

5

THE PUBLIC SECTOR

1. MAIN DEVELOPMENTS¹

In 1988, for the first time since the start of the 1985 stabilization program, the public sector accounts recorded a deficit as receipts fell short of expenditures. The overall deficit is estimated at over 4 percent of GNP, the domestic deficit, at more than 5 percent. The major part of the 1988 deficit can be attributed to cyclical and transitory factors—the slowdown in economic activity, the redemption of compulsory loans, and tax refunds. The government pursued a neutral policy which enabled it to adhere to the short-run objectives of the stabilization program—principally, preventing a rise in the inflation rate or the external current account deficit, and the public debt—without deepening the recession. However, the indicators of the relative size of the public sector, its involvement in the economy, and its contribution to the efficiency of the capital market and resource allocation indicate a regression in 1988. In the long run, this has detrimental macro-economic effects.

The year's increase in the public sector deficit had several causes: a) the slowdown in economic activity (which was not a result of fiscal policy) reduced the public sector's receipts; b) the political process, more dominant in an election year, influenced economic priorities and the public's expectations regarding them, contributing to the increase in civilian public spending and changing the composition of the deficit's financing; c) exceptionally large tax refunds, due to the delay in implementing the 1987 direct tax reform; and d) large-scale redemption of compulsory loans falling due in 1988.

The rapid expansion of the public deficit occurred mainly in the second half of the year, and was financed primarily by sales of foreign currency to the public. These sales accelerated towards the end of the year, as the public's expectations of devaluation strengthened (Table 5.1, item 4a). At the same

¹ The public sector comprises the central government, the National Insurance Institute, the local authorities, the National Institutions, and the nonprofit institutions financed mainly by the former, such as the sick funds, universities, etc.

TABLE 5.1

Public Expenditure and Revenue, the Deficit and its Financing, 1980–88*(Percent of GNP, current prices)*

	1980–1985–								
	1984	1988	1982	1983	1984	1985	1986	1987	1988
1. Total public expenditure	72.8	65.6	72.5	67.4	73.3	71.2	65.5	62.7	62.8
a. Domestic	61.2	54.8	61.4	58.6	60.2	57.0	54.0	53.3	54.9
b. Foreign	11.6	10.8	11.1	8.8	13.1	14.2	11.5	9.4	7.9
2. Total income	58.4	63.9	59.2	59.3	54.5	68.6	67.4	61.4	58.2
a. Domestic	48.3	50.1	50.3	50.4	42.7	48.8	51.5	50.8	49.3
b. Foreign	10.1	13.8	8.9	8.9	11.8	19.8	15.9	10.6	8.9
3. Public deficit (–) or surplus									
a. Total	–14.4	–1.7	–13.3	–8.1	–18.9	–2.6	1.9	–1.3	–4.6
b. Domestic	–12.9	–4.7	–11.1	–8.2	–17.5	–8.2	–2.5	–2.5	–5.6
c. Foreign	–1.4	3.0	–2.1	0.1	–1.3	5.6	4.4	1.2	1.0
4. Financing of total deficit or surplus									
a. Net borrowing from abroad	6.5	–0.2	5.8	5.1	10.4	–1.3	–1.8	–2.5	4.9
b. Net money creation	1.8	0.3	2.2	0.7	2.8	5.7	0.7	0.5	–5.7
c. Net domestic borrowing	2.4	–2.2	0.8	–1.1	–1.1	–7.2	–5.3	0.0	3.8
d. Residual	3.6	3.7	4.5	3.5	6.8	5.4	4.5	3.3	1.8
5. Public debt									
a. Domestic	121.4	119.6	123.6	118.0	123.6	133.2	121.1	113.5	110.7
b. Foreign	40.2	37.8	37.5	40.8	49.3	51.0	39.8	31.4	29.0

DEFINITIONS:

Domestic expenditure: Domestic public consumption (civilian and defense), public sector investment, subsidies, transfer payments and domestic interest payments.

Direct demand for foreign currency: Direct defense imports (net of import duties), advance payments on defense imports, government imports n.e.s., interest payments to rest of the world, and Bank of Israel expenditures abroad on minting and printing money.

Domestic revenue: Revenue from taxes and compulsory payments, income from property and other income (imputed depreciation and imputed commitments for pension payments).

Receipts from abroad: Unilateral transfers to the public sector plus interest receipts on foreign reserves, less transfers to the Civil Administration of the administered territories.

Public sector deficit: The difference between expenditure and receipts. Total public sector deficit less public investment equals gross saving of the public sector.

Net borrowing from abroad: Short, medium or long term changes in the foreign reserves, less repayment of principal and less advances on defense imports.

Net money creation: Increase in narrow money base (currency in circulation and deposits of commercial banks with the Bank of Israel) less Bank of Israel expenses on the money base (interest paid on deposits of commercial banks, changes in the discount-window loan, etc.).

Domestic borrowing: Domestic public sector borrowing as estimated by the Department of Management Accounting in the Accountant-General's Office and the Bank of Israel.

Residual: The difference between the total public sector deficit and receipts from loans from abroad, net money creation, and domestic borrowing; includes deficits of public sector non-profit institutions and 'errors and omissions'.

Domestic public debt: Total private sector claims on the public sector (excluding the government commitment under the Bank Shares Arrangement).

Foreign public debt: Total claims of foreigners on the public sector less foreign reserves. The annual estimate of the public debt, domestic and foreign, is calculated as the arithmetic mean of quarterly debt/GNP ratios.

SOURCE: Central Bureau of Statistics and the Department of Management Accounting in the Accountant-General's Office, and Bank of Israel.

time, public borrowing exceeded the requirements of financing the deficit and recycling of the public debt. This excess borrowing was to hedge against possible difficulties in recycling the bank shares which fell due for redemption in the last quarter of the year. This renewed government involvement in the capital market weakened the effectiveness of the 1987 reforms, designed to reallocate the sources of finance in favor of the private sector.

The public sector's direct domestic demand expanded in 1988 by some 3 percent in real terms. The rise was similar in all components of demand (Table 5.1, items 2a, 2b and 3). The ratio of the public sector's direct domestic demand to GNP at current prices rose back to nearly its 1985 level (see Table 5.2). The share of domestic public consumption in total resource uses also increased. For the first time in three years, public sector wages rose in 1988 more than in the private sector (although the cumulative gap between the respective wage levels was not closed). Labor input in the public sector increased more than in the 1982–87 period. It may therefore be concluded that the public sector's involvement in the economy has increased, particularly in the labor market. In the long run, this impairs the efficiency of resource allocation, and to a large extent contradicts the objectives of the 1985 stabilization program.

Statutory tax rates remained practically unchanged in 1988. Nevertheless, tax revenue rose by 1.1 percent in real terms (after deflation of nominal revenue by the CPI). To assess the share of GNP absorbed by the government, revenue is measured as a percentage of GNP. This measure yields a decline of 1.3 percent, since GNP prices rose faster than the CPI. The composition of tax revenue changed this year. Revenue from direct taxes rose by approximately 8 percent in real terms, as a result of the rise in real wages; revenue from indirect taxes on domestic production, which had risen steadily since 1985, decreased by about 1 percent in real terms, as a result of the slower GNP growth. As imports contracted, revenue from import taxes fell 5 percent.

The tax burden on consumers (defined as total tax revenue as a percentage of GNP, less transfer payments and subsidies) declined considerably in 1988, after a peak in the preceding year. The principal factor in the decline was increased transfer payments to the public, including of compulsory loans redemption. Both indirect taxes on local production and import taxes also declined as a percentage of GNP. The decrease in the tax burden (as mentioned before, mainly from higher transfer payments) was not the result of government initiative. Transfer payments are linked to wages, and therefore rose automatically, in excess of GNP growth, which was slower than the wage increase. (The government can change this pattern of transfer payments only

TABLE 5.2

Principal Components of Public Sector Expenditure and Revenue, 1980-88*(Percent of GNP, current prices)*

	1980- 1985-								
	1984	1988	1982	1983	1984	1985	1986	1987	1988
1. Total public expenditure	72.8	65.6	72.5	67.4	73.3	71.2	65.5	62.7	62.8
a. Domestic expenditure	61.2	54.8	61.4	58.6	60.2	57.0	54.0	53.3	54.9
Direct domestic demand	35.4	31.1	35.8	35.1	35.3	31.9	30.4	30.8	31.3
<i>of which:</i> Civilian	17.8	16.5	17.5	17.4	18.1	16.3	16.2	16.4	16.9
Defense, net	14.3	11.5	14.9	14.2	14.3	12.8	11.1	11.0	11.0
Public sector									
investment	3.2	3.1	3.3	3.5	2.9	2.7	3.0	3.4	3.4
Direct subsidies	5.7	3.7	5.8	5.8	6.3	4.8	3.1	3.2	3.5
Transfer payments	11.3	11.6	11.5	10.9	10.3	10.5	11.5	11.4	13.0
Credit subsidies	4.5	1.5	3.9	3.3	3.2	2.1	1.5	1.5	1.1
Real interest payments	3.4	6.0	3.5	2.5	3.9	6.8	6.6	5.5	5.0
b. Direct demand for foreign currency	11.6	10.8	11.1	8.8	13.1	14.2	11.5	9.4	7.9
<i>of which:</i> Direct defense imports	8.1	7.3	7.1	5.0	7.7	9.1	5.1	8.7	6.2
Advance payments on defense imports	0.2	-0.2	0.1	0.4	1.0	0.2	2.3	-2.2	-1.2
Net interest payments to abroad	2.1	3.6	2.2	2.2	3.9	4.8	3.7	3.2	2.8
2. Domestic revenue	48.3	50.1	50.3	50.4	42.7	48.8	51.5	50.8	49.3
Taxes and transfer payments by households	43.2	46.5	45.5	46.1	38.1	44.9	48.0	47.2	45.9
Income from property	2.3	1.0	1.9	1.6	1.8	1.3	0.9	1.0	0.9
Income n.e.s.	2.8	2.6	2.8	2.7	2.8	2.6	2.6	2.7	2.6

DEFINITIONS

Domestic civilian public consumption: Civilian public consumption less government imports n.e.s.

Domestic defense consumption: Total defense consumption less direct defense imports and less estimated domestic sales by the defense establishment, deflated by the CPI, annual average.

Public sector investment: Does not include public housing.

Direct subsidies: Subsidies to domestic production, imports and exports.

Credit subsidy: Subsidy element of credit to enterprises (includes subsidy derived from inflationary capital gains) and direct credit subsidy.

Real interest payments: Nominal interest paid to domestic factors by the public sector and the Bank of Israel, less adjustment for repayment of principal.

Net interest payments to abroad: Nominal interest on the foreign public debt less interest received on foreign reserves.

Tax revenue: Direct and indirect taxes (excluding import duties on direct defense imports) plus transfer payments from households.

Income from property: Domestic operating profit of the Bank of Israel, plus other income from property and entrepreneurship (rent, dividends, interest), property income of private nonprofit institutions classified as part of the public sector, less receipts of real interest on government loans to the public which are included under credit subsidy.

Income n.e.s.: Imputation as receipts of the obligations for pension payments to retired public sector employees who are entitled to a budgetary pension, and imputation for depreciation of capital stock in the public sector.

SOURCE: Central Bureau of Statistics and Bank of Israel.

by amending the system of social legislation, and such an initiative requires a far-reaching reform in this area.)

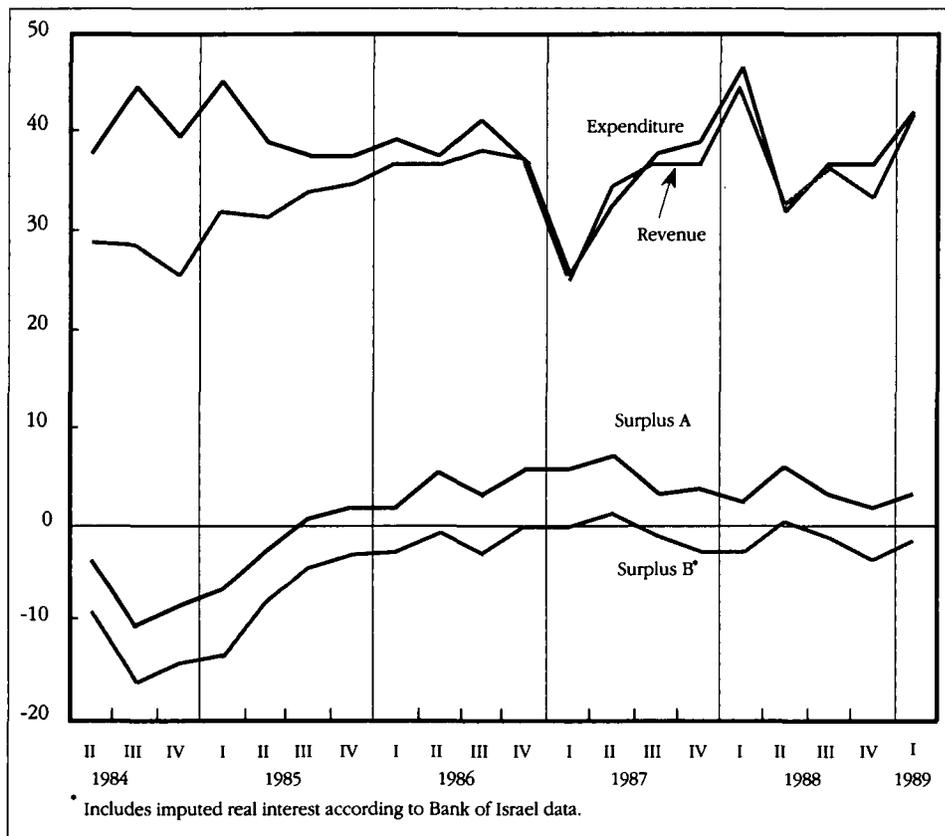
The Accountant-General's data on the government's income, expenditure and deficit, shown in Figure 5.1, indicate how of the public sector's deficit developed during the period. The Accountant-General's data are on a cash basis; they do not include all the institutions comprising the public sector, and are therefore not identical with the data of the Central Bureau of Statistics. Their advantage is that they describe the flows during the year. They show that the slide into a substantial domestic deficit began in the second half of 1988, after its earlier steady contraction (the surplus increased—see the upper graph in Figure 5.1).

2. FISCAL POLICY

The public sector accounts are comprised of two types of information on changes in expenditure and revenue—changes initiated by the government as part of its fiscal policy, and changes due to developments in the level of economic activity. A restrictive fiscal policy, based on legislative amendments introduced by the government, should lead to a rise in net tax revenue. But when such a restrictive policy is implemented, demand contracts, and as a result, tax revenue falls, thus offsetting the original increase. This is an automatic consequence of the fiscal stabilizers. At a time of economic slowdown, as in 1988, the fiscal stabilizers alone may create a deficit. When fiscal policy seeks to achieve budgetary balance in such a situation, it may neutralize the automatic operation of the fiscal stabilizers and thereby aggravate the recession. On the other hand, if policy-makers wish to stimulate economic activity, sole reliance on the fiscal stabilizers may prove insufficient; for that purpose, other expansionary instruments are required.

For an examination and evaluation of the policy actually pursued by the government, it is customary to use an indicator called 'index of full-employment deficit'. This index distinguishes between the two kinds of activity mentioned above—government-initiated, and that due to recession. The index measures the difference between (a) the tax revenue that would be produced with the tax structure of 1988 at full employment income, and (b) actual government expenditure. When this index is zero, it means that the government has not acted effectively to change aggregate demand. A deficit or surplus represents action designed to expand or restrict aggregate demand.

Figure 5.1
Government Expenditure, Income and Cash Deficit, April 1984–March 1989
(Percent of GNP)



SOURCE: Accountant-General, Ministry of Finance, and Bank of Israel calculations.

The index was calculated on the following basis: First, full employment GNP was assumed to be 5 percent above actual GNP in 1988. Second, the tax structure was broken down into two categories—taxes on domestic activity and on foreign trade, with respective taxation rates relative to GNP as shown in the last column of Table 5.6. The incremental tax revenue estimated for full employment GNP according to the 1988 tax rates was 1.3 percent of GNP. Third, the exceptional tax refunds of 1988, amounting to 1.2 percent of GNP, were added (for a further discussion, see the section on taxes). Finally, the redemption of the compulsory loans (amounting to 1.5 percent of GNP) was added to net tax revenue because of the transitory character of this redemption, which is spread over three years.

The result of this calculation is that net tax revenue under full employment (including the exceptional tax refunds and the redemption of the compulsory loans in 1988) was 4 percent of GNP higher than actual tax revenue. The overall full employment deficit was therefore close to zero.

This means that the government took no clear action in 1988 to either expand or restrain aggregate demand, and the actual deficit was mainly due to the combination of the operation of the fiscal stabilizers and the year's specific transitory factors. It should be noted that the government's expenditures exceeded the level planned in the budget (Table 5.3), but this had little effect on the level of economic activity because revenue diverged even more from the budget estimates.

The government's neutral fiscal policy therefore did not support the achievement of the economic policy objectives (particularly long run objectives) of the 1985 stabilization program, apparently to avoid deepening the recession. The fact that deficit increased mainly in the second half of 1988, when the slowdown in economic activity became more marked, and the elections approached, lends support to this argument.

3. DIRECT DEMAND

Following its steep rise in the preceding year, the volume of the public sector's direct demand declined by about 1 percent, (Table 5.4). The large fluctuations in direct public sector demand are due to the defense import component, while domestic demand is steadier. The rise in direct domestic demand— to 31.3 percent of GNP, from 30.8 percent in the previous year—was entirely due to the higher civilian public consumption.

In 1988, the salient development in the public sector's use of inputs was the 3.5 percent increase in the labor input, which had decreased steadily in the previous three years. This development runs counter to a major objective of the stabilization program—the release of workers from the public sector in favor of the private sector.

Wage rates in the public sector rose nominally by about 24 percent, a 7 percent increase in real terms (after deflation by the CPI). This increase in wage rates was higher than in the private sector, and came in the wake of a substantial cumulative lag in public sector wage rises since the adoption of the 1985 stabilization program. Such a wage policy contributes to slowing the shift of workers from the public to the private sector, and therefore hampers progress towards a more efficient resource allocation and future economic growth.

The public sector's local procurement increased this year less, in real terms, than the rise in labor input, while prices increased at the relatively low rate of 14 percent. These developments raised the share of wages in the public sector's total direct demand at current prices. The large relative increase in wage rates and of the number of public sector employees increased the share of the public sector's wage expenditure in the economy's total wage bill.

TABLE 5.3
Central Government Budget, 1982-89^a
(Percent of GNP, fiscal years, at current prices)

	1982	1983	1984	1985	1986	1987	Actual		Proposed
							1988	1988	1989
Total expenditure^b	65.2	61.2	62.8	59.3	57.4	51.5	52.0	51.5	51.2
Domestic	53.9	47.7	45.6	42.8	43.8	40.8	43.8	43.2	43.7
Expenditure abroad	11.3	13.5	17.3	16.4	13.6	10.7	8.2	8.2	7.5
Total revenue	53.9	51.2	48.3	59.2	61.4	51.8	48.4	47.4	46.2
Domestic revenue	45.9	41.8	34.1	39.9	44.9	41.1	39.6	38.5	38.1
Foreign currency receipts	8.0	9.5	14.1	19.2	16.5	10.7	8.9	8.9	8.0
Total deficit (-) or surplus	-11.4	-10.0	-14.5	-0.1	4.0	0.7	-3.6	-4.1	-5.0
Domestic deficit	-8.0	-5.9	-11.4	-2.9	2.1	0.2	-4.2	-4.8	-5.5
Foreign deficit	-3.4	-4.1	-3.1	2.8	2.8	0.1	0.6	0.6	0.5
Deficit finance, total	11.4	10.0	14.5	0.1	-4.0	-0.4	3.6	4.1	5.0
Net borrowing from the public	5.5	0.7	5.1	5.6	1.2	0.1	4.1	4.7	5.4
Net borrowing from abroad	7.6	6.7	10.1	1.3	0.0	-0.8	-2.4	-1.3	-0.7
Net borrowing from Bank of Israel	-1.8	2.6	-0.7	-6.8	-3.2	0.4	1.9	0.8	0.3

^a Differences in totals are due to rounding.

^b Includes net credit to the public.

SOURCE: Central Bureau of Statistics and the Department of Management Accounting in the Accountant-General's Office, the Budget Division in the Ministry of Finance, and Bank of Israel calculations.

TABLE 5.4
Direct Public Sector Demand, 1983–88

	NIS current million			Percent change over preceding year								
				Price		Quantity						
	1986	1987	1988	1987	1988	1983	1984	1985	1986	1987	1988	
Net public consumption												
Civilian consumption	7,004	9,014	11,184	24.9	20.9	1.2	1.7	0.2	-1.1	3.1	2.6	
Defense consumption, net	6,862	10,595	11,124	17.9	12.2	-9.5	10.6	6.8	-17.5	31.0	-6.4	
Total, net	13,866	19,609	22,308	21.0	16.5	-4.5	6.2	3.7	-10.0	16.9	-2.4	
Net public domestic consumption												
Civilian	6,866	8,843	11,007	25.0	21.1	1.2	1.6	-0.1	-0.6	3.0	2.8	
Defense	4,716	5,911	7,140	22.7	17.1	1.5	-0.2	-2.5	-5.8	2.2	3.2	
Total, net	11,582	14,754	18,147	24.1	19.5	1.3	0.8	-1.1	-2.8	2.7	2.9	
Nondwelling investment	1,265	1,826	2,193	22.9	14.2	17.1	-15.6	-3.3	13.0	17.4	5.1	
Direct public sector demand												
Total	15,131	21,435	24,501	21.1	16.3	-2.9	4.2	3.2	-8.4	16.9	-1.8	
<i>of which</i> : Domestic demand	12,847	16,580	20,340	24.0	18.9	2.8	-0.9	-1.3	-1.4	4.1	3.2	
Public construction	238	282	320	24.6	18.4	-17.3	-19.6	-20.5	-27.5	-4.8	-4.0	

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

The Defense Burden

Defense expenditure decreased in 1988 by 6 percent. The entire decline was due to the large contraction of defense imports. But domestic defense spending increased by 3.3 percent—the biggest increase since the Lebanon war. The decrease of defense imports—which fluctuate widely, depending on the timing of supplies—after a large increase in the previous year, does not signify any particular trend.

Particularly notable was the 6.5 percent rise in the defense labor input—after three consecutive year's of contraction—was due to the increased military operations in Judea-Samaria and Gaza. Local procurement increased by a mere 1 percent in real terms, continuing the post-196 decline in the proportion of domestic purchases in total defense expenditure.

The defense burden is a multi-dimensional concept; there is in fact no single quantitative measure to express the economic burden of defense. It is therefore customary to analyze several indicators, each of which highlights a different aspect of the defense burden, and all of which together provide an indication of the overall trend.

In the first year after the stabilization program, all the quantitative indicators presented in Table 5.5 showed a decline in the defense burden. But during each of the last two years, changes in the different indicators were uneven—primarily because of the wide fluctuations in defense imports—and mainly affected the first two indicators. These rose steeply in 1987, and declined in 1988, in line with the changes in defense imports. A multi-annual annual analysis of the defense burden smoothens these fluctuations, and better reveals its long-term trends. In a breakdown by sub-periods (see Table 5.5) all the indicators show an easing of the defense burden in recent years (1985–88) compared to the preceding period of 1980–84.

The first two indicators declined, as previously mentioned, because of the decrease in defense imports.² The third indicator, which measures the claim of direct defense demand on GNP, points to a stabilization of the defense burden in 1988, on the previous year's level.

The fourth indicator estimates the defense burden after deducting U.S. government grants, and the defense import tied to them, from total defense expenditure. This measure adds together domestic defense consumption, defense procurement abroad paid with foreign currency other than U.S. grant

² For the significance of these two indicators for the defense burden, see the 1987 Annual Report, p. 62).

TABLE 5.5

Indicators of Israel's Defense Outlays, 1980-88*(Percent, at current prices)*

	As percent of gross national income from all sources ^a	Defense consumption as percent of GNP			Defense wage bill as per- cent of total wage bill
		Total, net of defense grants ^b	Domestic ^c	Domestic, plus foreign-currency outlays and debt service ^d	
	(1)	(2)	(3)	(4)	(5)
1980-84	19.9	19.2	14.3	18.2	10.4
1984	20.0	17.6	14.3	19.0	10.4
1985-88	16.4	12.6	11.5	15.4	9.4
1985	18.4	13.4	12.8	17.6	9.7
1986	13.9	9.7	11.1	15.3	9.2
1987	17.5	14.4	11.0	14.6	9.0
1988	15.6	12.9	11.0	14.0	9.6

^a GNP plus unilateral transfers from abroad at the effective exchange rate; GNP data until 1979 are according to the old System of National Accounts definitions.

^b Grants include the grant-equivalent of U.S. government defense loans. This is the difference between the loan proceeds and the present value of the repayments at the going market interest rate, here assumed to be 10 percent for 1964-77 and 12 percent for 1978. Since 1979 the grant-equivalent has been negligible (For details of the calculation, see Oded Liviatan, 'Israel's External Debt,' Bank of Israel Economic Review, No. 48-49 (May 1980), pp. 144 &ff.).

^c Total domestic defense outlays less local sales of the defense establishment; does not include wages of soldiers in obligatory military service.

^d Principal and interest on U.S. government defense loans.

SOURCE: Columns 1-3 and 5—Central Bureau of Statistics and Bank of Israel calculations; column 4—Budget Division of the Ministry of Finance and Bank of Israel calculations.

funds, and the servicing of foreign debt incurred to finance defense expenditure, including U.S. government defense loans granted in the past. In 1988, this indicator sank to its lowest level since 1973.

For 1988, the first four indicators point to a certain easing of the defense burden. The fifth indicator, which examines the burden imposed by defense outlays on the labor market, points in 1988 in the opposite direction. The increase in the defense sector's wage bill, for the first time in four years, indicates how direct defense sector pressure on the labor market increased. As measured by this indicator, the defense burden returned to its 1985 level.

4. TAXES, TRANSFER PAYMENTS AND SUBSIDIES

In 1988, taxes and gross transfer payments by the public, at current prices, rose by 17.5 percent (an increment of about NIS 4.5 billion), while GNP prices and the consumer price index rose by 18.4 and 16.3 percent, respectively, and the ratio of gross tax revenue to GNP declined by 1.3 percentage point, to 45.9 percent.³

The year's real changes⁴ in tax revenue reflected developments whose effects went in different directions. The economic slowdown which followed the substantial GNP growth of the previous year, combined with the adjustment to the cuts in personal and corporate taxes in January and April 1987, resulted in a decline in net tax revenue. As against this, the continued rise of real wages contributed to a short-run increase in tax revenue. The 'tax burden' shouldered by the economy may be viewed from two aspects: a) the proportion of gross taxes in GNP, which relates to aggregate supply; and b) the ratio of net taxes to GNP which, through its effect on disposable income, is more closely connected with demand.

The stabilization policy, followed by the steep fall of the inflation rate, combined with the 1985 changes in fiscal policy to produce a large one-time increase in the ratio of gross taxes to GNP, which in 1984 had been at a low level. This sharp turnaround had run its course by 1986, and since then the gross tax burden decreased gradually (Table 5.6). This trend should help renewal of economic growth, by stimulating demand for labor and providing incentives for work, entrepreneurship and investment. A renewal of growth, assisted in part by a reduction of the tax/GNP ratio, may in turn lead to a further decline in the gross tax burden, due to the growth of GNP. Tax cuts, an alternative way of lowering the tax burden, depend on (and are limited by) the government's ability to reduce its involvement in the economy, and its deficit policy.

³ In 1987, the tax/GNP ratio in Israel was lower than in the Scandinavian countries and the Netherlands, but higher than in the rest of the OECD countries.

⁴ It should be pointed out that due to the sharp change in relative prices (the CPI, GNP prices, imports and private consumption), it is particularly important to select the relevant price index for an estimate of real changes. The share of different taxes in GNP were also affected by the changes in relative prices.

TABLE 5.6

Taxes, Subsidies and Transfer Payments, 1980–88*(Percent of GNP, current prices)*

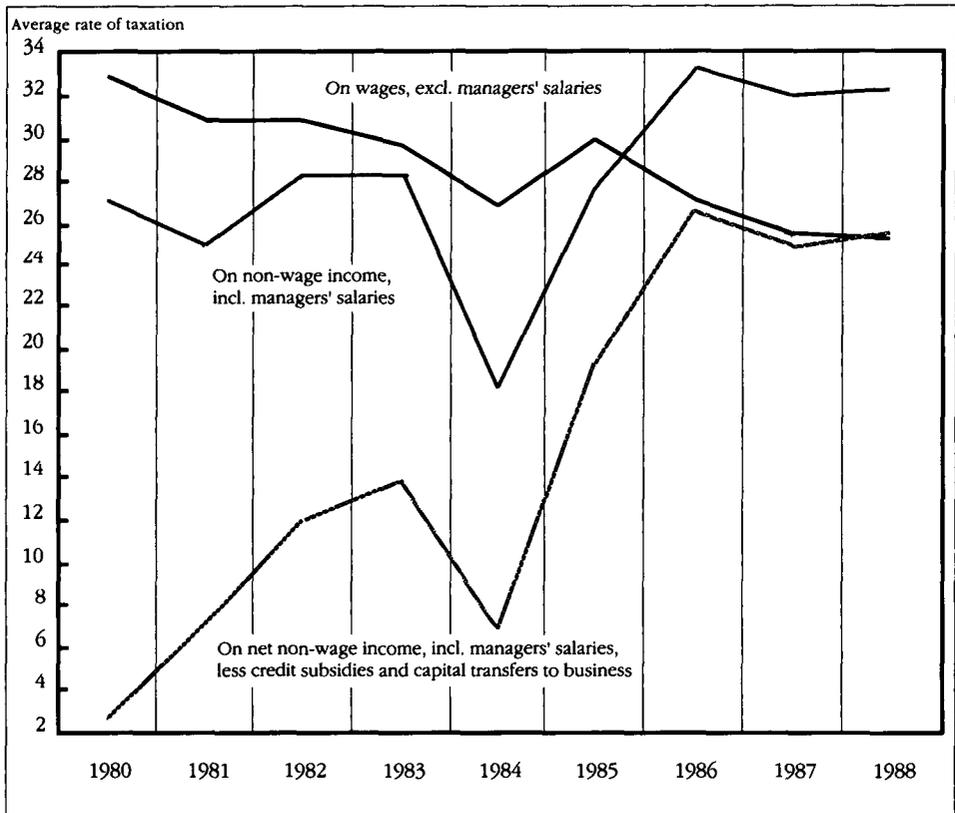
	1980– 1985–							
	1984	1988	1983	1984	1985	1986	1987	1988
Net taxes (1–2–4)	21.7	29.7	26.1	18.2	27.5	31.9	31.1	28.2
1. Total taxes and transfer payments by the public to the public sector	43.2	46.5	46.1	38.1	44.9	48.0	47.2	45.9
2. Total direct subsidies and transfer payments to the public	17.0	15.3	16.7	16.6	15.3	14.6	14.6	16.6
3. Net taxes, excluding credit subsidies	26.3	31.2	29.4	21.5	29.6	33.4	32.6	29.3
4. Imputed credit subsidies	4.5	1.5	3.3	3.2	2.1	1.5	1.5	1.1
Net direct taxes (5–7)	13.6	13.1	15.2	10.0	14.1	13.9	12.9	11.4
5. Direct taxes, compulsory loans and transfer payments by the public to the public sector	24.9	24.7	26.1	20.3	24.6	25.4	24.3	24.4
6. <i>of which:</i>								
Income tax	16.0	16.5	16.3	13.1	16.1	16.8	16.4	16.7
7. Transfer payments to the public	11.3	11.6	10.9	10.3	10.5	11.5	11.4	13.0
Net taxes on domestic production (8–9–10)	4.0	9.8	5.4	3.8	7.6	10.7	10.7	10.0
8. Indirect taxes on domestic production	11.0	13.7	11.2	10.4	12.9	14.3	14.2	13.5
9. Direct subsidies	4.4	2.5	3.9	4.7	3.5	2.1	2.0	2.4
10. Credit subsidies to businesses	2.6	1.5	2.0	1.8	1.8	1.5	1.5	1.1
Net taxes on foreign trade	4.6	6.8	5.8	4.5	5.8	7.2	7.5	6.8

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

The size of the net tax burden is customarily expressed by deducting transfer payments and subsidies from gross taxes. In 1988, the net tax burden so defined was 28.2 percent. This is 3 percentage points lower than in the preceding year. The decrease was due to the combined effect of a decline in the tax/GNP ratio, and similar increase, as a percentage of GNP, in part of the transfer payments and subsidies (including credit subsidies). It should be pointed out that in the last four years, the tax burden was much higher than in the early 1980s. This picture does not change even when compulsory loans are deducted from transfer payments, because of the exceptionally high redemption of these loans in 1988 (1.5 percent of GNP). The change in the scale of these redemptions, of course, does not reflect current operations or a change in policy

Figure 5.2

Effective Rates of Taxation on Wages and Non-wage Income, 1980–88

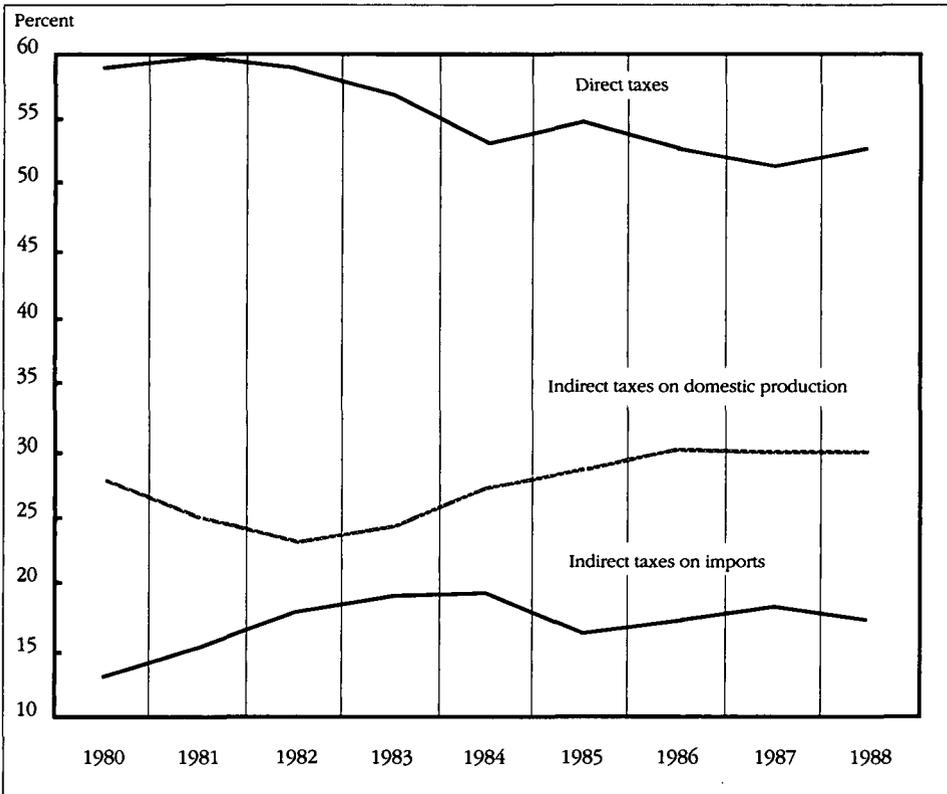


SOURCE: Central Bureau of Statistics and Bank of Israel calculations.

(these loans were imposed 15 years ago). But, it could be expected that fiscal policy would take these redemptions into account. After this deduction, the 1988 proportion of net taxes in GNP amounted to 29.7 percent, compared to an average 30.5 percent since 1985, and an average of 22.5 percent in 1980–84.

While 1987 was marked by the direct tax reform (mainly cuts in personal and corporate tax rates), there was no significant change in tax policy in 1988, although the earlier changes made themselves felt. Moreover, the sharp changes in the level of economic activity in the last two years (rapid GNP growth in 1987 and a recession in 1988), combined with the effect of the cuts in personal and corporate income tax in 1987 to spotlight the lag in adjusting tax collection to economic and legislative changes. In the year under review, this expressed itself in a large increase in income tax refunds, mainly to corporations and self-employed. These groups pay income tax advances based on previous years' level of economic activity and tax assessments. Since these advances are not

Figure 5.3
Tax Revenue, by Percentage of Main Tax Categories in Total, 1980–88



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

updated in line with the changes in economic activity, their effect is to reinforce cyclical swings. But this is not necessarily the case when income tax advances fail to be updated in line with changes in tax *rates*.

Thus, the failure to increase the advances in 1987, as called for by the accelerated economic activity, amplified the business cycle. The non-adjustment of the advances to the tax cuts had the opposite effect.

GNP growth in 1987 and 1988, could have justified an expectation of a 5 percent real increase⁵ (after deflation by the CPI) in tax revenue. But total tax revenue actually increased in 1988 by only 1.1 percent. According to Bank of Israel estimates, legislative changes during 1987 and 1988 caused a fall of 1.3 percent of GNP in tax revenue, and the tax refunds which were above the average of years in which there were no significant exogenous changes caused an

⁵ Nominal amounts deflated by the CPI.

additional 2.6 percent contraction in tax revenue. The 1988 tax refunds amounted to NIS1.15 billion—10.6 percent of net tax revenue. The refunds to corporations and self-employed amounted to 34 and 36 percent of their net tax payments, respectively. The total amount of these refunds was NIS 790 million, part of which was for 1988.

In 1988, as mentioned earlier, there was no continuation of the tax reform initiated in 1987. The recommendations of the Sheshinsky commission (see 1987 Annual Report, p. 64) were not implemented. The tax base was not broadened by the recommended elimination of exemptions and tax benefits, nor were the discriminatory provisions of the tax code eliminated. It should also be noted that the tax cuts which preceded the recommendations of the Sheshinsky commission, were not accompanied by a broadening of the tax base. The tax cut thus benefited all taxpayers, albeit not equally. In contrast, the full adoption of the commission's recommendations would have included an impingement on some incomes. It seems that one of the reasons for the failure to adopt the Sheshinsky recommendations was the lobbying by interested parties who stood to lose—a lobbying particularly effective in an election year.

The cuts in personal and corporate tax rates, and the lowering of labor costs through reductions of employers' payments to the National Insurance Institute initiated in 1987 had their full effect on tax revenue in 1988. At the same time, there was a considerable rise in tax revenue from wage income, due to the increase in both real wages and employment. The actual average taxation rate of wages remained at the previous year's level—about 25 percent.⁶ The long-run trend, nevertheless, is that of a moderate and gradual decline in the rate of taxation (disregarding its 1985 rise, which compensated for the decline in 1984 caused by the acceleration of inflation; see Figure 5.2).

No significant change occurred in 1988 in the taxation of non-wage income. Its actual average rate stood at 32 percent of GNP. It should be pointed out that the decline of the actual taxation rate in 1987 resulted from the cuts in statutory rates from the beginning of that year. Further, in 1988 the surtax on the upper income brackets was abolished. These income brackets include company managers, who are classified as recipients of non-wage income, and are therefore included in the calculation of the actual taxation rate of non-wage income. After deducting credit subsidies and capital transfer payments, which declined in

⁶ In this estimate, taxes on wages include the employers' tax and employers' payments to the National Insurance Institute. They do not include taxes on the salaries of company directors, which are included in taxes on non-wage income.

1988, from non-wage income, it was found that the net taxation rate on this income rose from 25 to about 26 percent. Figure 5.2 brings out several developments, among them the large fluctuations in the taxation rate of non-wage income, relative to the rate on wage earnings, which characterized the period before the stabilization program. These fluctuations reflected the taxation rate's high sensitivity to changes in the inflation rate and frequent changes in the tax code made to counter the detrimental effects of inflation on tax revenue, but which were generally introduced with a lag. In the post-stabilization period these fluctuations narrowed and turned into relative stability. When the stabilization program was launched in 1985 and inflation was curbed, effective tax rates rose steeply. This rise continued in 1986, albeit at a slower pace, followed by a period of relative stability. The gap between gross and net tax rate on non-wage income in the business sector has narrowed since 1985, due to the cuts in tax benefits and capital transfer payments to business firms.⁷ Until the stabilization program, the taxation rate of wages was higher than of non-wage income. Since 1986, this ratio has reversed.

Some of the above-described developments are consistent with a policy designed to renew economic growth. But the rise in the taxation rate of non-wage income may have exceeded a level which is sustainable in the long run and is in line with conditions prevailing in Israel's trading partner countries.

Revenue from direct taxes rose considerably in 1988, due to the increase in real wages. Revenue from indirect taxes (at current prices) increased less, as a result of the slowdown in economic activity. An even smaller rise was recorded in taxes on imports, as merchandise imports contracted and the exchange rate was held stable. As a result, the ratio of direct to indirect taxes, which in the two previous years had declined by a cumulative 12 percent, increased in 1988 by 8 percent. In 1988, this ratio was 1.1, compared to approximately 1.5 in 1981. In the OECD countries, by comparison, this ratio is 1.6–1.7, and the aim is to reduce it by shifting to taxing consumption and thereby stimulate the supply side. The direct/indirect tax ratio is sometimes regarded as a partial measure of the tax system's progressivity. The higher this ratio, the more progressive is the tax system. But it is more meaningful to examine the progressivity of the entire fiscal system. In Israel, the changes in this ratio apparently result

⁷ Figure 5.2 does not show net taxes on wage earnings, because it refers to taxes on wages, as distinct from taxes on wage earners. We have no data on the distribution of transfer payments between wage earners and their households and the rest of the population. This is mainly due to the fact that transfer payments to households are not made according to their economic activity.

from the fact that most changes in tax policy were in direct taxes, the revenue from which was hurt more than revenue from indirect taxes by the inflation of the 1980s. Enforcement of direct taxes seems to be more costly and more sensitive socially. Social sensitivity, for example, prevented the abolition of exemptions and benefits which have over the years mounted to considerable proportions.

Indirect taxes tend to be regressive with respect to income. Moreover, when tax rates are discriminatory, as they are in Israel, they cause distortions in both production and consumption. But it should be taken into account that direct taxes also cause distortions, and that Israel's value-added tax on most goods and services, with its uniform rate, accounts for a major proportion of indirect taxes. In 1988, VAT accounted for 48 percent of all indirect taxes (34 percent of import taxes and 57 percent of the taxes on local production).

Taxes on imports have undergone structural change in recent years. A gradual exposure to imports, through tariff cuts, is under way in the framework of the trade agreements with the US and the EEC. The major stages in this process were the tariff cuts of January 1987 and 1988, which abolished customs duties on most imports from the EEC, and on many imports from the US. These tariff cuts were accompanied by changes in purchase tax rates and their increase on imports.

The reduction of the overall rate of taxation relative to GNP is intended to create favorable conditions for sustained economic growth, by increasing the incentives for work and investment. In this respect, the tax structure and tax base have an important role, since they affect the composition of demand and the efficiency of use of production factors. Moreover, the renewed expansion of public consumption in 1988, with an increase in the deficit, may shake confidence in the firmness of the government's policy to reduce taxes, and increase uncertainty. This would have far-reaching implications for economic growth.

Income Distribution

One of the principal functions of the fiscal system is to influence the distribution of income, in order to achieve both economic and social objectives. The government affects income distribution through the tax system and the size of its expenditures on transfer payments, subsidies and public consumption. The full measurement of these is limited by the availability of statistical data. The latest Family Expenditure Surveys are for 1979/80 and 1986/87, and cover the

whole urban population, but for statistical reasons the data on income distribution in these surveys cannot be compared. The current income surveys mainly contain data on urban wage-earners. There are no data on the distribution of wealth, which are important for the discussion of the overall effects of inflation on income distribution. Nor are there data on the distribution of "public goods" and on the incidence of public expenditure on health, education, etc., or on the incidence of indirect taxes on households with different incomes. Our discussion of the effects of economic policy on income distribution is therefore deficient, since it must rely on the available surveys and their recomputations in the annual reports of the National Insurance Institute and in occasional studies.

An international comparison of income distribution in 1979–83 (the Luxembourg Income Study) for ten countries⁸ ranks Israel sixth, together with Switzerland, according to the Gini coefficient used to measure inequality. Inequality of income in Israel is lower than in the Netherlands, and higher than in West Germany.

The income surveys show that in 1979–83, despite the high inflation of those years, the inequality in economic income of wage earners (including those not economically active) increased only slightly—1.1 percent as measured by the Gini coefficient. When transfer payments to the population covered by the surveys are included, inequality is even seen to have declined by 1.1 percent. In disposable income, inequality decreased by 5 percent, due to the impact of direct taxation. It follows that the indexation of wages and National Insurance benefits, and the erosion of the tax brackets (which raised the progressivity of taxes on wage-earners) prevented a deterioration in income distribution, and even reduced inequality in the distribution of disposable income.⁹

A change occurred in 1984 (similar to 1979), when inflation accelerated and the indexation and updating systems, which had been perfected over the years, were not longer adequate to maintain the real value of National Insurance benefits. In 1984, there was almost no increase in the contribution of transfer payments and direct taxes to reducing income inequality. Instead, inequality increased, mainly due to higher wage differentials and the rise in unemployment.

⁸ The countries, in ascending order of inequality, are: Norway, Sweden, the Federal Republic of Germany, Israel, Switzerland, the Netherlands, the U.K., Canada, Australia, and the U.S. The data were published in *The Review of Income and Wealth*, June 1988.

⁹ See the study by Ahdut, L. and Bigman, D, *The Anatomy of Changes in Poverty and Income Inequality under Rapid Inflation: Israel 1979–84*; National Insurance Institute, Bureau of Research and Planning; September 1987.

A comparison of the income survey of 1985 (carried out before the stabilization program and during its implementation) with the 1987 data shows that the coefficient of inequality in the distribution of disposable income of wage earners, standardized per person, declined by 2.8 percent. The coefficient of inequality for households whose heads were not gainfully employed increased by 10 percent. Such households, of course, do not benefit from the progressivity of the income tax system.

The comparison of the two surveys further shows that among wage earners (classified by disposable income per standard person), the situation of the lower six deciles improved, and the upper four deciles' share in income declined, between 1985 and 1987. Analysis of overall inequality of income distribution is hampered by the non-inclusion of the self-employed, which are more concentrated in the top and bottom deciles than wage earners. The Family Expenditure Surveys are more appropriate for such an analysis. The 1986/87 survey shows that the inequality of disposable income distribution is 32 percent lower than in the distribution of economic income. Of this difference, 58 percent is explained by transfer payments and the rest by the effects of direct taxes and obligatory payments. The data of the 1979/80 survey show a similar picture: inequality in disposable income was 26.6 percent less than in economic income, but then the transfer payments explained 53 percent of the difference. This means that the effect of transfer payments on income distribution has increased over time.

The 1986/87 Family Expenditure Survey provides information on the progressivity of the transfer payments and direct taxes. When households are classified by the economic income of a representative adult, it is found that in the distribution of direct transfer payments to households, the share of the bottom decile is 31.5 percent, while that of the top decile is 5.3 percent. The two lowest deciles take 45 percent of the transfer payments, and the top two, about 10 percent. In contrast, the share of the lowest two deciles in direct taxes and obligatory payments is 0.5 percent, while the two top deciles pay 67 percent (48 percent are paid by the top decile).

It should be mentioned here that while the 1987 tax cuts and changes in the tax brackets benefited nearly all recipients of earned income, the greatest benefit went to the highest income brackets. As against this, the 'quiet reform' of 1985, which took the form of a real-term change in the tax brackets, was quantitatively greater and more progressive (among wage earners) than the 1987 changes in personal tax rates. That 1985 'reform' reduced the average rate of taxation on the upper wage brackets less than on the lower brackets. Re-

garding transfer payments, it is worth noting that while old age and survivors' pensions were increased, and the guaranteed minimal income was raised in 1985, the taxation of child allowances was increased and the allowance for the first child was abolished for many small families. However, the child allowances for large families have increased, in real terms, since the stabilization program began.

At present, it is difficult to evaluate the development of income distribution in 1988. The larger weight in GNP of the subsidies to basic goods and services, which have a progressive effect, increased in 1988, and the impact of the 1987 minimum wage law both point to a decline in inequality. But the effects of the changes in wage differentials and the rise in unemployment are not clear. The GNP proportion of transfer payments to the public increased slightly since the stabilization program, and particularly in 1988, but they comprise a large share of the redemption of compulsory loans, which is regressive (just as these loans were progressive when they were imposed). The net effect of the transfer payments in the year under review is therefore not clear.

Another indicator of the scale of the government's intervention in income distribution is an index of the ratio of transfer payments and subsidies to total gross taxes. These data, which include interest payments on the domestic public debt and the redemption of the compulsory loans, are presented in the table below.

Transfer Payments and Subsidies as a Percentage of Total Gross Taxes

1980	1981	1982	1983	1984	1985	1986	1987	1988
60.6	62.7	54.1	48.8	62.4	53.8	47.3	45.7	49.4

The data show that since 1981, there has been a continuous decline in the share of tax revenue the government has allocated to the redistribution of income and that this trend was reversed in 1988, with a simultaneous increase of the share of taxes allocated to financing public consumption and investment. Also notable is the decline in these indexes 1985–88 as compared to 1980–84—the result of the rise in gross taxes, the decrease in subsidies, the relative stability in transfer payments, and substantial increase in interest payments (all as a percentage of GNP). An international comparison for 1981–84 shows that relative to the OECD countries, the rate of gross taxation in Israel is high while the proportion of taxes allocated to the redistribution of income is roughly the same. This means that in Israel, taxes served more to finance public consumption and investment than to redistribute income.

APPENDIX TABLES

TABLE 5.A-1

Indicators of Civilian Public Services, 1980-88

(Percent, current prices)

	1980	1981	1982	1983	1984	1985	1986	1987	1988
Civilian public consumption as:									
Percent of GNP ^a	18.6	18.3	17.8	17.7	18.5	16.8	16.6	16.8	17.2
Percent of private consumption ^b	34.0	32.3	30.1	29.3	32.4	27.7	25.6	25.3	26.5
Per capita, index ^c	100.0	100.4	99.6	99.6	99.3	97.8	95.3	96.6	97.5
Public services employment as percent of total civilian employment	29.7	30.2	29.7	29.2	29.5	29.9	29.7	28.8	29.0
Public sector civilian wage bill as percent of total civilian wage bill	26.0	25.7	24.3	24.0	25.3	23.7	22.8	22.1	22.8
Proportion of age groups 0-24 and 65+ in population, index	100.0	99.7	99.3	99.2	98.8	98.7	98.6	98.6	98.6

^a Includes public consumption n.e.s.

^b Excludes private nonprofit institutions.

^c At 1986 prices.

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

TABLE 5.A-2

Consumption of Civilian Public Services by Type,^a 1975-88

(Percent, current prices)

	1975	1978	1981	1982	1983	1984	1984	1985	1986	1987	1988
Education	40	37	37	38	38	39	42	43	43	43	43
Health	19	23	24	24	24	24	18	18	19	20	18
Other welfare services	16	16	17	16	16	16	14	15	15	14	15
Total welfare services	75	76	78	78	78	79	74	76	77	77	77
Other economic services	25	24	22	22	22	21	26	24	23	23	23
Total civilian public services	100	100	100	100	100	100	100	100	100	100	100

^a Until 1983 the breakdown by type of services is based on estimates of civilian public consumption of nonprofit institutions providing public services. From 1984, the data are in accordance with the new system of national accounts (SNA). The first column for 1984 is an estimate according to the old definition. The estimates for 1985-88 are preliminary, based on the rates of increase in employee posts in the relevant economic sectors.

SOURCE: Central Bureau of Statistics.

TABLE 5.A-3

Wages, Taxes and Disposable Wages per Employee Post, ^a1983-88

	As percentage of gross wages				Real annual percent change ^b		
	1983	1985	1987	1988	1986	1987	1988
<i>Actual average wage</i>					11.6	8.2	6.0
Income tax ^c	19.0	16.4	13.7	14.2	-7.6	9.1	10.5
Net taxes ^d	18.2	16.6	16.0	16.7	4.7	10.8	11.0
Disposable wage income	81.8	83.4	84.0	83.3	12.9	7.7	5.0
<i>Out of average real wage^e</i>							
Income tax	18.9	18.0	12.1	11.7	-27.2	-9.0	-3.3
Net taxes	18.1	18.7	12.7	10.6	-19.2	-16.1	-16.2
Disposable wage income	81.9	81.3	87.3	89.4	4.4	2.9	2.4
<i>Out of twice actual average money wage</i>							
Income tax	32.4	31.0	26.3	26.9	-5.1	7.9	8.4
Net taxes	34.0	33.4	30.1	30.8	0.5	8.4	8.4
Disposable wage income	66.0	66.6	69.9	69.2	17.1	8.1	4.9
<i>Out of twice average real wage</i>							
Income tax	32.3	32.7	24.4	23.9	-20.3	-6.3	-2.1
Net taxes	34.0	35.4	28.1	27.6	-15.8	-5.5	-1.9
Disposable wage income	66.0	64.6	71.9	72.4	8.6	2.3	0.7

^a As defined by the National Insurance Institute.

^b Since wages are generally paid at the beginning of the month, the CPI by which wages are deflated has also been estimated for the beginning of the month, by averaging two consecutive monthly price indexes.

^c Income tax was calculated on the assumption that there is only one wage earner per family, and that there are no additional tax deductions or credits. For the period July 1982 to April 1983, income tax includes the compulsory "Peace for Galilee" loan.

^d Net taxes: income tax and national insurance contributions, less child allowances for two children. National insurance: the employee's contribution only, on the assumption that the whole income is subject to national insurance contributions up to the ceiling.

^e At the January-December 1986 level.

SOURCE: The National Insurance Institute, Income Tax Commission, and Bank of Israel calculations.

TABLE 5.A-4
Direct Taxes, Compulsory Loans and Transfer Payments,^a 1984-88

	NIS million, current prices					Real annual percent change ^b			
	1984	1985	1986	1987	1988	1985	1986	1987	1988
1. Income tax	952	4,355	7,092	8,814	10,867	13.1	9.9	3.7	6.0
<i>of which on:</i> wage earnings	506	1,835	2,528	3,393	4,501	-10.3	-7.0	12.0	14.1
non-wage income	446	2,520	4,564	5,421	6,366	39.6	22.3	-0.9	1.0
companies	65	680	1,379	1,385	1,899	159.0	36.9	-16.2	17.9
self-employed	105	587	1031	1,207	1,240	37.8	18.6	-2.3	-11.6
company managers and members of cooperatives	122	550	815	1,188	1,285	11.2	0.1	21.6	-7.0
deductions at source	154	704	1,339	1,640	1,942	13.1	28.5	2.2	1.8
2. National Insurance ^c	419	1,777	2,715	3,188	3,774	4.7	3.1	-2.0	1.8
<i>of which on:</i> wage earnings ^d	392	1,593	2,338	2,680	3,179	0.5	-0.9	-4.4	2.0
non-wage income	28	184	377	508	595	64.2	38.0	12.5	0.8
3. Surtax on stocks	3	9	-1	0	0	-26.4	-104.3		
4. Property levy	0	157	244	28	0	0.0	4.7	-90.3	-100.0
5. Fees and fines	14	85	186	299	359	49.0	47.2	34.0	3.0
6. Total direct taxes (1+2+3+4+5)	1,388	6,384	10,236	12,330	14,999	13.6	8.3	0.5	4.6
7. Compulsory loans	0	0	0	0	0	-100.0	0.0	0.0	0.0
8. Total direct taxes and compulsory loans (6+7)	1,389	6,384	10,236	12,330	14,999	13.6	8.3	0.5	4.6
9. Current transfer payments to households	535	2,245	3,790	4,866	6,299	3.6	14.0	7.1	11.3
<i>of which:</i> Through National Insurance	386	1,696	2,894	3,576	4,555	8.7	15.2	3.1	9.5
Other transfers and benefits	150	549	897	1,290	1,744	-9.4	10.3	20.1	16.2
10. Transfer payments to private nonprofit institutions	40	138	242	302	358	-14.8	17.9	4.2	2.0
<i>of which:</i> Current transfers	37	129	226	282	334	-13.8	18.5	3.9	1.9
Capital transfers	3	9	15	20	24	-26.4	9.9	8.5	3.3

continued on next page

Table 5A-4 continued

11. Capital transfers to firms	113	350	515	710	872	-23.7	-0.6	15.0	5.6
12. Redemption of compulsory loans	59	101	321	252	955	-58.0	115.4	-34.5	226.2
13. Total transfer payments to the public (9 through 12)	758	2,834	4,863	6,147	8,484	-6.4	15.9	5.5	18.7
14. Transfer payments from the public <i>of which:</i> Current transfer payments by households and nonprofit institutions	86	284	512	744	885	-18.3	21.6	21.3	2.3
Capital transfers ^e	16	41	63	88	145	-37.1	3.0	16.7	41.3
	70	243	449	656	740	-13.9	24.8	22.0	-2.9
15. Net current transfer payments	569	2,365	3,997	5,129	6,609	2.7	14.1	7.1	10.8
16. Total net transfer payments (13+14)	662	2,550	4,352	5,403	7,599	-4.8	15.2	3.6	21.0
17. Direct taxes and transfer payments by the public (8+14)	1,474	6,668	10,748	13,074	15,884	11.8	8.8	1.5	4.5
18. Direct taxes and compulsory loans, less net transfer payments (8-16)	726	3,834	5,885	6,927	7,401	30.4	3.6	-1.8	-8.1

^a Does not include interest payments on domestic loans and interest payments by the government to the Bank of Israel.

^b Deflated by the CPI; annual average.

^c For 1980-83, the total includes direct payments to the sick funds by self-employed persons.

^d Includes managers' salaries.

^e Includes the impost on sales of services.

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

TABLE 5.A-5

Indirect Taxes and Subsidies to Domestic Production, 1984-88

	NIS million, current prices			Percent real annual change ^a				
	1986	1987	1988	1984	1985	1986	1987	1988
1. Indirect taxes on								
economic activities	4,686	5,888	6,714	-6.5	11.2	13.4	4.8	-1.9
Value-added tax	3,112	3,881	5,005	-9.6	10.6	16.8	4.0	10.9
Purchase tax	344	388	417	11.7	-6.5	24.0	-5.9	-7.5
Fuel tax	356	375	488	-8.8	39.5	-13.2	-12.0	11.9
Employers' tax	579	521	444	1.9	-9.9	23.7	-24.9	-26.7
Other taxes on activities ^b	296	724	361	-7.7	58.0	-5.9	104.2	-57.2
Property taxes	65	87	131	-47.1	107.6	9.7	10.5	29.7
Local rates	1,008	1,287	1,506	20.9	45.3	34.9	6.6	0.7
Other taxes ^c	277	368	436	-20.1	4.5	8.6	10.8	1.9
2. Subsidies to								
domestic production	1,502	1,853	2,294	14.2	-25.4	-29.3	3.0	6.4
Direct subsidies	875	1,063	1,589	24.1	-31.3	-37.9	1.4	28.6
Imputed credit subsidies	626	790	704	-5.1	-10.2	-12.5	5.2	-23.3
3. Net indirect taxes on								
domestic production								
A. Excl. imputed credit								
subsidies	5,162	6,567	7,198	-21.1	54.4	36.3	6.2	-5.7
B. Incl. credit subsidies	4,535	5,777	6,494	-27.0	85.5	47.7	6.3	-3.3

^a Deflated by the Consumer Price Index; annual average.

^b Includes tobacco tax, cement excise, stamp tax, fees, various licence fees and, since 1985, the tax for the fuel equalization fund.

^c Surpluses of the Post Office, the Port Authority, and taxes from earmarked income.

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

TABLE 5.A-6

Estimated Value of Selected National Insurance Allowances, 1986-88

	1988 compared to January-June 1985	Real annual change in average monthly allowance		
		1986	1987	1988
<i>Deflated by Consumer Price Index^a</i>				
Allowance for 2 children	-33.1	-12.5	-0.7	0.1
Allowance for 4 children ^b	28.5	25.0	-0.8	0.4
Minimum income allowance for single person ^c	2.8	5.4	-4.0	5.9
<i>Deflated by price index of average wages^a</i>				
Allowance for 2 children	-40.7	-17.1	-8.0	-5.7
Allowance for 4 children ^b	13.9	14.8	-8.2	-5.5
Minimum income allowance for single person ^c	-3.4	-3.0	-11.2	-0.3

^a Monthly deflation.^b Includes allowance for ex-servicemen.^c Invalid allowances changed at the same rate as the minimum income.

SOURCE: National Insurance Institute and Bank of Israel calculations.

TABLE 5.A-7

Import Taxes and Subsidies, 1984-88

	NIS million, current prices			Percent real annual change ^a				
	1986	1987	1988	1984	1985	1986	1987	1988
1. Taxes on civilian imports	3,517	4,688	5,176	-13.0	-8.4	19.2	11.2	-5.0
Value added tax	1,245	1,666	1,748	-6.0	-5.3	2.5	11.7	-9.8
Customs duties ^b	774	765	792	-21.9	-10.1	33.5	-17.6	-10.9
Purchase tax and other taxes ^c	1,497	2,257	2,636	-14.5	-10.5	29.7	25.8	0.5
2. Subsidies to imports	-109	-88	-95	-248.1	30.0	-9.8	-32.9	-7.3
3. Net taxes on civilian imports	3,626	4,776	5,270	-8.9	-7.3	18.1	9.9	-5.1
4. Taxes on defense imports	383	762	650	52.2	16.8	-38.3	66.2	-26.6
5. Net taxes on foreign trade								
A. Excl. imputed credit subsidies	3,068	4,055	4,459	-13.3	-4.1	26.7	10.3	-5.4
B. Incl. credit subsidies	3,064	4,050	4,454	-20.5	18.2	32.0	10.3	-5.4

^a Deflated by the CPI; annual average.^b Excludes fines; includes, from 1983, the import levy.^c Includes, from 1982, the travel tax; since 1983 also includes the implicit tax component in the obligatory imports deposits and purchases of foreign currency. From 1984, includes the levy on imports of services, and from 1985, the impost on foreign travel tickets, and from 1987, the levy on credits from abroad.

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

TABLE 5.A-8
Direct Public Sector Demand by Main Items, 1983-88

	NIS current million				Percent change over preceding year ^a							
					Price		Quantity					
	1985	1986	1987	1988	1987	1988	1983	1984	1985	1986	1987	1988
Public consumption, total												
1. Civilian public consumption												
Wages	3,305	5,062	6,471	8,220	26.9	24.1	0.8	0.6	0.2	-3.0	0.8	2.4
Purchases	788	1,210	1,567	1,826	15.4	13.8	2.8	6.1	-0.2	5.4	12.3	2.4
Total	4,557	7,004	9,014	11,184	24.9	20.9	1.2	1.7	0.2	-1.1	3.1	2.6
<i>of which: Govt. n.e.s.</i>	124	138	171	178	16.2	10.1	3.7	7.2	15.6	-21.4	6.3	-5.5
2. Defense consumption												
Wages	1,355	2,038	2,646	3,458	32.3	22.7	0.6	1.5	-3.1	-6.3	-1.8	6.5
Domestic purchases	2,123	2,695	3,281	3,705	15.8	11.9	0.6	-2.4	-2.2	-5.4	5.1	0.9
Purchases abroad	2,469	2,171	4,707	4,018	12.3	3.1	-30.8	36.4	24.1	-35.0	93.1	-17.2
Gross defense consumption	5,947	6,903	10,633	11,181	17.8	12.2	-10.6	9.5	6.6	-17.4	30.7	-6.3
<i>less: Sales to abroad</i>	36	41	37	57	7.4	17.6	-47.6	-51.8	-23.6	-6.5	-15.9	29.4
Net defense consumption	5,911	6,862	10,595	11,124	17.9	12.2	-9.5	10.6	6.8	-17.5	31.0	-6.4
Net public consumption, total	10,468	13,866	19,609	22,308	21.0	16.5	-4.5	6.2	3.7	-10.0	16.9	-2.4
3. Domestic public consumption												
Civilian	4,432	6,866	8,843	11,007	25.0	21.1	1.2	1.6	-0.1	-0.6	3.0	2.8
Defense	3,478	4,733	5,926	7,163	22.6	17.1	0.6	-0.7	-2.6	-5.8	2.1	3.3
<i>less: Domestic component of sales to abroad^b</i>	14	17	15	23	7.4	17.6	-47.6	-51.8	-23.6	-6.5	-15.9	29.4
Defense, net	3,464	4,716	5,911	7,140	22.7	17.1	1.5	-0.2	-2.5	-5.8	2.2	3.2
Total domestic	7,896	11,582	14,754	18,147	24.1	19.5	1.3	0.8	-1.1	-2.8	2.7	2.9
Nondwelling investment	742	1,265	1,826	2,193	22.9	14.2	17.1	-15.6	-3.3	13.0	17.4	5.1
Total direct demand, net	11,210	15,131	21,435	24,501	21.1	16.3	-2.9	4.2	3.2	-8.4	16.9	-1.8
<i>of which: Domestic, net</i>	8,638	12,847	16,580	20,340	24.0	18.9	2.8	-0.9	-1.3	-1.4	4.1	3.2
6. Residential construction	209	238	282	320	24.6	18.4	-17.3	-19.6	-20.5	-27.5	-4.8	-4.0

^a Rates of change calculated at 1986 prices.

^b The domestic component of sales to abroad was taken as 40 percent of sales, according to the ratio of domestic purchases (excluding construction) to the multi-annual average of total purchases.

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