

# **Two Years of Destructive Policies**

## **Critique of the Budget Proposal for Israel for Fiscal 2004**

### **Executive Summary**

Dr. Shlomo Swirski  
Etty Konor-Attias

November 2003

## **Two Years of Destructive Policies**

The budget proposal for fiscal 2004 approved by the Israeli Cabinet in September 2003 under the salutary title, "Plan for the Recovery of the Israeli Economy -- Stage Two", is a direct continuation of the destructive fiscal policies promoted by the Sharon governments over the past two years.

In September 2001, a year after the outbreak of the second Palestinian uprising and six months after the first Sharon government took office, the Government embarked on a series of economic measures involving devastating consequences for employment and wages; the pension system; the safety net; the legal protections of wage earners; the education, health and social welfare systems; civil society institutions like the labor unions; and the status of the basic institution of parliamentary democracy -- the Knesset.

The measures came in fast sequence, first during the first Sharon administration, when Silvan Shalom was Finance Minister, then during the second Sharon administration, when Benjamin Netanyahu was Minister of Finance: the budget cuts of September 2001, additional budget cuts in December 2001, the "Economic Defensive Shield Plan" of June 2002, the cutbacks of the 2003 budget, the "Plan for the Recovery of the Israeli Economy -- Stage 1" in June 2002, and now the "Plan for the Recovery of the Israeli Economy - Stage 2 (September 2003).

These economic measures were initiated, ostensibly, in response to a decrease in tax revenues, the result of the shrinking of economic activity. The reduction of economic activity, in turn, was the outcome of two factors: the conflict with the Palestinians and the world recession (including the bursting of the hi-tech bubble). With time, the conflict became the dominant factor in the Israeli recession: while other parts of the world began to evince economic growth, the recession in Israel only deepened.

However, many of the economic measures taken in Israel had little to do with the need to reduce government spending in the wake of a decrease in tax revenues: rather, they were a reflection of, firstly, a right-wing, neo-liberal social and economic agenda, aimed at downsizing the state, at upfronting the role of big business in political and social affairs, at debilitating the unions, lowering the cost of labor and diluting the social support systems. Under the pretense of "the public coffers are empty", the governments of Israel have been carrying out a right-wing social revolution, tearing asunder structural and constitutional arrangements that have been in existence for years.

Moreover, the pretense of "the public coffers are empty" cannot explain the way in which the Government chose to cope with the conflict and the terrorist attacks. It was not a matter of "safeguarding home and hearth", as contended, but rather one of repeatedly reconquering Palestinian territories, weakening the Palestinian Authority, holding on to all the settlements and even expanding them. Despite the fiscal crisis and the threat of a financial crisis, the Government was able to find large enough sums of money to increase the defense budget, to keep a large army busy defending the settlements, and even to invest billions in a wall, whose cost is far higher than

originally planned, after its location was determined in such a way as to bite off huge chunks of Palestinian territory. These measures did not contribute one iota to economic stability.

The acts of the Sharon governments over the past two years have exacted an enormous price and dealt a devastating blow to broad sectors of Israeli society. The combination of a right-wing social and economic policy and an aggressive foreign policy led to the transfer of a growing portion of the collective wealth into the hands of the few; an increase in the financial burdens of the middle class; an increase in the ranks of the poor; and a weakening of the states' ability to maintain a reasonable balance between rich and poor.

**"There is no other way". But of course there is. There always is.**

All the so-called economic plans initiated by the Sharon administrations were carried out under the pretense of "there is no other way" to avoid a financial crisis, a fiscal crisis, the lowering of Israel's international credit rating, and the like. Moreover, each and every one of the six "economic plans" was conceived and presented as having, in and by itself, the power to change the situation. Accordingly, each was presented by the Finance Minister as if the responsibility for the Israeli economic situation and the ways and means of changing it were solely in the realm of economics and not in the realm of overall Israeli policy, both domestic and foreign, and solely dependent upon the Ministry of Finance - not on the entire Cabinet, under the leadership of the Prime Minister.

Since Israel's present economic crisis is the product of a larger malaise, it behooves us to approach it with a broader perspective. It then becomes clear that the contention that "there is no other way" is simply misleading.

### **Delimit the Borders of Israel -- and the Conflict**

It is hard to imagine that the economic situation in Israel is likely to change significantly or for very long, as long as the violent confrontation between Israel and the Palestinians continues. The conflict itself is presently the main factor contributing to Israel's continuing recession and to the shrinking of its economy. Even relatively long periods of calm are liable to end in the return of hostilities if there is no political agreement accepted by both sides.

Every conflict has two sides, of course, and clearly both sides have to change their strategies and come to compromise and agreement. For its part, Israel is not making the situation any easier, because the practical goals guiding it all along have been the continued control of the occupied territories, the weakening of the Palestinian Authority, and the strengthening the Jewish settlements in the occupied territories.

These goals assure the continuation of the confrontation. Continuing confrontation means continuing economic instability and continuing large outlays for defense.

Israel could contribute to the cessation of the hostilities by maintaining its obligation to recognize a Palestinian state, within borders recognized by the international community, and by dismantling the settlements located deep inside Palestinian territories.

### **Adjust the Defense Budget to New Geo-Political Realities**

Many experts are of the opinion that the geo-political situation of Israel improved considerably with the US intervention in Iraq. They believe this development enables the IDF to reduce the size of its forces - and the size of the defense budget.

Ministry of Finance officials are themselves among those who think it is time to reduce the defense budget. In discussions with representatives of the Defense Ministry, they demanded a cut of 20%, to be spread over a period of two years, but the Defense Ministry strenuously objected.<sup>1</sup> In the end, the Defense Ministry managed to bring the Prime Minister over to its side, and the latter decided on a smaller cut.

It should be pointed out that the defense budget is the only budget that has experienced significant growth in recent years: according to the *Annual Financial Statement* of the Ministry of Finance, between 2001 and 2002, the Defense budget (including secret service agencies) increased by three billion shekels, from NIS 44.8 billion to NIS 47.9 billion (an increase of 7%).

### **Put an End to Over-Funding in the Occupied Territories**

Delimiting the border will put an end to the huge outlays expended on the Jewish settlements in the occupied territories for their creation, settlement, upkeep and defense.

The settlements funnel large expenditures, due to their location in the midst of the Palestinian population, requiring huge investments for defense and access roads. The large expenditures are also the result of the fact that the settlements are built to high standards, in order to attract settlers, and of the high level of government financing of their municipalities, allowing for lower municipal taxes -- that, too, in order to attract settlers. According to a calculation made by the Adva Center, the Jewish settlements in the occupied territories receive municipal per capita over-funding (compared with localities within the green line) to the tune of about NIS 1 billion a year. According to another estimation, made by the *Haaretz* newspaper, the total over-funding of the settlements amounts to NIS 2.5 billion annually.<sup>2</sup>

If and when the settlements are moved to Israel, and if and when some of them are accorded recognition by both sides in their present locations, they will no longer need large-scale government over-funding, and it will be possible to save billions of shekels annually.

## **Raise the Capital Gains Tax; Postpone Tax Breaks on Earnings**

The Government can ease the present budgetary crisis by changing the way it implements the tax reform approved in July 2002. Firstly, it should increase the capital gains tax from 15% to 25%, as recommended by the Ben Bassat Commission.

At the same time, the Government should postpone implementation of income tax cuts until the present crisis is over. Even then, the reform should be altered so that not only the highest income bracket benefits: as it stands, the reform gives persons with lower-than-average incomes a negligible tax reduction, while giving persons earning NIS 25,000 or more a tax reduction amounting to NIS 2,000 or more.

Economists at the Bank of Israel have calculated that the cost of the income tax reform will be NIS 4.55 billion in 2004, NIS 6.7 billion in 2005, NIS 8 billion in 2006, and NIS 7 billion in both 2007 and 2008.<sup>3</sup> Most of the benefit will accrue to individuals in the top income bracket.

It defies all logic: at the same time that the Government dictates a series of so-called economic plans, the main element of which consists of budget cuts amounting to billions of shekels -- at the expense of a large portion of the Israeli public -- it hands out between five and eight billion shekels a year to persons in the top income bracket.

## **Needed: Government Initiatives to Promote Growth and Employment**

The Government of Israel needs to use the tools at its disposal -- the national budget, the possibility of borrowing, the ability to plan and regulate -- to stimulate economic growth and job creation.

The Government needs to jettison the ideology that proclaims that economic growth can only be promoted by the business sector. The business sector in Israel is neither as big nor as strong as that in the United States, France or Germany. Moreover, the business growth experienced in recent years was concentrated in a very restricted segment of the Israeli economy, hi-tech, while other sectors languished far behind.

## **Base Decision-Making on Rational and Long-Term Considerations Involving Processes of Consultation and Public Debate**

During the past two years, the Israeli Government has acted as if it were driven by external events, as if it lacked the ability to stop and think, and to operate rationally. Rather than reflecting rational considerations and long-term interests, its actions appear as frantic efforts to deal with emergencies as they arise.

The so-called economic plans consisted of measures grouped together in haste and presented to the public as *fait accompli*, with no prior deliberations with relevant bodies, agencies, and publics. The cutbacks in the safety net were decided upon without the benefit of consultation with the National Insurance Institute, the body

responsible for the safety net; some of the cutbacks in the budget of the Ministry of Education were made without the knowledge of the Ministry itself; the changes in the wage system were made without prior consultation with the Histadrut -- and involved a proposal to make such changes by legislative fiat; and the same is true for the upheaval in the pension system.

Israel is not the only country making structural changes. In other countries - France and Germany, for example - changes are presently being made in the areas of pensions and social security. The difference is that in those two countries, the changes follow years of deliberations with labor unions, with the relevant governmental agencies and with professionals in the field. Moreover, the changes are less extreme and more gradual, so that they do not threaten the very existence of the social security system.<sup>4</sup>

In Israel, in contrast, the changes made over the past two years can be likened to a coup designed to satisfy the government's immediate need for cash, without taking into account the destructive outcomes for the long term and carried out in complete alienation from large portions of Israeli society.

### **The Consequences of the "Economic Plans" for Employed Persons**

The aim of all six of the so-called economic plans initiated over the past two years has been, in accordance with the prevailing right-wing ideology, to lower the cost of labor in Israel and to debilitate the labor unions. The measures taken touch upon almost every aspect of working life:

**Employment:** The frequent budget cuts have affected one of the main sources of employment in Israel, the public service. Women, who constitute two-thirds of public service workers, were the hardest hit. Employment was affected not only by direct budget cuts but also by the privatization of government corporations and services, and by the abolition or merger of government agencies.

The budget proposal for fiscal 2004 includes additional reductions in government personnel, as well as steps towards the privatization of government enterprises that have strong workplace committees: dividing the Ports Authority into three separate government companies; dividing up and privatizing the oil refineries; incorporating the Postal Authority and opening postal services to competition; privatization of some of the activities of the Mekorot Company (national water supplier); eliminating the Public Works Authority and firing most of its employees.

**Working Conditions:** The so-called economic plans have had a negative impact on working conditions in Israel.

The budget proposal for fiscal 2004 includes two especially damaging measures:

One is the proposal that teachers in the public schools be employed by the municipal government rather than by the central government. If implemented, the proposal will lead to a worsening in teachers' working conditions and to a widening of the gaps between the teachers employed in affluent communities in the central area of the country and those employed in poor communities in peripheral areas.

Another is the postponement for three years of the implementation of a law enacted in 2000 mandating that employees of temp agencies receive the same working conditions as regular employees in the workplace, from the first day of work, and that after nine months of work they become employees of the workplace [rather than the temp agency].

**Wages:** As mentioned above, the so-called economic plans aimed to lower wages. The freeze on the minimum wage, the delay of CPI indexing, and the 4% reduction in the salaries of government employees affected the paychecks of most employed persons in Israel. At the same time, the "tax reform" results in higher take-home pay for persons in the highest income bracket.

The budget proposal for fiscal 2004 involves more of the same, due to plans to privatize additional government agencies. Experience shows that in privatized agencies, the salaries of management rise while those of all other employees fall.

**Pensions:** In the framework of two "plans for the recovery of the Israeli economy", the Government nationalized the pension funds, severed their connection with the labor unions, and worsened the terms of investment of the funds. At the same time, a number of positive steps were taken, among them the cessation of pay-as-you-go pensions for new government employees and their replacement by funded pensions in which both employee and employer make monthly contributions to pension funds.

**Labor Unions:** The Government tried time and time again to weaken the Histadrut and the workplace committees. The most radical measure was the attempt to change wages through legislation -- circumventing the unions and violating their basic right to negotiate over wages. The proposal to lower wages by legislative fiat was rescinded only after the Histadrut called a general strike.

**Legal Protections:** In Israel, labor legislation is progressive, but enforcement is sadly lacking. One of the institutions that has done the most to elevate the status of labor legislation is the Labor Court, established as a court with a special, independent status. The 2004 budget includes a proposal to abolish the special status of the Labor Court and to put it under the authority of the general court system. This measure is bound to weaken the legal protections of working people. The proposal is especially damaging in view of the fact that it comes during a period when both the Government and many large private sector employers are engaged in a campaign designed to weaken the status of labor unions.

## **The Consequences of the "Economic Plans" for the Social Services in Israel**

The budget proposal for fiscal 2004 involves significant cutbacks in the social services: reducing the benefits package under the National Health Insurance Law; a 15% cut in the budgets of the Ministry of Health, Ministry of Education, and Ministry of Building and Construction; and a 7% reduction in housing assistance grants.

One of the most positive developments of the twentieth century was the creation of government services enabling each and every citizen to get an education, to enjoy basic health services, to receive housing assistance if they need it, and to benefit from other social services. Prior to the twentieth century, in most of the world such services were the prerogative of a small minority of aristocrats, land-owners and prosperous merchants. Since then, they have become the hallmark of "modern life", and as such the line of demarcation between rich and poor countries.

Such services also constitute one of the major sources of legitimation of the state: industrial workers, clerical workers and farmers, whose income alone is not sufficient to enable them to afford an education, regular health care, or housing for themselves and their children, benefit from these services thanks to the intervention of the state. The state collects taxes from everyone, including the wealthy (whose share in taxes is high, as a result of their high incomes), and thanks to these taxes is able to offer education, health, housing and other social services to the general citizenry.

The neo-liberal ideology, which became the ideology of the government in the United States and England at the beginning of the 1980s, and which since has been very influential in other countries, including Israel, aims to reduce the function of the state and its obligations to its citizens. The downsizing of the functions of the state means, of course, cutting back its budget and cutting taxes. The main beneficiaries of these policies are the affluent. In other words, neo-liberalism aims to reduce the capability of the state to take from the affluent a part of their wealth in order to provide services to the whole citizenry.

In Israel, this phenomenon is reflected in the decreasing readiness of the Finance Ministry to finance social services -- while at the same time offering tax breaks to persons in the highest income bracket. The Education budget is reduced, and schools collect more and more monies from parents; the budget for the health benefits package is insufficient, and the health funds charge the sick more and more co-payments; government mortgages are offered on less favorable terms than in the past, and young couples depend more and more on bank loans at higher interest rates.

The outcome is that high-income persons, who can easily pay the additional fees charged by schools and health funds, receive the best education and the best health services, while other Israelis have to make do with the most basic services offered by the state. While we are not experiencing a return to pre-twentieth century times, what is happening is that the vision of universal services for all citizens is in retreat.

Over the past two years, Israel's cutbacks in social services have taken on serious proportions. In effect, a wall is being erected between persons of means, who can purchase for themselves and their children a good education, good health services and good housing, thanks to the fact that they receive enhanced state services by paying more, and between persons with less means, who receive minimal state services, whose budgets are constantly eroding.

## **The Consequences of the "Economic Plans" for Social Insurance**

### **and Social Assistance**

Over the past two years, the Government, with the Knesset's approval, has dealt a devastating blow to the social safety net provided by allowances paid out by the National Insurance Institute (Social Security Administration). This blow came against the background of a public campaign focused on Israel's poor, who depend on these allowances. The campaign was orchestrated by senior Cabinet ministers, Finance Ministry officials, political parties representing persons in the highest income brackets and broad sectors of the mass media. The allowances were portrayed as an unsufferable burden for the public coffers, while their recipients were portrayed, in a sweeping generalization, as a non-productive segment of society, weighing down on persons "who work and serve in the army". Often, the media attack took on defamatory overtones against ultra-Orthodox Jews and Arab citizens of Israel, two groups whose poverty rates are inordinately high, and who therefore are over-represented among citizens depending on allowances. Solo mothers, too, were the subjects of the same kind of defamation.

The public campaign to cut safety net allowances focused mainly on two payments, unemployment compensation and income maintenance. Both were portrayed as payments that allow "unproductive persons" to live high on the hog at public expense. However, under this false flag severe cuts were made in other allowances as well, among them social security for the elderly, and child allowances - benefits payable to all citizens.

While the Finance Ministry refers to National Insurance Institute allowances as "transfer payments", made from the state to its citizens, the truth is that the social security system is first and foremost an insurance scheme, financed by social security payments made by workers and their employers (as well as by the self-employed). Workers (and employers) finance social security payments to the elderly, survivors' pensions, child allowances, unemployment compensation, work injury allowances, general disability payments, home nursing care benefits, and pregnancy leave. The social security payments made by workers and employers are transferred each month to the National Insurance Institute; in turn, the National Insurance Institute pays out allowances in accordance with the law: after retirement, during periods of unemployment, after the birth of a child, and so on. The main allowance financed solely by the Finance Ministry is the income maintenance payment.

Thus, the vast majority of recipients of allowances from the National Insurance Institute are persons who work, who have worked in the past or will work in the

future, and somewhat over half of the money comes from monthly payments of workers and employers, and not directly from the public coffers. In other words, under the ideological camouflage of "they should go out and get a job", and under the argument that money was short (the National Insurance Institute is not responsible for this shortage), the Government dipped its hands into a fund established with monies collected from employees and employers, in order to assure the former a safety net for retirement, unemployment and other adverse or unusual conditions.

The outcome was a severe blow to the system of allowances paid by the National Insurance Institute: unemployment allowances, once a temporary support at a level for bad times, turned into truncated welfare payments; income maintenance allowances have fallen below previously-set minimum standards; and all the other allowances have been reduced. Worst of all, the Government decided to freeze the value of all allowances until 2006. Moreover, at that time (2006), indexing will be done in accordance with the Consumer Price Index rather than the average national wage, as in the past. This will result in smaller allowances.

Up to now, the safety net has succeeded in significantly reducing the negative consequences of the increase in income inequality experienced in Israel over the last two decades. However, the measures taken over the past two years will increase poverty in Israel and exacerbate the feeling of helplessness among very wide sectors of Israeli society.

### **And What About Transparency?**

When we add up all the budget cuts made in the six so-called economic plans over the last two years, we arrive at the figure of NIS 50 billion, a sum equal to twice the annual Education budget.

Was this amount actually cut?

It's hard to know. That is to say, the public has no way of knowing.

The Finance Ministry does not present the Knesset, the representative body, with any document that would allow it to monitor the budget cuts it voted on.

Some budget cuts are decided upon by the Cabinet but in the end foregone and not brought to the Knesset for a vote. As for budget cuts approved by the Knesset, either in the framework of the Budget Arrangements Law or the Budget Law, not all are actually implemented: at the voting stage Finance Ministry officials engage in a process of bargaining with the various political parties, in order to assure a majority for their budget proposal. The compromises arrived at are not always documented in the budget books.

It is reasonable to assume that among all the cuts approved, the highest degree of implementation is in salary cuts and in allowances paid out by the National Insurance Institute. These cuts require changes in computer programs, in accordance with the legislative changes, and for this reason their implementation is assured from the

moment the program is altered. In contrast, budget cuts in government ministries are subject to on-going negotiation, and thus their degree of implementation is probably much lower.

The government document that is supposed to monitor implementation of budget cuts is the *Annual Financial Statement* presented to the Knesset by the chief financial officer in the Ministry of Finance. However, this report contains information on the major divisions in each government office, without its subdivisions, and thus it does not provide information on all the cuts. Moreover, the report does not specify the reason for increases or decreases in budget lines: if the changes are the result of the budget cuts decided upon by the Cabinet and approved by the Knesset -- or if they are due to other reasons, like intra-ministry decisions.

It should be noted that the chief financial officer at the Ministry of Finance also prepares a more detailed financial report, at the level of one sub-division. However, this report is presented only to the State Auditor. In addition, each ministerial unit receives a detailed report of its own expenditures.

It is time that legislators also received more detailed reports. These constitute invaluable tools for deliberating budget proposals.

This report was prepared as part of the  
Budget Analysis Project,  
supported by the following foundations, to which  
The Adva Center would like to express its gratitude:

Ford Foundation  
Mazon: A Jewish Response to Hunger

**Adva Center would also like to thank  
the following foundations and individuals  
for their support:**

Heinrich Boell Foundation  
Jacob and Hilda Blaustein Foundation  
Richard & Rhoda Goldman Fund  
Mr. Howard Horowitz and Ms. Alisse Waterston  
Levi Lassen Foundation  
Middle East Peace Dialogue Network/Richard Goodwin  
National Council of Jewish Women  
New Israel Fund  
NOVIB  
US/Israel Women to Women

{Notes}

- <sup>1</sup>. *Haaretz* newspaper. October 24, 2003.
- <sup>2</sup>. *Haaretz* newspaper, special magazine. "The Cost of the Settlements". September 26, 2003.
- <sup>3</sup>. Koby Broide and Adi Brender. "The Effect of the Economic Plan on the Government Budget: 2003-2008". p. 25. Bank of Israel website (Hebrew).
- <sup>4</sup>. See Dr. Sarit Ben Simchon-Peleg and Attorney Rachel Franco. 2003. "Changes in the Safety Net: It Can be Done Differently". Tel Aviv: Adva Center (Hebrew).

Fax. 03-5602205 ,Adva Center, POB 36529, Tel Aviv 61364, Tel. 03-5608871

**e-mail:** [advainfo@bezeqint.net](mailto:advainfo@bezeqint.net)