

## **Government Expenditure on Social Services**

After three years of economic recovery and growth, there seems to be an increasing awareness that economic growth alone cannot narrow Israel's poverty levels and economic disparities in any significant way. In the meantime, the hostilities in the North in the summer of 2006 may slow down the rapid economic growth and create political and security realities that require a rethinking of priorities in resource allocation. Under these new conditions, the problem of coping with Israel's socio-economic issues has become even more complicated and difficult.

The challenge of crafting the desired policy for the improvement of the welfare of weak population groups suffers, among other things, from difficulties in identifying, measuring and, particularly, in comparing cost-benefit ratios among different public social outlays. The goal of this survey is to contribute to the debate over the government's socio-economic policy by improving its factual base. It describes long-term developments in a way that is consistent with previous surveys, gauges the main trends in government expenditure on social services, and attempts – to the extent possible – to assess the effectiveness of the expenditure.

### **1. State Budget – Deviations from Planned Expenditure**

The state budget reflects the policies and priorities of the government. A discrepancy between the budget program and the

final expenditure data published at the end of the fiscal year may indicate that the policies were either changed or not implemented.

The last year for which there is final expenditure data is 2005. According to the reports of the Accountant General of the Ministry of Finance, total government expenditure that year was 3 percent lower than the original budget and 9 percent under the final budget. These deviations were slightly smaller than in 2004. Most of the deviations from the original plans, the reports explain, were the result of imprecise budgeting and large budget reserves that were released too late to be fully used. Further, previous year's budget surpluses were transferred and added to current year's budget at a late stage which precluded the full utilization of these sums.

Actual government expenditure on social services was no exception; it, too, fell short of the budget. According to data analyzed by the Taub Center (Table 1), social expenditure in the 2005 current budget was supposed to come to NIS 93.2 billion; various mid-year changes increased the sum to NIS 94.4 billion. Utilization, however, was NIS 92.4 billion – NIS 2 billion (more than 2 percent) under the adjusted budget. The 2006 state budget was not approved until June; until then, government expenditure was based on the previous year's budget. Thus, there was massive underutilization in the first half of the year – 7 percent in total expenditure and more than 20 percent in social spending.

Since the discussion of this issue focuses on actual expenditure data, the base year for the analysis is 2005. The main deviations occurred in expenditure on in-kind services, especially education, immigrant absorption, and employment, whereas expenditure on income-maintenance held to the budget. In comparison with previous years, the rates of deviation between budget and actual expenditure in 2005 were not exceptional in regard to both the overall expenditure on social services and the main expenditure headings (Table 2). There had

been some improvement in 2004; the deviations then were smaller than in 2003. In 2005, however, they widened again, although not at the rates observed in 2003.

**Table 1. Social Expenditure, Current Budget, 2005 – Actual Expenditure versus Budget (NIS billions and percent)**

Type of expenditure	Budget proposal	Adjusted budget	Final expenditure	Deviation from*:	
				Adjusted budget	Proposed budget
<b>Total</b>	93.2	94.4	92.4	-1.0	-2.2
<b>Income-maintenance</b>	39.0	39.0	38.9	-0.2	-0.1
<b>In-kind services</b>	54.2	55.5	53.5	-1.4	-3.6
Thereof:					
Education	29.8	30.4	29.4	-1.5	-3.5
Health care	16.6	16.7	16.5	-0.4	-1.2
Personal social services	5.3	5.5	5.4	+0.2	-1.9
Other services**	2.4	2.8	2.2	-9.2	-22.7

\* Rates of deviation calculated before rounding

\*\* "Other services" includes mainly immigrant absorption and employment

**Table 2. Social Expenditure, Current Budget, 2003-2005 – Actual Expenditure versus Budget (Percent)**

	Deviation of expenditure from:					
	Proposed budget			Adjusted budget		
	2003	2004	2005	2003	2004	2005
<b>Total</b>	-6.0	-2.3	-1.0	-3.2	-1.5	-2.2
<b>Income-maintenance</b>	-6.1	-4.6	-0.2	-2.2	0.0	-0.1
<b>In-kind services</b>	-5.9	-0.6	-1.4	-4.0	-2.6	-3.6
Thereof:						
Education	-5.4	-1.0	-1.5	-2.3	-3.0	-3.5
Health care	-5.6	+1.2	-0.4	-3.8	0.0	-1.2
Personal social						

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services	-5.5	+0.6	+0.2	-3.7	+0.4	-1.9
Other services	-16.0	-8.9	-9.2	-25.0	-18.3	-22.7

## 2. Economic Developments – Distribution of the Benefits of Recent Growth

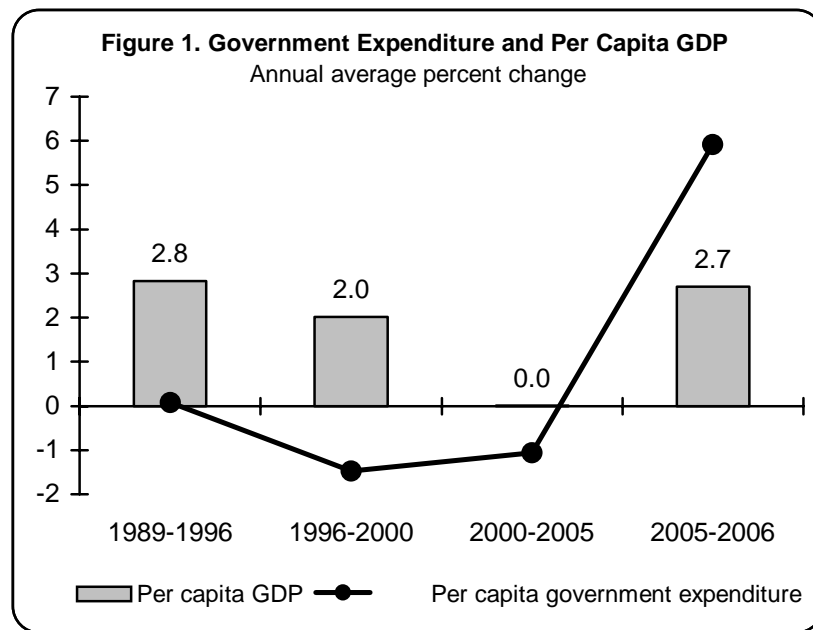
At the time of writing it seems the war that erupted in the summer of 2006 may have slowed down the economic growth process that began in the second half of 2003 and was gathering momentum, although it is too early to assess the extent of the slow down. It is feared that the recovery and the emergence from the severe recession may be adversely affected. It is appropriate to ask whether the approach adopted by Israel's economic policymakers in 2002 – reliance on the resumption of business sector growth to narrow unemployment and its attendant woes – is sufficient.

Consistent with their overall economic policy, the policymakers took measures that assured stability and held the growth of the public sector in check. In particular, they held to policies of low inflation and budget deficit targets and avoided direct steps that would ease the economic plight of weak population groups. In fact, some of the measures actually made the weak even worse off: the budget deficit target was met largely by means of massive cutbacks in social spending, foremost in transfer payments. After three consecutive years of economic growth, the results are steadily coming into view. Regarding the distribution of the fruits of this growth, it would seem that a pro-growth macro-economic policy is not enough to advance the well-being of society's weaker strata.

The expansion of economic activity accelerated in 2005 and the first half of 2006. GDP increased by 5.2 percent and the business sector product increased by 6.7 percent in 2005, and by 5.9 percent and 7.4 percent (in annual terms), respectively, in the first half of 2006. The war in Lebanon dealt a temporary

blow to economic activity although it is too early to assess its overall effects on economic growth.

The growth was accompanied by an absolute and relative increase in the economically active population. The labor force participation rate rose from 54.5 percent in 2003 to 55.9 percent in mid-2006; at the same time, the unemployment rate fell from 10.7 percent to 8.9 percent. Without belittling the significance of the improvement that occurred, it is doubtful that it fulfills the expectations that accompanied the resumption of growth.



About one-fifth of the addition to Israeli employment rates during the relevant years was due to the replacement of foreign workers with local workers; this had nothing to do with the expansion of economic activity. A tough enforcement policy reduced the number of non-Palestinian foreign workers by 11 percent in 2003 and another 9 percent in 2004. The distinction is

important in estimating the contribution of economic growth to employment, mainly because the opportunities of replacing foreign workers with Israelis are limited. Indeed, in 2005, despite the declared policy, the number of foreign workers increased by 3 percent.

**Table 3. Economic Developments – Positive and Negative Indicators (Percent)**

	2003	2004	2005	2006 (est.)
<b>Economic growth</b>				
• GDP	1.5	4.8	5.2	4.5
• Business sector product	2.2	6.8	6.7	5.6
<b>Employment</b>				
• Labor force participation	54.5	54.9	55.2	55.9*
• Unemployment rate	10.7	10.4	9.0	8.9*
• Increase in number of Israeli employed	2.0	3.0	3.9	3.5*
<b>Increase in income and standard of living</b>				
• Real wage per employee post	-3.0	2.5	1.2	1.2**
• Per capita private consumption	-1.0	3.7	1.6	2.8
<b>Widening of economic gaps and increase in poverty</b>				
• Unemployment rate:				
High education level	5.9	5.3	4.4	
Low education level	16.6	16.1	15.0	
• Change in household gross income:				
Top decile		2.5	3.4	
Bottom decile		-2.6	3.5	
• Gini index of disposable income distribution	0.3685	0.3799	.3878	
• Incidence of poverty among households	19.3	20.3	20.6	
• Poverty gap	30.5	33.3	33.1	

\* Second quarter (increase in Israeli employed, annualized)

\*\* First quarter of 2006 against year earlier period

Most population groups benefited from the improvement in employment but all groups did not benefit equally. Those who gained the most were of higher educational levels: in 2005, the unemployment rate among the well educated (16+ years of study) was 4.4 percent as against 15 percent among those with only a minimum level of education (up to 8 years). As further evidence, 80 percent of new workers in 2005 had post-secondary schooling, even though their share among all Israeli employed was 50 percent.

As employment increased, so did income levels. In 2005 and the first few months of 2006, real wages per salaried position continued to rise, although more slowly than in 2004 – by 1.2 percent as against 2.5 percent. Obviously, a differential improvement in employment leads to differential rises in income. Whereas the real income of high education salaried workers increased (in 2005), that of salaried workers with medium and low education levels actually declined. When the wage increases in 2005 are ranked by industries, a similar picture is obtained: industries that have a high proportion of employees with high education gave larger wage increases than industries with a low proportion of such employees.

The expansion of economic activity encouraged people to join the labor force and decreased the unemployment rate. Nevertheless, unemployment remained high in both absolute and relative terms. Furthermore, the improvement in employment and the increase in income was focused on the highly educated; among the poorly educated, the unemployment rate remained high and income did not increase.

Alongside economic growth, the relative economic situation of different population groups was also influenced by the government's tax and transfer payment policies. At the same time that renewed growth slowed down the widening of gaps in economic income distribution, the overall effect of the changes



in taxes and transfers caused the widening of disparities in disposable income.

The Gini index of inequality in disposable income rose by 2.1 percent in 2005 and by 5.4 percent in the past three years. In effect, the contribution of taxes and transfer payments to the narrowing of income inequality lessened from year to year – from 31.5 percent in 2002 to only 25.8 percent in 2005.

Similar conclusions can be drawn from the data on the incidence of poverty. In the past three years, the poverty rate, measured in terms of economic income, remained steady among households, total persons, and number of children, but increased when measured in terms of disposable income. In 2005, the incidence of poverty among households did not change significantly and the average poverty gap remained unchanged. The incidence of poverty among children, however, rose for the seventh consecutive year, mainly because child allowances continued to erode.

The contrasting effects of economic growth and improvement in employment, on the one hand, and of the tax and transfer payment policies, on the other hand, were reflected in an increase in the number of poor households headed by working people. In 2005, the number of poor households of all kinds increased by 4.2 percent whereas that of households headed by working poor increased by 10.5 percent and that of poor households headed by salaried employees rose by 15.6 percent. Thus, job creation and higher labor force participation was not sufficient, least of all in the case of salaried employees, to raise households out of poverty in 2005.

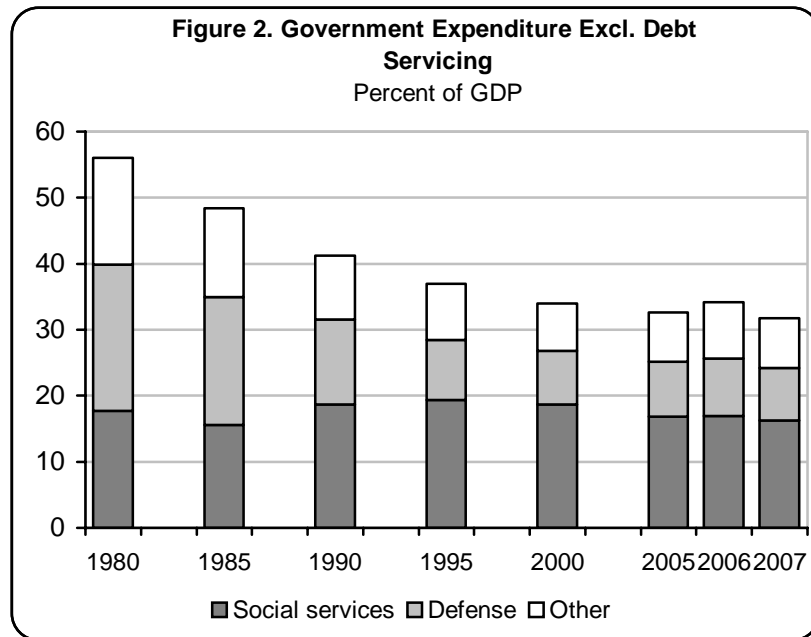
In summary, the macro-economic policies that were adopted helped to restart growth but the results in terms of employment were insufficient. In order to encourage growth, steps were taken some of which deepened the economic disparities in society and offset the possible favorable effects that the expansion of employment and the increase in economic income

could have had on the weaker population groups. The only conclusion is that reliance on economic growth alone for the advancement of weak groups is insufficient; more direct and focused policy measures are needed.

### **3. Government Expenditure Policy**

According to the official documents, the government's budget policy in recent years has been crafted within the framework of a multi-phase plan. In Phase 1 (2003), its purpose was to stop the contraction of economic activity. In Phase 2 (2004 and 2005), it sought to promote the resumption of growth and in Phase 3 (2006) it aimed to improve the conditions for the consolidation of growth. In 2005 and 2006, a new goal was added: strengthening the social fabric. Although the goals changed from year to year, identical means were adopted to attain them: budget restraint, tax cuts, and structural reforms. These vehicles remained in use even when non-recurrent needs – the disengagement in 2005, coalition agreements, war costs, the rehabilitation of northern Israel after the war in 2006, and so forth – had to be met.

In recent years, the budget has been planned with two constraints: a 1 percent maximum rate of real expenditure growth and a deficit no greater than 3 percent of GDP. Heading into 2007 and in view of coalition agreements that followed the 2006 elections, it was decided to boost expenditure by 1.7 percent and to set the deficit target at 2 percent of GDP. To pay for the Lebanon war and the rehabilitation of the North, non-recurrent expenditures were added, raising the planned budget deficit in 2007 to 2.9 percent of GDP.



The purpose of the budget restraint was to facilitate growth by freeing resources for the use of the business sector. Indeed, the ratio of government expenditure to GDP declined: expenditure excluding debt servicing accounted for 36.6 percent of GDP in 2002, 32.6 percent in 2005, and an estimated 33.6 percent in 2006 (Table 4). The ratio of government *social* expenditure to GDP also declined between 2002 and 2005 – from 19.8 percent to 16.9 percent – and, according to the estimate, recovered to 17.2 percent in 2006. The fall in 2005 occurred despite the declarations about the goal of strengthening society. In fact, throughout the period and in 2005, most of the decrease in the government expenditure/GDP ratio – 75 percent – came at the expense of social spending, even though social spending accounted for only half of total government expenditure excluding debt servicing.

**Table 4. Government Expenditure as Percent of GDP**

	<b>Total expenditure</b>	<b>Expenditure excl. debt servicing</b>	<b>Social expenditure</b>
1999	50.5	35.4	19.5
2000	48.4	33.9	18.7
2001	52.0	36.3	20.4
2002	51.7	36.6	19.8
2003	52.3	35.6	19.3
2004	47.7	33.8	17.8
2005	47.7	32.6	16.9
2006	48.8	33.6	17.2

Without a real change in the composition of the budget, it is doubtful whether a policy that holds the increase in government expenditure to a rate lower than that of population growth can strengthen society. Transfer payments are an important factor in the income of the weak population groups and in-kind government services count heavily in these groups' consumption. If the budget is kept within its current constraints and social expenditure is not increased at the expense of other expenditure items, social outlays will decline in per capita terms, leading to greater inequity and widening disparities.

To illustrate how the gaps have widened, the trend in per capita private consumption can be compared to the trend in government social expenditure on per capita average (Table 5). In the 1990s, per capita private expenditure grew by 31 percent and average per capita government social spending increased by 24 percent. In 2000–2005, per capita private expenditure increased by another 9 percent while average per capita government social expenditure dropped by 13 percent. According to the estimate, this trend continued in 2006. Thus, the opposing trends in recent years have allowed an intolerable gap to open: per capita private expenditure was 46 percent

greater in 2006 than in 1990 but average per capita government social spending rose by a mere 11 percent.

**Table 5. Private Consumption and Government Social Expenditure (Indices)**

	<b>Per capita private consumption</b>	<b>Per capita social expenditure</b>
1990	100.0	100.0
1995	122.8	117.5
1999	130.7	124.2
2000	137.5	123.4
2001	137.8	130.1
2002	136.1	123.3
2003	134.8	118.1
2004	139.7	110.3
2005	141.9	107.5
2006	145.9	111.2

#### **4. Government Expenditure by Main Areas of Activity – Guns or Butter?**

In recent years, about 30 percent of government expenditure has been earmarked for debt servicing and the rest has been divided between social services (about half of the balance), defense and economy and administration. To be precise, in 2005, 31.6 percent of government expenditure went for debt servicing and the rest was divided between social expenditure (51.7 percent), defense (25.3 percent), and economy and administration (23 percent) (Table 6). The share of *disposable* government expenditure (government expenditure after debt servicing) continued to contract relative to the previous year and, within this aggregate, the share of social expenditure continued to decline and that of economy and administration continued to

rise. The economy and administration component includes a wide variety of activities that range from incentives for investment, exports, and research and development to maintenance of public order, environmental quality, and other matters. The share of disposable government expenditure devoted to these uses has been growing steadily for five consecutive years. The trend in defense spending changed direction: after falling in 2003 and 2004, the share of disposable government expenditure for defense increased in 2005. In fact, defense spending constituted more than one-fourth of total disposable government expenditure in 2005, matching its level at the peak of the terror wave in 2002 and exceeding that in all years since the early 1990s.

**Table 6. Distribution of Government Expenditure by Main Areas (Percent)**

	1985	1992	2001	2002	2003	2004	2005	2006
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Debt servicing	43.4	29.8	30.2	29.2	32.0	29.1	31.6	31.1
Disposable expenditure	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Social services	32.1	51.7	56.1	54.2	54.1	52.6	51.7	49.7
Defense	40.2	26.1	23.6	25.4	24.3	24.6	25.3	25.3
Economy and administration	27.7	22.2	20.3	20.4	21.6	22.8	23.0	25.0

In 2006, according to the original budget, the share of disposable government expenditure continued to decline. The proportion of defense spending was to decrease and that of economy and administration outlays was to continue rising. The share of social spending was expected to grow for the first time since 2002. However, the large underutilization of social expenditure during the first half of the year, coupled with the major budget adjustments due to the war in Lebanon (in the

second half of the year), could well result in large discrepancies. From a long-term perspective since the mid-1980s, the share of social spending in disposable government expenditure climbed steadily, accounting for more than half of disposable government expenditure in 1992 and peaking at 56 percent in 2001. The trend turned around in 2002, so that by 2005 social expenditure accounted for only 52 percent of disposable government expenditure. When the proportion of social expenditure was rising, this happened mainly at the expense of the share of defense spending. The decline in recent years, in contrast, has been accompanied by a proportional increase in economy and administration expenditure.

The issue of tradeoff between defense expenditure and social expenditure – or, more generally, between defense and civilian uses – again became central on the public agenda due to the summer 2006 war in Lebanon. Specifically, it was argued that domestic defense expenditure had been cut too seriously (most defense imports are financed by American aid grants, which have increased) and that economic and social goals had been given too much priority in recent years.

Table 7 presents a comprehensive analysis of domestic public expenditure and revenues during the past decade and a half and points to the following trends. Throughout this period, the most conspicuous change pertained to the decline in the domestic deficit – from 7.6 percent of GDP in 1990 to 2.8 percent of GDP in 2005. The change reflects the high priority given to the maintenance of economic stability and the effect of the ideological approach shared by all governments since the inflation crisis of the mid-1980s that favored a smaller role of government in the economy.

**Table 7. Components of Public Sector Domestic Expenditure and Revenues, 1990–2005**

	Percent of GDP				Rate of change (percentage points)			
	1990	1995	2000	2005	'90– '95	'95– '00	'00– '05	'90– '05
Domestic defense consumption	10.0	7.5	6.6	6.3	-2.5	-0.9	-0.3	-3.7
Domestic civilian consumption	16.5	20.0	19.3	19.5	+3.5	-0.7	+0.2	+3.0
Investment	2.8	3.3	2.5	2.4	+0.5	-0.8	-0.1	-0.4
Total domestic demand	29.3	30.8	28.4	28.2	+1.5	-2.4	-0.2	-1.1
Taxes	37.4	38.9	39.0	37.6	+1.5	+0.1	-1.4	+0.2
Transfer payments to public, net	10.6	11.0	11.3	10.8	+0.4	+0.3	-0.5	+0.2
Taxes less transfer payments to public	26.8	27.9	27.7	26.8	+1.1	-0.2	-0.9	0.0
Direct subsidies	2.8	1.3	0.9	0.8	-1.5	-0.4	-0.1	-2.0
Interest payments	6.6	5.0	4.3	4.1	-1.6	-0.7	-0.2	-2.5
Revenue from property and other	4.3	4.0	2.5	3.5	-0.3	-1.5	+1.0	-0.8
Domestic deficit	7.6	5.2	3.4	2.8	-2.4	-1.8	-0.6	-4.8



The decline in the domestic deficit since 1990 – by 4.8 percent of GDP – was a result of a 2.5 percent of GDP reduction in interest payments to the public (occasioned, in turn, by the decline in the deficit and the government debt/GDP ratio), a 2 percent of GDP cutback in direct subsidies, and 1.1 percent of GDP reduction in domestic demand. In the opposite direction, domestic revenues from property and other sources dropped by 0.8 percent of GDP. Overall, the cutback in the domestic deficit was achieved with no increase in the tax burden. Tax revenues and net transfer payments to the public increased insignificantly – by 0.2 percent of GDP in each component – and the share of taxes less net transfer payments to the public was unchanged.

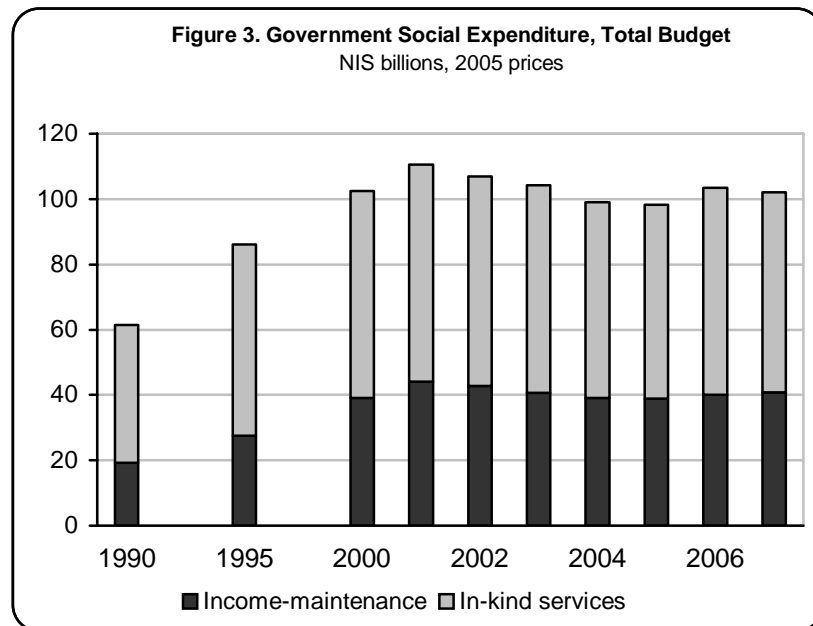
Within total domestic demand, there was a tradeoff between domestic defense consumption and domestic civilian consumption: over the decade and a half, defense consumption fell by 3.7 percent of GDP and civilian consumption increased by 3 percent.

Dividing the period into sub-periods shows that the main changes occurred in the first half of the 1990s and that the relative shares of the various expenditure and revenue components remained nearly unchanged in the years 2000-2005. In particular, domestic defense consumption declined by only 0.3 percent of GDP in the past half-decade. Since GDP increased during that time, absolute domestic defense expenditure actually rose; in constant prices, it was 3 percent greater in 2005 than in 2000.

## **5. Social Expenditure – In-Kind Services and Transfer Payments**

Social expenditure pays for services delivered directly by government, services provided to the public by other public and private institutions with full or partial government participation in financing, and transfer payments via the National Insurance

Institute. The in-kind services include education, health care, personal social services, public housing, and assistance for new immigrants. The main transfer payments are child allowances, benefits for the elderly and survivor benefits, allowances for persons with disabilities, unemployment compensation, and income-maintenance benefits.



In 2005, NIS 98.3 billion was spent on social purposes, mostly – 94 percent – through the current budget. In 2002-2005, social expenditure decreased by 11 percent in cumulative real terms: 3.3 percent in 2002, 2.4 percent in 2003, 4.9 percent in 2004, and 0.7 percent in 2005. The year 2005 was the fourth consecutive year of decline in government social expenditure, although the rate of decrease slowed relative to previous years. In absolute constant sums, social expenditure was NIS 12.3 billion lower in 2005 than in 2001.

The relatively steep decrease came about after a continuous upward trend since the mid-1980s (in 1984-2001, the average annual increase was 5.5 percent).

The 2006 budget provided for a real increase in social expenditure. Since utilization is expected to fall far short of the original plan, however, the downward trend may well have continued this year, too. In 2005, NIS 59.4 billion was earmarked for in-kind services (60.4 percent of the total) and NIS 38.9 billion for transfer payments.

Social expenditure, as stated, is divided between in-kind and in-cash services. In-kind services are delivered by government ministries and the attendant expenditure is fully included in the state budget. Most transfer payments, in contrast, are made by the National Insurance Institute and the state budget covers the difference between total payments and revenues from National Insurance contributions from the public. For a full picture of the social expenditure, the discussion that follows (and the data in the Appendix) relates to total transfer payments from the government (including National Insurance Institute) to the public.

Over the years, the share of in-kind expenditure has been trending downward and that of transfer payments has been trending up (Table 8). A noteworthy deviation from this overall development occurred in the early 1990s, due to mass immigration from the former Soviet Union and the need to provide hundreds of thousands of immigrants with public housing. Later in the 1990s, the share of in-kind expenditure declined by 11 percentage points and that of transfer payments increased commensurably. In recent years, expenditure on in-kind services has accounted for roughly 60 percent of total government social expenditure and transfer payments have made up the remaining 40 percent.

**Table 8. Social Expenditure, by Main Components (Percent)**

	<b>Total</b>	<b>In-kind services</b>	<b>Transfer payments</b>
1980	100.0	69.3	30.7
1989	100.0	57.6	42.4
1992	100.0	71.1	28.9
2001	100.0	59.6	40.4
2002	100.0	59.0	41.0
2003	100.0	60.1	39.9
2004	100.0	60.5	39.5
2005	100.0	60.4	39.6
2006	100.0	61.5	38.5

The changes in the composition of social spending reflect large differences in the development of each component in the 1980s and 1990s (Table 9).<sup>1</sup> In-kind service expenditure was more or less constant throughout the 1980s, increased steeply in the first half of the 1990s due to needs related to immigrant integration, and leveled off again in the second half of the 1990s. Transfer payments, in contrast, continued to rise in real terms for two decades without interruption. Thus, whereas expenditure on in-kind services doubled from the beginning of the 1980s to the beginning of the twenty-first century, transfer payment outlays more than quadrupled. In 2002–2005, in contrast to a common misconception, the cutbacks in social expenditure reduced both components equally.

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<sup>1</sup> Real changes in expenditure on in-kind services were calculated by deflating by the Public Civilian Consumption Price Index, whereas transfer payments were deflated by the Consumer Price Index.

**Table 9. Development of Main Components of Social Expenditure** (Indices, constant prices, 1980 = 100)

	<b>In-kind services</b>	<b>Transfer payments</b>
1980	100	100
1989	99	175
1996	190	271
2001	196	405
2005	175	357
2006	187	368

## 6. In-Kind Social Services

Expenditure on in-kind social services was NIS 59.4 billion in 2005 as against NIS 59.9 billion in 2004 and NIS 66.5 billion in 2001 – a cumulative decrease of around 11 percent since the beginning of the decade. Within the aggregate of in-kind service expenditure, education is the largest item – around NIS 30 billion or slightly more than half of the total expenditure last year.

### *a. Composition of Government Expenditure on In-Kind Social Services*

The changes in the composition of expenditure on in-kind social services (Table 10) were affected strongly by the mass immigration that occurred in the early 1990s. The increase in immigrant absorption expenditure, especially investment in housing, resulted in a proportional increase in expenditure on “Other Services” – an aggregate that includes mainly the budgets of the Ministry of Construction and Housing and the Ministry of Immigrant Absorption. In recent years, the effect of this factor has been lessening. Excluding the impact of mass immigration, the share of education spending in the total has been remarkably stable (about half of expenditure on in-kind

services in the 1980s and the first half of the current decade), health care expenditure has fallen in relative terms (from about one-third of service expenditure in the 1980s to about one-fourth at the beginning of the current decade, with a slight upward trend in the past two years), and the share of expenditure for personal social services has increased slightly, especially since the mid-1990s.

**Table 10. Composition of In-Kind Social-Service Expenditure** (Percent, current prices)

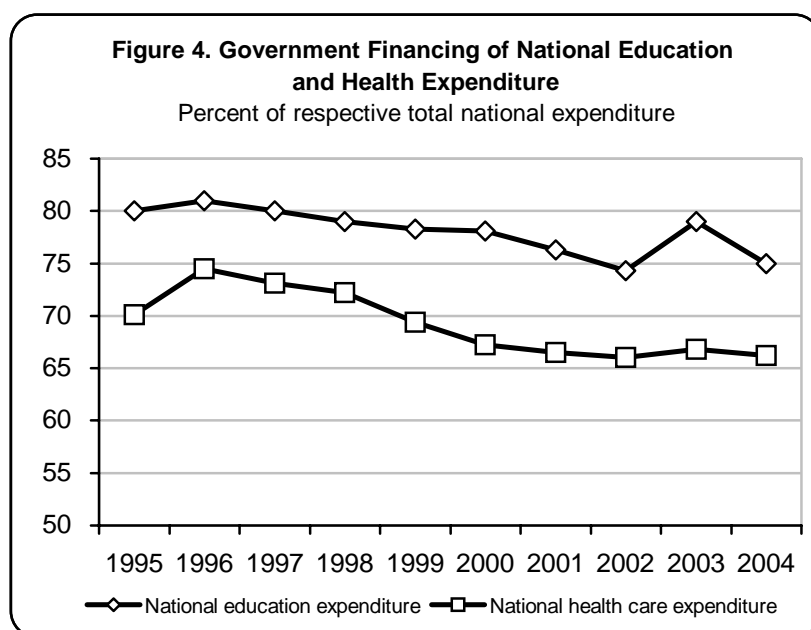
	<b>Total</b>	<b>Education</b>	<b>Health care</b>	<b>Personal social services</b>	<b>Other</b>
1985	100.0	48.5	33.7	5.2	12.6
1989	100.0	49.4	33.1	6.8	10.7
1992	100.0	32.3	19.1	4.2	44.4
1995	100.0	43.5	26.3	5.8	24.4
2001	100.0	50.0	24.8	7.7	17.5
2002	100.0	49.8	25.4	8.7	16.1
2003	100.0	50.4	25.0	8.6	15.9
2004	100.0	50.2	27.3	8.9	13.6
2005	100.0	50.5	28.2	9.1	12.2
2006	100.0	49.7	26.7	9.0	14.6

***b. Government's Share in National Education and Health Care Expenditure<sup>2</sup>***

National education expenditure comprises spending on all public and private education institutions from preschool to higher learning, household outlays for tutoring, textbooks, and the like, and expenditure for the construction of new education institutions and acquisition of equipment. National health care expenditure comprises spending on all health care services provided by clinics, hospitals, private physicians, and dentists,

<sup>2</sup> The data in this section are based on estimates by the Central Bureau of Statistics and may differ slightly from data in other parts of the survey, which are based on Taub Center calculations.

plus private expenditure for medicines and medical instruments, government research and administration in the field of health care, and investments in health care institutions' buildings and equipment. The funding of national expenditure on education and health care is divided between general government (including municipal authorities) and households.<sup>3</sup>



According to estimates of the Central Bureau of Statistics, the share of national education expenditure in gross national income<sup>4</sup> increased from 9.1 percent in 1995 to 9.7 percent in 2000 and 2002 and receded to 9.2 percent in 2003 and 9.1 percent in 2004. However, the share of general government in

<sup>3</sup> In recent years, around 3 percent of national education and health care expenditure has been covered by donations or unknown sources.

<sup>4</sup> Recently a new method of calculating gross national income in the national accounts has been applied retroactively since 1995.

funding the total has been decreasing all along: from 80 percent in the mid-1990s to 77 percent in 2002–2003 and 75 percent in 2004.

The share of national health care expenditure in GDP stood at 7.9 percent in the mid-1990s, rose to 8.6 percent in 2002, and then fell from year to year to 8.1 percent in 2005. As with education, the government has been steadily cutting back on its share in financing national health care expenditure, but to an even larger extent: from 74 percent of total national health care expenditure in 1996–1998 to 65 percent in 2005.

As the share of general government in funding national education and health care expenditure has been falling in proportional terms, household private expenditure has been rising significantly. This development – the “privatization” of the funding of education and health care services – carries the risk of increasing inequality in the consumption of these services. Indeed, at least in respect to health care, the Taub Center surveys indicate that much of the public has refrained from using some medical service due to the cost of the co-payment. Some of the increase in private expenditure for education can be linked to the development of the higher education system (establishment of colleges, etc.) and gives evidence of the widening circle of Israelis who acquire higher education.

### *c. Government Expenditure on Education*

The government spends more on education than on any other in-kind social service. In 2005, the government spent NIS 30 billion on education, matching the 2004 expenditure but falling short of expenditure in 2003 by about NIS 2 billion, for a real decrease of 6 percent.

In constant prices, government expenditure on education was 9 percent lower in 2004 and 2005 than in 2001. From the mid-1980s until 2001, this expenditure climbed steadily at an



average annual rate of 5.3 percent in real terms. The growth was especially vigorous in 1989-1996 – at 8.2 percent per year – because the education system had to expand in order to accommodate new pupils who had arrived in the mass immigration of the early 1990s. After 1997, the rate of increase slowed to only 0.2 percent per year.

The discussion that follows focuses on two main aspects: changes in priorities and developments in the quality of education.

An assessment of government priorities in education spending may be made by plotting the distribution of current expenditure among the levels of education (Table 11). Thus, the distribution of expenditure has not changed markedly in the past decade and a half, including the 2006 budget program. The most visible change has to do with a proportional increase in spending on preschools, reflecting the expansion of compulsory education to the 3 year-old age groups. Another change, the proportional decrease in expenditure for *yeshivot* (religious institutes of higher learning), is evidently the result of the elimination of redundancies after the relevant budget was transferred from the Ministry of Religious Affairs to the Ministry of Education. This relative stability over a lengthy period of time may indicate that the expenditure path was affected much more by demographic trends (the “autopilot” effect) than by policies and priorities, which exerted only a slight influence.

**Table 11. Distribution of Current Education Expenditure – Main Components (Percent)**

	1990	1995	2000	2004	2005	2006
Total	100.0	100.0	100.0	100.0	100.0	100.0
General expenditure	7.8	7.1	7.0	6.8	7.1	7.5
Preschool	4.9	4.6	6.1	7.7	7.4	7.3
Primary	26.7	28.5	26.4	28.7	29.3	29.4
Post-primary	34.5	34.6	35.5	35.9	34.3	33.9

Higher education	17.2	17.4	18.3	16.6	18.0	17.4
Vocational training	3.1	3.0	2.6	2.2	1.9	2.4
<i>Yeshivot</i>	5.8	4.8	4.1	2.1	2.0	2.1

Another aspect of priorities pertains to the distribution between the current budget and the development budget. The development budget includes expenditure for the construction, renovation, and equipping of schools, i.e., expenditure related to adjustment of the physical infrastructure of the education system for the future. In the past two years, only 2 percent of total government education expenditure has been earmarked for the development budget. In constant 2005 prices, development expenditure was NIS 1.2 billion in 1998–2001, NIS 852 million in 2002–2003, and NIS 556 million in 2004–005 (all in annual average terms). The declining level of investment, low to begin with, raises the possibility that investment in the future is being neglected. Given the natural increase of the pupil population, a dangerous gap between needs and available infrastructure may form, with a likely detrimental effect on the quality of education. Although an increase was built into the 2006 budget (10 percent over 2005), a real response to the disparity would require much more. Furthermore, experience in recent years points to considerable discrepancies between program and implementation.

Current expenditure on per pupil average, in constant prices, may be considered a rough indicator of overall education quality. Table 12 presents data on the change in average per pupil expenditure in the past decade by levels of education, and partial data on the change in average per pupil classroom hours. The relationship among the changes gives some indication of an improvement in efficiency.

**Table 12. Average Per Pupil Expenditure and Classroom Hours (Period percent change)**

	1995–2000	2000–2005	1995–2005
<b>Avg. per pupil expenditure</b>			
Total	+7.1	-11.9	-5.7
Primary	+5.3	+1.6	+7.0
Post-primary	+4.1	12.6	-9.0
Higher education	-3.7	-20.7	-23.6
<b>Avg. per pupil classroom hours</b>			
Primary	+10.2	-3.3	+6.6
Post-primary	+3.1	-4.5	-1.6

During the entire decade, average per pupil expenditure throughout the system fell by about 6 percent. The decline was especially steep in higher education but was also rather marked at the post-primary level. In primary schooling, in contrast, expenditure increased. In fact, the period is composed of two distinct sub-periods. In the second half of the 1990s, average per pupil expenditure increased throughout the system, including the primary and post-primary levels, and dropped sharply in higher education. In the first half of this decade, expenditure continued to rise modestly at the primary level but declined significantly at the post-primary level, in higher education, and in the system at large. Thus, the quality of education seems to have declined, especially in the past five years.

This finding, however, should be qualified by several additional remarks. First, the steep decrease in average per student expenditure in higher education does not necessarily mean that the quality of education fell commensurably; it may reflect a change in the mix of students. In the past decade, higher education enrollment increased by 60 percent, from 160,000 to 260,000, and most of the increase was absorbed by colleges and other new academic institutions that have lower average per student cost than the veteran universities. Second, at

the primary education level, average per pupil expenditure and average per pupil classroom hours increased at similar rates. Thus, quality may have improved even though efficiency did not. Finally, at the post-primary level both average per pupil expenditure and average per pupil hours decreased, but since the decline in the latter parameter was smaller, improved efficiency may have helped to prevent a decline in education quality.

#### ***d. Government Health Care Expenditure***

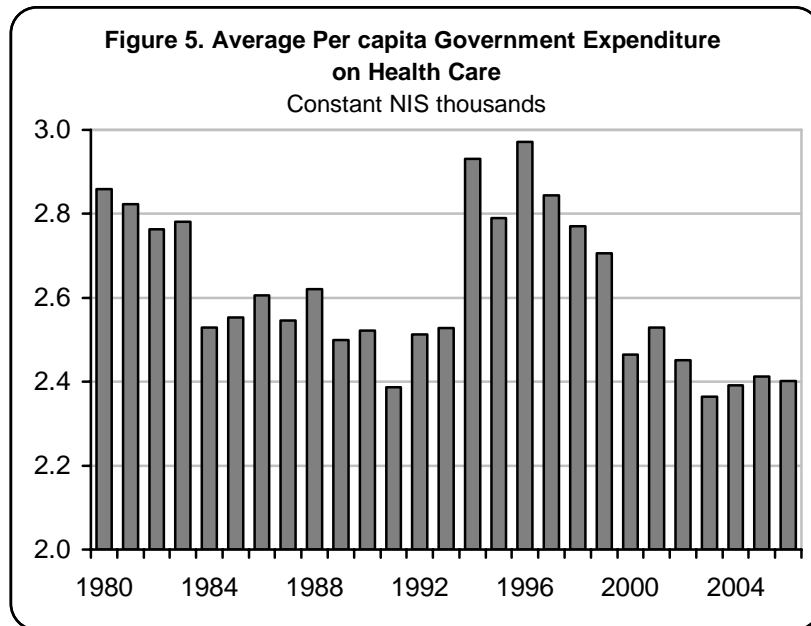
In 2005, the government spent NIS 16.7 billion on health care, 2.7 percent more in real terms than in 2004.

From a long-term perspective (back to 1980), the trend in government health care expenditure falls into three periods. The first ten years, 1980-1989, were typified by stability. In the following seven years, 1990-1996, rapid growth took place and expenditure rose by about 50 percent in a stepwise manner. During the subsequent decade, expenditure leveled off with small fluctuations (except for a 6.2 percent decrease in 2000 relative to 1999).

If real expenditure remains constant over a period of years, average per capita expenditure decreases. Furthermore, the prices of health care services tend to rise more quickly than the general price index.<sup>5</sup> The combination of stable outlays, population growth, and the increase in the relative price of health care services leads to the estimate that the delivery of government funded health care services to the public has eroded by 25-30 percent since 1997.

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<sup>5</sup> The health care services price index (included in the Consumer Price Index) climbed in 2000–2005 by roughly 9 percent more than the total CPI. During the same years, the price per day of inpatient care rose by roughly 10 percent more than the CPI.



Government health care expenditure includes investments in buildings and equipment. These investments fell from NIS 685 million per year in 1993-1997 to NIS 348 million per year in 1998-2003 and only NIS 168 million in 2004-2005 (all in 2005 prices). In the past two years, only 1 percent of total government health care expenditure has been earmarked for investment. As with education, underinvestment erodes the physical infrastructure of the health care service system and may be reflected in poor service quality in the future.

Current expenditure is divided between participation in financing health insurance (actually, funding of health care services that are delivered by non-governmental institutions) and direct expenditure on in-kind health care services. Over the years, the share of government participation in health insurance has been falling and that of direct private spending has been

rising (Table 13). Some of the decrease in transfers to other institutions originates in the elimination of the “parallel health tax” (paid by employers) in 1997.

In direct expenditures there is a distinct reduction in spending related to general inpatient care while there were moderate increases in expenditure on psychiatric and long-term care. The changes in the distribution of the expenditure indicate that the focus is being placed on special health care services.

**Table 13. Distribution of Current Health Care Expenditure  
Main Components (Percent)**

	1990	1995	2000	2004	2005	2006
Total	100.0	100.0	100.0	100.0	100.0	100.0
Participation in insurance	71.2	70.0	66.0	67.2	67.3	67.0
In-kind expenditure	28.8	30.0	34.0	32.8	32.7	33.0
Total	100.0	100.0	100.0	100.0	100.0	100.0
General inpatient care	10.0	11.9	3.4	3.5	3.1	2.3
Psychiatric care	21.9	23.2	22.6	25.3	27.3	25.0
Long-term care	17.1	17.2	20.8	24.5	21.8	23.1
Public health	14.0	17.2	22.1	18.6	18.6	18.4
Other*	37.0	30.5	31.1	28.1	29.2	21.2

\* Includes health care expenditure outside the Ministry of Health budget, mainly National Insurance outlays for maternity hospitalization, treatment of workplace casualties, etc.

#### *e. Personal Social Services*

The personal welfare services are administered by the Ministry of Social Affairs and municipal welfare bureaus. In 2005, the government spent NIS 5.4 billion on these services, a real increase of less than 1 percent over 2004, following a 3 percent cumulative real decrease in 2003-2004.

In the 1980s, until the Long-Term Care Insurance Law was passed in 1988, expenditure was around NIS 1.8 billion per year (in 2005 prices) with minor year-to-year fluctuations. Since

then, annual expenditure has been increasing steadily and has roughly tripled.

Government expenditure on personal social services is divided into two main groups: long-term care benefits (44 percent) and other services, including social services for children and teens, care for the elderly, care for special population groups, (marginalized youth, persons with disabilities, and the mentally disabled), and personal and family welfare services – both institutional and community-based.

## **7. Transfer Payments – The National Insurance System**

For more than two decades, until 2001, transfer payments to the public via the National Insurance Institute increased continuously – at real annual average rates of 6 percent in the 1980s and 8 percent in the 1990s and up to 2001. An abrupt turnaround occurred in 2002 after it was decided to decrease benefits, change the eligibility rules, and toughen enforcement: transfer payment outlays declined by 2005 to NIS 38.9 billion, approximately NIS 5 billion or 12 percent less, in real terms, than the peak level in 2001.

The rates of decrease from the peak to 2005 were spread unevenly across the various kinds of transfers (Table 14). The cumulative decline was especially steep in unemployment compensation (47 percent), child allowances (45 percent), and income-maintenance benefits (26 percent). In contrast, general disability benefits increased. If the change is calculated as a proportion of the total decrease in transfers, it can be seen that cutbacks in child allowances accounted for 71 percent, in unemployment compensation for 35 percent, and income-maintenance benefits for 19 percent.

**Table 14. Decreases in Transfer Payments –2005 versus 2001**

	<b>Absolute change (NIS millions)</b>	<b>Relative share in change, %</b>	<b>Cumulative rate of change, %</b>
Total	-5,140	100	-11.7
Old-age/survivors	-54	1	-0.3
Child allowances	-3,647	71	-44.9
General disability	1,162	23	18.4
Unemployment	-1,777	35	-47.1
Income-maintenance	-990	19	-26.4
Other	166	3	2.9

The reasoning behind the turnaround in the government's transfer payment policy was serious. Since the benefit levels and eligibility rules were legislated, the government had to budget in continuous annual increases in transfer payments, if only for demographic reasons (population increase including immigration, plus changes in the population's composition). Added to this was a seemingly liberal interpretation and generous application of the eligibility rules and a rise in the public's awareness of benefits and rights. Gradually, social transfer payments became a heavy burden on the budget: their share in government expenditure, in current prices, rose from 7 percent in 1980 to 11 percent in 1990 and 16 percent in 2001. In view of this, the government adopted the approach that in order to lower expenditure and the budget deficit to levels that characterize stable economies, the transfer payment policy had to be changed. At the same time, as economic growth froze and employment rates among Israelis declined, it was argued that transfer payments were creating a disincentive to labor – especially among those of low income. As specific evidence, the critics noted the steep increase in the number of working age recipients of income-maintenance benefits: from about 9,900



households in 1982 (when the Income Maintenance Law went into effect) to 32,000 in 1990 and 155,000 in 2003. Thus, the benefit cutbacks were meant to stimulate participation in the labor force.

However, the cutbacks that were adopted claimed a socio-economic price that cannot be disregarded. The combination of social transfer payments and the tax system is designed to mitigate in some way inequality in national income distribution. The effect of taxes and transfer payments on lowering the Gini index of income distribution has been declining in recent years – from 32.5 percent in 2001 to only 25.8 percent in 2005. Likewise, the two systems have been less effective in reducing the incidence of poverty: the percentage of poor households as measured by disposable income was 47.5 percent lower than that of poor families measured by economic income in 2001, as against only 38.5 percent lower in 2005.

Furthermore, transfer payments serve as a social safety net that is supposed to assure weak population groups – the elderly, persons with disabilities, the unemployed, etc. – a minimum income at an appropriate ratio to society's general standard of living. The effect of the cutbacks in transfer payments, then, should be tested not only in absolute terms but also in relative terms.

One way to measure this is to calculate the ratios between the various transfer payments, on per recipient average, and the average standard of living, reflected in per capita private consumption, at different points in time. The first point chosen was 1989, when the impact of mass immigration from the former Soviet Union had not yet become evident. (Due to data availability issues, the first point of reference is 1990 for child allowances and 1991 for unemployment compensation.) The second point was 2001, preceding the government's decisions reversing the long-term trend in transfer payments. The last point is 2005, the last year for which full expenditure data exist.

To gauge the changes in 2005, data for 2004 are also presented. The changes that occurred in these ratios are shown in index terms, with 1989 as the base year (Table 15).

**Table 15. Average Benefits Relative to Average Standard of Living (Percent)**

	1989	2001	2004	2005
Old-age and survivors	100	92	83	83
Child allowances	100*	76	43	39
General disability	100	106	104	102
Unemployment	100**	111	111	101
Income-maintenance	100	94	71	68

\* 1990 \*\*1991

In all types of benefits, a lower ratio was found in 2005 than in 2001. Furthermore, in regard to old-age and survivors' benefits, child allowances, and income-maintenance, the ratio was lower in 2005 than at the initial point in time. (The ratios in disability benefits and unemployment compensation were similar at both points.) The decreases were steepest in child allowances and income-maintenance. In 2005 alone, the gap between average benefits and average standard of living was unchanged with respect to old-age and survivors' benefits, continued to widen in child allowances and income-maintenance (although much more slowly than in previous years), and appeared for the first time in unemployment compensation. Even though these rough calculations have their drawbacks, they lead to the inescapable conclusion that the cutbacks clash with a policy of proportionality, as outlined above.

The largest component of transfer payments is **old-age and survivors' benefits** (Table 16). The level of expenditure on this item depends mainly on the size of the elderly population and the proportion of this population group that receives supplementary income-maintenance benefits. In the 1990s, the

increase in expenditure was furthered by an influx of elderly members of the mass immigration, many of whom also needed income supplements. As part of the policy introduced in 2002, it was decided to make a general cutback in benefits, raise the age of eligibility, expand the income tests, and link the benefits to the Consumer Price Index instead of the national average wage. Consequently, outlays were roughly 4 percent lower in 2002–2003 than in 2001, even though the number of recipients grew. Expenditure increased by 1.9 percent in 2004 and by another 1.7 percent in 2005, bringing it back to its beginning-of-decade level. Contributing to the increase in 2005 was an increase in the income supplement component, a decrease of the overall cutback from 4 percent to 1.5 percent and by the adjustment of the benefit to price increases.

**Table 16. Distribution and Change in Social Transfer Payments – Main Components (Percent)**

	1990	1995	2001	2004	2005	Annual average % change	
						1991–2001	2002–2005
<b>Total</b>	100.0	100.0	100.0	100.0	100.0	7.8	–3.1
Old-age/survivors	44.6	40.5	37.0	40.9	41.8	6.0	–0.1
Child allowances	22.2	22.8	18.5	12.4	11.5	6.0	–13.8
General disability	11.3	11.6	14.4	18.4	19.3	10.2	4.3
Unemployment	7.3	6.7	8.6	5.5	5.1	9.4	–14.7
Income-maintenance	3.3	5.9	8.5	7.6	7.1	17.4	–7.4
Other	11.3	12.5	13.0	15.2	15.2	9.2	–0.7

In most years, **child allowances** ranked second place in expenditure rate. In the 1990s, expenditure for this purpose increased due to three main changes: cancellation of the freeze

on first- and second-child allowances, the extension of eligibility to households headed by non-army veterans, and the Large Families Law. The decisions that the government has taken since 2002 include, but are not limited to, a 15 percent reduction in benefits and phased equalization over seven years of the benefits for each child irrespective of birth order (and, for children born after June 2003, immediately). For these reasons, the real expenditure on child allowances has fallen by 45 percent in recent years and is expected to continue declining as additional phases of the plan are implemented. In 2005, the decline in child allowance outlays came to roughly 8 percent.

Expenditure on **disability benefits** increased rapidly throughout the period in question, especially since the mid-1990s. This is the only type of transfer payment that the 2002 cutback policy left untouched. In fact, a special benefit was added for persons with severe disabilities, another for disabled persons with especially low earning capacity, another for disabled children, etc. Expenditure on disability benefits increased by 4 percent in 2005, for reasons including the effect of the increase in retirement age, which leaves persons with disabilities in the disability benefit system longer than before.

Expenditure on **unemployment compensation and income-maintenance benefits** was the fastest growing type of social transfer in the 1990s. The steep rise reflected not only the economic deterioration and the spreading unemployment that occurred at that time but also greater public awareness of eligibility for these benefits. Unemployment compensation expenditures increased in the 1990s despite various crackdowns. Since 1995, for example, unemployed young people (up to age 35) have been required to accept any job offered them, and since 1999 the maximum unemployment compensation payment has been capped. The decisions from 2002 onward, in contrast, have brought down expenditure steeply. The new policy lengthened the qualifying period for unemployment compensation, limited

the maximum term of eligibility for younger unemployed persons, and reduced compensation for the chronically unemployed and participants in vocational training programs. The income-maintenance benefit was cut by 4 percent and the maximum levels of the benefit were reduced by 10–23 percent, depending on household composition. Furthermore, eligibility for the higher rate benefit was eliminated for certain age groups of new applicants, the parameters of the income test were modified, exemptions from the employment test were cancelled in certain cases, and various discounts (on municipal property tax, public transport fares, etc.) were reduced or cancelled for the newly unemployed. The decrease in expenditure in 2005 – roughly 7 percent – also reflects the improvement in employment: the number of income-maintenance recipients decreased and the unemployed received compensation for less time.

Social transfer payments are funded by National Insurance contributions from the public, state-budget participation, and interest revenue from the National Insurance Institute's financial reserves. Since 1987, as part of the government policy to reduce labor costs, contributions from employers and the self-employed have been reduced and the Ministry of Finance has been reimbursing the National Insurance Institute for the difference. In analyzing the changes in the composition of funding sources over time, this reimbursement was included in the state budget participation, along with government participation in financing contributory benefits and government funding of non-contributory benefits. In most years, in fact, revenues from public contributions and the state budget were greater than the transfer payments disbursed (Table 17) and the remainder – after operating expenses – allowed the National Insurance Institute to build up its interest bearing financial reserves, which are kept with the Accountant General of the Finance Ministry.

Until 2002, the share of state budget participation was greater than that of public participation by several percentage points. The cutbacks in benefits and the 1 percent increase in National Insurance contributions from employers and the self-employed, coupled with a concurrent cutback in the rate of Finance Ministry indemnification starting in July 2002 brought the shares of the two sources into equilibrium in 2003. This allowed the share of contributions from the public to exceed that of state budget participation in the past two years.

**Table 17. Funding Sources for Transfer Payments (Percent)**

	<b>Total benefit outlays*</b>	<b>Contributions from public</b>	<b>State budget participation**</b>
1990	100	44	50
1995	100	33	67
2000	100	46	49
2001	100	43	51
2002	100	44	51
2003	100	49	50
2004	100	52	50
2005	100	54	50

\* Net of third-party compensation

\*\* Not including crediting of interest on account of reserves deposited with the Accountant General of the Finance Ministry

## 8. Conclusion

The economic growth process and expansion of economic activity that began in the second half of 2003 encouraged people to join the labor force and lowered the unemployment rate, even though it still remains high. Furthermore, the improvement in employment and the attendant increase in income focused on the well educated; among those with a low level of education,

unemployment remained high and income did not increase. Some of the measures that were taken to encourage growth exacerbated economic disparities and offset the benefits that the growth in employment and the increase in economic income could have had for the weaker population groups. Consequently, the evidence leads to the conclusion that a pro-growth macro-economic policy is not enough to advance the well-being of society's weak groups. Instead, more direct and focused measures are needed.

Although the government's budget policy included the goal of "strengthening the country's social fabric," the share of social expenditure in GDP continued to decline in 2005 for the fourth straight year. The proportion of social spending in total disposable government expenditure also continued to fall. In fact, the budget restraint in 2002–2005, which was meant to facilitate economic growth by freeing resources for the use of the business sector, was to a large extent achieved at the expense of social spending.

Social expenditure increased steadily during a period of two decades if not longer and peaked, in terms of its share in disposable government expenditure, in 2001. The trend turned around in the following year. During the years of proportional growth, it came about mainly at the expense of the share of defense spending. The decline in recent years, in contrast, was accompanied by an upturn in the proportion of expenditure for economy and administration. If the "guns and butter" tradeoff cut too deeply into the "guns" component, as has been argued, it did not do so in recent years. In fact, defense outlays in 2005 surpassed one-fourth of total disposable government expenditure, equaling their level during the peak of the terror wave in 2002 and exceeding outlays in all years since the early 1990s. Analyzed from a different perspective, in the most recent five-year period the share of domestic defense consumption in GDP fell by only 0.3 percentage points, and since GDP

increased, absolute defense consumption grew and was 3 percent higher in 2005, in constant prices, than in 2000.

Actual social expenditure was under the planned budget in 2005 – not for the first time – and seems to have been under budget again in 2006, according to the partial data available. The main deviation occurred in expenditure on in-kind services, whereas the utilization of social transfer payment funds approximated the planned budget. Within the overall social expenditure, the distribution between in-kind and in-cash services was unchanged for an additional year. Thus, the cutbacks since 2002 have reduced both components at more-or-less the same rate, in contrast to the widely held belief that transfer payments took the brunt of the blow.

The proportion of national expenditure on education and health care in GDP has been declining since 2002. Concurrently, the share of general government in financing these services has been falling and that of households has been rising. This “privatization” of funding may result in greater inequality in the consumption of education and health care services.

During the past decade and a half, including 2006 in accordance with the budget program, no major changes occurred in the distribution of current education expenditure among the levels of the education system. This relatively long period of budget stability indicates that the expenditure path may have been affected much more by demographic trends (the “autopilot” effect) than by policies and priorities, which exerted a small influence only.

In the past five years, average per pupil expenditure increased modestly at the primary level but fell significantly at the post-primary level and in higher education. Since the increase at the primary level was accompanied by a decrease in average classroom hours per pupil, it may reflect a lowering of efficiency and not necessarily an improvement in quality. At the post-primary level, in contrast, both average per pupil



expenditure and average per pupil classroom hours declined. However, since the decrease in the latter parameter was smaller, it is possible that greater efficiency helped to prevent a significant decline in education quality. Finally, the decrease in average per student expenditure in higher education is largely indicative of a change in the mix of service recipients and not of a decrease – at least not at the same rate – in the quality of education provided.

Government health care expenditure has been constant in real terms for a decade now. The combination of unchanging expenditure, population growth, and the increase in the relative price of health care services has led to an erosion in the delivery of government funded health care services to the public by a magnitude of some 25-30 percent since 1997.

Investments in the development of physical infrastructure in the education and health care systems have been inconsequential in recent years and are trending down. The low and declining level of investment raises concern about the formation of a dangerous gap between needs and available infrastructure in the future.

The trend in social transfer payments to the public by means of the National Insurance Institute turned around steeply in 2002. Transfer outlays decreased by approximately 12 percent in real cumulative terms during the four years following the 2001 peak. The decline was focused on child allowances, unemployment compensation, and income-maintenance benefits. Consequently, the gaps between average benefit levels and the general standard of living have widened and the social safety net that the transfer payments represent has frayed. In 2005 as against 2004, the gap between average benefits and the average standard of living was unchanged in regard to elderly and survivors but continued to widen with respect to children and income-maintenance recipients, although much more slowly than in previous years. Furthermore, a gap of this kind appeared

for the first time in regard to recipients of unemployment compensation.

Until the past two years, the share of state budget participation in funding social transfer payments exceeded that of contributions from the public. The benefit cuts and an increase in the rates of National Insurance contributions from employers and the self-employed brought the two sources into equilibrium in 2003 and caused contributions from the public to exceed state-budget participation in 2004-2005.