



מרכז אדוה
מידע על שוויון וצדק חברתי בישראל

The Israel State Budget 2015-2016

Wanted: "A Public Option"

Adva Center Critique of the
Israel State Budget Proposal for Fiscal 2015-2016

October 2015

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Adva Center would like to thank
The New Israel Fund for its ongoing
support of its activities.

Free Market Policies Hand Over a Growing Chunk of the Public Arena to "Market Forces"

In contrast to its name, the "free market" is not an arena in which individuals and corporations with equivalent resources and freedom of operation meet, but rather one characterized by stark inequality between the owners of capital and public power – referred to as "the market forces" – and the rest.

The state also operates in the marketplace. As it is a big player that is supposed to represent the general citizenry, we expect it to act to correct the imbalance.

However, when the government opts to promote free market policies, it is not acting to lessen inequality but the very opposite; when a government restrains its activities and budgets, the owners of capital and power take over control of those parts of the public arena abandoned by the government.

A. HOUSING

The Example of Housing

The high cost of housing can provide us with a good opening for our discussion of the proposed state budget for 2015-2016. The sharp increase in the cost of housing is a central political, economic and social issue.

- It was the issue that galvanized the social protest of 2011;
- It also served to springboard politician Moshe Kahlon to the position of Minister of Finance.

Housing: Government Commitment to the Free Market

Prior to the second half of the 1980s, all Israeli administrations were committed to providing a roof over the heads of Israelis (in actuality, only the Jews among them).

Governments were directly responsible for construction – planning, development and building – or delegated that responsibility to government-controlled housing corporations. Alternatively, they focused on subsidizing housing for young couples and others without a home of their own – via housing loans and rent subsidies; or they focused on regulation of housing construction, by controlling the costs of construction inputs and by channeling investments. All these required large budgets.

Following the Emergency Stabilization Plan of 1985, successive governments have aimed to reduce their involvement in the housing market as well as their housing budgets, with the exception of the short period of mass immigration from the former Soviet Union and Ethiopia.

The free market took over that part of the housing arena that the state abandoned – and “the market forces” began to influence housing costs.

Market Forces and the Rise in the Cost of Home Ownership

The market forces raise the cost of housing in two ways:

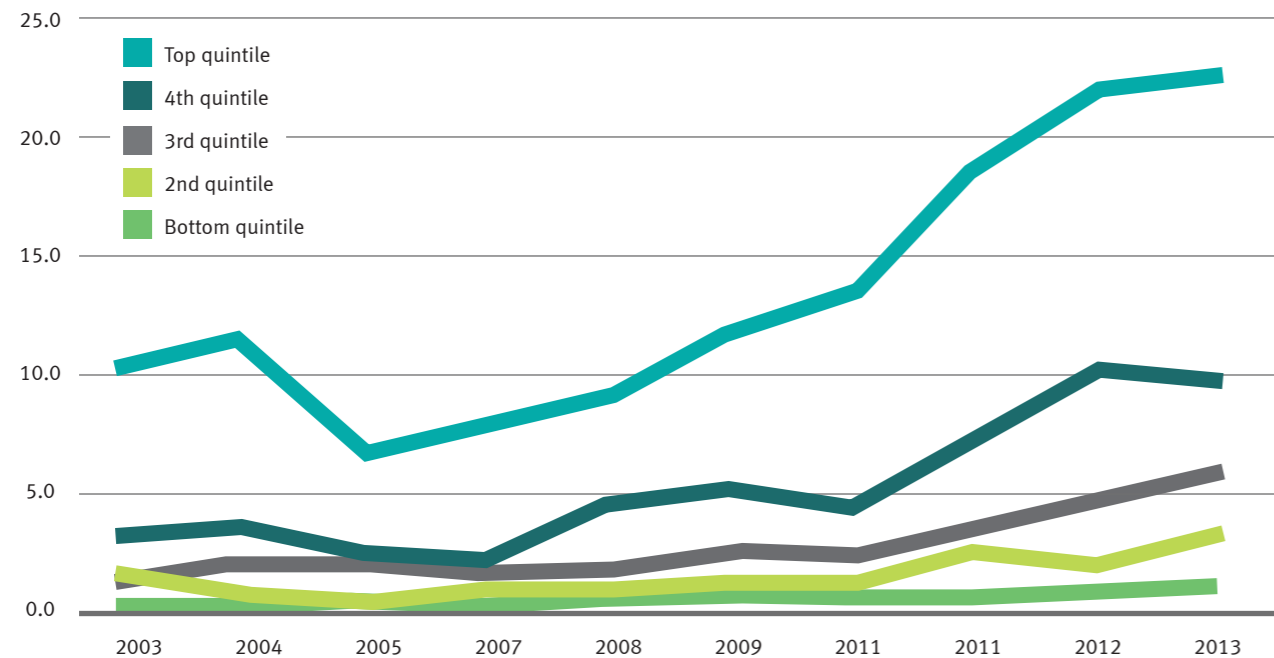
Firstly, individuals referred to as “the investors” by Ministry of Finance officials, whose incomes place them in the top income decile, purchase housing units for their children or as investments, and in so doing increase the demand for housing as well as the cost. In recent years such purchases accounted for between a fourth and a third of all new home purchases.

Secondly, affluent persons purchase high-end housing units in prestigious residential towers, thus influencing housing prices by creating higher and more expensive standards.

The rise in housing costs is detrimental to young couples and especially to those of modest means.

Percentage Owning Two Housing Units or More, 2003-2013

By income quintile per net standard person and number of units owned



	Top quintile	4th quintile	3rd quintile	2nd quintile	Bottom quintile
2003	10.0	3.0	1.3	1.4	0.2
2004	11.3	3.5	2.0	0.7	0.2
2005	6.6	2.3	1.9	0.3	0.4
2007	7.9	2.1	1.4	0.8	0.2
2008	8.9	4.5	1.7	0.9	0.4
2009	11.4	5.1	2.4	1.2	0.7
2010	13.4	4.2	2.4	1.1	0.6
2011	18.4	7.3	3.3	2.4	0.6
2012	21.8	10.2	4.6	1.8	0.9
2013	22.4	9.6	6.0	3.2	1.0

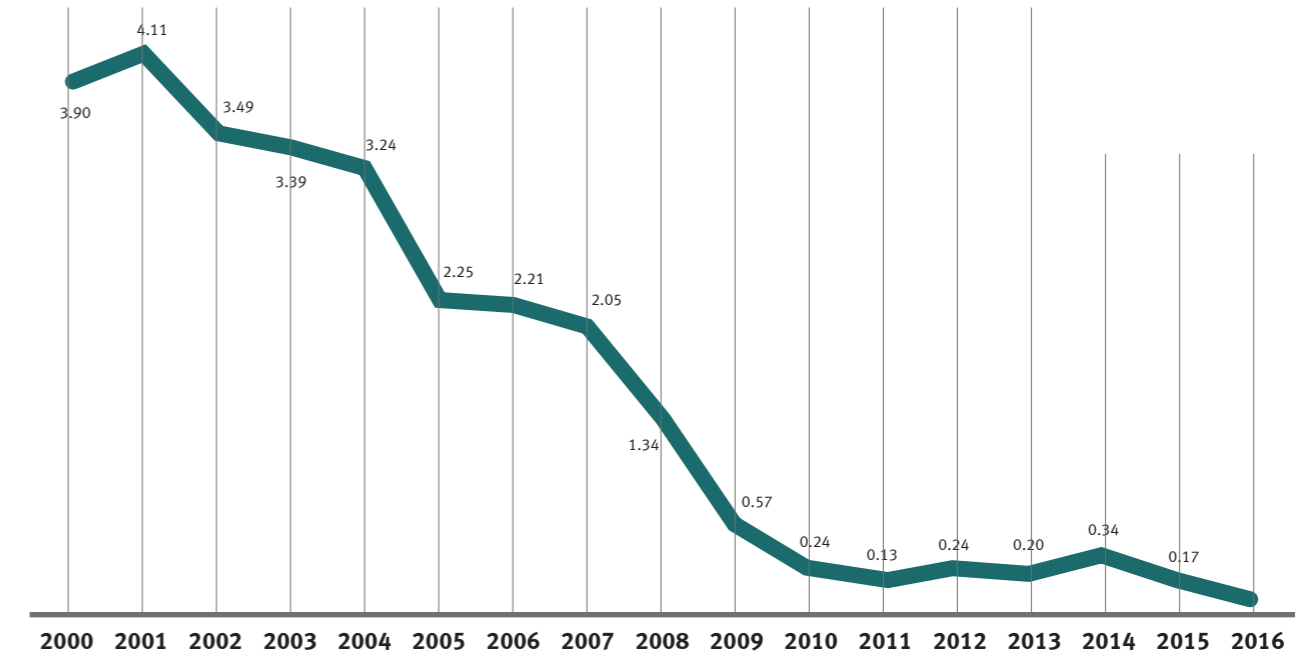
Government Fails to Act to Lessen Inequality

In such a situation, we would expect the government to act to lessen the degree of inequality, but instead it hindered its own capability to do so by reducing its housing budget.

- The housing budget, which was NIS 9.9 billion in 2000, decreased to NIS 3.1 billion in 2014. In 2015-2016 it is expected to be NIS 4 billion.
- The allocation for rent subsidies, which was NIS 2 billion in 2000, was NIS 1.5 billion in 2014. The proposed budget for fiscal 2015-2016 sets the allocation at NIS 1.58 billion.
- The allocation for government housing loans saw a steeper reduction: from some NIS 4 billion in the first years of the millennium to NIS 340 million in 2014. The allocation for 2015 is even less – NIS 170 million. The allocation for 2016 has yet to be set.

Allocation for Government Housing Loans, 2000-2014 and Proposed Budget for 2015-2016

In NIS billions, constant 2014 prices

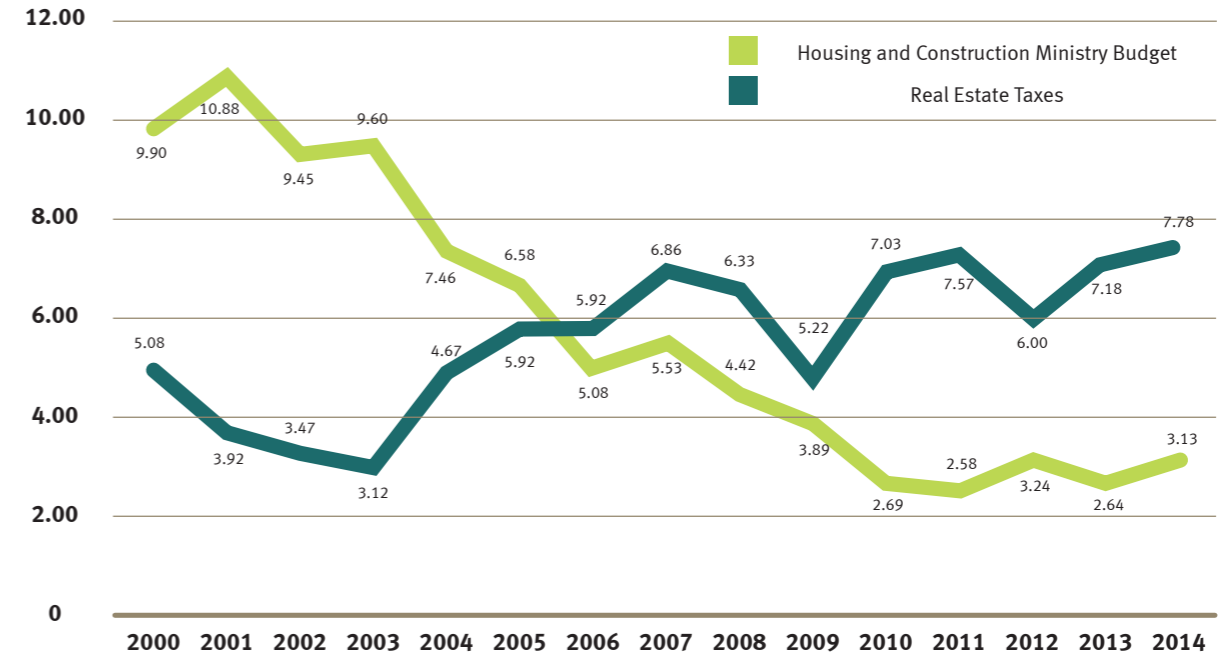


The Israeli Government Earns More from Housing than it Invests in it

The Israeli government has no financial incentive to slow down the rise in the cost of home ownership, as today it "profits" from higher real estate prices: income from real estate taxes grew more than the housing budget.

- Between 2000 and 2014 income from real estate taxes increased from NIS 5.08 billion to NIS 7.78 billion. The proposed budget estimates receipts from real estate taxes for each of the years 2015 and 2016 at NIS 10 billion (current prices).
- At the same time the housing budget was reduced from NIS 9.9 billion in 2000 to NIS 3.1 billion in 2014.

Housing and Construction Budget and State Income from Real Estate Taxes, 2000-2014
In NIS billions, 2014 prices



What is to be Done?

The solution most often suggested is to increase the housing supply. However, there is no assurance that the construction of more and more housing units will lower housing prices, as the monies accumulated in the hands of persons in the top income decile will enable them to continue to purchase a significant portion of any new supply. In recent years, the proportion of new housing units snapped up by such persons has been stable – between one-fourth and one-third.

The solution may well lie in the creation of a significant "public option" – massive government construction of housing for both purchase and rental, near employment centers, with a high standard of construction and maintenance and at affordable prices.

But the Israeli government is stuck on free market policies.

The state budget proposal for fiscal 2015-2016 does not include any government program that could create a public alternative in the area of housing. It does not even consider devoting receipts from real estate taxes to the financing of a public housing option.

B. Schools and Higher Education

Education Ministry and Higher Education Budgets Have Grown

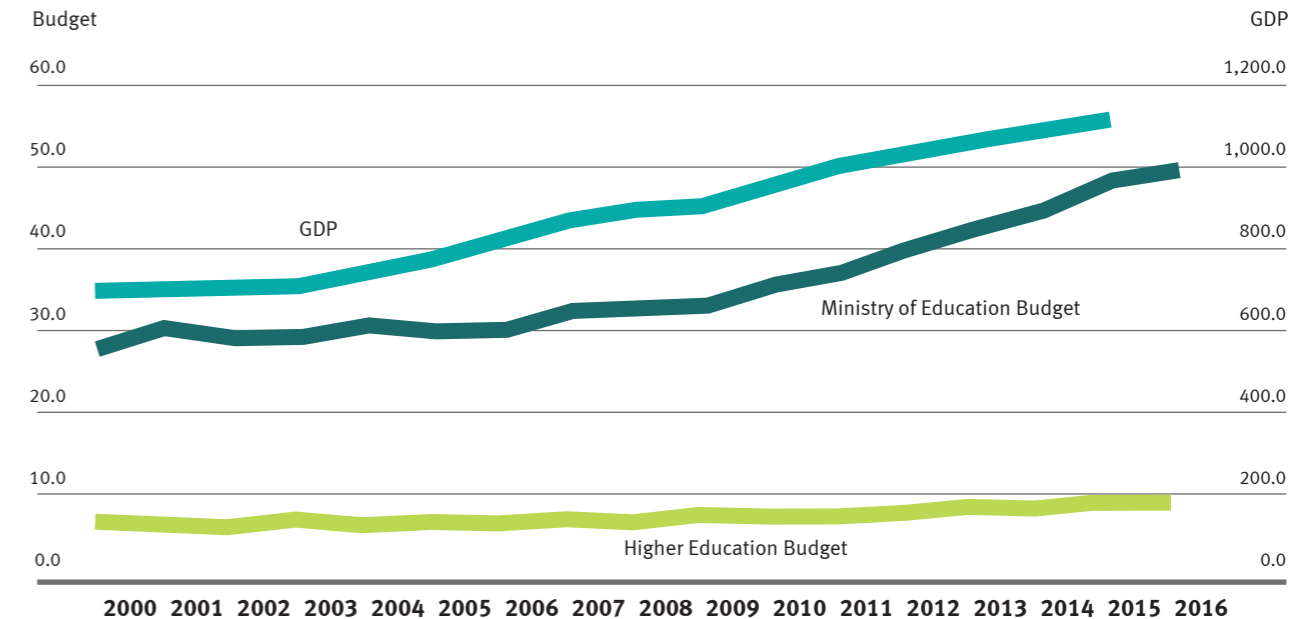
In contrast to the budget of the Ministry of Construction and Housing, the budget of the Ministry of Education (not including the investment budget) and of Higher Education has grown, from a total of NIS 34.7 billion in 2000 to NIS 53.9 billion in 2014. The proposed budget for fiscal 2015-2016 includes NIS 50 billion for the Ministry of Education (not including the investment budget) and NIS 10 billion for Higher Education – for a total of about NIS 60 billion.

This is a significant increase, but it suffices to keep pace with the increase in GDP, no more than that.

The increase was not evenly spread: The budget for preschool, elementary and high school kept pace with GDP growth, while the Higher Education budget did not.

Ministry of Education Budget and Higher Education Budget, 2000-2014 and Proposed Budget for 2015-2016; GDP, 2000-2015

Without the investment budget, in NIS billions and 2014 prices



The Increase Went Mainly to Raise Teachers' Salaries

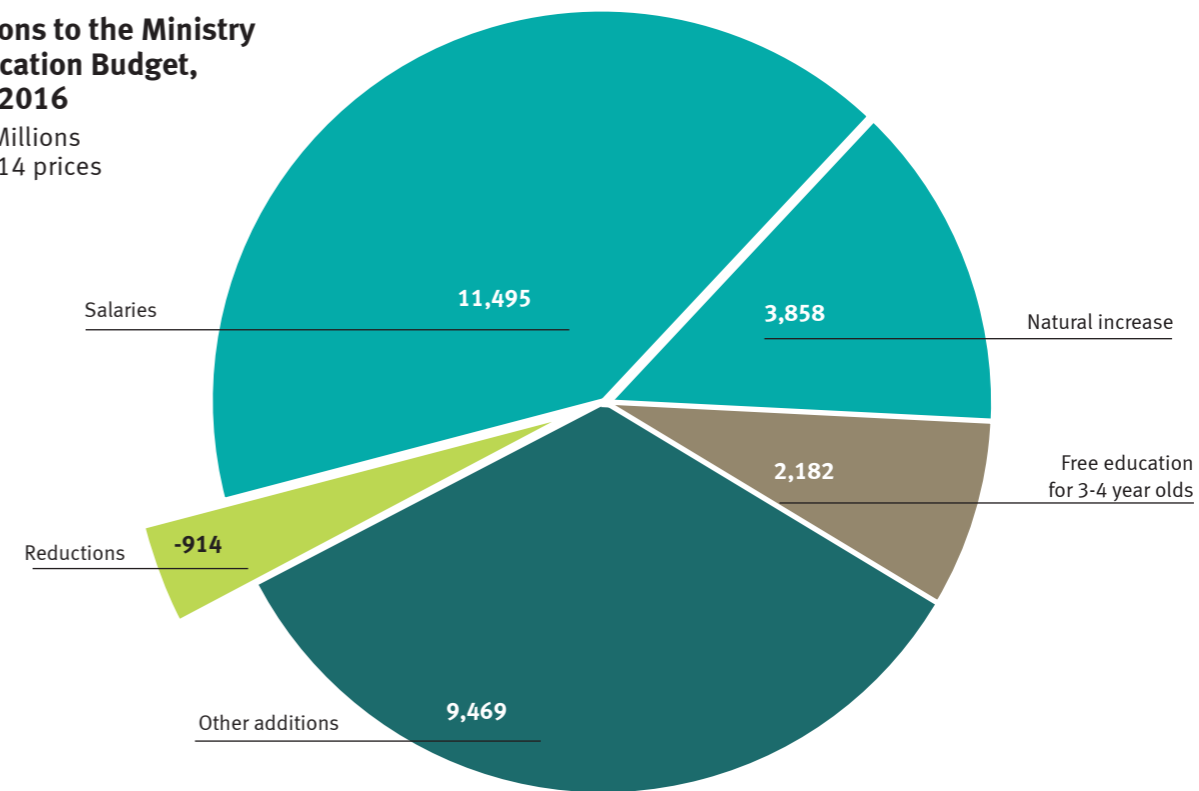
The Ministry of Education Budget has undergone significant increase, especially since 2008, the year a wage agreement with one of the teachers' unions took effect.

Between 2008 and 2016 the school system will receive an accumulated increase of about NIS 26 billion. The biggest increase, accounting for about 44%, is for teachers' salaries.

Raising teachers' salaries is a welcome step, which reduced the wage gaps between teachers in Israel and teachers in other OECD countries. Still, a significant gap remains: OECD figures from 2012, the most recent available at the time of writing, reveal that the gap has yet to disappear.

Additions to the Ministry of Education Budget, 2008-2016

In NIS Millions and 2014 prices



As a Percentage of GDP, the School and Higher Education Budgets are Lower than They Were Prior to the Emergency Stabilization Plan (1985)

Since 2000, the budget of the Ministry of Education has grown in tandem with GDP growth.

However, if we examine a longer period of time, the picture changes:

In 1985, the year the government adopted the Emergency Stabilization Plan, the program that opened the sluice gates to all areas of public life in Israel to “the market forces,” the education budget was 9% of GDP. After five years, it had decreased to 6% of GDP, where it has remained ever since.

This is not a global phenomenon. In many countries, among them Ireland, Denmark, New Zealand, France and Finland, the Education budget as a percentage of GDP has grown in recent years. In Denmark it is 8.7% - similar to the figure in Israel 30 years ago.

Public Expenditure on Education as a Percentage of GDP

Selected OECD Countries, 1985 and 2012

	1985	2012
Denmark (1980)	6.0	8.7
Iceland (1990)	4.3	7.8
Cyprus	3.6	7.3
New Zealand	3.6	7.2
Sweden (1980)	7.0	7.0
Finland	5.1	6.8
Belgium (1980)	5.4	6.6
Ireland	5.4	6.5
Israel	9.0	6.0
Austria	5.4	6.0
Holland	5.9	6.0
France	4.9	5.9
Portugal	3.3	5.8
Great Britain	4.8	5.6

	1985	2012
United States (1990)	5.0	5.6
Canada	6.4	5.5
Switzerland	4.5	5.4
Poland (2000)	5.0	5.2
Germany	--	5.1
South Korean	4.2	5.0
Spain (1990)	3.7	5.0
Italy	4.7	4.9
Hungary	4.9	4.5
Czech Republic (2000)	3.8	4.2
Slovakia (2000)	3.9	4.2
Greece (1990)	2.1	4.1
Chile (1990)	2.4	4.1
Japan (1980)	5.2	3.8

Budget Increases for Education Fail to Reduce the Inroads of the Private Market

Increases in the public financing of schools and higher education were not high enough to lower the influence of market forces on the education system:

- In 2014 the share of private financing (in contrast to public financing, most of which comes from the Ministry of Education) of the expenditures of schools and institutes of higher learning was 21.4%.
- This is one of the highest shares recorded among OECD countries, among which the average share of private outlay is 16.1%.
- Most of the private outlays come from the pockets of the same stratum as the real estate investors. Their sons and daughters are the main recipients of private financing of education, thanks to which they are able to reach the highest rungs of the educational ladder.

To Date, Increases in the Education Budget Have not Led to Reductions in Educational Achievement Gaps

Increases in the Education budget went primarily to raise teachers' salaries. Yet the wage agreements with the two teachers' unions were meant to lead to pedagogical improvements as well.

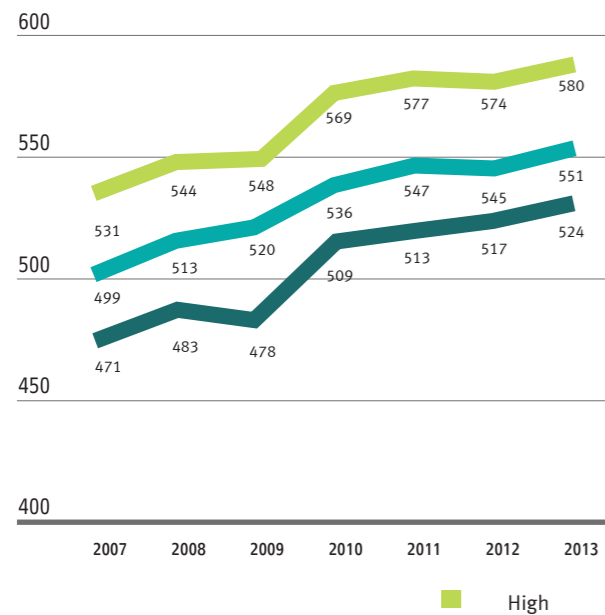
While in recent years improvements have been registered in the marks of Israeli schoolchildren in local achievement tests, it appears that these improvements reflect the fact that a greater proportion of learning time is being devoted to preparing the children for those tests.

Moreover, the improvement of test results was not accompanied by a reduction in educational achievement gaps between children from different backgrounds. This is clearly shown in the following graphs, which present results from local Israeli exams in mathematics in the fifth and eighth grades for the years 2007-2013, disaggregated by ethnic group (Jews and Arabs) and by socio-economic level (high, middle and low) for each ethnic group (there is no high level for Arab students).

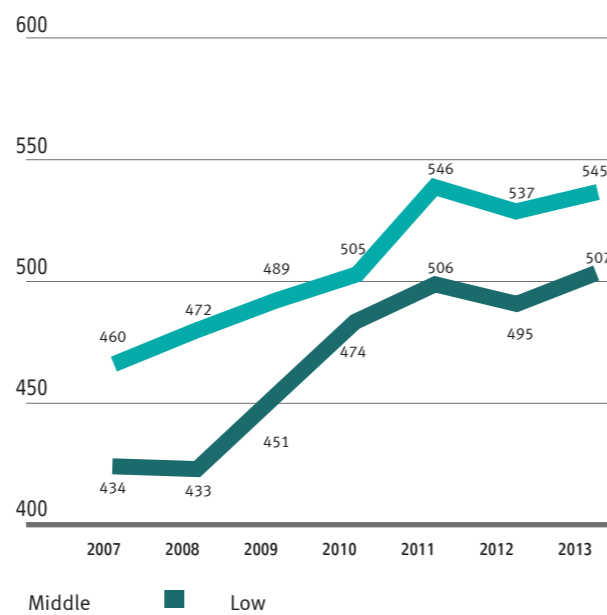
OECD reports reveal that Israel "leads" when it comes to inequality of achievements among children from different socio-economic backgrounds.

Achievement Gaps in Math by Socio-Economic Background in Local Israeli Exams, Fifth Graders, Hebrew and Arabic Speakers, 2007-2013

Fifth Grade Math – Hebrew Speakers



Fifth Grade Math – Arabic Speakers

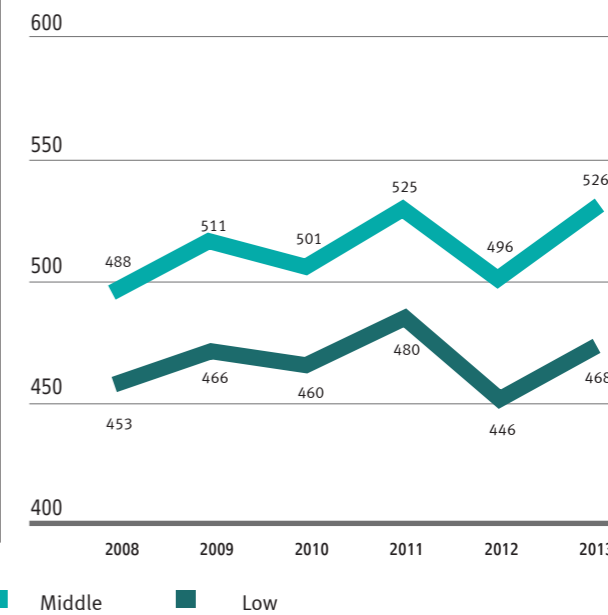


Achievement Gaps in Math in Local Israeli Exams, by Socio-Economic Background, Eighth Grade, Hebrew and Arabic Speakers, 2008-2013

Fifth Grade Math – Hebrew Speakers



Fifth Grade Math – Arabic Speakers



Proposed Budget of the Ministry of Education for 2015-2016

The proposed budget for fiscal 2015-2016 includes a number of improvements in the public education system: expanding free education for children aged 3-4, addition of a second assistant kindergarten teacher, and reducing class size.

The changes are to occur universally, throughout the education system.

At the same time, the budget proposal includes a change from prioritizing schools serving populations of low socio-economic status to prioritizing schools serving religious sectors of the Jewish population. The budget for children with special needs, which for years has been channeled to low-income localities, will be increased by NIS 216 million, while nearly a billion shekels are to be added to state religious schools, state Haredi schools and to the strengthening of Jewish Studies in all schools.

Gaps in the Budgets of Different Schools

One cannot discuss the education budget without mentioning the differences between the budgets of different schools. Unfortunately, the education system does not publish figures by school. Still, one can point to a few examples with which all Israeli educators are familiar:

- The cost of employing teachers in affluent neighborhoods and localities is higher than the cost of employing teachers in other neighborhoods and localities, mainly due to differences in educational level, teaching tenure and participation in in-service training opportunities, to the advantage of teachers in well-to-do localities.
- Schools in affluent localities have income from a variety of sources that are not available to schools in less affluent localities: high parental fees, contributions, commercial use of school buildings, and budgetary increments from the local authority. Per pupil, the above additions to the basic budget of the Ministry of Education can amount to tens of thousands of shekels per year.
- Not only that: poor localities have a hard time providing the matching funds that are supposed to cover items like school janitors, school buses, school psychologists and other auxiliary personnel.

What is to be Done?

The education system in Israel does not need a public option, as nearly all schools are public. What is needed is to strengthen the schools that depend entirely on public funds -- the budgets of the Ministry of Education and the local authority.

- The Ministry of Education should create a new budget model that takes into consideration the costs of the improvements made during the last two decades in schools for the privileged. These schools were able to obtain resources above and beyond public allocations. The Ministry should allocate budgets to all schools in accordance with the new model.
- In other words, the state should develop a public alternative to the advantages of the prestigious schools developed on the basis of parental payments and other non-public sources of income.

While a better budget is no assurance of better achievements, it can certainly serve as a good basis.

C. HEALTH

The Health System in Israel Needs to be Healthier

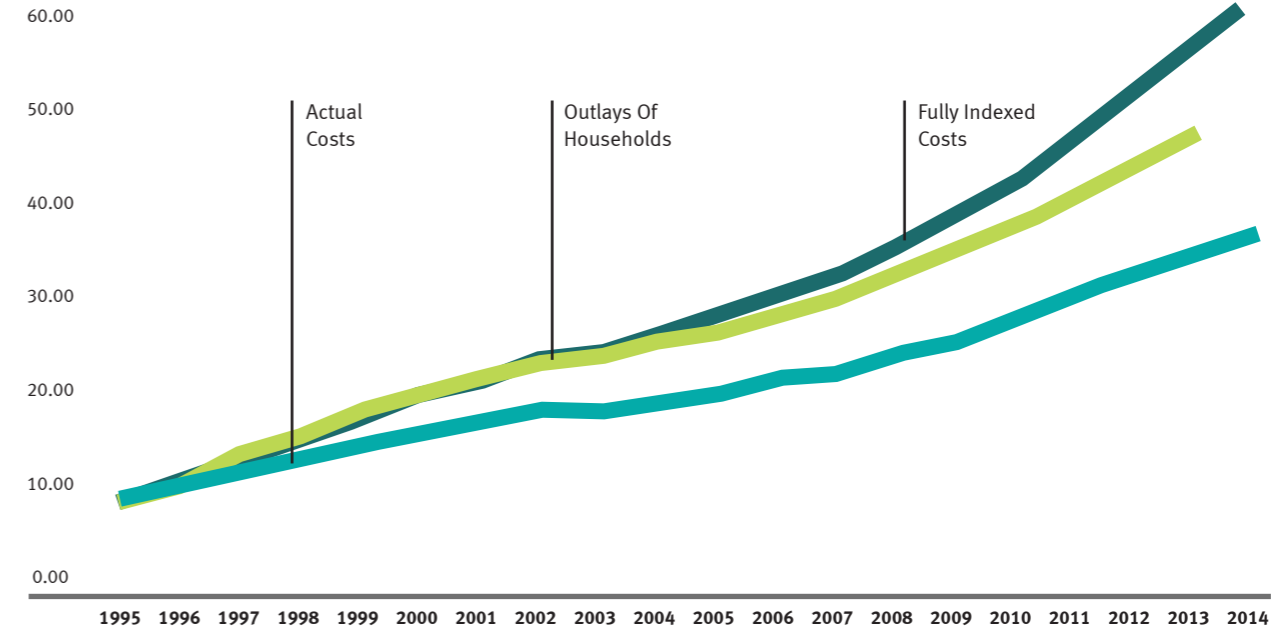
Israel's public health system is more universal and more equitable than its systems of education and housing. Given a sufficient budget, the public health system has the capability to serve the entire population with a high level of services relative to other places in the world.

However, the budget is not sufficient. When the National Health Insurance Law was legislated, the Ministry of Finance objected to a budget formula that would include an annual budget increase in accordance with recognized needs. Within a few years, a gap began to develop between the level of financing of the basket of health services under the law and that required to keep pace with population growth, input costs, and technological improvements.

Households that could began to make up the difference by resorting to private options.

Cost of the Basket of Services under the National Health Insurance Law 1995-2014

In current prices, Payments to the Health Funds and Outlays of Households for Health



The Vacuum Filled by Market Forces

The gap between full financing of the health law and the actual financing for the basket of health services provided under the law led to the creation of a vacuum that was quickly filled by "the market forces."

The health funds, in an effort to increase their revenues, began to offer supplementary health insurance, in addition to the health insurance paid for by the universal health tax.

Commercial insurance companies soon followed suit, offering their own health insurance policies.

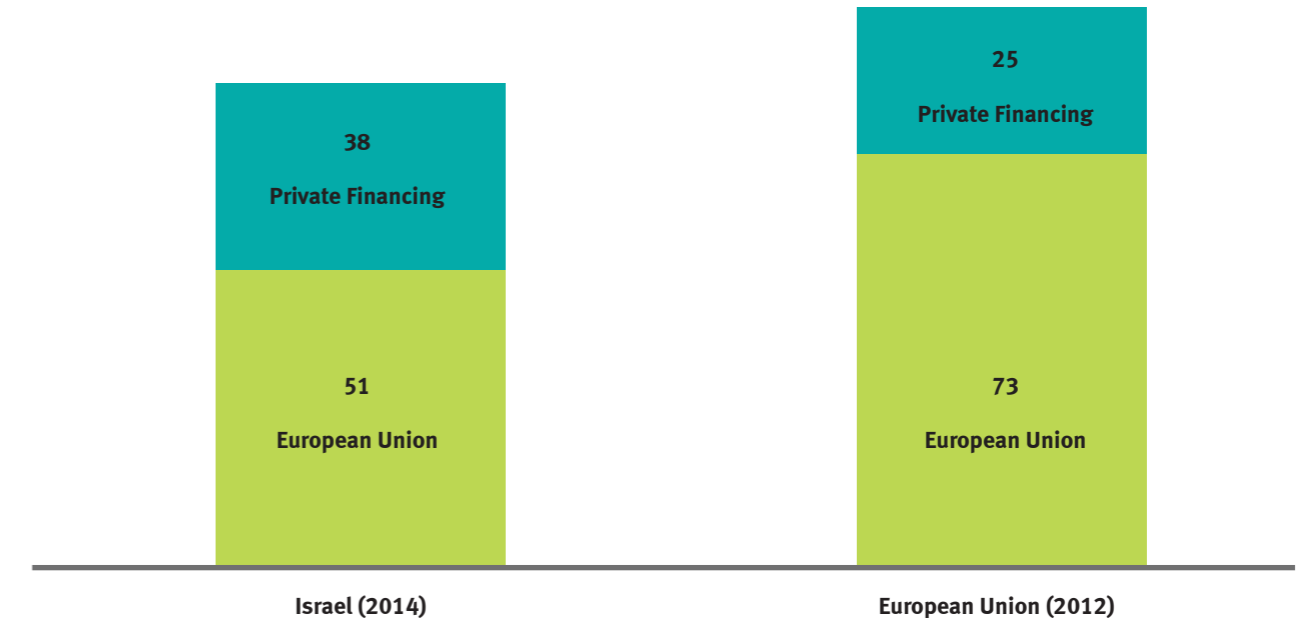
Affluent households purchased everything on offer.

These phenomena were accompanied by others:

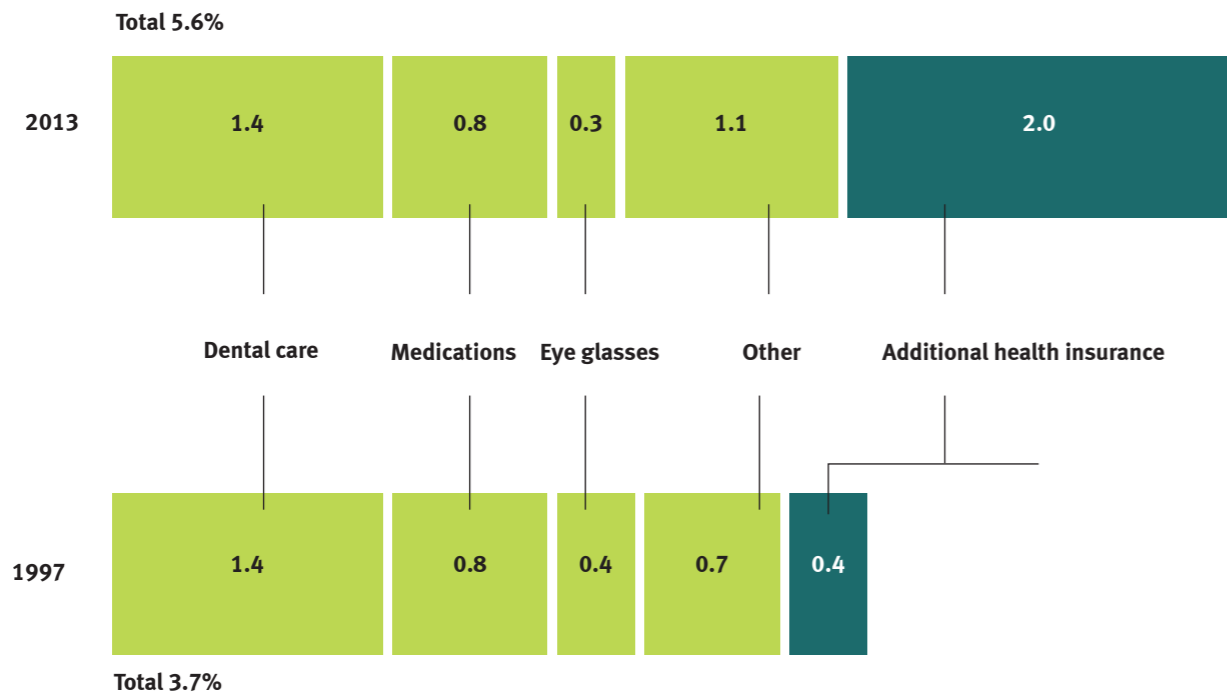
- Public hospitals that offer private services;
- Physicians who obtain private patients through their work in public hospitals;
- Public hospitals that allow physicians involved in medical tourism to utilize public facilities, and more.

In such ways, private money, or, if you will, "the market forces," are taking over that part of the public health system abandoned by the state.

National Expenditures on Health by Financing Sector, Israel (2014) and the European Union (2012), in Percentages



Household Expenditures on Health as a Percentage of Total Consumption Expenditures, 1997 and 2013



Strengthening the Public Part of the Health System

The health system does not need a "public option" because it is basically public.

What is needed is to strengthen the public aspect of the system, by amending the National Health Insurance Law so that it includes full indexing of the cost of the services it provides.

Also needed: assimilation of the supplemental insurance policies currently marketed by the health funds into the basic basket of services, along with a slight increase in the health tax. This would enable the main extra services desired by Israelis – a "second opinion" by hospital departmental heads and the choice of surgeon – to be accessible to all.

In addition, the infrastructure of the public hospitals needs to be expanded and improved and their medical staffs expanded, so as to better serve the growing Israeli population. Until then, medical tourism should be halted in public hospitals.

D. THE PUBLIC OPTION

The proposed state budget for fiscal 2015-2016 represents one more stage in the weakening of the "public option" in Israel, and, at the same time, one more stage in the expansion of the vacuum into which "market forces" enter the public arena.

A proper public option involves, among others, more generous financing of the social services. However, the following graphs reveal that Israel is moving in the opposite direction:

- Israel invests less in her citizenry than other members of OECD, resulting in a negative effect on its ability to provide quality services;
- Israel's expenditure on its social safety net is the lowest among OECD countries, resulting in a negative effect on the ability of Israelis to break out of poverty;
- Central government subsidies to poor local authorities, which are supposed to contribute to the co-financing of state services, has decreased sharply, thus increasing social gaps.

The Israeli Dream Diminished

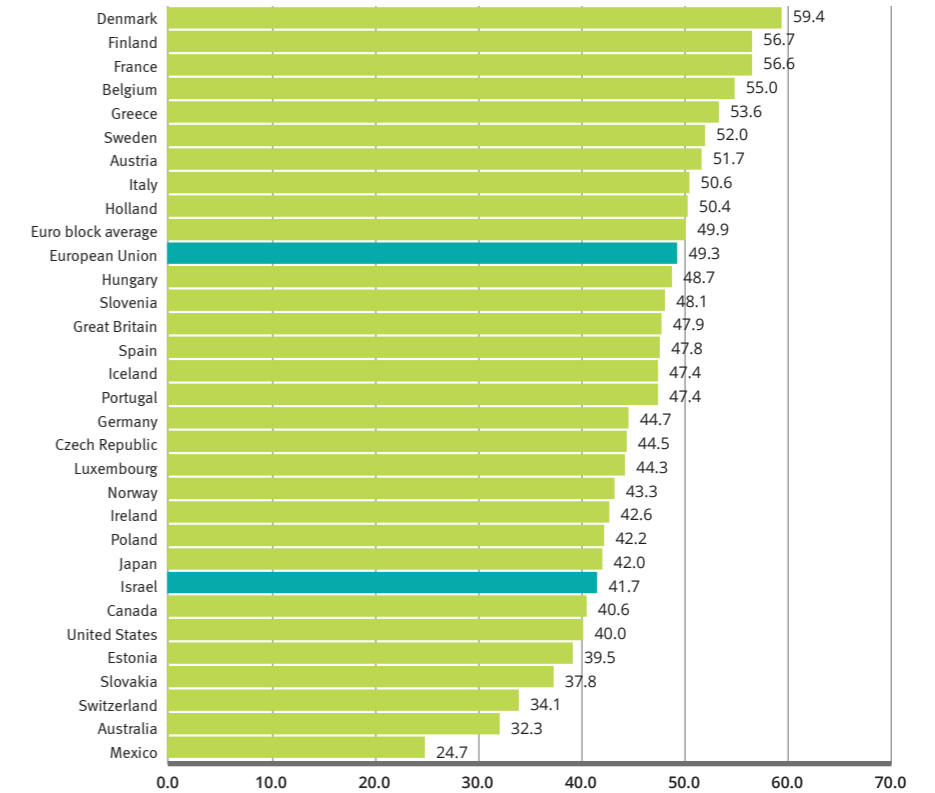
Israel spends less on its citizens than the other members of OECD.

The result:

- Lower quality services;
- Geographic areas and social groups that receive inferior services;
- A middle class that finds it difficult to pass on its standard of living to the next generation;
- Large numbers of people who find it impossible to join the middle class.

And in general, a diminishing of the Israeli dream.

Government Expenditures as a Percentage of GDP, OECD Countries, 2013

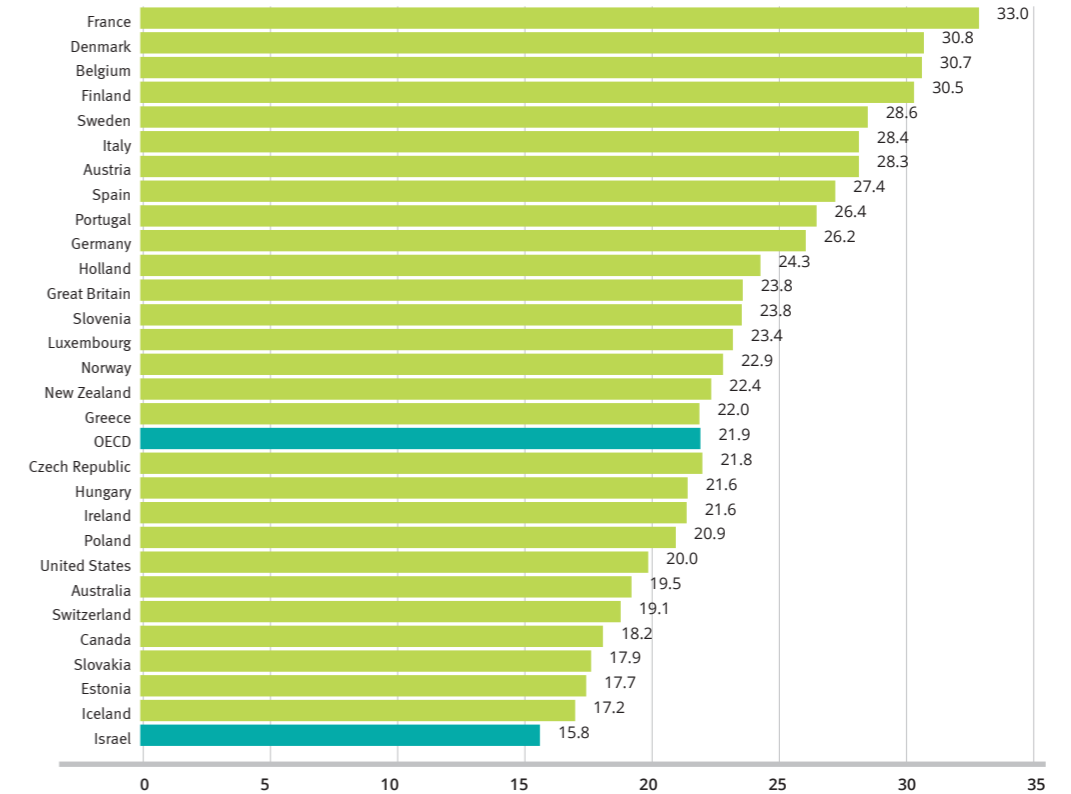


Low Expenditure on the Social Safety Net

Israel's expenditure on the social safety net is the lowest among OECD countries: 15.8% of GDP in contrast to the average of 21.9% for all OECD countries.

This is one of the reasons that Israel's poverty rate is among the highest among OECD countries. In 2012 (the most recent year for OECD figures at the time of writing), Israel's poverty rate, at 18.4%, was second only to that of Mexico, with 18.9%. In contrast, most OECD countries registered a poverty rate of between 5% and 10%.

Expenditure on Social Safety Net as a Percentage of GDP, OECD Countries, 2013



Reduced Expenditure for Strengthening Weak Local Authorities

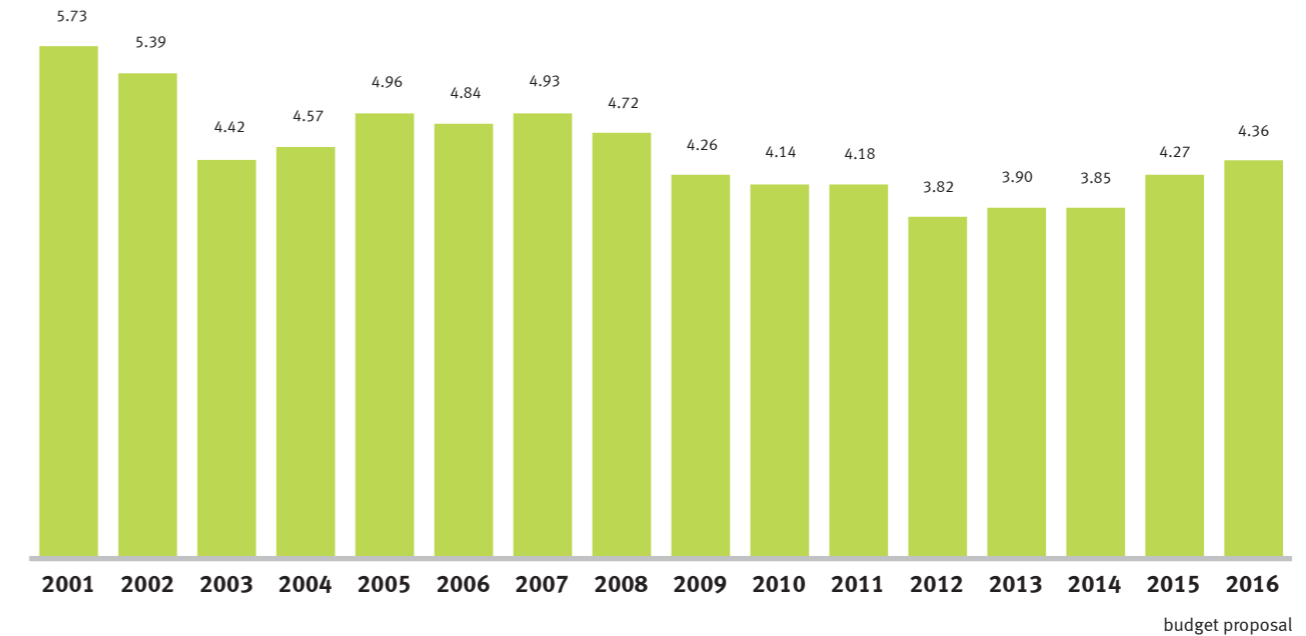
Most of the local authorities in Israel lack resources, because their tax base is quite narrow: Residents cannot afford to pay much in local taxes, and revenues from local businesses are also low.

This is the background to the "balance grants," subsidies the central government transfers to local authorities with sparse resources so as to enable them to pay their share of basic social services.

However, these subsidies have undergone erosion, from NIS 5.73 billion in 2001 to NIS 3.85 billion in 2014.

Central Government Budget for Subsidies to Local Authorities in Israel, 2001-2014 and Proposed Budget for Fiscal 2015-2016

Regular budget, in NIS billions and 2014 prices



E. POSSIBLE SOURCES OF FINANCING TO STRENGTHEN THE PUBLIC OPTION

Two Sources for Financing a Proper "Public Option"

There are two main sources of financing for strengthening the capability of the state to offer Israelis a high quality public option:

- Transferring part of the money devoted to the defense budget to the social services;
- Raising direct taxes.

1. Reducing the Defense Budget

The Defense budget of Israel, like the Education budget, measured as a proportion of GDP, was reduced following the Emergency Stabilization Plan of 1985. However, while the Education budget (as a proportion of GDP) is lower today than that of many OECD countries, the Defense budget is much larger, for reasons some of which are a matter of consensus and others that are the subject of public debate.

During the past 15 years, the Defense budget – for both internal (public security police and border police) and external defense – grew significantly, from NIS 60.1 billion in 2000 to NIS 78.6 billion in 2014. This included a doubling of the budget of the Ministry of Public Security, many of whose activities are the result of Israel's continuing control of the Palestinian population in the territories occupied in 1967.

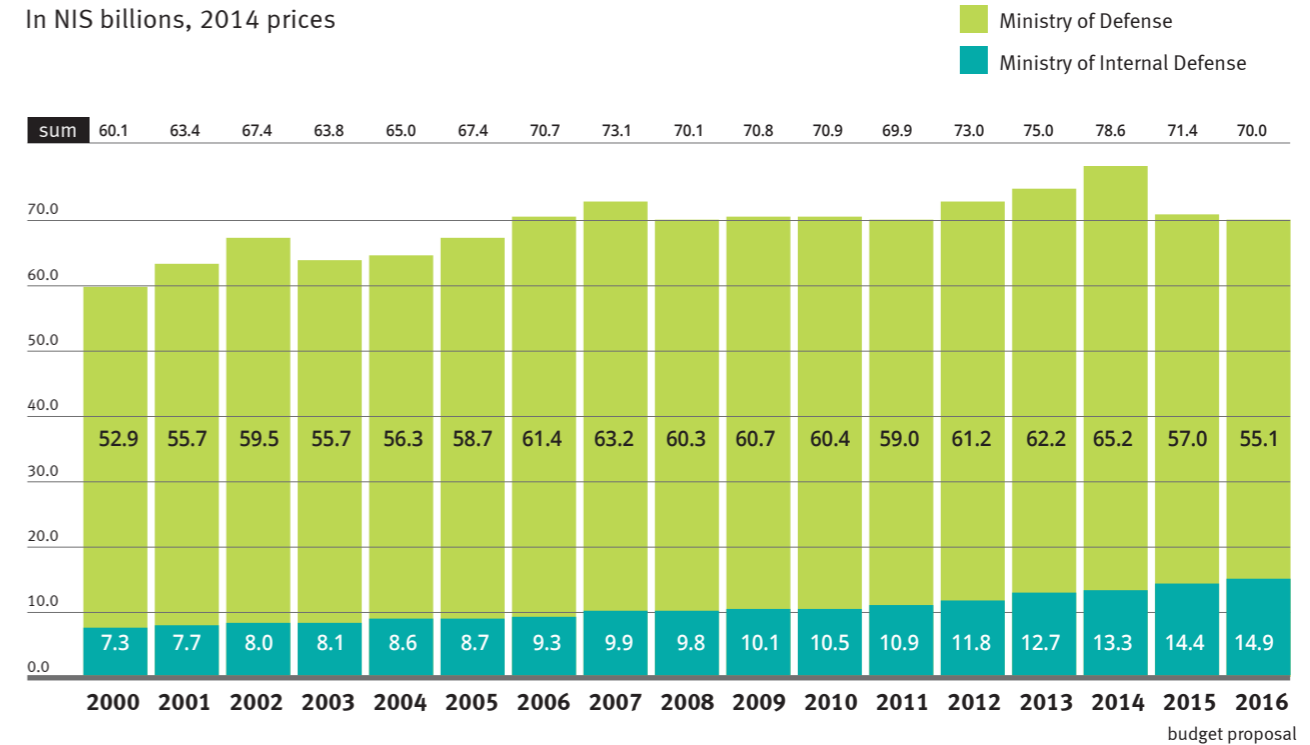
The budget proposal for fiscal 2015-2016 appears to contain a reduction in the Defense budget, but past experience has shown that after the budget is approved the Defense Ministry receives significant additional monies in the course of the fiscal year.

Many experts, among them officials at the Finance Ministry, are of the opinion that the Defense budget can be cut and the monies better used to improve social services.

The first condition for reducing the Defense budget is a political move in the direction of a political settlement with the Palestinians and with other countries in the region. At the time of writing, there are no signs of such a move.

Budget of the Ministry of Defense and the Ministry of Public Security, 2000-2014 and Proposed Budget for Fiscal 2015-2016

In NIS billions, 2014 prices



2. Raising Direct Taxes

In 2003, Binyamin Netanyahu, then Minister of Finance, instituted a significant tax cut.

Following that tax cut, the tax burden in Israel became one of the lowest among OECD countries.

The tax cuts increased the disposable income of families in the top income decile and made it easier for them to invest in real estate, to make large parental payments to public schools, and to demand and pay for private health services on top of the public ones.

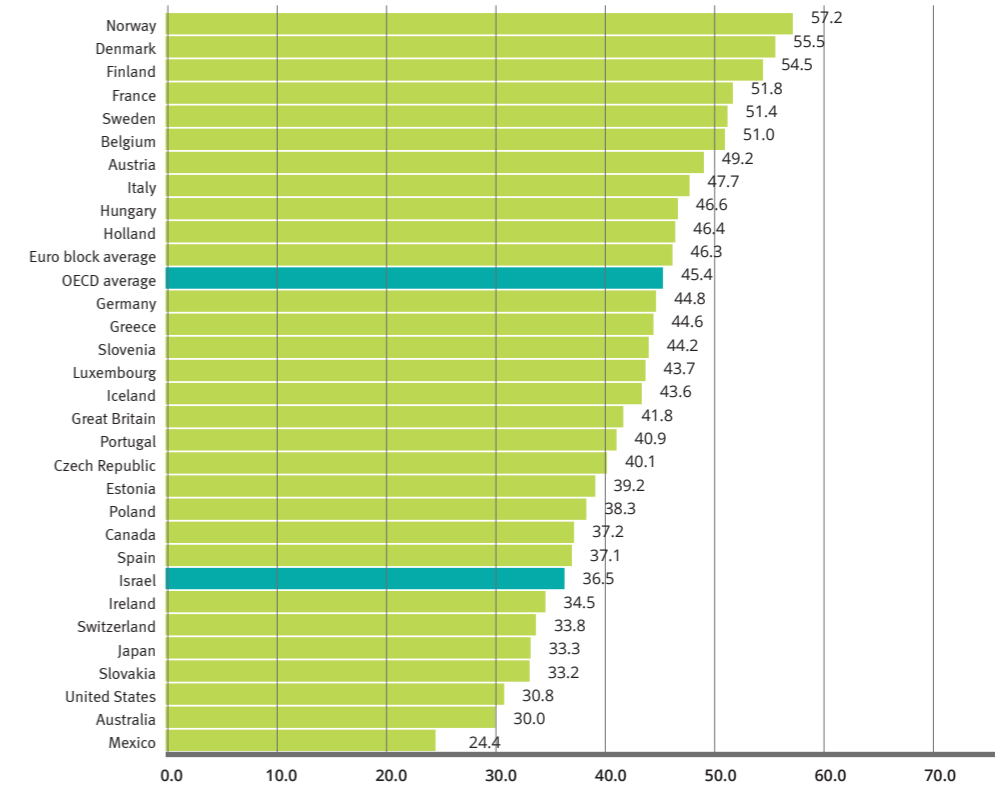
In contrast, the capability of the state to finance a proper "public option" diminished.

The proposed budget for fiscal 2015-2016 includes an increase in real estate purchase taxes, a positive but far from adequate development.

If we are to increase the state's capability to finance a real "public option," direct taxes need to be raised, first and foremost individual income and corporate taxes.

It should be noted that The Bank of Israel has for years called for raising direct taxes for the purpose of obtaining increasing financing for Israel's social services.

Government Revenues as a Percentage of GDP, OECD countries, 2013



Notes and Sources

As the notes are quite technical in nature, and most of the sources are in Hebrew, the interested reader is referred to the presentation in the original Hebrew:

<http://adva.org/wp-content/uploads/2015/10/budget2015-20162.pdf>

