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INFORMATION ON EQUALITY AND SOCIAL JUSTICE IN ISRAEL

מידע על שוויון וצדק חברתי בישראל

مركز «أدفا» – معلومات حول المساواة والعدالة الاجتماعية في إسرائيل

The Social Implications of Fiscal Policy

Looking at Israel's 2005 Budget Proposal

Presentation for Knesset Members, November 16, 2004

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Introduction

This presentation takes a critical look at the proposed Israel Budget for 2005 and its Budget Arrangements Law.

The 2005 Budget is the fifth since the outbreak of the second intifada. It comes on the heels of four years of budget slashes in both the social safety net and the social services. Many people assume that the major damage has already been done, but this is not the case, as the following presentation will show.

In 2004, for the first time after three consecutive years of recession, fragile signs of economic growth began to appear. If this trend continues, we need to ensure that the fruits of future growth are distributed as equitably as possible, in order to compensate those Israelis who were adversely affected by the fiscal policies of recent years. However, Israel's budget proposal for fiscal 2005 does not contain any such tidings.

Note About the Figures

The budget figures presented here for the years up to and including 2003 are actual expenditures, taken from the annual reports of the chief financial officer of the Ministry of Finance and from the annual budget book, “Executive Summary of the Budget.”

The figures for 2004 are from the budget allocations approved by the Knesset.

The figures for 2005 are from the budget proposal now before the Knesset.

All figures are in real 2003 prices, based on the Consumer Price Index.

The 2005 figures are based on an estimated inflation of 2.5%.

All the figures are for government outlays only and do not include expenditures that depend on income from other sources, unless so indicated.

Is the 2005 Budget Better Than its Predecessors?

Not at all.

1. It includes a cut of NIS 6.3 billion and comes on the heels of 7 previous budget cuts during the past three years.

2. It includes mechanisms for multi-year cuts that will continue to operate through 2005: for example, the erosion of social security allowances as a result of a freeze on the indexing of those allowances.

Is the 2005 Budget Better Than its Predecessors?

3. It includes new measures that will decrease social cohesion, among them the creation of a new, for-profit HMO (the 4 existing HMOs are non-profit) and the reduction of employers' contributions to the social security of their employees.

4. It includes the continuation of a gradual tax break for high-income persons, to be financed by abolishing tax breaks for middle and low income persons.

8 Budget Cuts in 3 Years

Year	Date	Amount, in NIS Billions
2001	September	Undefined
	December	6.9
2002	June	13.1
	September	8.8
2003	June	9.0
	September	10.0
2004	March	4.8
	September	6.3

What are the Government's Priorities?

1. **Downsizing the Public Sector:** Like all the budgets of recent years, the 2005 budget aims to cut back on public services. It is as if the government perceived the most serious problem of Israel to be the size of its public sector rather than the suicide bombings, the need for a political solution to the conflict with our Palestinian neighbors, the economic recession and the decrease in tax revenues.

What are the Government’s Priorities?

2. **Tax Cuts:** In 2005, as in previous years, the central notion guiding fiscal policy designed to encourage economic growth is tax breaks for people in the highest income bracket. It is as if the top income decile, or, to be more precise, the top one percent, was the only relevant sector of the economy.
3. **Growth Led by the Private Sector:** The reigning growth model calls for transferring the reins of the economy to the private sector and shedding government responsibility. This is the rationale behind downsizing the public sector and cutting taxes.

Who is First Priority?

High-income persons. These are the people who are expected to move the economy and the society forward; thus they are perceived as deserving every possible benefit.

According to the Israel Ministry of Finance, tax breaks to be implemented between 2003 and 2005 are to cost NIS 12.9 billion in lost tax revenues.

The tax reductions mainly benefit persons with high incomes: persons with monthly incomes of NIS 25,000 and over will receive increments of NIS 2,000 and over in their monthly pay checks.

It should be remembered that this valuable gift is being bestowed on persons in the highest income bracket, in the midst of a political, economic and social crisis. It should also be recalled that while with one hand this generous gift is given to the well-off, with the other hand the allowances of persons who have a hard time making a living (including those whose total monthly income is no higher than the monthly tax break of the well-off) are being reduced.

Who is to Pay the Price?

According to the Ministry of Finance, the tax breaks are to be financed by abolishing other tax exemptions and by cutting down on public expenditures.

Abolishing Exemptions: The Budget Arrangements Law contains proposals to reduce tax exemptions on retirement income and on extra income earned for working second and third shifts.

In other words, blue-collar workers and people in the middle income bracket will finance the tax breaks of people in the upper income bracket.

Public Expenditures: Cutbacks in social spending.

Tax cuts for the rich mean that other Israelis will receive less public education, less public health, fewer personal services and less housing assistance.

When Will Everything Come Together?

As the government is transferring the reins to the private sector, its prognosis for better times is based not on the actions it intends to take, but rather on the results of activity on the “free market.” This is the way it is supposed to work:

Things will improve only if the economy demonstrates “a consistent growth rate of at least 4%, every year until the end of the present decade.”

When Will Everything Come Together?

What is supposed to happen then?

1. Israel will catch up to the average per capita income in OECD countries;
2. Social gaps will decrease;
3. "The most significant social improvement" will occur – the unemployed will become gainfully employed.

When Will Everything Come Together?

There is no doubt that economic growth is a prerequisite for increasing average per capita income. But what about the social gaps? In the recent past, when Israel experienced economic growth, the fruits of that growth went mainly to the upper income bracket.

The 2005 budget holds no promise of a better distribution of the fruits of the anticipated economic growth.

Damage to the Public Services Continues

Like its four predecessors, the 2005 budget contains budget cuts in the public services – education, health, social affairs and housing – and in the social safety net.

With one hand the present administration is lowering corporate and income taxes for persons in the upper income bracket, and with the other it is reneging on its commitment to provide basic services to every Israeli:

Damage to the Public Services Continues

In education, public financing for teaching is being reduced, and parents have to make up the difference;

In health, public financing of the benefits package under the National Health Insurance Law fails to keep pace with demographic and technological developments, and health consumers have to make up the difference;

In housing, government assistance is being rapidly reduced, and young couples are finding it harder and harder to buy a home;

In the social safety net, allowances are losing their buying power.

The Education System: The Teaching Budget Decreases and Parents' Payments Increase

Between 2001 and 2005, while the number of schoolchildren grew, the budget for teaching was reduced. In per capita terms, the allocation for teaching decreased by 12% in 4 years.

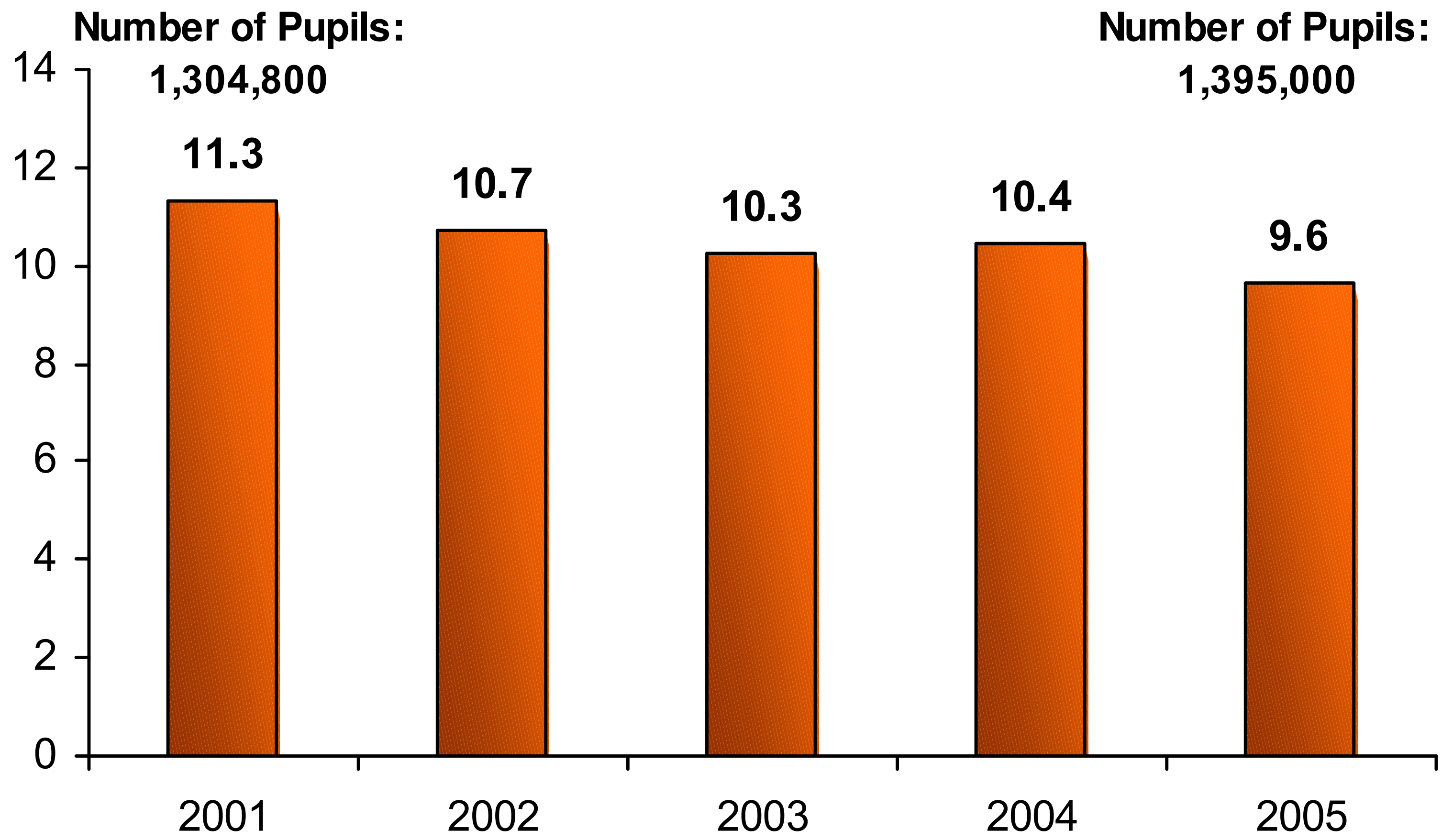
Schools are supposed to collect the missing monies from parents. The problem is that not all parents are able to pay. According to a survey conducted by the Central Bureau of Statistics in 2001,

In Jewish **elementary schools**, parents paid an annual average of NIS 849 per pupil; in Arab elementary schools, parents paid an average of NIS 178 per pupil;

In Jewish **high schools**, parents paid an annual average of NIS 1,253 per pupil; in Arab schools, parents paid an average of NIS 132 per pupil.

Ministry of Education – Allocations for Teaching Hours

In NIS Billions, Constant 2003 Prices



Public Education System:
The “Reform” is Unbudgeted

The public education system has been deteriorating for many years and is in dire need of change.

In 2004 the government approved the recommendations of the Dovrat Commission for Reform in the Public Education System. The Prime Minister and Minister of Finance promised to implement them.

Among other things, the Dovrat Commission recommended instituting a long school day. It also recommended raising teachers’ salaries. Each one of these recommendations is expected to cost billions of shekels.

Public Education System: The "Reform" is Unbudgeted

The proposed budget for fiscal 2005 allocates the sum of NIS 0.5 billion for the Dovrat reforms, while at the same time it proposes a billion shekel cut in the Education budget.

Not only is the reform unbudgeted; the budget for public education is to be reduced.

Higher Education and Research – Support for Israeli Science

In recent years, budget allocations for higher education and research have decreased.

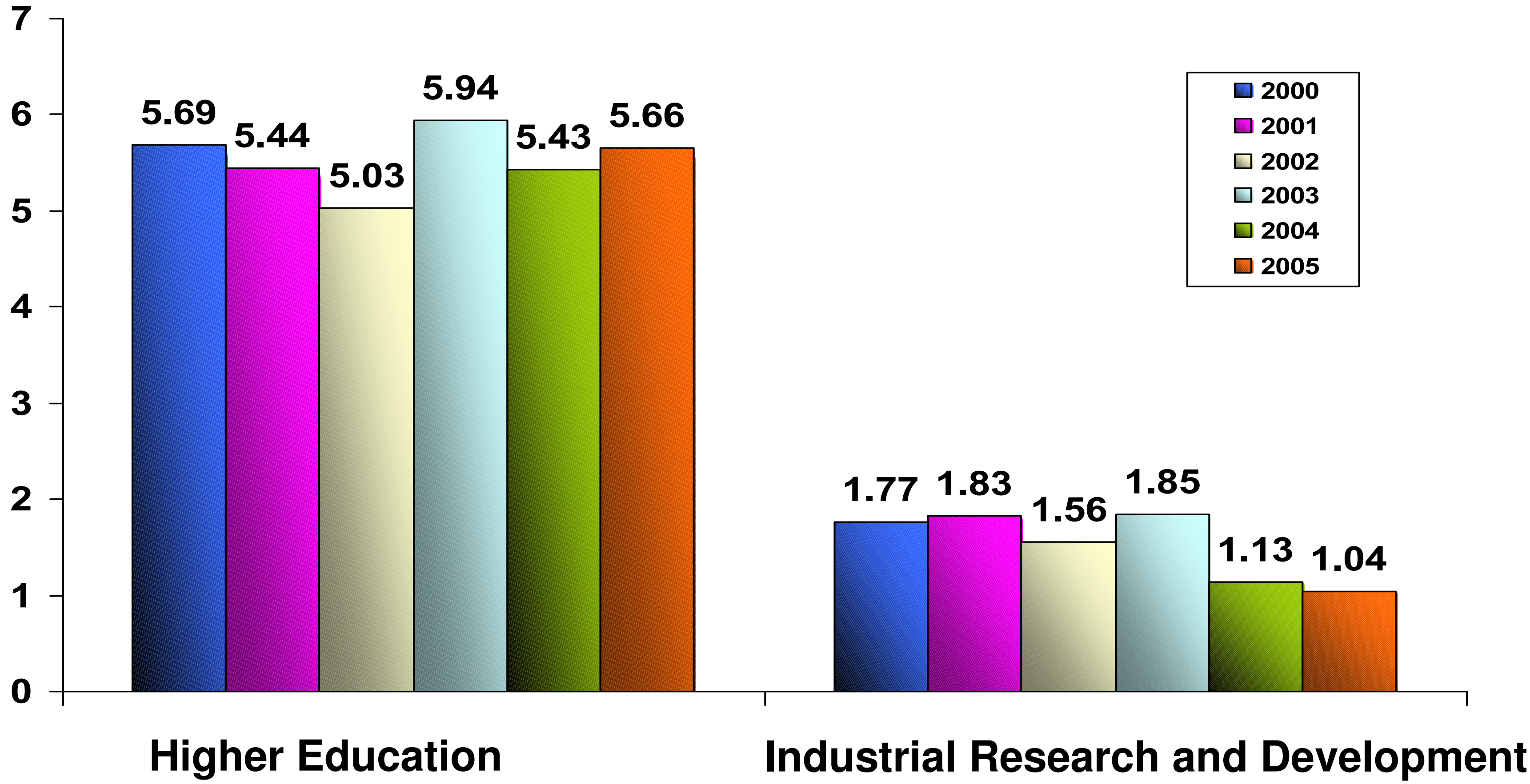
In order to make the damage more tangible, we present the budget for Higher Education alongside the budget for Research and Development in the Ministry of Commerce, Industry and Labor. Both are supposed to promote science and technology in Israel.

The budget for Higher Education experienced a significant cut in 2004. In 2005, there is a slight increase, but the level of funding is still lower than it was in 2003.

The budget for Research and Development in Industry, whose purpose is, among others, to encourage economic growth and create new jobs, was slashed by one-third in 2004. It will be pared down again in 2005.

Less for Higher Education, Less for Research

In NIS Billions, Constant 2003 prices



The Budget for Cultural Affairs was Also Cut

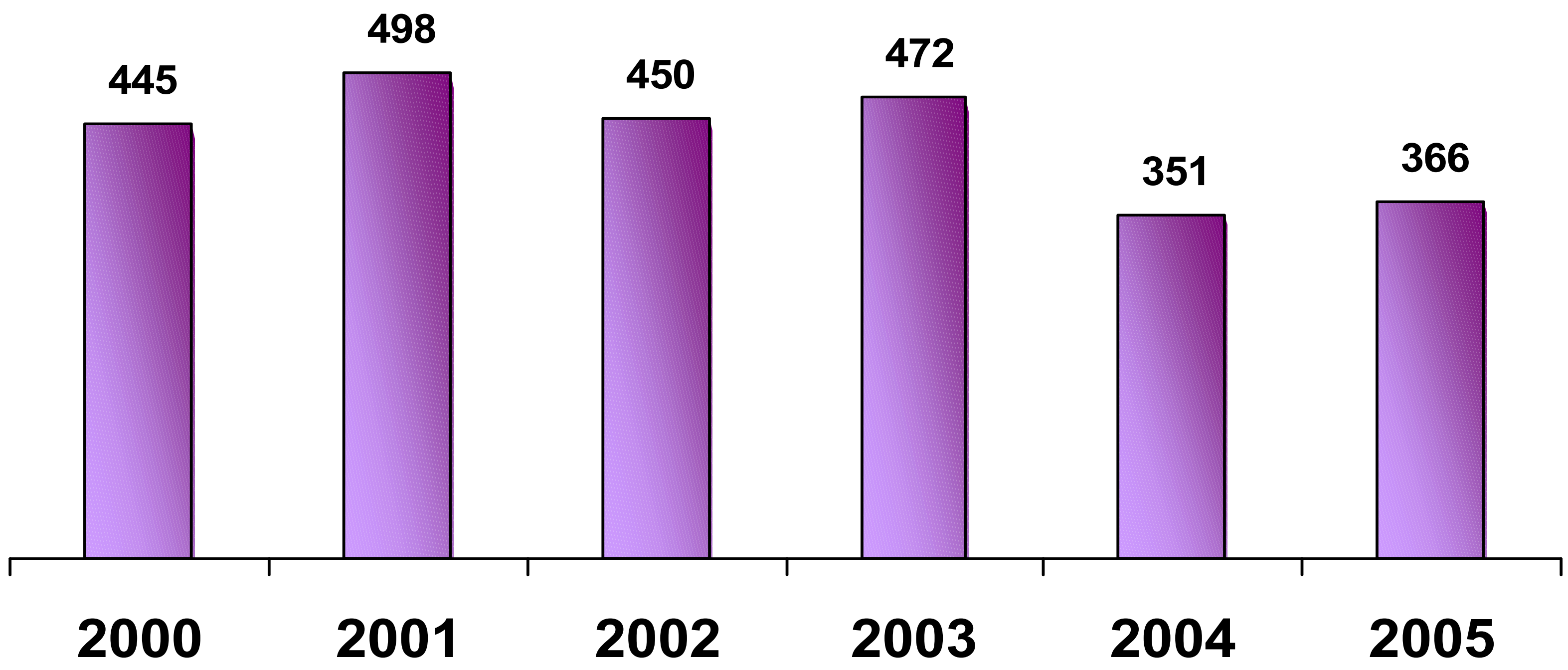
A series of cuts reduced the budget for Cultural Affairs.

In most countries, cultural institutions receive public funding. This is the case even in countries dominated by the neo-liberal ideology that guides Israeli fiscal policy.

Budget for Cultural Affairs

Cultural Institutions, Art and Research, Artists

In NIS Billions, Constant 2003 prices



Public Health System

The 2005 Budget Arrangements Law includes a proposal to create a new HMO, to be run for profit.

If such an HMO is created, it is liable to destabilize the entire public health system:

A for-profit HMO will open the way to not only to local privatization of the public health care system, but also to foreign domination of the same. This is because under the General Agreement on Trade in Services (a World Trade Organization agreement), once a government provides services on a commercial basis, it is obligated to permit corporations from abroad to compete in public tenders.

Public Health System

The end result of allowing a for-profit HMO into Israeli public health will be a two-tiered health care delivery system, one tier for those who can pay and another for those who cannot. In addition, the affluent will have less of a stake in the public system and their willingness to support it with tax money will be seriously diminished.

Public Health System: Erosion of the Budget for the Benefits Package

Between 1995, the year the National Health Insurance Law came into effect, and 2004, funding for the benefits package eroded as follows:

Based on demographic developments and the changes in the Health Price Index, the cost of the benefits package has eroded by 15%. One percentage point of the cost of the benefits package is worth some NIS 210 million; that is, the budget of the benefits package now has a shortfall of some NIS 3.2 billion shekels.

If we add the shortfall stemming from the non-inclusion of new medications and procedures in the benefits package, we arrive at an additional 9% shortfall, or NIS 1.9 billion shekels.

When Public Funding Falls Short of Needs, Families Pay out of Pocket

Between 1997 and 2002, funding of the benefits package did not increase to take into account demographic and technological developments.

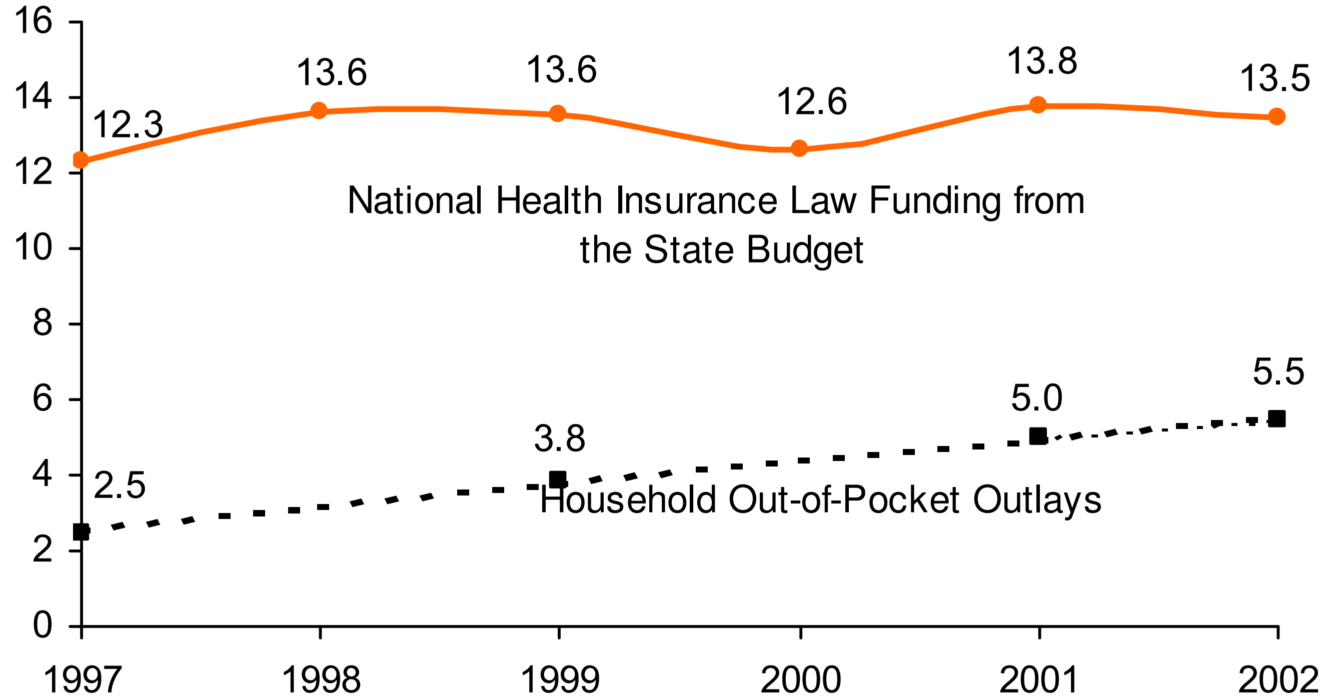
As a result, the HMOs, part of whose funding comes from the Ministry of Health, cut back on services, charged more copayments and began to market supplemental health insurance. Commercial insurance companies also began to market health insurance policies.

In 2002, Israelis paid a total of NIS 5.5 billion shekels out of pocket to health funds (for medications, co-payments and supplemental insurance) and to insurance companies (for private health insurance policies).

Implications of the Erosion of Health Budgets:

Larger Out-of-Pocket Payments to Health Funds and Insurance Companies

In NIS Billions, Constant 2003 prices

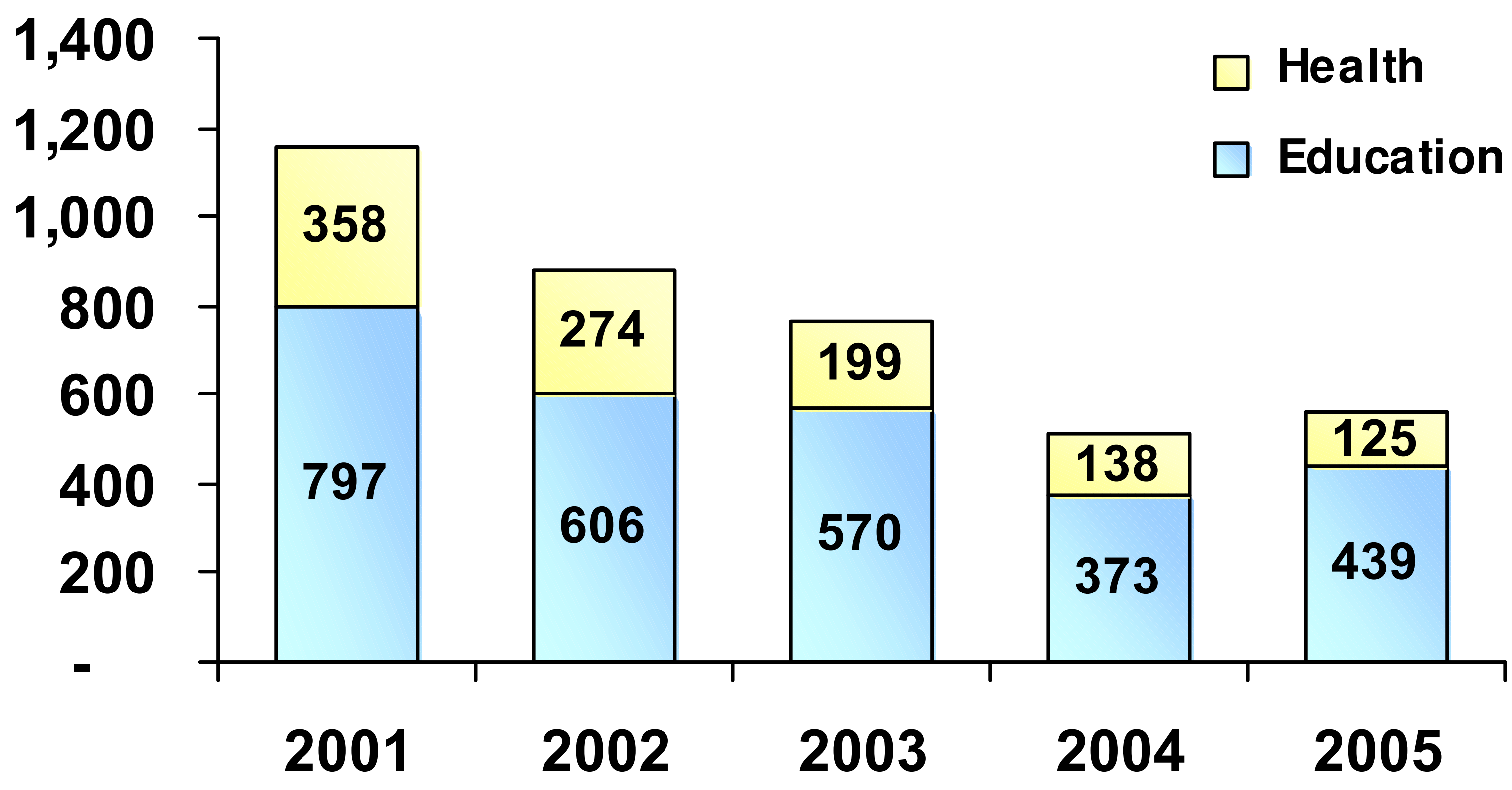


Erosion of Development Budgets of the Ministries of Education and Health

- In the Ministries of Education and Health, development budgets are used for building and renovation.
- Drops in development budgets mean depreciation of infrastructure.

Development Budgets of the Education and Health Ministries

In NIS Billions, Constant 2003 prices



Ministry of Construction and Housing:

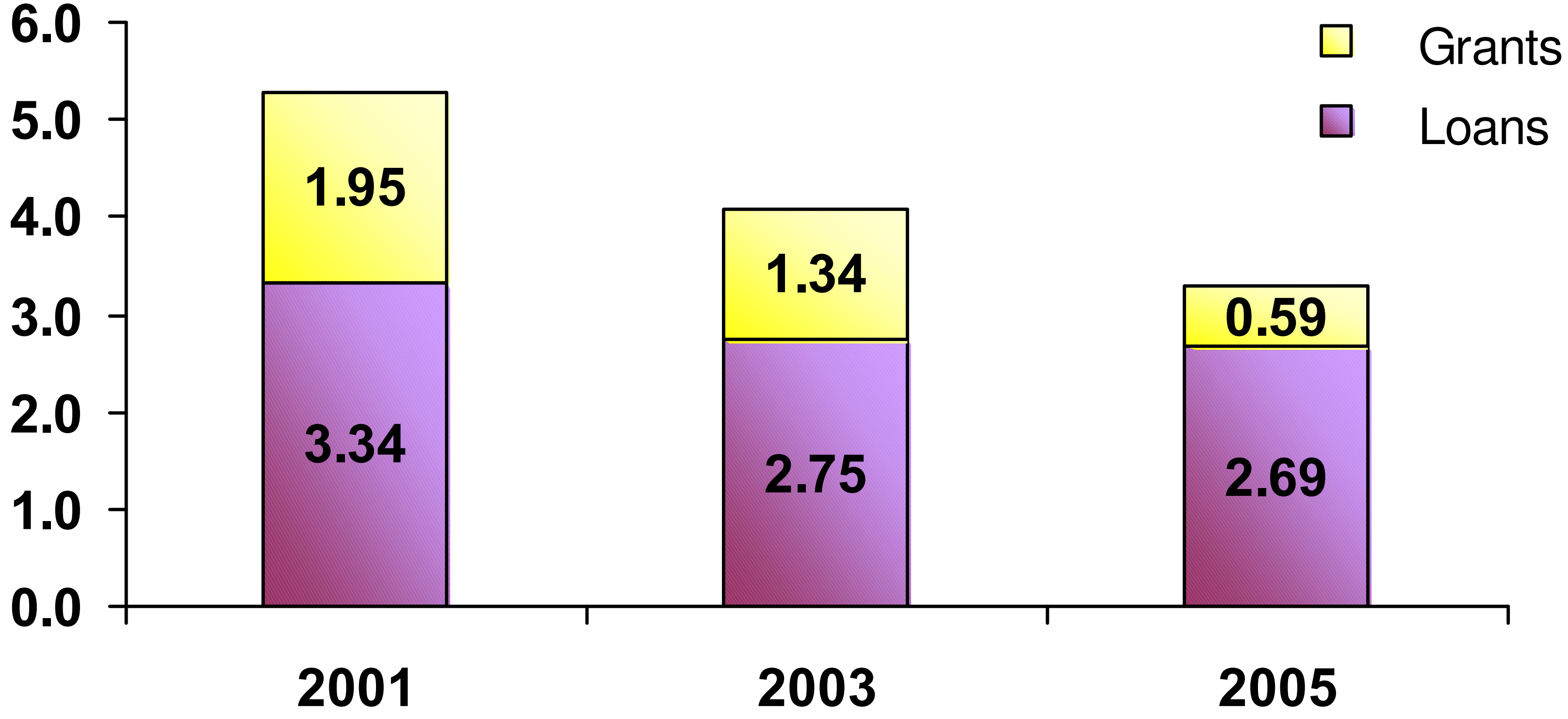
The Government Phases Out Housing Assistance

Government housing assistance is being phased out. In 2001, the allocation for housing grants and loans amounted to NIS 5.3 billion shekels. In 2003, it was NIS 4.1 billion shekels, and in 2005, NIS 3.3 billion shekels.

Today, the financial burden of purchasing a home is far greater than it was in the past

Ministry of Construction and Housing:

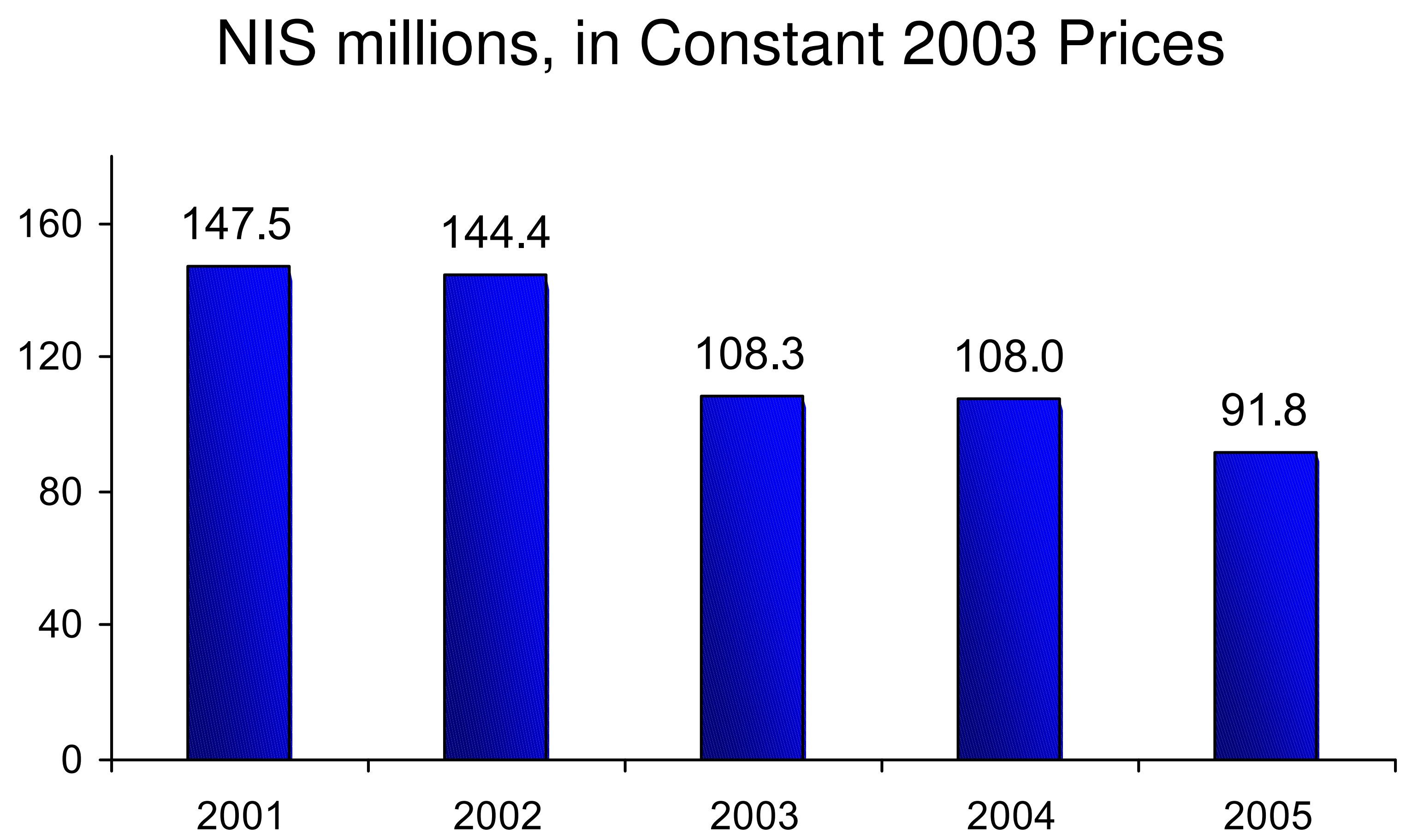
The Phasing Out of Government Housing Assistance



The Budget for Vocational Training is Getting Smaller and Smaller

- At every turn, the government urges the unemployed to “go out and get a job.” At the same time, the budget for vocational training is being drastically cut, reducing the chances of unemployed persons to return to the job market with new skills.
- In 2005, 40% of the budget for vocational training is to be devoted to training Israelis to take over the jobs of migrant laborers from abroad. Yet as everyone knows, most of the jobs done by migrant workers do not require any training at all.
- Thus, the Department for Vocational Training, whose original purpose was to give Israeli job seekers better and more up-to-date skills, has become irrelevant. In effect, the government is saying that it no longer considers itself responsible for the quality of the workforce – especially when it comes to workers at the lower echelons of the wage ladder.

"Go Out and Find a Job" is the Slogan, as Budget for Vocational Training Diminishes



Budgets for Local Governments Subjected to Shock Treatment

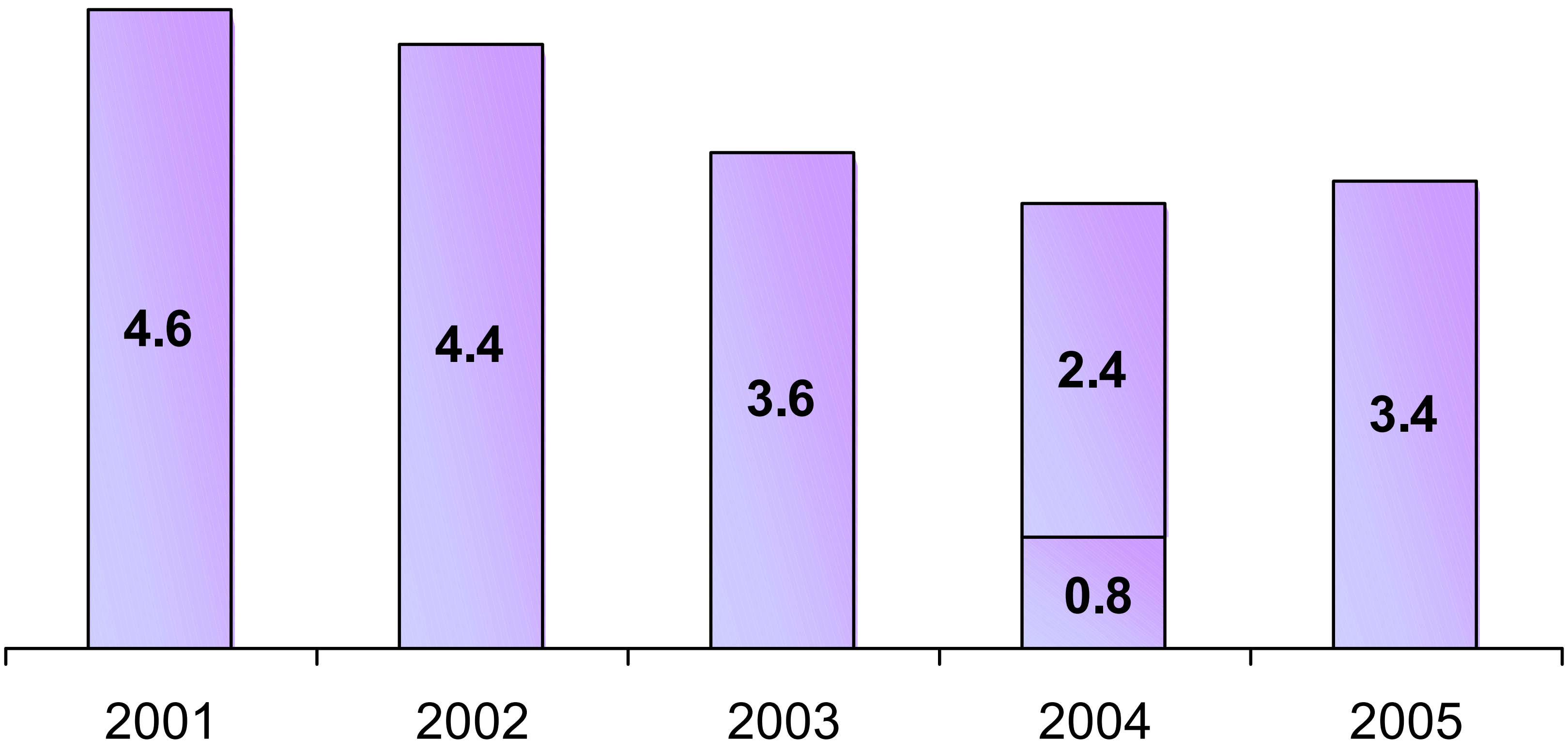
- In 2004 there was a drastic cut in central government support for local governments. After widespread protests, NIS 1.5 billion was returned to the support budgets, to be spread over a three-year period. The increment was conditioned on the laying off of a large number of employees
- The budget for 2005 is at the level attained following the protests. In other words, the 2005 budget is to be one-fourth lower than the budget of 2002.

Budgets for Local Governments Subjected to Shock Treatment

- Most local governments in Israel are unable to balance their budgets without central government assistance, due mainly to the facts that (1) their residents are not well off and (2) they have no businesses in their jurisdictions that can provide local tax income.
- The cutback in support budgets to poor localities is yet another blow for low-income Israelis, who took most of the brunt of the cutbacks of previous years.

Budget for Support to Local Governments

NIS millions, in Constant 2003 Prices



Cutting into Social Security

The National Insurance Institute (Social Security), whose purpose is to provide a safety net that will enable Israelis to maintain a reasonable standard of living in times of unemployment, work injury or old age, has found itself under siege in recent years. The government has made one cut after another in social security allocations, despite the fact that in most cases, the origin of those allocations was monies that Israeli workers and their employers paid out as social insurance.

The 2005 budget contains a proposal to lower the social insurance payments employers make on behalf of their employees.

3 Billion Shekel Tax Break for Employers

The Budget Arrangements Law for 2005 proposes reducing the social insurance payments of employers on behalf of their employees, from 5.95% of salaries to 4.43%. This is presented as compensation for raising pension contributions by 1.5%.

On the surface, it looks like a fair deal: 1.5% for 1.5%.

However, only about 10% of salaried persons have pension plans in the program whose rates are being increased, while social insurance payments are relevant for all salaried persons.

Thus, according to a recent estimate made by the National Insurance Institute, the deal will relieve employers of NIS 3.2 billions in social insurance taxes, while asking them to pay an additional NIS 300 million in pension contributions.

This is an unfair deal: NIS 300 million is less than a tenth of NIS 3.2 billion!

Partial Compensation Only

The Budget Arrangements Law proposes that the Finance Ministry compensate the National Insurance Institute for the decrease in employers' social insurance payments. However, the whole arrangement is problematic:

1. Firstly, the sum that the Finance Ministry proposes to transfer to the National Insurance Institute does compensate for the full loss of income. Child allowances will lose 11%; old-age pensions 18% and disability allowances 14%. The total loss in income will amount to NIS 3.2 billion, according to the estimate of the National Insurance Institute, and slightly more than that, according to our own estimate.
2. Secondly, the compensation is defined as a temporary measure only.

Meanwhile, the Cutbacks of Recent Years Are Having an Impact

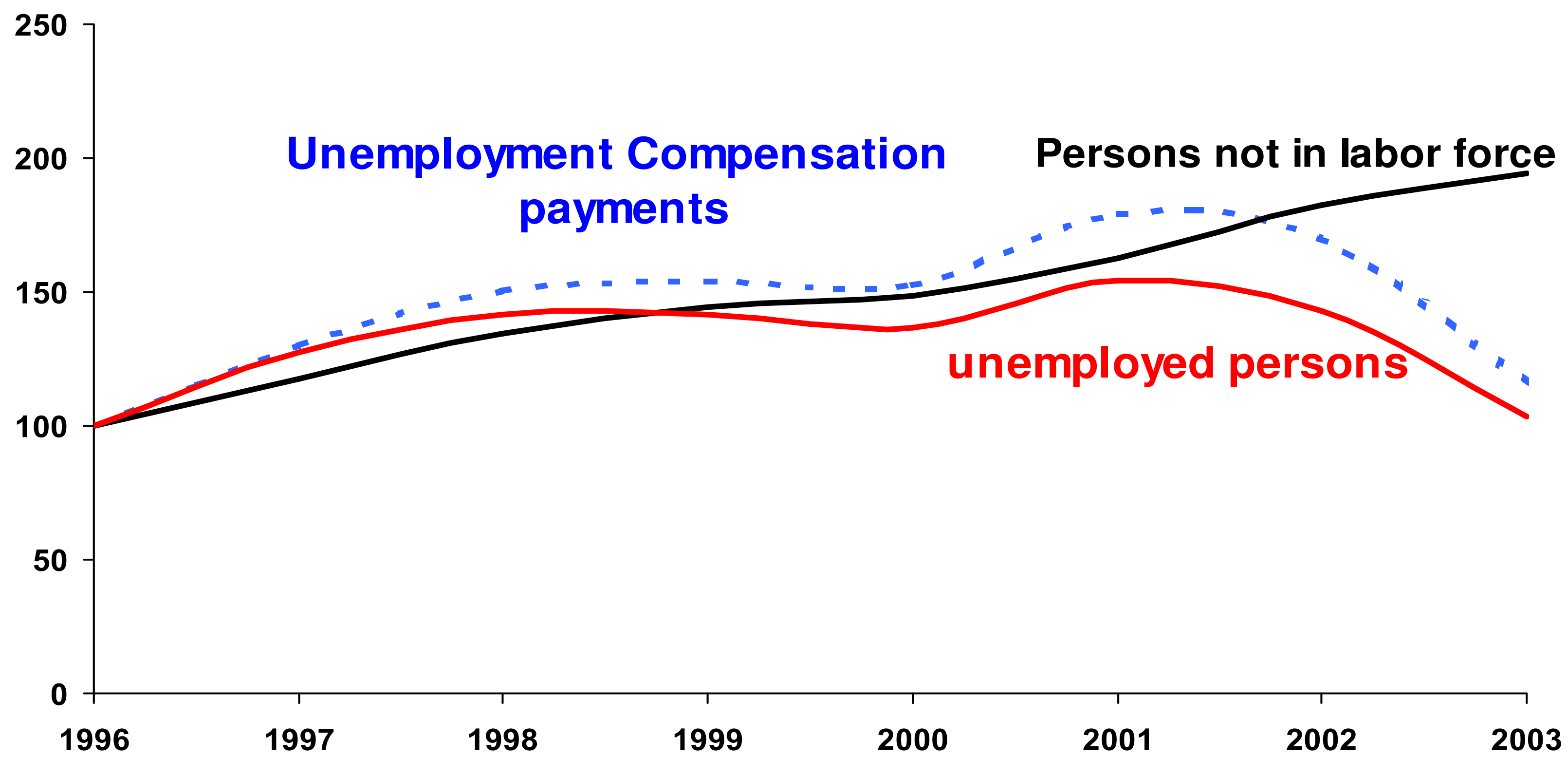
The cutbacks made in recent years in social security allowances are reflected in the number and amount of allowances actually paid out. This is at a time when the needs are growing.

The Number of Unemployed Grows While Unemployment Compensation Drops

- The cutbacks made in recent years in the social safety net will show increased impact as time goes on.
- Even now, it can be seen that while the number of unemployed persons has grown, the number of persons seeking jobs at government employment offices and the amount of unemployment compensation paid out has dropped.

Total Unemployment Compensation Payments and Number of Unemployed Persons

Ratio: Number in 1996 = 100



As Child Allowances Decrease, Child Poverty Increases

Ratio: Figures for 1997 = 100