

A D V A ה ^ז ו ^כ ד ^ר א ^מ
C E N T E R

INFORMATION ON EQUALITY AND SOCIAL JUSTICE IN ISRAEL
מידע על שוויון וצדק חברתי בישראל
מרכז «אדפא» - מלומות חול המסאווה וועדאלה الاجتماعية في إسرائيل

**THE ECONOMY IS GROWING
STATE REVENUES ARE INCREASING
BUT A TIGHT LID IS KEPT ON SOCIAL SPENDING**

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Presentation made in the Knesset

November 13, 2007

The Policy of Inflexible Fiscal Restraint

Economic growth and investment in society:

- Since the slackening of the second Intifadah, in the second half of 2003, the Israeli economy has been experiencing growth.
- Supposedly, economic growth increases state revenues, enabling government to invest in social and economic development – for example, in education or in the development of peripheral areas.
- This is not what successive Israeli governments chose to do.

The Policy of Inflexible Fiscal Restraint - I

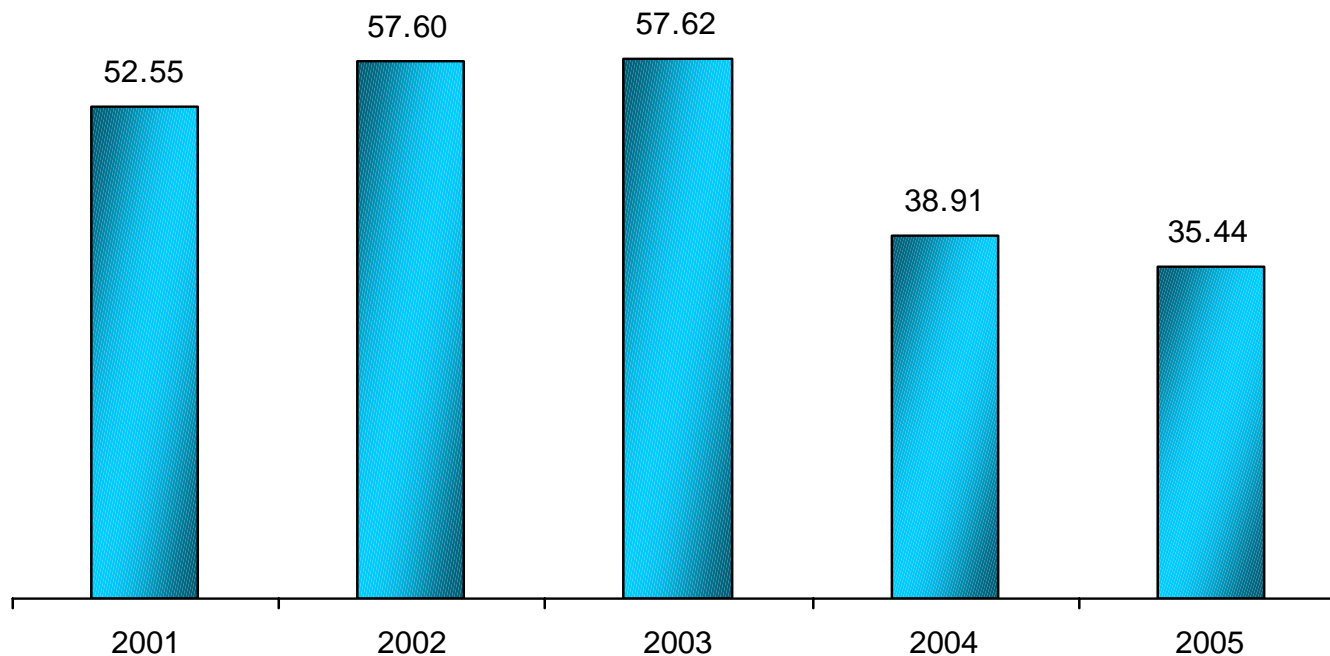
- Fiscal policy has focused solely on one goal: stimulating economic growth, by keeping government expenditures down.
- Keeping government expenditures down is meant to reduce the cost of borrowing for investors;
- Reducing the cost of borrowing is supposed to promote investment and accelerate economic growth.

The Policy of Inflexible Fiscal Restraint - II

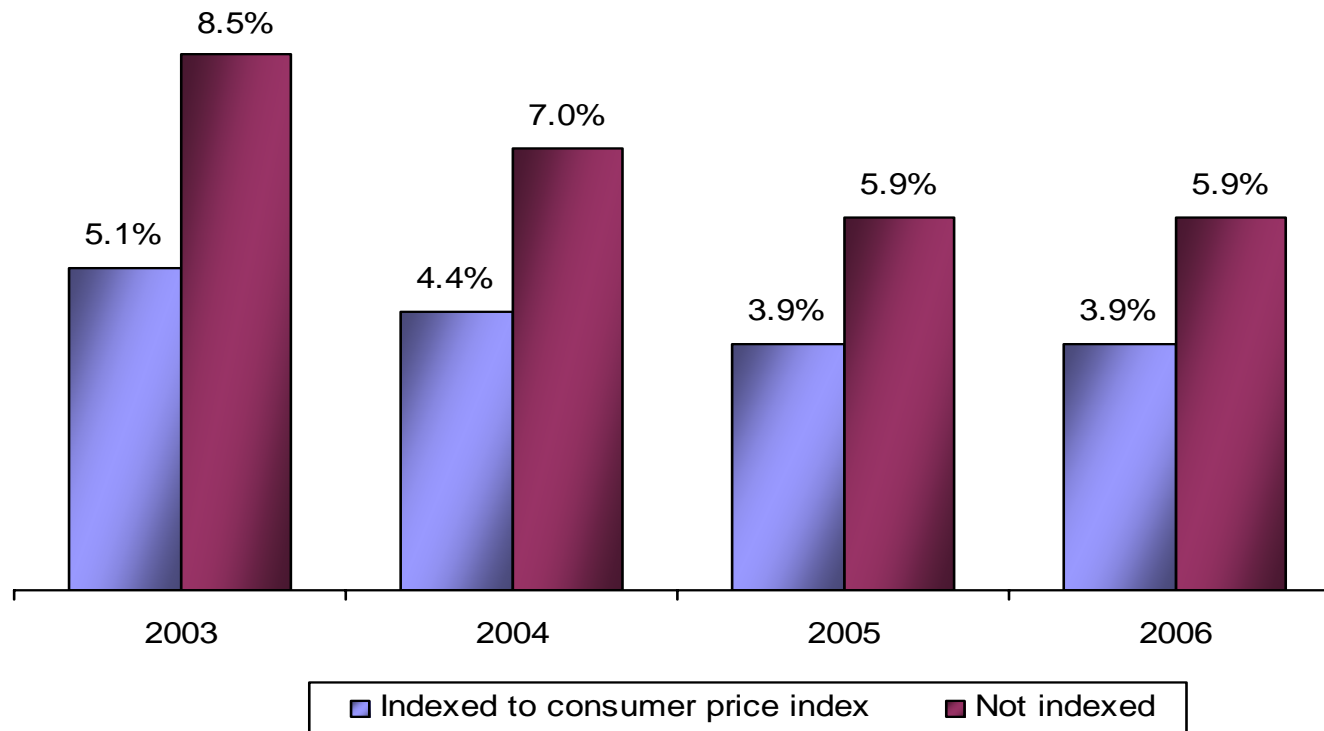
- When the government spends less, it has less need to raise money.
- In which case, a larger portion of the available credit can be used by private business, at a lower rate of interest:
 - Economists call this “freeing up resources for the business sector”;
 - The Finance Ministry calls this “making it easier for the business sector to finance its investments.”
- Indeed, the report of the Finance Ministry CFO shows a sharp decline in the amount of money raised by the government,
- And the report of the Bank of Israel reveals that the cost of borrowing in Israeli currency has declined.
 - Of course, the cost of borrowing is influenced by other factors as well – but fiscal policy is a major factor.

Government Borrowing by Issuing Bonds , 2001-2005

In NIS billions, 2006 prices



Interest Rate for Borrowing NIS, 2003-2006



The Policy of Inflexible Fiscal Restraint - III

We saw that businesses gain from the policy of keeping expenditures down, due to a decline in the cost of borrowing. The business sector also benefits from it in other ways:

When the government spends less on labor, more workers are available to the private sector – at lower wages.

When the government spends less, it can lower taxes – and then businesses and high-income persons are left with more disposable income.

The Policy of Inflexible Fiscal Restraint - IV

Indeed, in the present decade successive Israeli governments have made significant tax cuts, notably in income and corporate taxes.

As a result of income tax cuts, for example, salaried persons in the top earning decile will get a tax break of NIS 2,000 a month or more.

Some taxes were raised – but in the last analysis, between 2002 and 2010, the state is to lose some NIS 22 billion in tax monies, which it could have used to invest in, for example, education.

Tax Cuts and Hikes, 2002-2010

Cumulative Effect, in Comparison With 2001

In NIS billions

	2002	2003	2004	2005	2007	2006	2007	2008	2009	2010
Total tax cuts	0.0	-3.6	-11.7	-17.2	-29.3	-24.5	-29.3	-33.0	-35.9	-38.9
1. Government taxes	0.0	-3.6	-10.9	-16.0	-26.4	-22.5	-26.4	-29.6	-31.8	-34.8
a. Income tax on individuals	0.0	-3.6	-7.7	-11.5	-14.7	-13.7	-14.7	-16.9	-18.5	-21.0
b. Corporate tax	0.0	0.0	-0.4	-0.8	-3.1	-2.2	-3.1	-4.0	-4.4	-4.9
2. Social security	0.0	0.0	-0.8	-1.2	-2.9	-2.0	-2.9	-3.4	-4.1	-4.1
Total tax hikes	3.6	8.4	11.8	12.8	14.9	14.3	14.9	15.7	16.6	17.3
1. Government taxes	2.2	5.6	9.0	10.0	12.1	11.5	12.1	12.9	13.8	14.5
Net effect	3.6	4.8	0.1	-4.5	-14.4	-10.2	-14.4	-17.4	-19.3	-21.7
1. Total government taxes	2.2	2.0	-1.9	-6.0	-14.3	-11.0	-14.3	-16.7	-18.0	-20.3
2. Social security	1.4	2.8	2.0	1.6	-0.1	0.8	-0.1	-0.6	-1.3	-1.3

The Policy of Inflexible Fiscal Restraint - V

The policy is implemented by means of a number of laws and practices:

1. The Law for Reducing the Deficit requires the government to keep the deficit at 3% or less of GDP (from 2009 – 1%);
2. The Law for Reducing Spending limits annual increases in government outlay to 1.7%;
3. The Law for Limiting Private Legislation prevents legislators from proposing a bill whose implementation costs more than NIS 5 million – a negligible sum - unless 50 legislators vote for it;
4. The Finance Ministry practice of transferring monies to government ministries in arrears – resulting in partial use of budgets approved;
5. The Budget Arrangements Law, which enables the government to make large reductions in government activities without giving the legislature an opportunity to examine them in the framework of the normal legislative process.

The Policy of Inflexible Fiscal Restraint - VI

The government has yet another way to reduce spending: by making forecasts that support the policy of keeping expenditures down:

- Underestimating economic growth and tax revenues, which enables it to contend that there will not be sufficient funds for increased spending;
- Overestimating the deficit and the national debt, which enables it to contend that the budget cannot be increased.

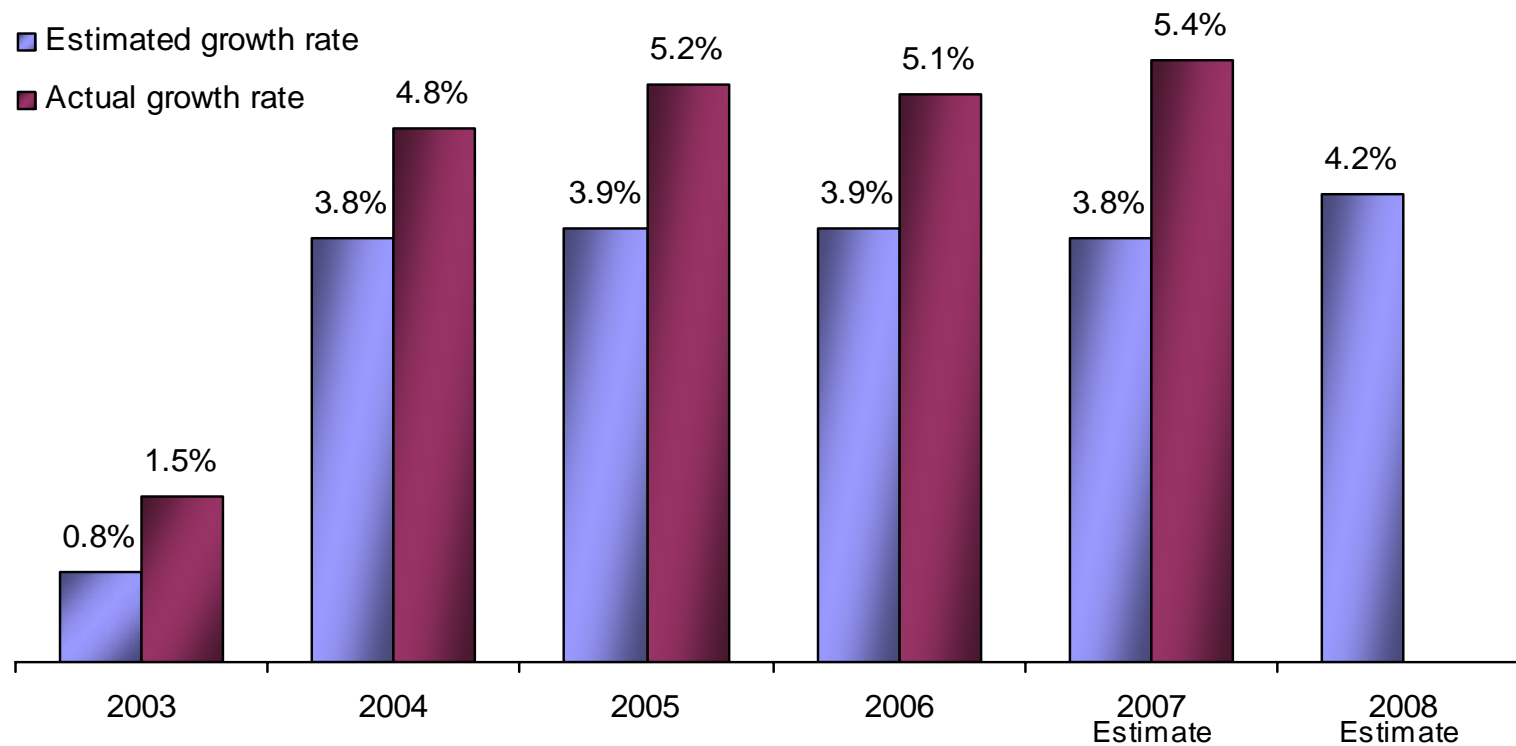
The Policy of Inflexible Fiscal Restraint - VII

The following figures show how the predictions of the Finance Ministry have supported inflexible fiscal restraint:

- Since 2003, the growth forecast has been lower than the actual growth;
- In 2006 and 2007, the estimate of tax revenues was significantly lower than actual tax revenues;
- Since 2004, the deficit forecast was higher than the actual deficit;
- Since 2003, the national debt forecast was higher than the actual debt;
- Since 2003, the approved government expenditure was lower than the actual expenditure.

Economic Growth in Israel, 2003-2008

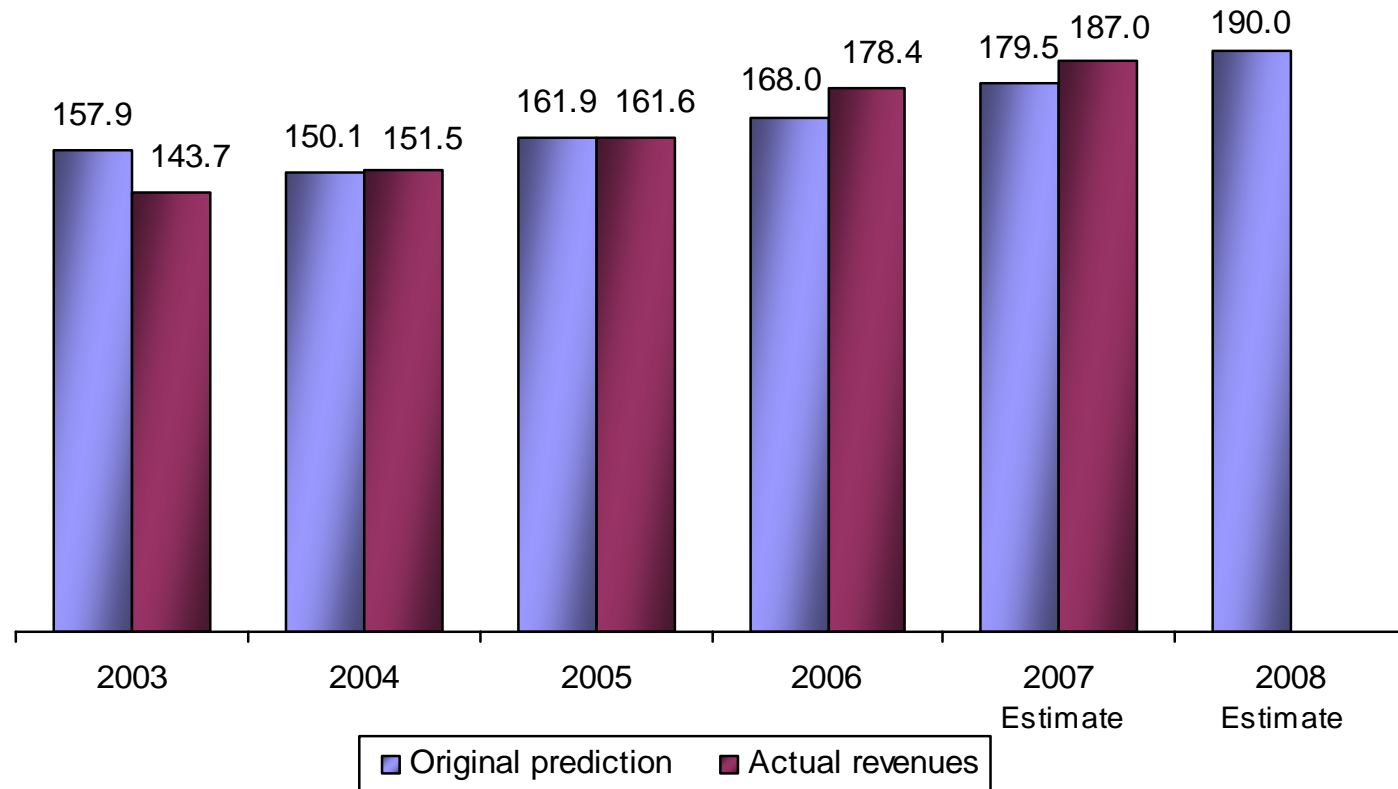
Estimated Growth Compared With Actual Growth



Tax Revenues, 2003-2008

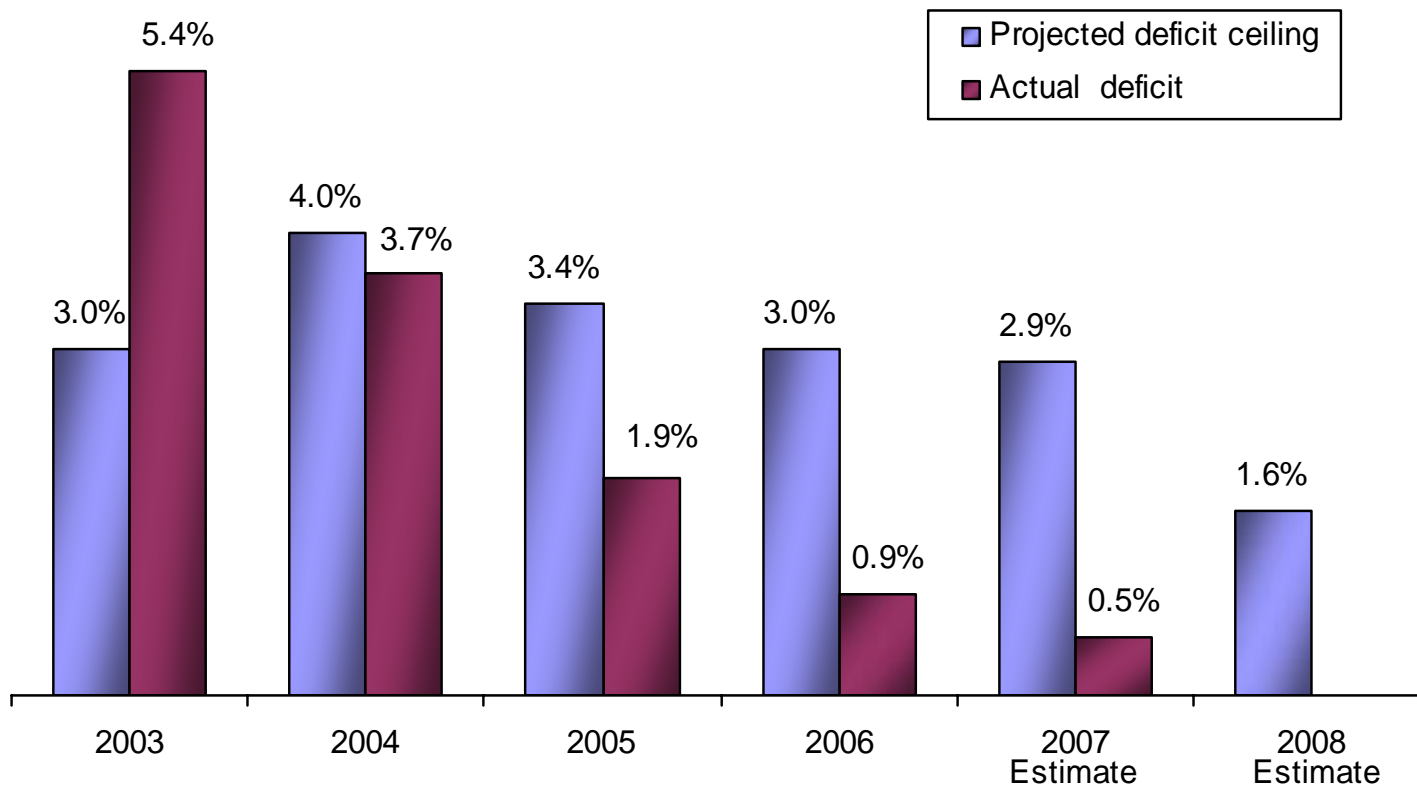
Original Prediction, Compared With Actual Revenues

In NIS billions, current prices



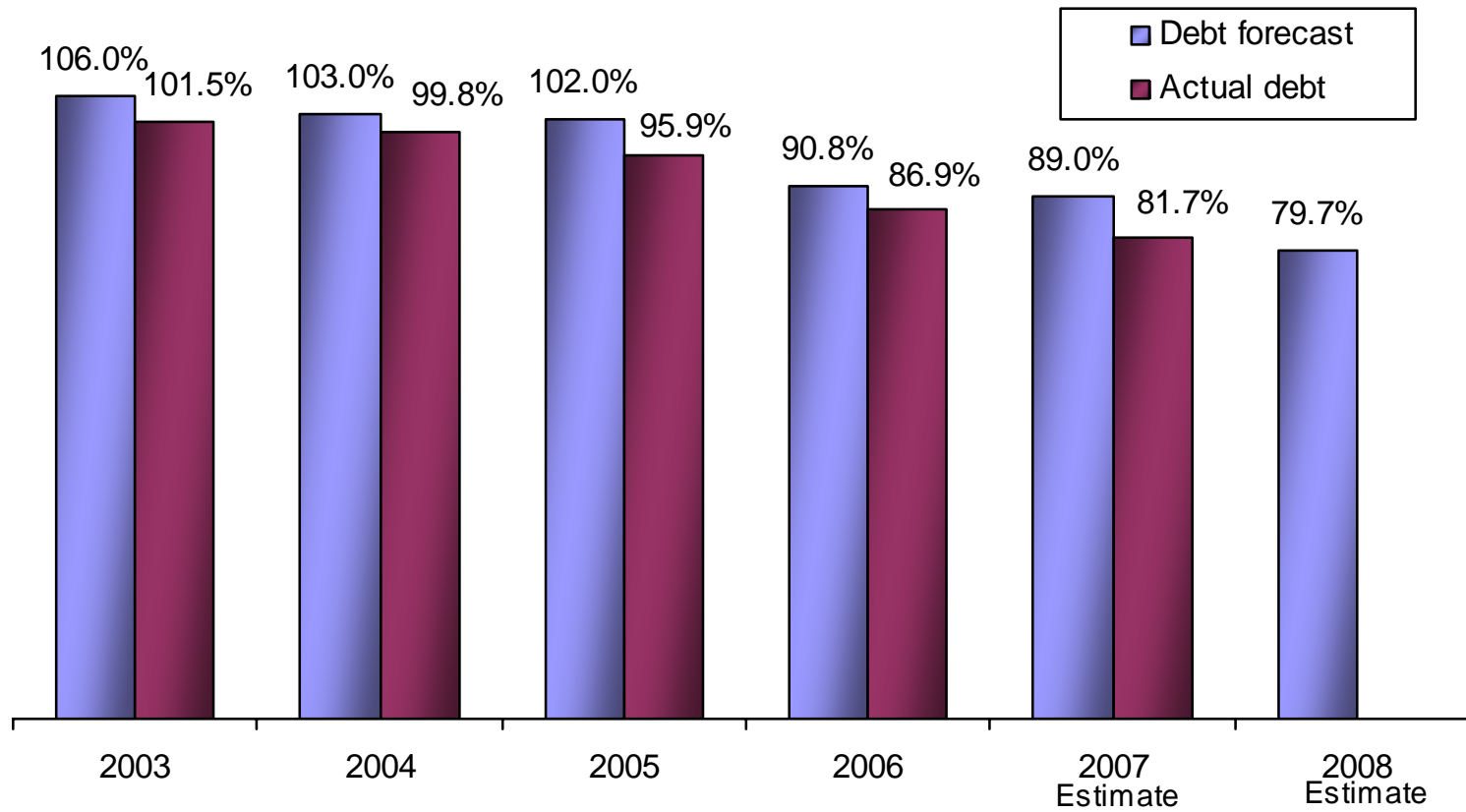
Budget Deficit as a Percentage of GDP, 2003-2008

Projected Deficit Ceiling Compared with Actual Deficit



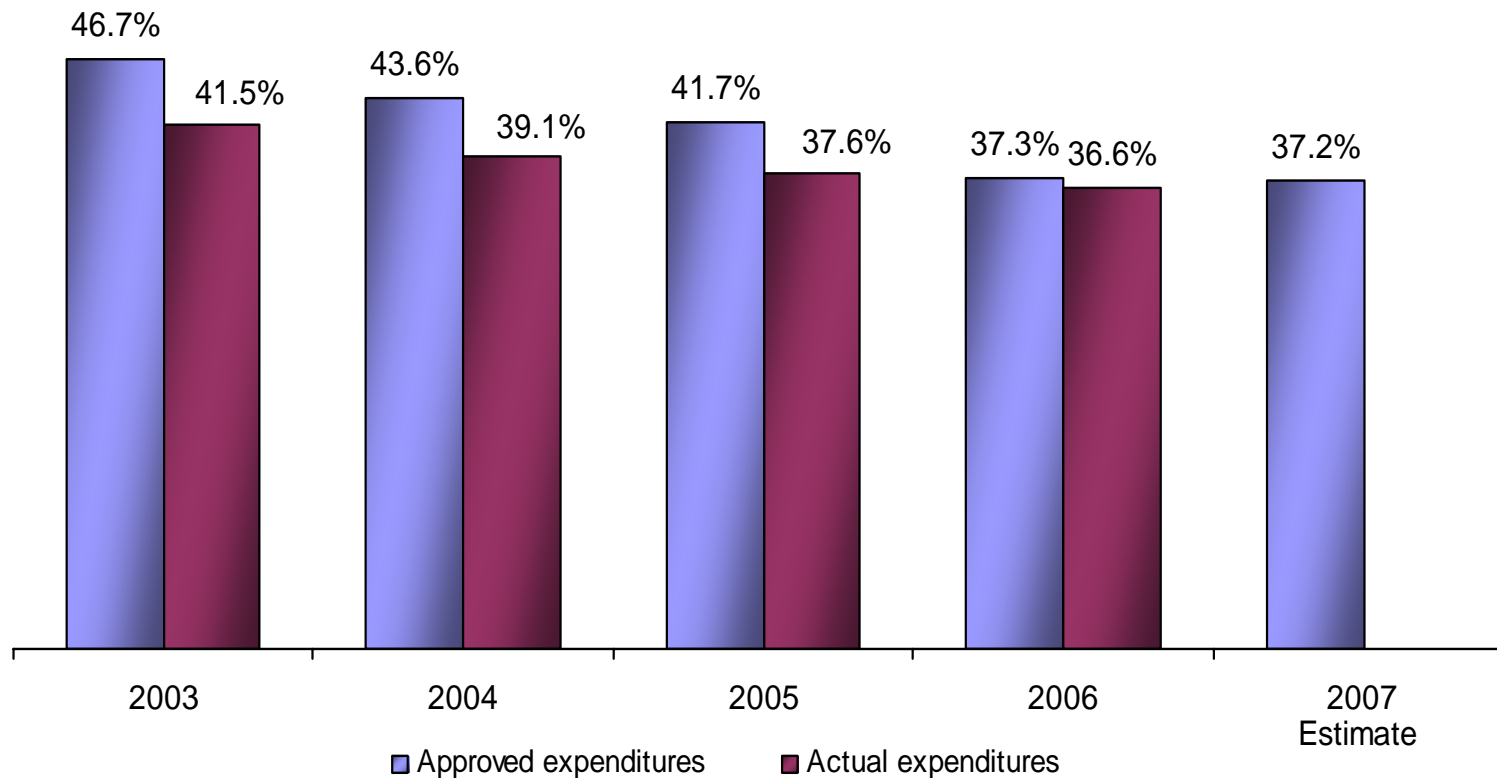
National Debt, 2003-2008

Debt Forecast Compared With Actual Debt
As Percentage of GDP



Government Expenditures as Percentage of GDP, 2003-2008

Approved Expenditures Compared With Actual Expenditures



The Policy of Inflexible Fiscal Restraint - VIII

Often figures are distorted in order to keep expenditures down.

For example: When the Cabinet met to decide on the size of the 2008 budget, the Finance Ministry and the National Economic Council explained that it was urgent to reduce the national debt, as Israel's ratio of national debt to GDP was much higher than the average in OECD countries – 58.8%.

However, the OECD gives the figure of 77.5% as the average ratio, as does the National Debt Department at the Finance Ministry! Cabinet ministers were not informed of this discrepancy.

If we take the figure of 77.5%, Israel's national debt – 87.7% in 2006 - does not look so bad.

The Policy of Inflexible Fiscal Restraint - IX

As we have seen, actual growth was higher than predicted growth, tax revenues were higher than predicted revenues and actual expenditures were lower than approved expenditures. In other words, every year the state coffers accumulated more monies, which could have been used for economic and social development.

However, the policy of keeping expenditures down prevents this. Instead, the monies left over became a bone of contention between the Finance Ministry and the Bank of Israel: The Ministry wants to make more tax cuts; this, at a time when high-income persons already enjoy significant tax breaks. The Bank of Israel wants to use the money to reduce the national debt. This is an important goal – but the question is whether it trumps all other uses.

The Policy of Inflexible Fiscal Restraint - X

The ratio between national debt and GDP is an important component in the determination of the credit rating of a country.

The credit rating affects, among others, the interest rate that local businesses pay to borrow money.

In other words, the emphasis on reducing the national debt also serves to make credit cheaper.

In Israel, the ratio between national debt and GDP is not much higher than the OECD average. Moreover, in contrast to states that have experienced debt crises, most of Israel's debt is internal and does not threaten economic stability. Against this background, one might legitimately question the wisdom of a policy prioritizing reduction of the national debt – at a time when so many public services are experiencing fiscal crisis.

The Possibility of an Economic Slow-Down

The Possibility of an Economic Slow-Down - I

At the time of the tabling of the 2008 budget proposal (October 2007), the forecast of economic growth is less certain than in the past, due to the sub-prime crisis in the United States, which escalated into a global credit crisis. In various international financial institutions, growth forecasts are being reduced. If there is a worldwide slow-down of economic growth, Israel will be seriously affected, as a large part of Israel's production is geared to export. Some people in Israel talk about an economic slow-down and others talk about the end of the growth cycle that began in 2003.

In contrast, Finance Ministry officials remain optimistic, perhaps because they would like to preserve the image of Israel as a growth economy worth investing in.

The Possibility of an Economic Slow-Down - II

When the Finance Ministry presented its budget proposal to the Cabinet (June 2007), its growth forecast was 4.2%. At the time, prior to the sub-prime crisis, the forecast was considered low: non-governmental financial bodies predicted higher growth rates. However, a low forecast justifies keeping expenditures down, and thus the Finance Ministry kept to its low forecast.

Today, following the sub-prime crisis, the forecast may turn out to be too high. Indeed, the Finance Minister was quoted a number of times as saying that we ought to take into consideration the possibility of a slow-down in economic growth.

The Possibility of an Economic Slow-Down - III

If there is a slow-down, the government will be able to continue its line of keeping expenditures down. The only thing that will change will be the justification given: if during periods of growth expenditures are not increased so as to stimulate further growth, in periods of economic slow-downs expenditures are not increased because tax revenues are predicted to be insufficient.

During recessions, governments often increase spending, in order to grease the wheels of economic activity; the phenomenon is referred to as anti-cyclical activity.

However, Minister of Finance Roni Bar-On has already made a commitment to the 3 biggest credit-rating firms, Standard and Poors, Moodys, and Fitch, that “the Israeli government will not increase the budget even if economic growth slows down for one reason or another.”

The Possibility of an Economic Slow-Down - IV

- Thus, the present wave of growth is liable to end without the majority of Israelis reaping substantial benefits.
- The main beneficiaries, to date, have been business people and employers: the employers' share of the national income has grown year after year, at the expense of the workers' share. Workers' increased productivity has not been paralleled by a rise in wages.
- The general public has not seen, to date, meaningful government investments designed to upgrade the public services: education, social security, personal services and housing services.

Increase in the Defense Budget

Budget Cuts Have Not Been Across the Board

As we have seen, the policy of keeping expenditures down has had an adverse effect on the government's ability to invest in Israeli society.

But budget cuts have not been across the board: one notable exception is the defense budget.

Israel needs a large defense budget. The question is whether, when considering the overall interests of Israel, it is possible to justify a policy based, on the one hand, on a strict policy of holding down expenditures and on the other, on regular exceptions to the rule when it comes to the defense budget.

Increases in the Defense Budget - I

Between 1989 and 2008 Israel experienced two Intifadahs and the Second Lebanon War, for which the Ministry of Defense received special budget allotments (above and beyond the regular budget) totaling NIS 44 billion.

In both 2003 and 2004, budget increases due to the Intifadah amounted to 12% of the regular defense budget.

With the ebbing of the Intifadah, the defense budget was expected to be downsized. However, in July 2006, the Cabinet's decision to respond to the abduction of Israeli soldiers by actions that developed into a month-long war, had the effect of ratcheting up the defense budget. In 2007, the budget increases for the Second Lebanon War totaled 11% of the regular budget; in 2008 they are expected to total 10%.

Increases in the Defense Budget - II

At the end of the Second Lebanon War, the Defense Ministry demanded a larger budgetary increase. The Cabinet appointed a public commission – headed by David Brodet, former CEO of the Finance Ministry - to examine the demand and the defense budget as a whole.

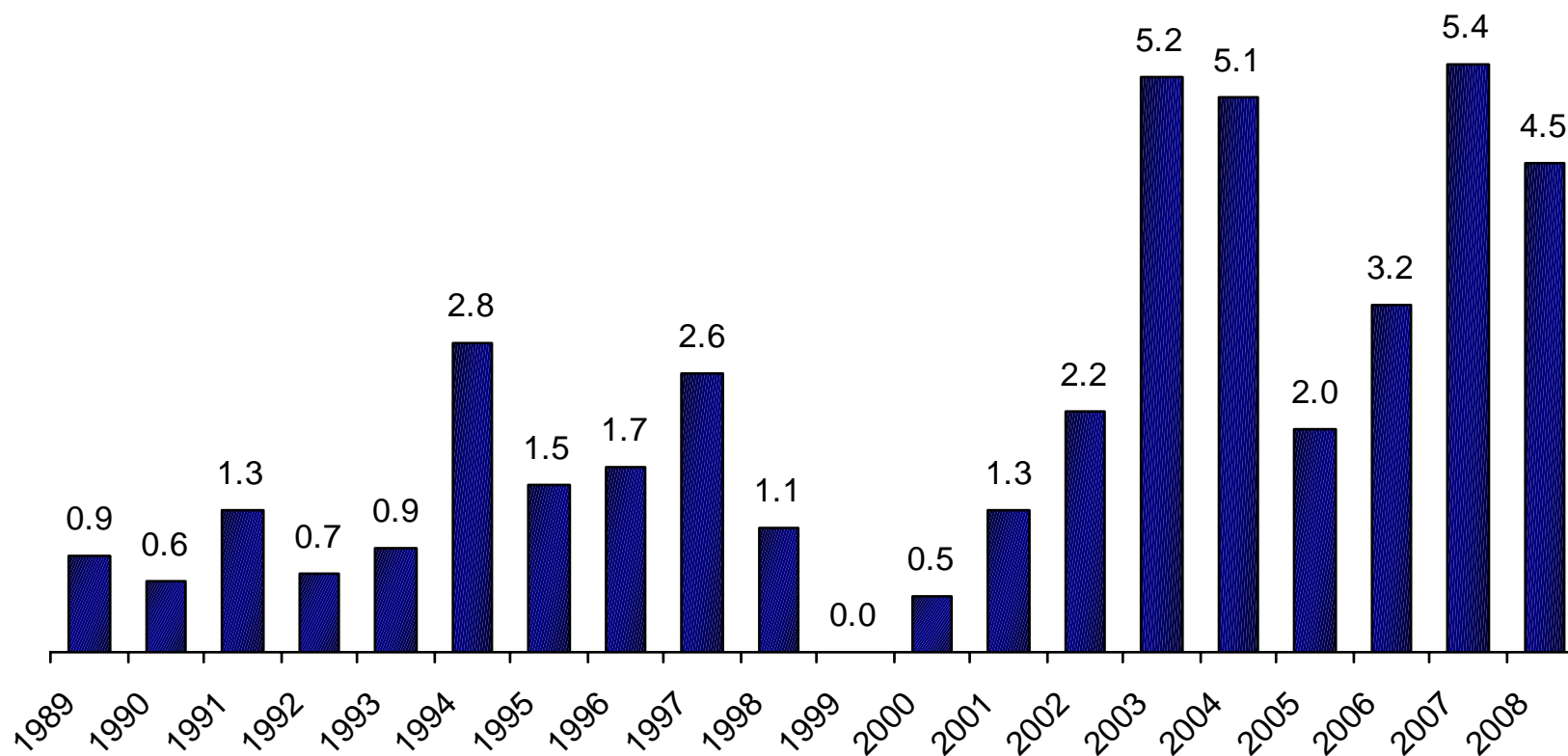
The commission recommended adding NIS 46 billion to the defense budget over a period of 10 years – an average of NIS 4.6 billion a year.

In addition, the United States agreed to increase its military aid to Israel by NIS 30 million over the next 10 years.

In other words, during the next 10 years, the defense budget is to increase by an average of NIS 7.6 billion a year.

Additions to the Defense Budget Attributed to Israeli-Palestinian Hostilities and to the Second Lebanon War, 1989-2008

NIS billions, 2006 prices



Increases in the Defense Budget - III

To increase the defense budget without violating the principle of fiscal restraint, the Finance Ministry came up with the idea of “boxes” for expenditures that were over and above the 1.7% limit imposed.

The boxes are meant to keep up the appearance of limiting expenditures while actually increasing them.

In recent years, such “boxes” have been used for defense expenditures only.

The next slide, taken from the presentation made by the Finance Ministry at the Cabinet meeting that discussed the size of the 2008 budget, shows the use of boxes.

“Boxes” in the 2008 Budget Proposal

2007 prices

- For covering the cost of the Second Lebanon War in 2006 – a budget increase of 1% (beyond the 1.7% limit), that is, an addition of NIS 2.2 billion.
- For the 2005 disengagement from the Gaza Strip – a budget increase of 0.5% (beyond the 1.7% limit), that is, an addition of NIS 1.1 billion.

The Cost of Occupation

Holding on to the Palestinian territories requires large budgetary outlays.

We saw the additions to the defense budget attributed to the two Intifidahs. The Brodet commission anticipates that this outlay will continue and even increase in the coming years.

Among other things, the Brodet commission recommended training special units to police the territories.

Increases in the Defense Budget - IV

On the eve of the Second Lebanon War, another national commission, headed by former Finance Minister Dan Meridor, had recommended maintaining the defense budget at its current level, so that within a few years - assuming that economic growth continues – the defense budget/GDP ratio would decline from 8%-8.5% to 5%-5.5%.

Following the Second Lebanon War and under heavy pressure from the Defense Ministry, the Brodet commission departed from the recommendations of the Meridor commission. As we have seen, it recommended increasing the defense budget, in accordance with the following table.

Additions to the Defense Budget 2008-2017

Based on Recommendations of the Brodet Commission
Annual Increments, Against the 2007 Budget, NIS billions

2008	1.4
2009	2.3
2010	2.9
2011	3.6
2012	4.2
2013	4.9
2014	5.6
2015	6.3
2016	7.0
2017	7.7
Total	46.0

Increases in the Defense Budget - V

The Brodet commission recommended that up to 2010, government expenditures would increase by 1.7% a year, and after that, by 2.5% a year.

Had the new commission accepted the recommendation of the Meridor commission – that the defense budget remain at its 2007 level - the defense budget would not take up any of the expected increase in government expenditures: all the increase would go for civilian expenses.

However, following the Brodet commission's recommendations, defense expenditures will take up a significant proportion of the anticipated growth in government outlays in the coming decade.

Figures in the following slide do not include the growth in US military aid.

Growth in Defense Expenditures, as a Percentage of Projected Growth in Total Government Expenditures, 2008-2017

Based on recommendations of the Brodet commission,
Compared with the 2007 budget, in percentages

2008	38%
2009	31%
2010	25%
2011	20%
2012	18%
2013	16%
2014	15%
2015	15%
2016	14%
2017	14%

Fiscal Crisis in the Public Services

With the Exception of Defense, All the Public Services in Israel are in Serious Fiscal Crisis

The policy of inflexible fiscal restraint reduces the cost of borrowing for investors – at the price of fiscal crises in all the public services, with the exception of defense.

The public services have been forced to respond to the crisis in a variety of ways:

- By reducing services – resulting in, for example, fewer teaching hours in schools, and fewer books and laboratories in universities;
- By reducing expenses – mainly by hiring personnel through temp agencies. For example – school nurses;
- By offering “special services” for pay. For example, additional teaching hours for schools in middle-class neighborhoods; supplemental health insurance. In turn, these “special services” threaten the universal, public nature of education, health, social security and housing services in Israel.

Social Implications of the Fiscal Crisis

First and foremost, the fiscal crisis of the public services has an adverse effect on the employment, salary and promotion opportunities of women. For many women, the public sector is the ticket to the labor market: nearly half of working women are employed in the public services.

Women are affected not only as workers but also as clients – as in most families, it is the women who come into contact with the public services – schools, health services, social welfare services and the like.

Finally, women are adversely affected by the fact that they are the ones who provide the services that the government cuts: for example, nursing care for family members.

The budget crisis also threatens the stability of the middle class, based as it is on two bread-winners. The middle class suffers from the decline in the quality of the public services, on which their hopes for the next generation depend. They are also hard pressed by payments for privatized services.

The following slides show some of the major areas affected by the policy of inflexible fiscal restraint in social spending.

The Decline of Public Expenditure Per Capita

Israel is in its fifth year of economic growth, and state revenues are increasing – but government expenditures per capita are declining.

The following slide shows that between 2002 and 2004, the government per capita outlay declined. Since 2004 it has risen, but the proposed outlay for 2008 is still lower than it was in 2001.

Erosion in the Per Capita Government Outlay, 2001-2008

In 2001, the per capita outlay was NIS 29,683;

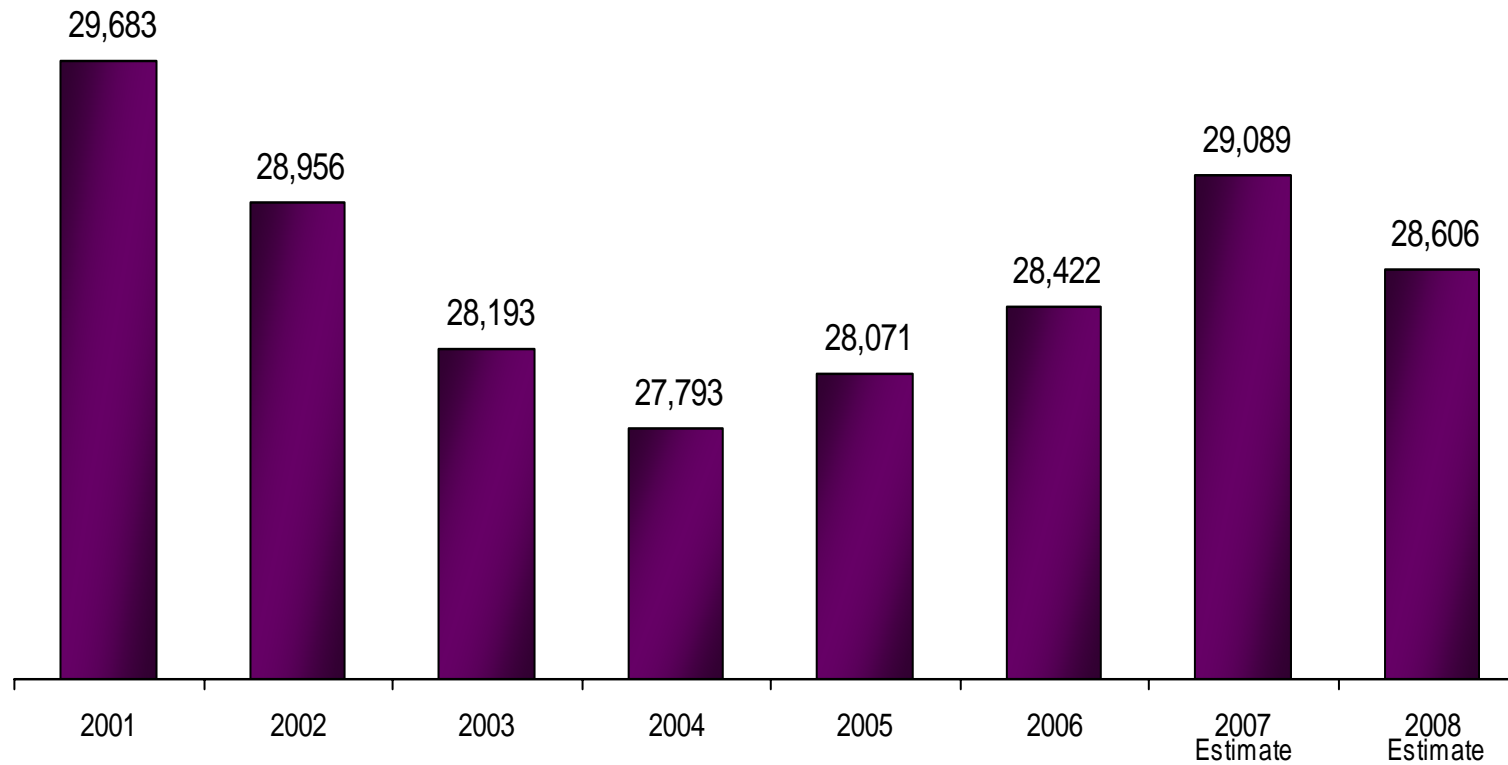
In 2007, it was NIS 29,089;

In 2008, it will continue to decline to NIS 28,606.

- Had the government maintained the 2001 level of per capita outlay, government expenditures in 2008 would total NIS 218.1 billion; in effect they are to total NIS 210.1 billion (in 2006 prices).
- Had the government improved services by increasing the per capita outlay by only 1% per year, the expenditure budget in 2008 would be NIS 233.8 billion.

Government Outlay Per Capita, 2001-2008

NIS, 2006 prices



Erosion in Social Outlays, Per Capita, 2001-2008

The per capita outlay for social expenditures declined even more than the general outlay.

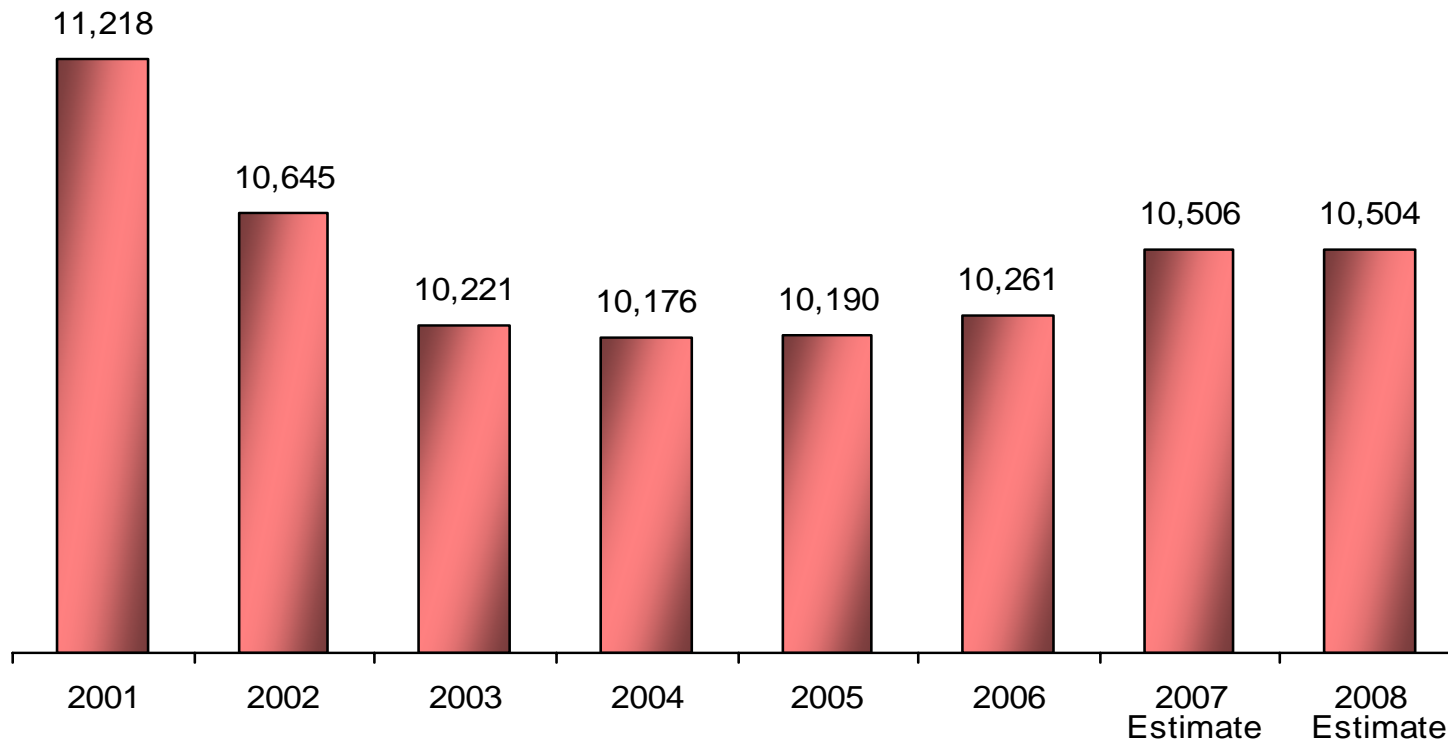
In 2001 the social outlay per capita was NIS 11,218;

In 2008 it will be NIS 10,504.

- Had the government maintained the 2001 expenditure level, the social outlay for 2008 would be NIS 82.4 billion; in effect it is to be NIS 77.2 billion.
- Had the government improved education, health and social services by increasing the per capita outlay by only 1% per year, the social expenditure in 2008 would be NIS 88.4 billion instead of NIS 77.2 billion.

Social Outlay, Per Capita, 2001-2008

NIS, 2006 prices



Elementary and Secondary Education: Erosion in Teaching Hours Per Pupil, 2001-2008

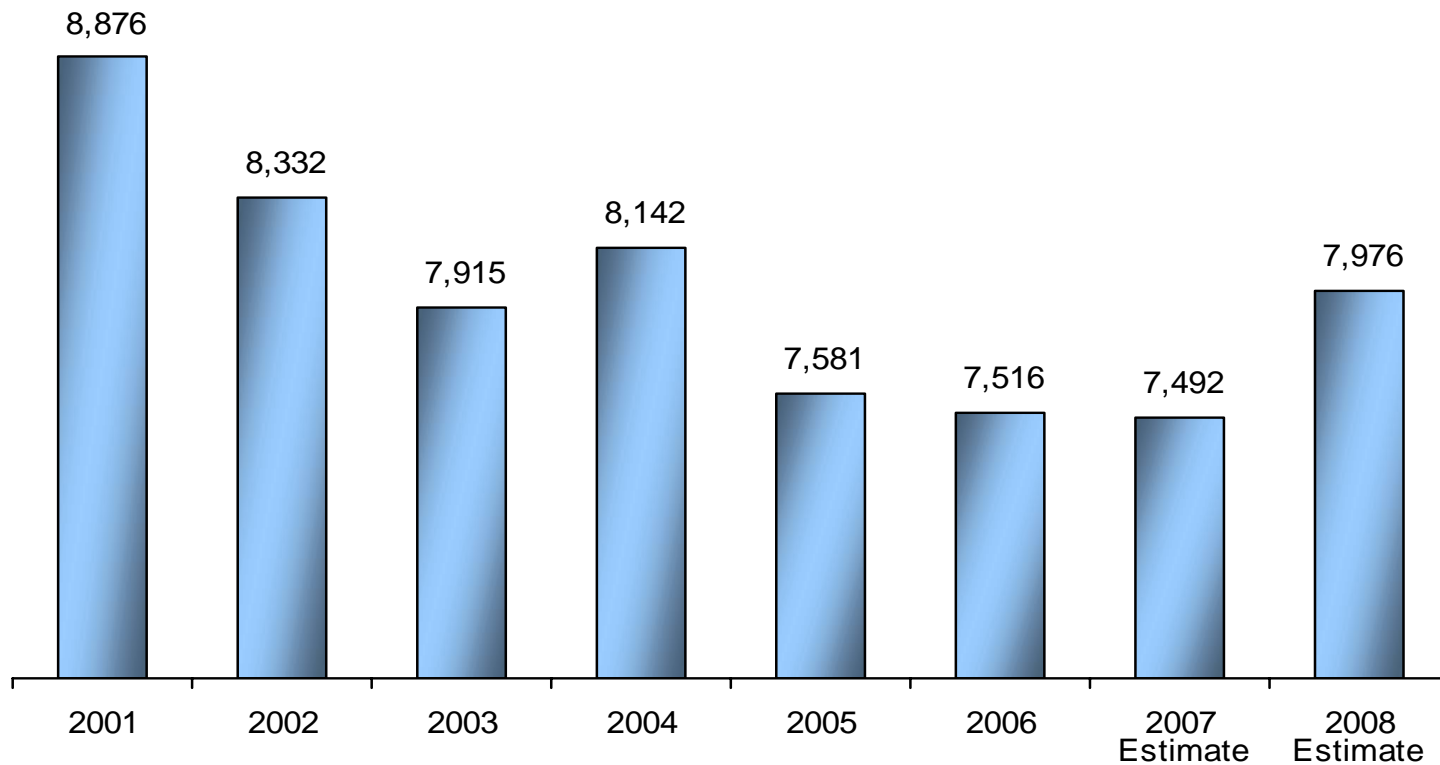
Between 2001 and 2007, teaching hours per pupil declined by 16%;

In 2008, this budget is expected to increase. This increase, if it is implemented, will return the budget to its 2003-2004 level, but not to its 2001 level.

The budget cuts in the education system are the background of the recent teacher strikes.

Teaching Budget, Per Pupil, 2001-2008

NIS, 2006 prices



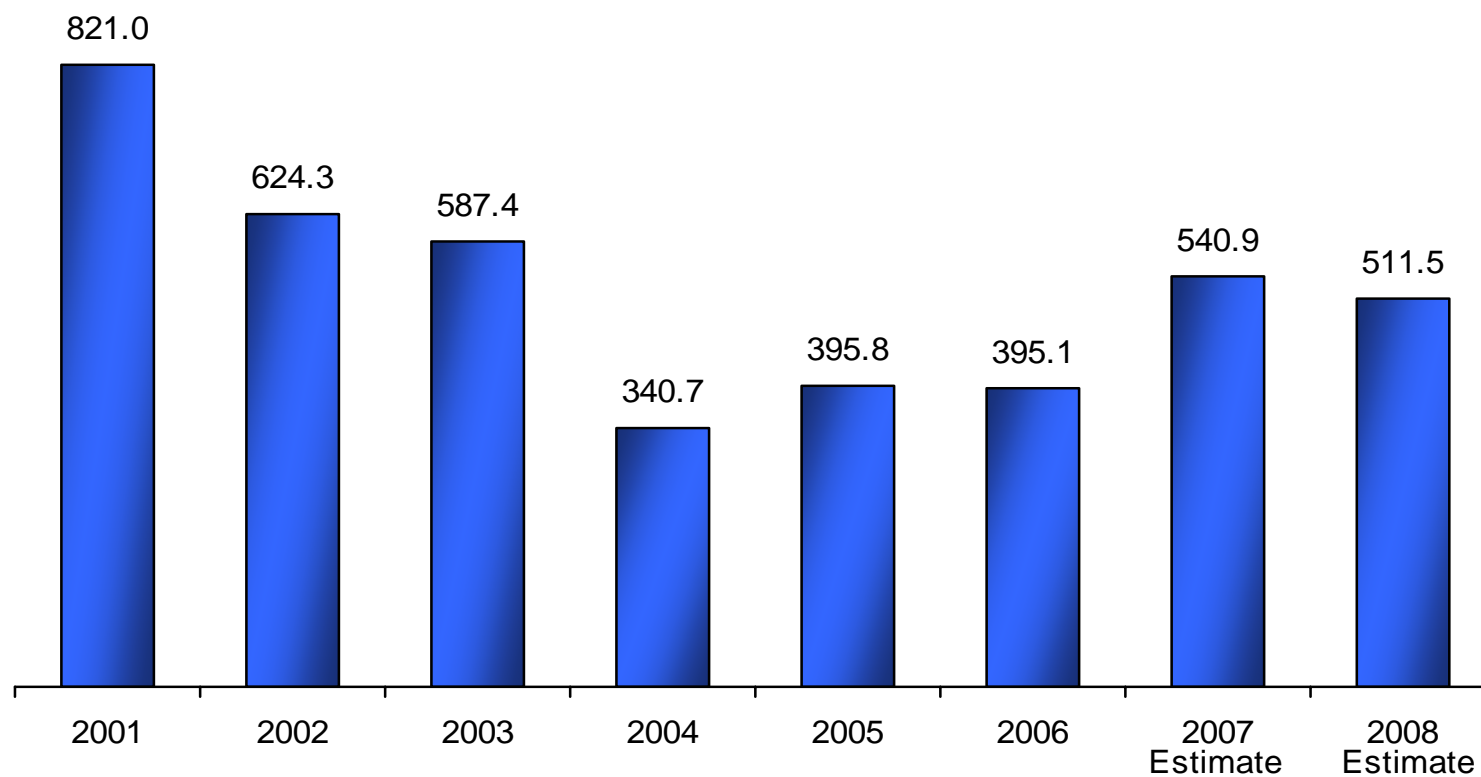
Erosion in the Education Investment Budget, 2001-2008

Between 2001 and 2008, the investment budget of the Ministry of Education declined by 38%.

The result: neglect of infrastructure and a shortage of classrooms.

Education Investment Budget, 2001-2008

NIS millions, 2006 prices



Higher Education: Erosion of the Per Student Budget, 2000-2007

Between 2000 and 2007, the budget for higher education, per student, declined by 17%.

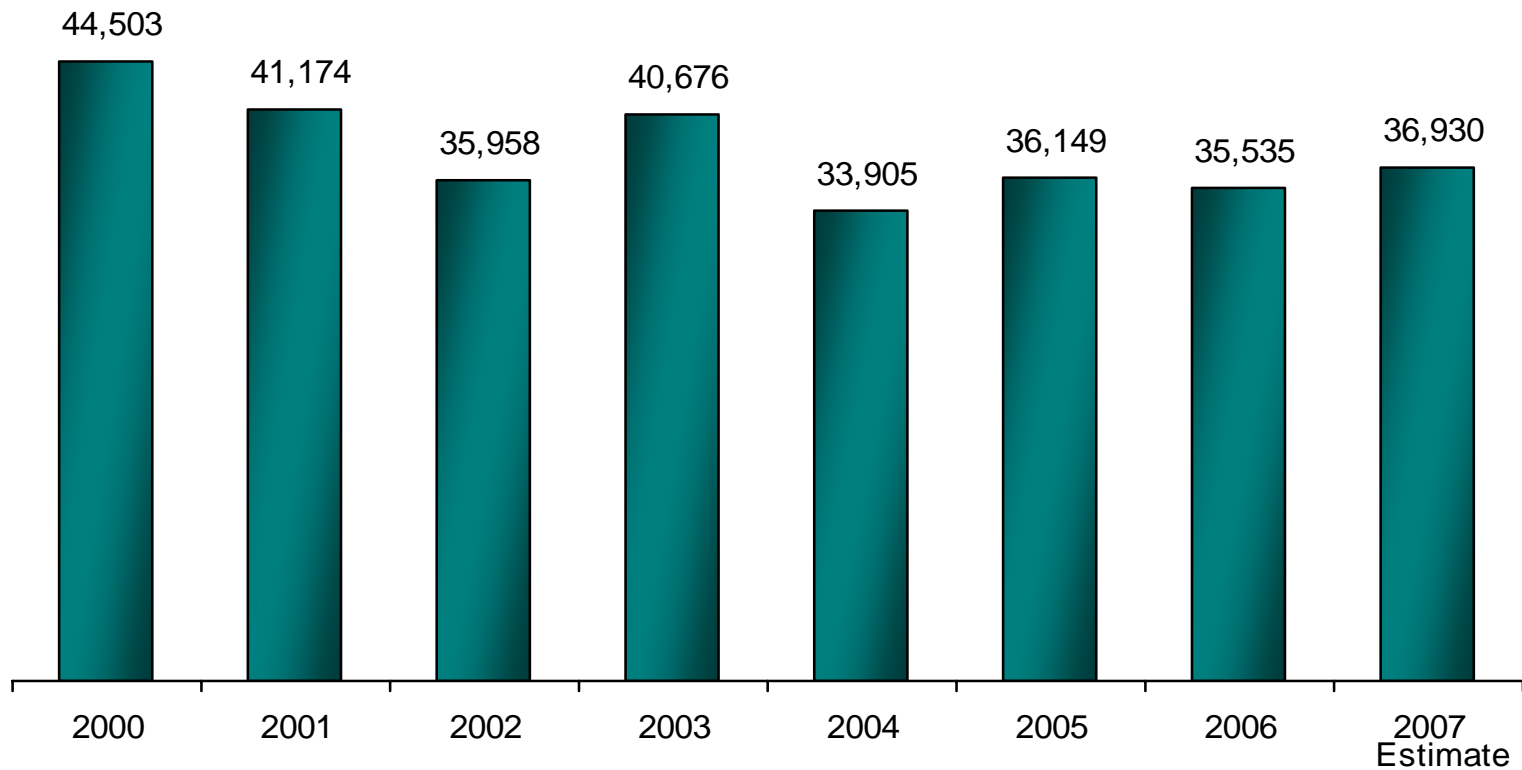
The result: fewer teaching assistants, larger classes, fewer library acquisitions – and projected tuition hikes.

The budget cuts in higher education are the background of the present crisis at the universities and public colleges.

Higher Education Budget, Per Student, 2000-2007

Students in universities and public academic colleges

NIS, 2006 prices



Shohat Commission Recommendations

The Shohat commission, appointed to examine Israel's higher education system, found, not surprisingly, that it was in a fiscal crisis – but recommended dealing with that crisis by raising tuition.

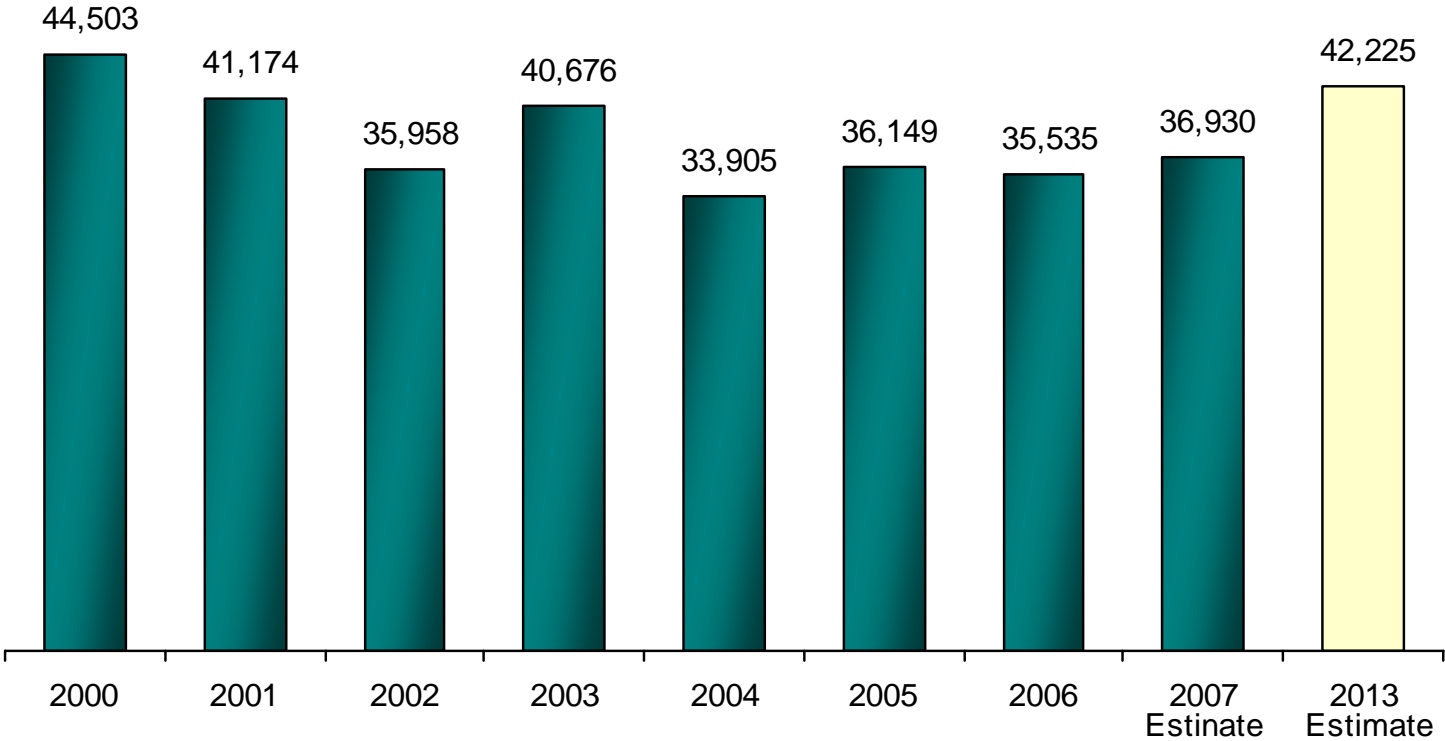
The Shohat commission also recommended increasing, gradually and over a number of years, government funding of higher education.

However, a close look reveals that the anticipated result of the Shohat Commission recommendations will not be an increase in government funding per student but rather a return, by 2013, to the funding level of 2001.

The bottom line: the Shohat commission serves to legitimize the decreasing government commitment to the future of higher education in Israel.

Higher Education Budget, Per Student, 2000-2007 Anticipated Budget, Per Student, in 2013 – According to the Shohat Committee Recommendations

Students in universities and public academic colleges, NIS, 2006 prices

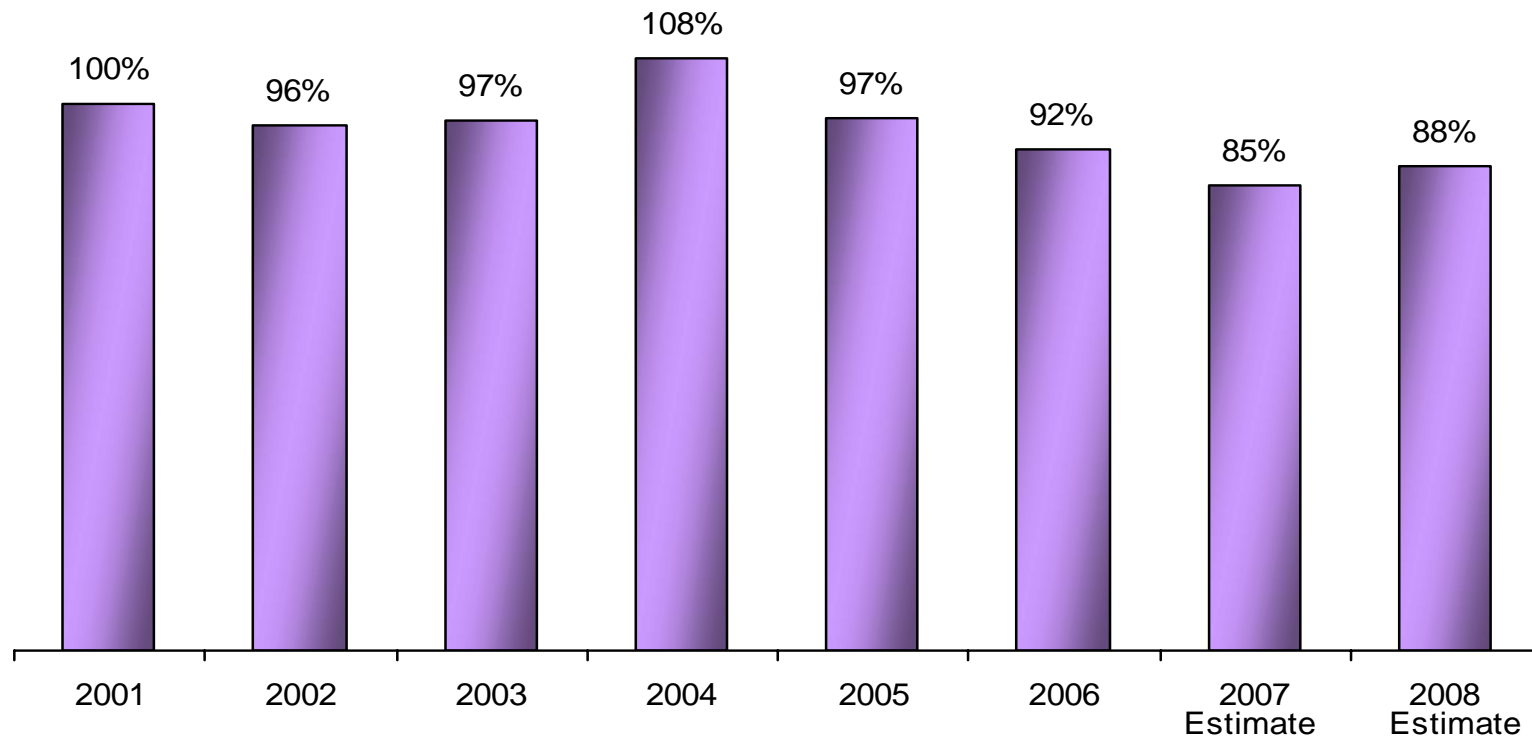


The Public Health System: Erosion in the Health Budget, 2001-2008

In 2008, the health budget per capita (age-adjusted, not including allocations for the health law, for mental health and for investment), will be 88% of the same budget in 2001.

Health Budget, 2001-2008

Per capita, age-adjusted; excluding allocations for health law, mental health and investment; in percentages: 2001 = 100%



Erosion in the Ministry of Health Investment Budget, 2001-2008

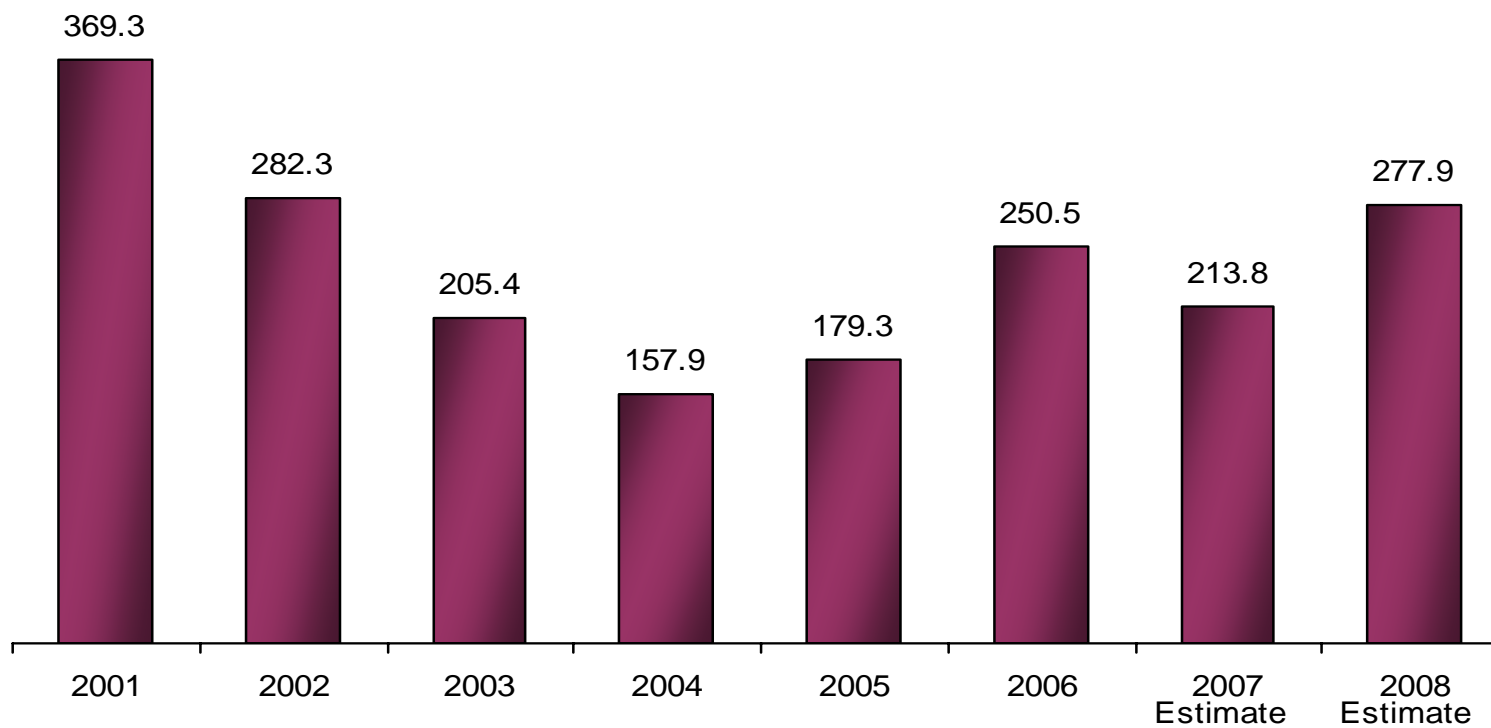
Between 2001 and 2008, the investment budget of the Ministry of Health declined by about one-fourth.

Although the budget has seen some increases, it has yet to return to its 2001 level.

The result: fewer hospital beds in peripheral areas and deteriorating infrastructures.

Health Investment Budget, 2001-2008

NIS millions, 2006 prices



Budget Erosion in the Health Benefits Package of HMOs

The National Health Insurance Law did not establish a mechanism for indexing the cost of the benefits package, which needs to be updated annually to take into account:

- Population increases and increases in the proportion of the elderly;
- Rises in health costs (labor, equipment, medications);
- New medications and medical procedures.

Successive governments have opposed an updating mechanism, because it would require increasing government support for the law. The result: erosion in the budget of the health benefits package.

The slides show the present budget, compared with a fully indexed budget.

Cost of Benefits Package, 1995-2006

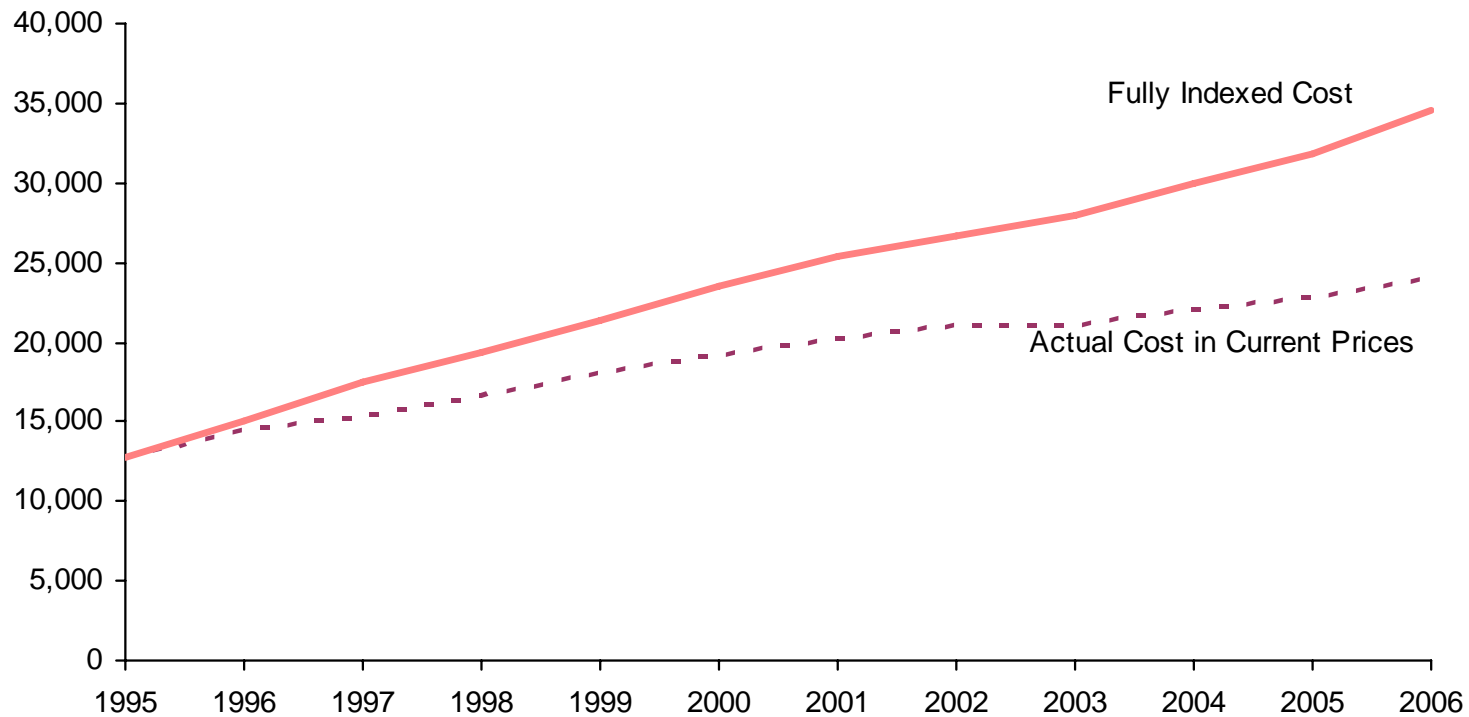
Year	Actual cost (NIS millions, current prices)	Fully indexed cost (NIS millions)	Actual cost per capita (age-adjusted) (NIS)	Fully indexed cost (NIS)
1995	12,741	12,741	2,447	2,447
1996	14,439	15,062	2,655	2,769
1997	15,358	17,451	2,722	3,093
1998	16,614	19,364	2,860	3,334
1999	18,008	21,431	3,010	3,583
2000	19,269	23,454	3,128	3,807
2001	20,268	25,376	3,198	4,004
2002	21,118	26,642	3,255	4,106
2003	21,135	27,968	3,185	4,215
2004	22,008	30,016	3,253	4,436
2005	22,768	31,783	3,302	4,610
2006	24,041	34,588	3,409	4,904

Cost of Benefits Package, 1995-2006

Actual Cost and Fully Indexed Cost

Fully Indexed Cost, Actual Cost in Current Prices

NIS millions



Social Security: Erosion in Social Security Payments, 2001-2007

Social Security payments have declined:

In 2001 they totaled NIS 49.9 billion;

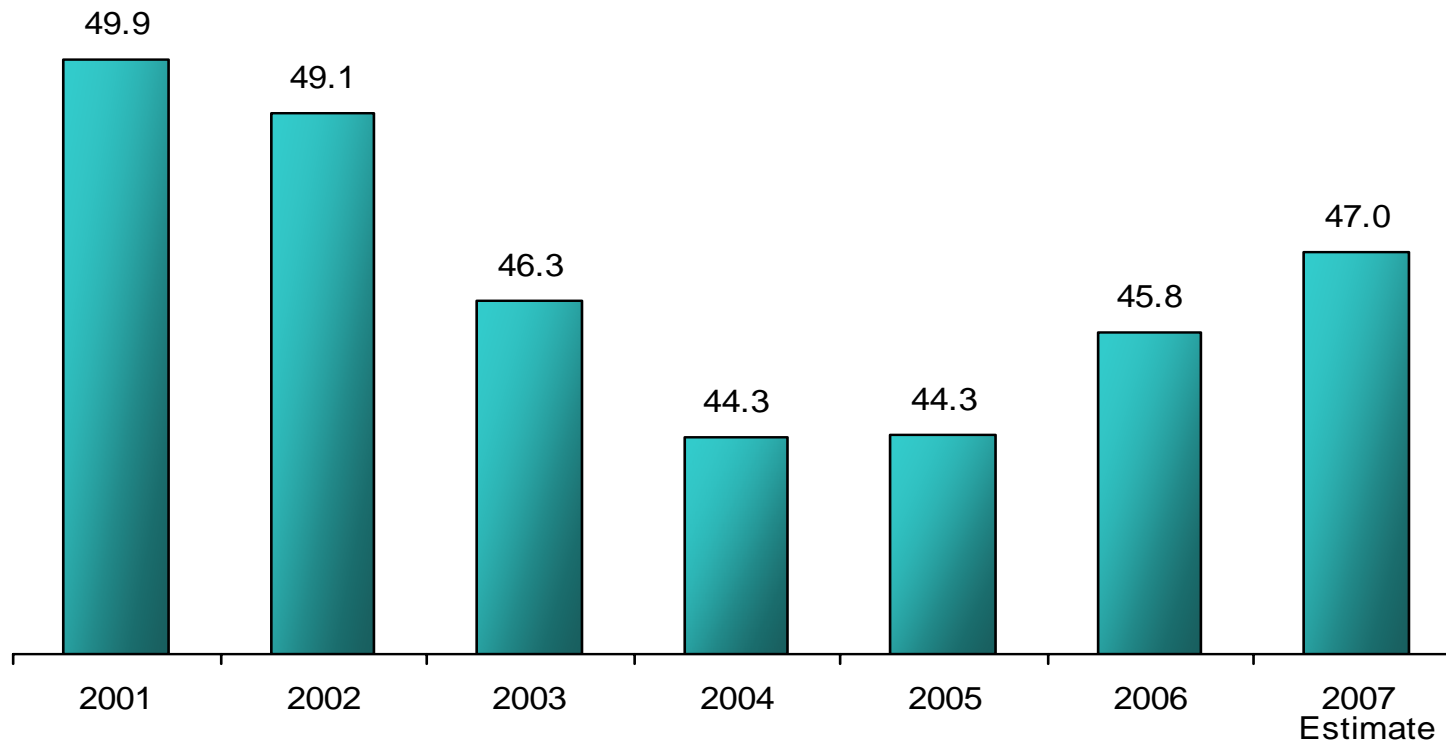
In 2006 they totaled NIS 45.8 billion;

In 2007 they rose to approximately NIS 47 billion.

In other words, in 2007 social security recipients still received NIS 2.9 less than they would have received had there been no cuts and no freezing of payments (and this without taking into account the increase in population and in needs).

Social Security Payments, 2001-2007

NIS billions, 2006 prices



Inflexible Fiscal Restraint and Investment in the Israeli Economy

Inflexible Fiscal Restraint and Investment in the Israeli Economy - I

The Second Intifadah resulted in declining investments in the Israeli economy. Fixed capital formation declined for three consecutive years – 2002, 2003 and 2004. In 2005, investments increased and in 2006 they returned to their 2001 level and even surpassed it.

Neo-liberal politicians boast that the policy of keeping government expenditures down, along with the policy of privatization, were responsible for economic growth and for the increase in investments – and thus they call for continuing that same policy.

However, according to the Research Department of the Bank of Israel, fiscal policy accounted for only a third of the growth; two-thirds were attributable to external factors, including the easing of the Israel-Palestine confrontation and the increase in global trade.

In other words, the contribution of fiscal policy to growth is far less than its promoters like to admit. Fiscal restraint is good for large Israeli corporations – but their function in promoting growth is much less clear-cut.

Gross Domestic Capital Formation, 2001-2007

NIS billions, 2006 prices

	2001	2002	2003	2004	2005	2006	2007
Total gross domestic capital formation (including increase in inventory)	112.1	100.9	95.8	102.0	114.3	119.8	131.3
Fixed capital formation (including buildings and construction)	100.9	96.1	92.3	95.1	98.1	108.3	118.5

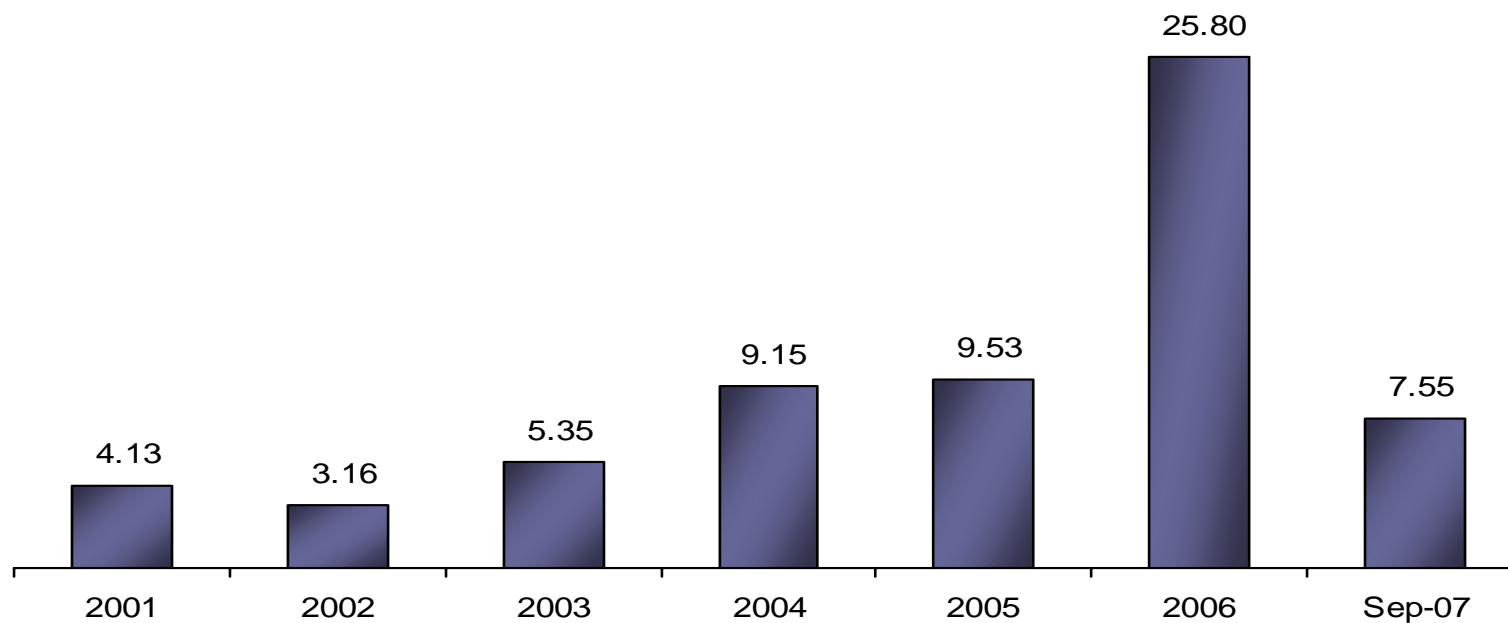
Inflexible Fiscal Restraint and Foreign Investments in the Israeli Economy - II

The present growth wave has lured foreign investors.

In 2006, foreign investors invested 6 times as much in Israel as they invested in 2001.

Increase in Foreign Investments in Israel 2001-September 2007

Direct investments, tradable portfolio investments and other investments
Billions of dollars



Inflexible Fiscal Restraint and Investment in the Israeli Economy - III

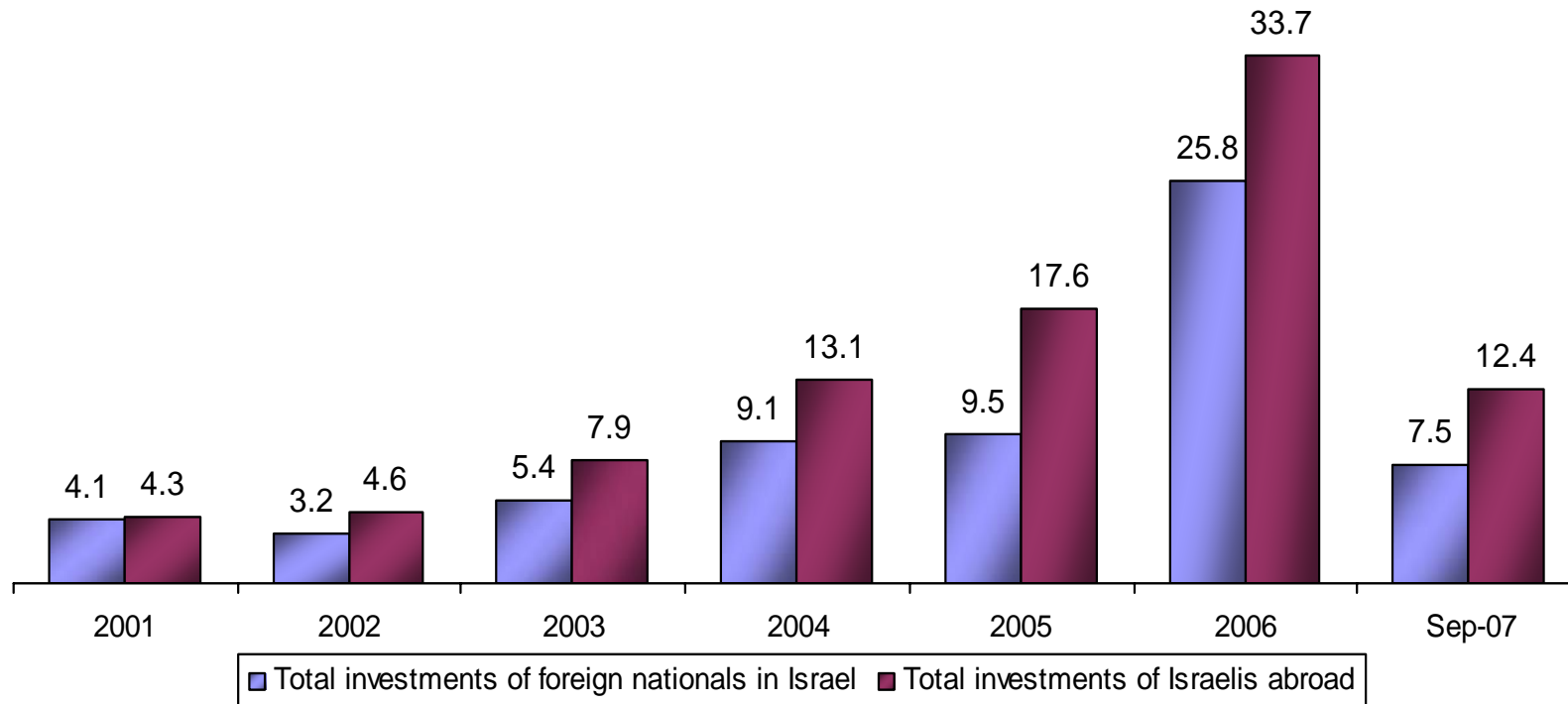
However, the policy of making credit cheaper and removing limits on the movement of capital also led to a large increase in the investments of Israelis abroad.

While the investments of foreign nationals in Israel grew 6-fold, the investments of Israelis abroad grew 8-fold.

The question: Is it justified to continue to offer cheap credit, when one of the outcomes is increased investments abroad.

Investments of Israelis Abroad Surpass Investments of Foreign Nationals in Israel 2001-September 2007

Direct investments, portfolio investments and other investments, in billions of dollars

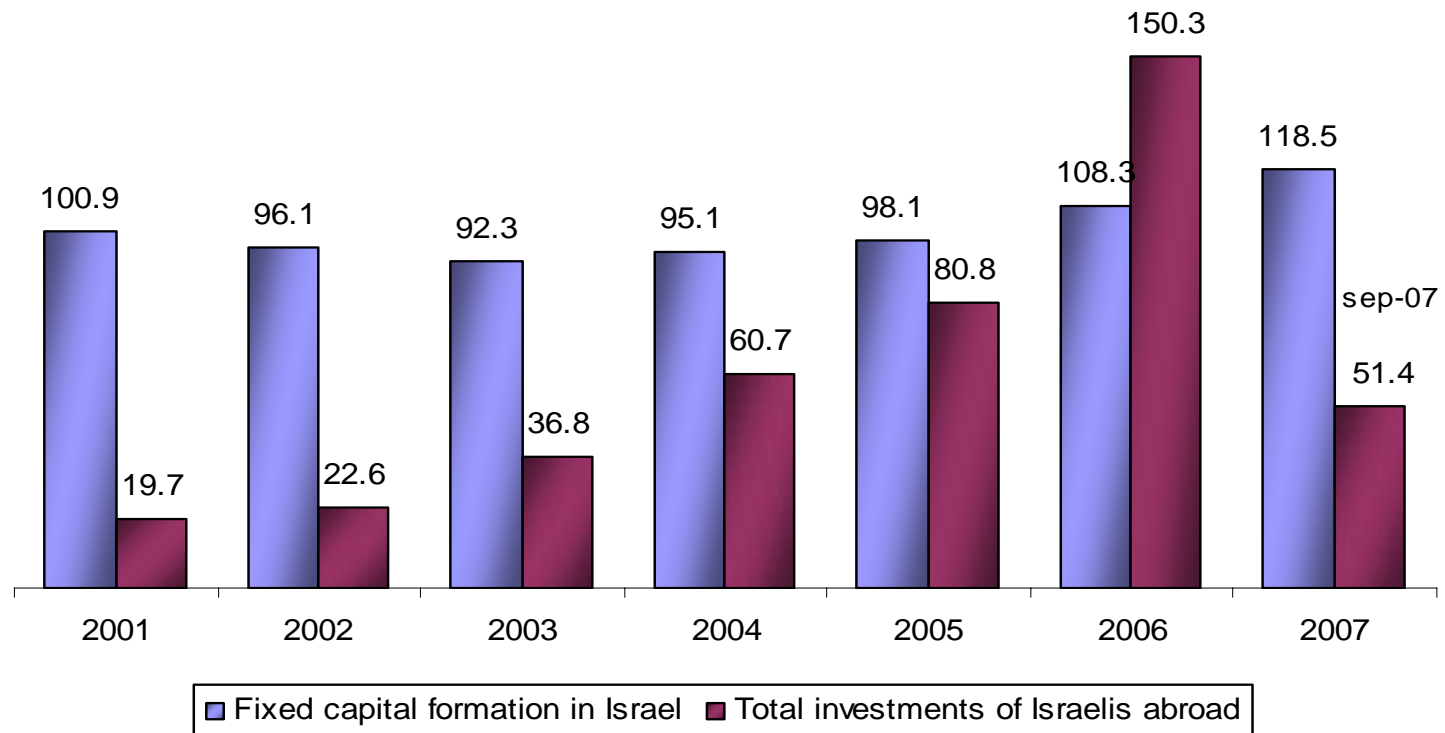


Inflexible Fiscal Restraint and Investments in the Israeli Economy - IV

Investments of Israelis abroad grew faster than total investments in the Israeli economy: in 2006, the investments of Israelis abroad were significantly higher than the total investments in the Israeli economy (fixed capital formation).

Fixed Capital Formation in Israel and Investments of Israelis Abroad, 2001-2007

NIS billions, 2006 prices



The Level of Total Investments in Israel is not High

The foregoing figures are especially significant when one takes into account the fact that in international comparison, Israel does not rank high in total investments.

In 2002, taking the average level of investment in OECD countries as 100, the level of investment in Israel was 95; investments in machinery and equipment was 92. The top investors were the United States (144), Ireland (139), Japan (138) and Australia (131).

During the last decade, a large part of the investments went to hi-tech; here Israel ranks quite high, while in the other sectors of the economy, it ranks quite low.

Inflexible Fiscal Restraint and Investments in the Israeli Economy - V

We have seen that the policy of cheap credit, cheap labor and low taxes contributed to the growth and enrichment of conglomerates and corporations in Israel.

Now, after they have become rich, some of Israel's tycoons are beginning to give Israel the kick. For example, Nochi Dankner recently told the Bloomberg Agency: "I am a big believer in Israel, and I am a big believer in the Israeli economy. At the same time it's clear that we need to go abroad if we want to grow."

According to Bloomberg, Israel, with its 7 million inhabitants, is too small for what it terms "the new generation of entrepreneurs that control a significant portion of the local market."

**As it is said in the Book of Deuteronomy, chapter 32,
"But Jeshurun waxed fat, and kicked."**

Inflexible Fiscal Restraint and Investments in the Israeli Economy - VI

The question is:

In view of the fact that the economic growth of recent years is concentrated mainly in the center of the country and mostly in the hi-tech and financial services sectors,

And in view of the fact that Israeli tycoons declare that Israel has become too small for them,

Isn't it time for the state to stop pinning all of its hopes for growth and development on the business sector, and to begin assuming responsibility for economic development, especially in regions that have not benefited from the growth of the hi-tech and financial services industries.

Inflexible Fiscal Restraint and Investments in the Israeli Economy - VII

While the government is intent on increasing business investments, its own share of investments is on the decline.

Between 2002 and 2006, government investments declined from NIS 15.6 billion to NIS 9.8 billion.

Between 2000 and 2006, the government's share of gross domestic capital formation declined from 11.3% to 8.7%.

Fixed Capital Formation by Government, 2000-2006
 (in NIS billions, 2005 prices), and
Share of Government in Gross Domestic Capital Formation, 2000-2006
 (in percentages)

	2000	2002	2003	2004	2005	2006
Total	14,871	15,614	14,982	11,656	10,205	9,835
Investment in infrastructure	4,281	4,472	4,445	3,426	2,426	2,345
Social services	6,644	6,852	6,224	5,249	4,777	4,753
Administration and other	3,945	4,286	4,317	2,984	3,002	2,737
Share of government in gross domestic capital formation	11.3%	14.5%	15.5%	11.1%	9.1%	8.7%

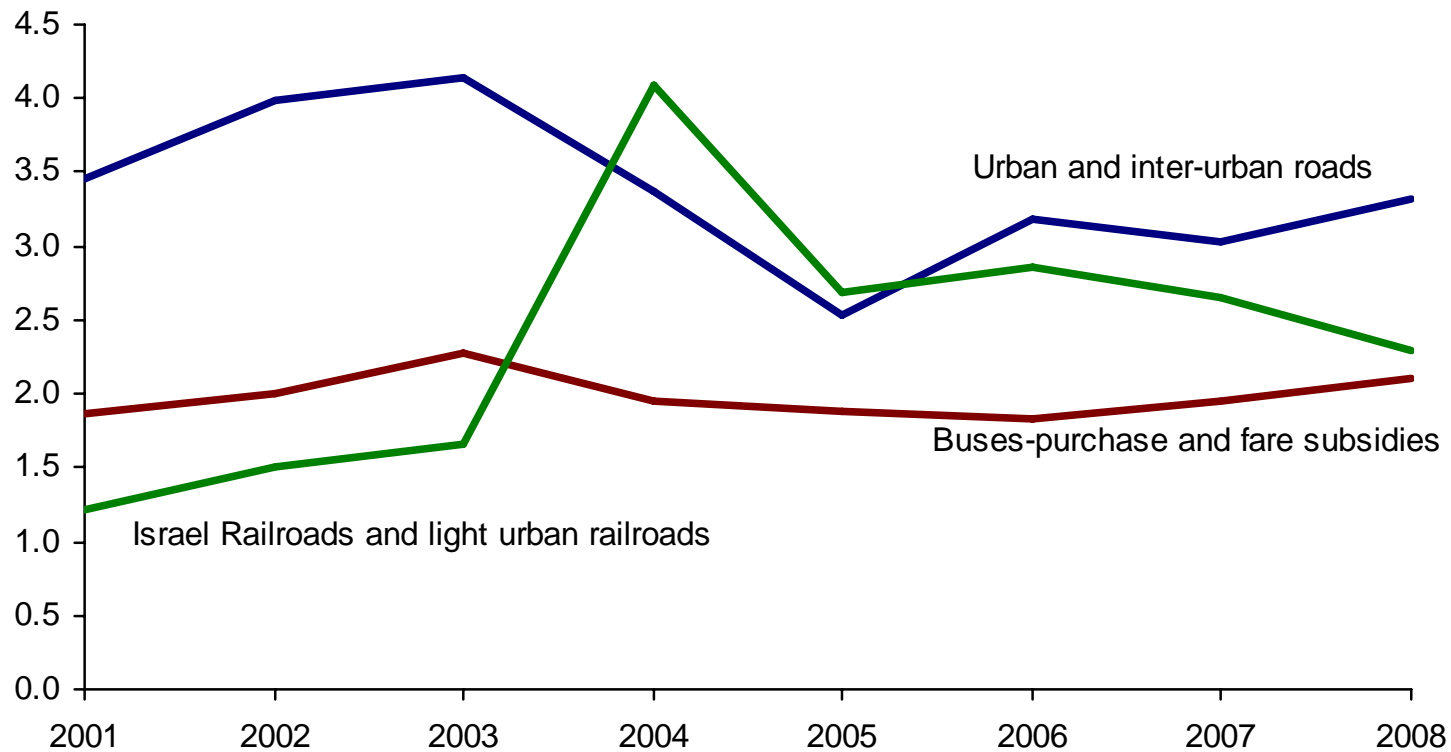
Notable Exception: Government Investment in Infrastructure

Practically the only area in which there has been an increase in government investment is infrastructure, mainly transportation infrastructure.

The largest increase was in investment in railroad development. (In 2007 and 2008, there was a slight decrease in railroad investments.)

Investment in Transportation, by Type, 2001-2008

NIS billions, 2006 prices, by road paving supplies index



Alternatives

The Cost of Current Fiscal Policy

Current fiscal policy is focused solely on encouraging growth, mainly by reducing the cost of credit, reducing the cost of labor and cutting taxes.

We have seen that this policy contributes to the enrichment and growth of large corporations and conglomerates. It also contributes to the enrichment of high-income households and individuals.

We have seen that economic growth is uneven and is concentrated in only a few economic sectors and in the center of the country.

We have also seen that this policy resulted in a serious fiscal crisis in the public services. That crisis has the effect of reducing education, health and housing opportunities for the majority of Israelis.

This lessening of opportunities, in turn, dampens the potential for development and growth for future generations. If we want to increase opportunities instead of reducing them, we need to rethink our policy priorities.

A “Box” for Social Development

As we have seen, one of the ways in which the government increases the defense budget without violating the official policy of reducing expenditures is by creating the fiction of a “box” that is not taken into account when calculating the size of the budget outlay.

There is no reason why such a “box” cannot be used for civilian purposes.

Civilian Investment and Credit Raters

The “box” was created to satisfy the international credit rating companies. A country’s rating affects not only the interest that government pays on borrowing, but also the interest that corporations within each country pay on borrowing.

The “box” was created to prevent the lowering of Israel’s credit rating, despite the deviation from the policy of fiscal restraint, in order to increase the defense budget.

Israeli administrations, which know how to justify drawing a “box” around increased expenditures for defense, ought to apply the same principle for social purposes, especially with regard to real investments in the future, like the budget for the public education system or the budget for higher education.

There are Other Alternatives as Well

Other alternatives include:

- Revising the recommended increase in the defense budget;
- Stopping tax cuts: We have seen that by 2010, the public coffers are to lose the accumulated sum of NIS 22 billion from tax cuts, whose main beneficiaries are corporations and high-income persons.
- Investing in the peace process – a process that will contribute to the growth of economic activity to a much greater extent than most of the steps being taken by Israeli governments to stimulate economic growth.

A Social Lobby vs. a Defense Lobby

As we have seen, the defense budget was increased; this was the result, among others, of the activity of a very successful defense lobby comprised of the leaders of the defense services and industries.

In contrast, we saw that the budgets for the social services were not increased. One of the reasons for this is that those who stand at the head of these services do not act together and do not develop long-term goals.

Without working in unison and with long-range goals, it will be very difficult to change the present policy, a policy that works to the benefit of large corporations and the wealthiest stratum of society – as well as the defense establishment.

For information about the figures used in this presentation, for footnotes and for references, see the original Hebrew presentation:

<http://www.adva.org/view.asp?lang=he&catID=4&articleID=489>