
Summary of Findings

Government Expenditure

1. The current government's economic policy is dictated by a socioeconomic outlook that believes in decreasing the share of the state in the national economy to the greatest extent possible, especially where transfer payments are concerned. It is true that this outlook has attracted considerable support in Israel and abroad, but quite a few economists and politicians consider it a threat to the country's socioeconomic fiber.
2. Since the 1985 Stabilization Program, economic policy has been aiming to reduce the share of government in GDP and made impressive strides towards this goal in the second half of the 1980s. The effort continued in the 1990s, the share of expenditure declining from 62 percent at the beginning of the decade to 51 percent in 2000. The trend reversed direction in 2001. Economic growth stopped, the state budget continued to grow, and the result was a turnaround in the government's share in GDP, which climbed from 51 percent to 58 percent. The forecasts for 2004 indicate no change in this trend.
3. More than half of the disposable state budget (the total budget net of debt servicing expenditure) is spent on social services, and in 2003 social expenditure accounted for 54 percent of the total budget. The defense budget has been stable in the long term, with a downward trend that is hardly affected either by exceptional security events or by periods of calm and political activity to promote the peace process.

4. Social service expenditure was NIS 104 billion in 2003 as against NIS 103 billion in 2002. In the current budget (not including investment expenditure), the reported expenditure was NIS 93.6 billion, down NIS 0.8 billion from the previous year. It should be borne in mind, however, that the data for 2003 are not final; according to our estimate, the final expenditure will be smaller than the presently reported amount. This estimation is based on a Finance Ministry report that presents expenditure "as of the end of October 2003." Analysis of developments in the first ten months of the year suggests that the actual cutback in 2003 will be much larger than that reported in the 2004 Budget Proposal, which was recently presented to the Knesset.
5. Returning to the official Finance Ministry data, expenditure in 2003 will be NIS 3 billion smaller than in 2001 (and, as stated, we believe that the actual difference may come to NIS 5-6 billion).
6. The share of in-cash benefits in total social expenditure is 40 percent today as against 30 percent at the beginning of the decade. Fluctuations in this indicator are not unique to the 1990s; a similar pattern occurred in the 1980s. In the past two years, almost NIS 2 billion has been cut from the combined category of unemployment compensation and income maintenance payments. Since unemployment has only increased during this time, the decrease in expenditure means less compensation for the unemployed and stricter criteria for eligibility.
7. The Center's Annual Public Opinion Survey on the social services shows that the public is feeling the effects of the economic crisis acutely. Most respondents indicate that social services have deteriorated, socioeconomic gaps have widened, and the standard of living has declined. More than 40 percent of respondents noted that they feel very vulnerable

to the possibility that unemployment will affect them directly.

8. The survey also showed that the public gives the government a rather broad mandate to stimulate economic growth and, concurrently, to take action to reduce social disparities. The public also favors steps to make benefits contingent on means tests and to reduce the number of foreign workers. The measures that received the greatest public support were related to improvement of the education and health systems, even at the expense of the defense budget.

Education System

1. Education accounts for nearly one-third (30 percent) of total social expenditure. According to the Center's public opinion poll, the public regards education as a field that should be immune to budget cuts even in times of budget distress.
2. The share of the Arab education system in total enrollment has been rising appreciably at all age levels in recent years, due to natural increase and a rising trend in enrollment rates. Concurrently, the share of education budgets earmarked for Arab schools has been rising significantly at all education levels, at a faster rate of increase than the number of Arab pupils. The data show that the policy of corrective and compensatory budget allocations for the Arab sector is in fact being implemented but that substantial disparities remain between the share of the Arab population in total enrollment and the share of this population group in the total budget.
3. The rising age of teachers is having a notable effect on the budget because Israel's wage structure gives teachers a salary increase for each year of seniority. Since the total wage expenditure for teachers is nearly NIS 20 billion, wage increases occasioned by the aging factor alone add an annual NIS 400 million to the payroll.

4. As in last year's survey, one-fourth of participants in our 2003 public opinion survey, expressed the view that the education system is exacerbating social gaps and another 40 percent believed that the system is having no effect whatsoever. This year's survey found again that a substantial majority (three-fourths) of respondents believe that there are significant disparities among schools in the level of studies offered.

Health Services

1. On per-capita average, the government spends NIS 2,300 on health, a level that has been declining steadily from NIS 2,600 in 1996 (in constant prices). The search for complementary sources of funding – charges for clinic services, higher co-payments for medications and treatments, and greater recourse to supplemental insurance – has infringed upon one of the health system's main principles, the provision of service in accordance with the basic insurance package with no further payment required. The Center's survey shows that 20 percent of the population, and up to 30 percent in some population groups, have refrained at least once in the past year from using a vital medical service due to its cost. This has an adverse effect on health, especially amongst members of weaker population groups. The changes are gradually leading Israel toward a health system that is increasingly based on private medicine and have contributed to a rising inequity in health care.
2. A comparison of Israel and the OECD countries in terms of **per-capita** national health expenditure shows that all but eight of the OECD countries spend more on health than Israel. At the same time, Israeli households are paying directly for a rising proportion of national health expenditure – one-third today as against one-fourth in the mid-1990s. Household financing of health care is fundamentally

regressive and is reflected in the widening of socioeconomic gaps, including unequal access to medical services. The share of public funding is continuing to decline. Most European countries provide a larger proportion of public funding than Israel does.

3. In the Center's previous public opinion surveys, a large majority of respondents rated the health services "good" or "very good" and fewer than one-fifth gave the health system less than a passing grade. The current survey reports an increase in the share of Israelis who believe that their country's health services are declining.

Personal Social Services

1. Some 430,000 households, about one-fifth of households countrywide, receive welfare services from units of the Ministry of Social Affairs. One-fourth of these households receive services at a high level of intensity. According to the Ministry's preliminary estimates, this year's budgets for these services required an additional 20 percent to meet these needs. The actual increase was only six percent.
2. According to the Ministry of Social Affairs, 16 percent of children countrywide are in settings that impair, or may impair, their ability to integrate into normal social, family, and school life. The Ministry's Service for Children and Youth handles more than 70,000 youngsters – only one-fifth of the potential target population.
3. The share of the "old-old" (the 75+ population group), whose social service needs are particularly intensive, has been growing rapidly in recent years. Therefore, the allocation needed to assure their quality of life has been rising. One-fourth of poor households are composed of elderly persons, whose hardships have been exacerbated this year by the government's economic program. Under this program, old-age pensions have not been adjusted, the pension eligibility

age has been raised, National Insurance benefits have been reduced in cumulative stages, and the levels of nursing benefits have been modified.

4. Analysis of recent developments in social service expenditure shows that benefit recipient households, including those with children, have been dealt a sweeping and significant blow. These households have suffered several direct effects: cutbacks in monthly benefits, non-adjustment of benefits for inflation, and reduction of maternity grants. Additionally, they have suffered indirectly by the reduction of income maintenance benefits for poor households and single-parent families and by cutbacks in benefits for population groups that include families with children. A more sensitive distinction should be made between households with children that include potential breadwinners and those that do not. Such a distinction would limit the damage that has been done to the social service policy.

Selected Issues*

1. Zvi Sussman, in his article, "***Considerations in Determining the Optimal Size of the Government Sector***," states that the size of government should be determined by thorough analysis of the factors that may influence the optimum size for better or worse. Such an analysis has not yet been performed in Israel. When we consider the size of general government in European countries that resemble Israel in size and level of development, we find that the accepted share of public and social services in GDP is not markedly different from that in Israel. Israel's tax burden, relative to GDP, is also in line with the norm in these European countries.

* These findings refer to chapters in the full Hebrew report. They have not been included in the present English translation of the Report.

Comparison of Israel's tax to GDP ratio to that of other countries does not indicate a need to reduce either the ratio or its concomitant, civilian public expenditure. There is no *prima facie* reason to downscale the public sector beyond the extent needed to achieve budget equilibrium in order to avert financial crisis. Furthermore, the sluggish real growth of Israel's public services and social security, relative to consumption, does not warrant a significant reduction in the tax burden. Israel's free market creates a great deal of poverty and inequality that will hamper the growth process and will persist even after the economy emerges from the current crisis.

2. In "***The Fiscal and Monetary Trap of the Israel Economy: Heading for the 'Second Lost Decade'***," Rafi Melnick argues that the country's fiscal and monetary policies have fallen into a trap. In its most concrete manifestation, the trap prevents the efficient implementation of macroeconomic policy and prevents appropriate actions to cope with the crisis that began in late 2000. Errors in fiscal and monetary policies since the onset of the crisis augmented the insidious effects of the trap, dealt a severe blow to the credibility of the government and the Bank of Israel, and brought the Israeli economy to the brink of financial crisis. A comparative analysis of the current economic data with those of the 1970s shows that the country has embarked on its "second lost decade" and, in several respects, the situation this decade is worse than the previous one. The two most salient indicators are the decline in investment and labor and the decline in total productivity.
3. In the article, "***Man Does Not Live by Bread Only***," Menachem Monnikendam and Yosef Katan compare various methods of measuring poverty, including the one currently used. The accepted indicators in Israel and most Western countries measure relative poverty on the basis of families'

and households' monetary income and disregard other factors such as property ownership, deficiencies in living conditions, various material hardships, as well as the psychological sense of poverty, lack of social affiliations, and behavior patterns that reflect a culture of poverty. The authors believe that thought should be invested in the development of a complementary poverty index, acceptable from a public standpoint and applicable in administrative and methodological terms. The index should provide an appropriate reflection of the complexity and multidimensionality of the poverty phenomenon and should equip social policymakers with the information they need to improve the situation.

4. In their article, "***Inequality in Education***," Chaim Adler and Nachum Blass focus on disparities by socioeconomic cross-section and by national group (Jews/Arabs). The authors note that during the period reviewed the gaps continued to narrow both in regard to the financial and human inputs invested by the education system, and outputs as measured in enrollment rates and matriculation certificate eligibility. Still, the Jewish sector has an especially significant advantage in enrollment rates at the preschool, senior-high, and higher education levels. The main contributing factors in the narrowing of Jewish-Arab gaps in enrollment rates were the extension of the Compulsory Education Law to the 3-4 year old age cohort and the expansion of frameworks for technological education. In the authors' opinion, a change in the principles that inform the budgeting of primary education, in the direction recently introduced, may help to reduce inequality within the education sector.
5. Gilat Benchetrit's article on "***Housing Policy in Israel***" explores the country's housing problems. Government policy has favored private housing ownership ever since the State was established. Consequently, Israel has a relatively high

rate of home ownership by Western standards and has adopted home ownership as a social norm. The percentage of homeowners among immigrants of the 1990s is actually higher than the owner occupancy rate of the population at large – 71 percent in 1999. It is doubtful whether all homeowner's will be able to meet their mortgage payments and remain in the homeowner's market. Indeed, the number of households that have defaulted on their mortgages has been rising in the past few years.

Although there is a social stigma attached to public housing (social rental), the policy of encouraging home ownership does not address the needs of low-income groups. For the weakest income groups, solutions should be sought in the establishment of tenured tenancy rights in rental housing. The maintenance of a stock of rental housing as a way of assuring the entitlements of the weakest population groups should be considered.

6. Irit Zmora, Dov Chernichovsky, and Amir Shmueli, in their article, "*The Capitation Mechanism and the Public Allocation to Health Services in Israel*," examine the government's main instrument for resource allocation to health funds. The application of the capitation tool in connection with the implementation of the State Health Insurance Law helped to improve resource allocation for the health system by applying a universal mechanism to all residents through the National Insurance Institute. Even though the capitation mechanism is crucially important for the functioning of Israel's health system, it has been subjected to only minor adjustments and corrections since its adoption in 1995. The authors present recommendations for improvement in the use of this method and propose that it be updated regularly on the basis of the health funds' expenditure data.