	1,957	26.3	30.4
Taxes	365	446	552	22.2	23.8
Other domestic revenue	285	336	406	17.9	20.8
Net transfers from the Government	538	719	999	33.6	38.9
3. Demand surplus (1-2)	262	338	464	29.0	37.3
B. Financing of demand surplus					
4. Credit (net)					
Government	36	86	100	138.9	16.3
Banking system	170	208	269	22.4	29.3
Other domestic sectors	56	44	95	-22.4	115.9
Total	262	338	464	29.0	37.3

^a Excluding interest paid to the Government.

cent in 1972 to 37.8 percent in the first three quarters of 1973 and 28.7 for the entire year.

This strong expansion of the local authorities' operations resulted in a IL 464 million demand surplus, as compared with IL 338 million in 1972. To finance this they had to borrow 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 hikes facing the authorities, and to service their mounting indebtedness.

The Government approved an increase of nearly 20 percent in the authorities' current budgets for 1972/73, which was deemed to be sufficient for covering the estimated wage and price rises, the growth of population, and some expansion of services. The freeze on municipal tax rates, which had been imposed upon the authorities as part of the "package deal" on prices, taxes, and wages,

was lifted and a 20 percent gain in revenue (including Government grants and participations) was projected. The budgets approved were actually deficit budgets, with the average deficit exceeding 9 percent of the total budgeted expenditure.

In 1973/74 the Government approved an increase of some 30 percent in the authorities' current budgets—in both expenditure and revenue; this again meant an average deficit exceeding 9 percent of the total budgeted expenditure. The authorities therefore had to resort to borrowing (estimated at approximately IL 150 million) to finance their current deficits, in addition to the credit required to cover their development budgets.

There is no effective constraint whatsoever on the authorities' development budgets other than their ability to mobilize the requisite funds to finance their investments. About 70 percent of the development budgets is financed by loans and credit, while the remaining 30 percent is obtained through the participation of property-owners and institutions in various outlays, Government participations, the sale of property, etc.

Loan repayments are 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. The weight of repayments and interest in total ordinary expenditure rose from 17.6 percent in 1972/73 to 19.1 percent.

The authorities' heavy investment demand has made them one of the prime sources of upward pressure on capital goods prices on the one hand and the foremost cause of pressure in the credit market on the other. The authorities have tended to swallow the precipitate rise in investment prices and the stiffening of the terms of their investment credit.

The authorities' revenue, excluding receipts on financial account and including net transfers from the Government and the National Institutions, expanded by 30.4 percent in 1973, compared with 26.3 percent the year before. Two factors accounted for this growth: a larger volume of Government transfers and an increased 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 and 1973, but not to a significant degree. Tax revenue and other transfer payments from the public (including fees for various services and owners' participation in local authority expenditure) rose 22 percent in the first three quarters of 1973 and by 22.5 for the entire year, as against 20.5 percent in 1972. Considering the expansion of those economic activities which constitute the municipal tax base, the increases in 1972 and 1973 seem fairly low.

One item whose weight has been moving up from year to year is transfers from the Government. Net receipts from this source (including net loans) went up 36.5 percent, bringing their weight in the authorities' total revenue

up to 45.4 percent, compared with 43.8 percent in 1972 and 39.5 percent in 1971.

Government transfers, as calculated above, include the authorities' share in Government tax collections (see section [b] below). Part of the 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 other Government and National Institution transfers in the authorities' total receipts, which implies a deliberately increased Government participation in the authorities' activities.

The authorities financed their demand surplus by borrowing more heavily from other domestic sectors, mainly financial. In the past three years their principal source of finance was bank credit, and in 1972 their debt to the banking system rose by IL 269 million, most of it medium- and long-term loans. The rest of the requisite funds consisted of net loans from the Government, financial institutions, State Lottery, and contractors.

Since the authorities have run a demand surplus for many years, their outstanding indebtedness has grown appreciably. As of March 31, 1973 this was estimated at approximately IL 1,650 million on account of principal and another IL 1,450 million in linkage differentials and accumulated interest. About 15 percent of these sums originated in the cumulative deficit in their current budgets, and it consisted mostly of Government-directed loans for the consolidation of debts. The balance of principal, linkage differentials, and accumulated interest at the end of 1973 is estimated at IL 4,000 million—almost double the authorities' total ordinary budget receipts for 1973/74.

(b) *Revenue and expenditure*

Autonomous municipal tax revenue—taxes collected directly by the local authorities, not counting their participation in Government tax collections—expanded by 23.2 percent in the first nine months of 1973 and 23.8 percent for the year as a whole to total IL 552 million. For fiscal 1972/73 increases of 25–40 percent had been authorized in general rates and of 40–50 percent in the business tax. These revisions terminated the freeze on municipal taxes which had been in force for many years, but they actually had a very slight effect on tax revenue in 1972 and the first three quarters of 1973. The revenue gain during this period is partly 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. Presumably there was also an increase in municipal tax arrears.

Nontax revenue added up to IL 406 million in 1973. Approximately 55 percent of this sum represented the participation of various institutions and property owners in development and other costs, while the balance represented

participations in the cost of services provided, including service charges in primary schools and tuition fees in other educational institutions, as well as the authorities' income from property.

The net participation of the Government in local authority budgets¹⁹ was stepped up by 36.5 percent to IL 1,099 million. This participation consists of three items:

(a) General grant-in-aid, consisting of ordinary and special 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 provided to local authorities according to various criteria: per capita receipts from taxes, average per capita expenditure on social welfare, and the demographic structure of the population. The special 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 272 million in 1972 to IL 373 million.

(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), one-third of the land betterment tax collected by the Government, 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 in 1973, these allocations went up by IL 731 million, compared with IL 261 million in 1972. The shared revenue was allocated to the authorities in proportion to their weight in municipal tax collections before the Government assumed responsibility for collection, the number of vehicles owned by their residents, and the volume of real estate transactions carried out within their boundaries.

(c) Government participation in the financing of the authorities' current operations, mainly the participation of the Ministries of Social Welfare, Education, and Religious Affairs in the financing of services, as well as development budget loans and grants for construction and investment purposes. These transfers (less various local authority participations in Government expenditure, including interest paid to the Government) amounted to IL 355 million in 1973, compared with IL 272 million the year before.

Local authority expenditure on real account—i.e. consumption, investment, and transfers—increased 31.6 percent at current prices, following a 26.8 percent rise the year before, and totalled IL 2,421 million.

The authorities' consumption spending rose 34.7 percent to reach IL 1,328 million; of this, IL 894 million was payroll outlay (up 36 percent in 1973).

¹⁹ Allocations, grants, participation in various local authority activities, and net loans granted to the authorities, less interest paid to the Government and their participation in various Government outlays.

At 1972 prices, the increase in the authorities' consumption came to 9.5 percent in the first three quarters of 1973 and 10.5 percent for the year as a whole, compared with a real increase of 8.6 percent in 1972.

A functional breakdown of the authorities' expenditure reveals that more than half the consumption spending and transfer payments was in the social field—education, health, social welfare; about 40 percent was on municipal services, such as sanitation, waterworks, and public properties; while the remaining 10 percent was on administrative expenses.

Local authority investment was, at IL 646 million, up 28.7 percent in the year reviewed. The increase during the first three quarters was 27.2 percent, with the amount expended on buildings, which accounted for three-quarters of total investment, rising 33 percent, and outlays on road paving, which accounted for about 20 percent, going up 55.5 percent.