State Budget
Proposal for Fiscal Years
2017 and 2018

Major Provisions of the Budget
Multi-Year Budget Plan

Jerusalem **October 2016**

To the Reader,

This booklet summarizes the major provisions of the budget proposal for the fiscal years of 2017 and 2018. Additional material on government activities relating to the 2017-2018 budget is presented in the full version of the budget proposal as well as on the Finance Ministry's website.

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Summary

The annual budget law is submitted in accordance with the provisions of the Basic Law: State Economy, pursuant to which the state budget will be established by law and will include the projected and planned expenditures of the Israeli government. In accordance with the amendment to the law, enacted as a temporary order, the government submits the state budget for the fiscal years 2017 and 2018 in a bi-annual format.

Together with the annual budget law for the years 2017 and 2018, the government submits for the Knesset's approval the **Economic Efficiency Law** (Legislative Amendments to Achieve the Budget Goals in the Budget Years 2017-2018), which includes policy changes in the state budget, which require legislative changes, including fiscal adjustment measures with respect to both expenditures and revenues, as well as the **Economic Efficiency Law** (Legislative Amendments for Implementing the Economic Policy in the Budget Years 2017-2018), which consists of the legislative changes required for the implementation of the government's key reforms in 2017 and 2018.

The budget proposal and the detailed explanations thereto, include several measures aimed at enhancing public involvement in Israel in the preparation and approval of the State's budget: breakdown of the government's main expenditures into groups, for the purpose of identifying the breakdown of government expenditures in a clear and uniform manner; explanations regarding the current risk management in the state budget; an analysis of the budget proposal; details of the main changes in the state budget in relation to the previous budget; and an in-depth analysis of the assumptions and risk management relating to growth projections, government revenues and the ministries' budget framework. For our readers' convenience, the Finance Ministry's website displays the "fiscal digital" system whereby the government budget may be accessed by the public.

The budget summary booklet, which is hereby submitted to the Knesset and the public, provides the underlying assumptions in the construction of the state budget, presents a summary of the analyses and data which are relevant to the budget in the fiscal years 2017-2018. Additional information is available in the detailed explanations to this budget proposal.

Below are the state budget's highlights:

PART A – Budget Documents

- **Budget proposal for fiscal years 2017 and 2018:** this chapter presents the amounts of expenditures, revenue-dependent expenditures, spending authorization and the maximum number of positions (maximum workforce), which will be the government will be permitted to fill in the fiscal years 2017 and 2018, with a division into budget items.

Total net government spending in the fiscal year 2017 is NIS 446.8 billion and the budget for calculating the expenditure limit is NIS 359.7 billion. In 2018, the total government spending is NIS 460.0 billion and the budget for calculating the expenditure limit is NIS 367.7 billion

- **Business enterprise budget proposal for the fiscal years 2017 and 2018:** this chapter presents the amounts of expenditures, revenue-dependent expenditures, spending authorization and the maximum number of positions (maximum workforce), which will be the government will be permitted to fill in the fiscal years 2017 and 2018, as part of the business enterprise budget.

  The total business enterprise budget for the 2017 fiscal year is NIS 22.3 billion and for the 2018 fiscal year NIS 22.3 billion.

- **Forecast of revenues and loans for fiscal years 2017 and 2018:** this chapter details the projected state revenues for the fiscal years 2017-2018

  The total revenues for the deficit calculation is the 2017 fiscal year is expected to be NIS 322.7 billion and in the 2018 fiscal year NIS 337.9 billion.

- **The forecast of tax benefits for the fiscal years 2017 and 2018:** this chapter details the current tax benefits in Israel. According to this forecast, in the 2017 fiscal year tax benefits are expected to amount to NIS 61.9 billion and in the 2018 fiscal year tax benefits will total NIS 64.0 billion.

The triennial budget plan for the fiscal years 2017-2018: this chapter details the changes in the government's spending authorizations and revenues for the years 2018-2020, as well as the adjustments required in those years to meet the fiscal limits stipulated by law.

PART B – General Review

- **The economic policy and budget policy for the fiscal years 2017 and 2018:** this chapter outlines the economic background for the state budget proposal for the fiscal years 2017-2018. The chapter begins with an analysis of the challenges and opportunities facing the economy, including competition and cost of living, encouragement of equal opportunities for all sectors of the population, improvement of productivity and enhancement of economic growth. It continues with a description of the main macro-economic developments affecting the budget policy and planning as well as the economic measures which are intended to address these challenges and threats, amid developments in the local and global environments.

  The chapter also outlines the fiscal policy, in reference to the main fiscal developments in the last decade, the development of budget items and public spending on a multi-annual comparison and by expenditure items, describes the fiscal rules and forecast changes and provides a description of the budget convergence plan,

which constraints the budget to the expenditure limit stipulated by law, and to a budget deficit of 2.9% of DGP, in each of the years.

- **The budget proposal for the fiscal years 2017 and 2018:** this chapter presents the gross amount of expenditures (including the revenue-dependent expenditure) for the fiscal years 2017-2018, totaling NIS 497.1 billion in 2017 and NIS 502.0 billion in 2018. In addition, this chapter outlines the main changes in the state budget for the years 2017-2018 compared to the state budget in 2016.

- **The multi-annual budget plan for the fiscal years 2018-2025**: this chapter presents the forecast government spending for the years 2018-2020, with a division into expenditure items and the assumptions underlying the budget. It also presents the required adjustments in those years for the purpose of convergence into the fiscal limits stipulated in the law, based on current estimates and data. In 2019, adjustments totaling NIS 11.9 billion are required for the purpose of meeting the fiscal targets stipulated by law (the deficit limit and the budget expenditures limit).

  2020 is the first year in which adjustments will not be required for the purpose of constraining the budget into the expense limit, once the state's undertakings for future years are implemented, provided new resolutions are not made without proper budget resources and subject to the realization of underlying assumptions and macroeconomic forecasts detailed herein. Accordingly, the amount of adjustments for meeting the deficit target is NIS 12.4 billion.

- **The deficit and financing of the deficit in the fiscal years 2017 and 2018:** this chapter presents the budget deficit for the fiscal years 2017-2018, which is estimated at NIS 36.6 billion in 2017 and at NIS 38.5 billion in 2018. The deficit to be financed in the said years is estimated at NIS 33.7 billion in 2017 and at NIS 35.9 billion in 2018. In addition. The chapter outlines the sources of financing of the estimated deficit.

PART C – Review of the Main Expenses and Activities of Government Ministries

This chapter outlines the main expenses and activities of government ministries in the fiscal years 2017 and 2018, and it is divided into the following items: defense and public order, headquarter ministries, social services, economy and administration, infrastructures, debt payment and other expenses.

PART D – Tax Revenues

- **Forecast of macroeconomic developments and government revenues from taxes and other receipts in the years 2017 and 2018:** this chapter details the macroeconomic variables underlying the projected tax revenues, such as: GDP growth projections, the labor market and changes in prices and, based on these parameters, the projected government revenues from taxes and other receipts. The

economic growth forecast for the 2017 fiscal year is 2.7% GDP and in the 2018 fiscal year it is 2.8% GDP.

The forecast tax revenue in the 2017 fiscal year is NIS 294.5 billion and the forecast of other receipts is NIS 28.2 billion. The forecast tax revenue in the 2018 fiscal year is NIS 307.2 billion and the forecast of other receipts is NIS 30.6 billion.

- **The forecast tax revenues for the fiscal years 2017 and 2018:** this chapter details all the tax benefits offered by the Israeli tax system. The cost of tax benefits in the 2017 fiscal year is NIS 61.9 billion and in 2018 NIS 64.0 billion.

PART E – Appendixes

- **The budget law principles, the budget law documents, budget prices, the budget law for the fiscal years 2017-2018:** these chapters detail the legal infrastructure required for the planning of the budget, as well as the price forecasts used in the preparation of budget in current prices.
- **Workforce positions in the fiscal years 2017 and 2018:** this chapter presents the number of positions which the government is permitted to full in the 2017 fiscal year, with a division into budget items. In the 2017 fiscal year, the government may fill positions up to a maximum workforce of 122,224 positions (including non-permanent labor) and in the 2018 fiscal year, the government may fill positions up to a maximum workforce of 124,125 positions (including non-permanent labor)
- **The gross expenditure budget for the fiscal years 2016-2018:** this chapter presents a multi-annual comparison of gross expenses (net expenses plus revenue-conditioned expenses**)** with a division into budget items.
- **The net expenditure budget for the fiscal years 2016-2018:** this chapter presents a multi-annual comparison of net expenses (net expenses plus revenue-conditioned expenses) with a division into budget items.
- **Payment of principal and interest in the fiscal years 2016-2018:** these chapters present a multi-annual comparison of government expenditures for the payment of principal and interest.
- **Forecast of revenues and loans in the fiscal years 2016-2018:** this chapter presents a multi-annual comparison of revenues and loans.

BUDGET FOR 2017- 2018

Government budget for the fiscal year 2017

In NIS, billion

Government budget for the fiscal year 2018

In NIS, billion

PART A
Budget Documents

Budget proposal for the fiscal years 2017-2018

Business enterprises budget proposal for the fiscal years 2017-2018

Forecast of revenues and loans for the fiscal years 2017-2018

Forecast of tax benefits for the fiscal years 2017-2018

Budget proposal for the fiscal year 2017

In NIS, thousands

Summary of the First Schedule		Expenditure	Revenue-Dependent Expenditure	Spending Authorization	Maximum Workforce
Grand Total		**446,817,453**	**44,917,387**	**126,439,765**	**80,689.5**
==========		=========	========	=========	======
Budget for calculation of the expenditure limit*		359,719,453			
Debt repayments excluding debt repayments to National Insurance		87,098,000			
Part I: Regular budget		319,811,843	33,869,212	61,616,551	80,689.5
Part II: Development and capital account budget		127,005,610	11,048,175	64,823,214	
Part I: Regular budget		**319,811,843**	**33,869,212**	**61,616,551**	**80,689.5**
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	Government and administration	**17,216,598**	**1,629,460**	**2,044,477**	**16,213**
	==========	=========	========	========	======
01	President of the State	51,872	1,300		61
02	The Knesset**	740,561	180		827
04	Prime Minister's Office	1,995,080	9,500	1,222,625	841
05	Ministry of Finance	2,269,098	474,757		5,269.5
06	Ministry of the Interior	247,300	500	27,102	462
08	Ministry of Justice	3,358,101	1,005,794		5,686
09	Ministry of Foreign Affairs	1,643,358	77,471		969
10	National Security Council	53,883			7
11	State Comptroller**	360,081			591
14	Financing of political parties	150,983			16
18	Local authorities	4,996,860		712,750	
22	Ministry of Religious Services	659,133	12,786	82,000	339
68	Population, Immigration & Border Authority	690,288	47,172		1,144.5
	Security and Public Order	**79,202,610**	**79,202,610**	**20,086,580**	**40,526.50**
	==========	=========	=========	=========	========
07	Ministry of Public Security	16,335,432	968,679	3,092,000	37,986
15	Ministry of Defense	52,033,176	18,494,000	35,864,000	2,194
16	Civil emergency expenses	596,012		200,000	43.50
17	Coordination of activities in the territories	104,807	345,901		241
31	Miscellaneous security expenses	7,561,355	278,000		62
35	Committee for Nuclear Energy	147,927			
46	Discharged Soldiers Law	2,423,901			

Summary of the First Schedule		Expenditure	Revenue-Dependent Expenditure	Spending Authorization	Maximum Workforce
	Social Services	**15,351,064**	**9,469,333**	**3,888,009**	**16,828.5**
	==========	=========	=========	=========	========
19	Ministry of Science, Technology and Space, Ministry of Culture and Sports	1,496,897	84,431	264,500	150
20	Ministry of Education	52,786,862	2,387,698	2,147,000	2,138
21	Higher education	10,549,017			
23	Ministry of Social Affairs	6,857,929	2,118,459	81,183	3,296.5
24	Ministry of Health	33,129,624	4,875,745	375,326	10,500.5
25	Holocaust Survivors Rights Authority	4,150,118			97
27	National Insurance Institute	40,510,936			
30	Ministry of Immigrant Absorption	1,869,681	3,000	1,020,000	403.5
	Infrastructures	**4,075,665**	**199,896**	**1,056,800**	**1,915**
	==========	=========	=======	=========	========
29	Ministry of Construction and Housing	270,361	9,000		548
34	Ministry of Energy and Water	560,335	49,000	1,045,000	287
40	Ministry of Transport, National Infrastructure and Road Safety	414,287	115,488	11,000	743.5
41	Government Water & Sewage Authority	111,449	1,288		116.5
42	Construction and housing grants	2,621,150	4,320		
43	Israel Mapping Center	98,083	20,800	800	220
	Economy and administration	**8,887,244**	**1,726,585**	**5,058,250**	**3,033.5**
	==========	=========	========	========	=======
26	Ministry of Environmental Protection	373,553	877,842	320,000	592
33	Ministry of Agriculture and Rural Development	1,830,774	225,745	652,500	1,339
36	Ministry of Economy	3,630,431	48,101	1,020,000	1,851
37	Ministry of Tourism	327,918	5,764	70,000	151.5
38	Support for economic sectors	2,654,242	548,898	2,995,750	
39	Ministry of Communications	70,326	20,235		100
	Other expenses	**20,663,662**	**757,358**	**10,413,015**	**1,173**
	==========	=========	========	========	======
12	Pension and severance pay	16,048,508	731,858		
13	Miscellaneous expenses	3,016,329			
47	General reserve	680,000		10,000,000	700
54	Supervisory authorities	918,825	25,500	413,015	473
	Debt repayments	**38,415,000**			
	==========	=========			
45	Payment of interest and fees	38,415,000			

Budget proposal for the fiscal year 2017 (cont.)

	Summary of the Third Schedule	Expenditure	Revenue-Dependent Expenditure	Spending Authorization	Maximum Workforce
Part II:	**Development and Capital Account Budget**	**127,005,610**	**11,048,175**	**65,823,214**	
	Development budget	27,329,610	11,048,175	64,823,214	
	Government and administration	**886,498**	**2,963,574**	**9,773,500**	
51	Government housing	806,438	2,963,574	9,773,500	
53	Courts	80,060			
	Security and public order	**492,895**	**60,866**	**868,000**	
52	Police and prisons	492,895	60,866	868,000	
	Social services	**1,832,107**	**1,491,311**	**4,122,298**	
60	Education	719,224	1,260,000	2,704,837	
67	Health	1,112,883	231,311	1,417,461	
	Infrastructures	**20,521,140**	**4,531,700**	**47,092,588**	
70	Housing	1,905,823	3,604,700	6,226,284	
73	Water plants	976,682	102,000	1,106,625	
79	Transport development	17,638,635	825,000	39,759,679	
	Economic sectors	**793,533**	**160,000**	**879,550**	
76	Industry	163,913	60,000	260,500	
78	Tourism development	629,620	100,000	619,050	
	Other expenses	**2,803,437**	**1,840,724**	**2,087,278**	
83	Other development expenses	2,803,437	1,840,724	2,087,278	
	Debt repayments	**99,676,000**			
84	Debt payments	12,676,000			
	Of which: debt payments to National Insurance	12,578,000			

* Net budget (NIS 446,817,453) less debt repayments (NIS 99,676,000) excluding debt repayments to National Insurance (NIS 12,578,000).

** The Knesset's annual budget proposal is submitted for approval to the House Committee of the Knesset by the Chairman of the Knesset, and is part of the Budget Law.

*** The State Comptroller budget is set by the Finance Committee of the Knesset, and is part of the Budget Law. Details of this budget are published separately, pursuant to the Basic Law: State Comptroller.

Budget proposal for the fiscal year 2018

In NIS, thousands

Summary of the Third Schedule		Expenditure	Revenue-Dependent Expenditure	Spending Authorization	Maximum Workforce
Grand Total		**460,012,622**	**41,959,581**	**114,565,738**	**81,297.5**
==========		=========	========	=========	=======
Budget for calculation of the expenditure limit*		376,720,622			
Debt repayments excluding debt repayments to National Insurance		83,292,000			
Part I: Regular budget		337,107,560	31,558,557	58,867,801	81,297.5
Part II: Development and capital account budget		122,905,062	10,401,024	55,697,937	
Part I: Regular budget		**337,107,560**	**31,558,557**	**58,867,801**	**81,297.5**
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	Government and administration	**18,046,208**	**1,502,994**	**1,875,227**	**16,529.5**
	==========	=========	========	========	=======
01	President of the State	51,564	1,300		59
02	The Knesset**	758,143	180		827
04	Prime Minister's Office	2,021,980	9,800	1,088,125	826
05	Ministry of Finance	2,568,883	304,997		5,483
06	Ministry of the Interior	607,925	500	27,102	462
08	Ministry of Justice	3,500,512	1,046,788		5,855
09	Ministry of Foreign Affairs	1,623,321	77,471		944
10	National Security Council	53,708			7
11	State Comptroller**	368,613			591
14	Financing of political parties	151,102			16
18	Local authorities	4,985,532		682,000	
22	Ministry of Religious Services	638,993	12,786	78,000	344
68	Population, Immigration & Border Authority	715,932	49,172		1,115.5
	Security and Public Order	**82,795,360**	**17,736,022**	**37,790,000**	**40,661.5**
	==========	=========	=========	=========	=======
07	Ministry of Public Security	17,205,834	828,721	3,422,000	38,114
15	Ministry of Defense	53,858,714	16,461,000	34,368,000	2,203
16	Civil emergency expenses	465,436			42.5
17	Coordination of activities in the territories	104,495	154,301		240
31	Miscellaneous security expenses	8,380,448	292,000		62
35	Committee for Nuclear Energy	147,927			
46	Discharged Soldiers Law	2,632,506			

Summary of the First Schedule		Expenditure	Revenue-Dependent Expenditure	Spending Authorization	Maximum Workforce
	Social Services	**158,769,201**	**9,668,551**	**3,927,004**	**17,062.5**
	==========	==========	==========	==========	==========
19	Ministry of Science, Technology and Space, Ministry of Culture and Sports	1,567,933	84,431	269,500	147
20	Ministry of Education	55,143,570	2,387,698	2,147,000	2,376
21	Higher education	10,764,039			
23	Ministry of Social Affairs	7,362,655	2,194,374	81,183	3,378.5
24	Ministry of Health	35,454,434	4,999,048	409,321	10,659.5
25	Holocaust Survivors Rights Authority	4,084,082			95
27	National Insurance Institute	42,477,639			
30	Ministry of Immigrant Absorption	1,914,849	3,000	1,020,000	406.5
	Infrastructures	**4,319,194**	**199,996**	**256,800**	**1,875.5**
	==========	==========	==========	==========	==========
29	Ministry of Construction and Housing	269,734	9,000		529
34	Ministry of Energy and Water	676,254	49,000	245,000	290.5
40	Ministry of Transport, National Infrastructure and Road Safety	442,333	115,588	11,000	725.5
41	Government Water & Sewage Authority	112,371	1,288		115.5
42	Construction and housing grants	2,720,705	4,320		
43	Israel Mapping Center	97,797	20,800	800	215
	Economy and administration	**8,785,368**	**1,646,918**	**4,632,755**	**3,985.5**
	==========	==========	==========	==========	==========
26	Ministry of Environmental Protection	346,480	798,175	320,000	585
33	Ministry of Agriculture and Rural Development	1,827,456	22,745	647,000	1,306
36	Ministry of Economy	3,792,215	48,101	665,000	1,840
37	Ministry of Tourism	306,388	5,764	70,000	153.5
38	Support for economic sectors	2,442,740	548,898	2,930,755	
39	Ministry of Communications	70,089	20,235		101
	Other expenses	**24,617,229**	**804,076**	**10,386,015**	**1,183**
	==========	==========	==========	==========	==========
12	Pension and severance pay	16,666,808	778,576		
13	Miscellaneous expenses	2,850,177			
47	General reserve	4,180,000		10,000,000	700
54	Supervisory authorities	920,244	25,500	386,015	483
	Debt repayments	**39,775,000**			
	==========	==========			
45	Payment of interest and fees	39,775,000			

Budget proposal for the fiscal year 2017 (cont.)

	Summary of the Third Schedule	Expenditure	Revenue-Dependent Expenditure	Spending Authorization	Maximum Workforce
Part II:	**Development and Capital Account Budget**	**122,905,062**	**10,401,024**	**55,697,937**	

	Development budget	26,882,062	10,401,024	55,697,937	
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	Government and administration	**751,716**	**2,294,693**	**11,301,153**	
	==========	========	========	========	
51	Government housing	671,656	2,294,693	11,301,153	
53	Courts	80,060			
	Security and public order	**453,094**	**60,866**	**868,000**	
	==========	=======	=======	=======	
52	Police and prisons	453,094	60,866	868,000	
	Social services	**1,236,902**	**1,423,041**	**3,668,577**	
	==========	========	========	========	
60	Education	571,480	1,300,000	2,738,577	
67	Health	665,422	123,041	930,000	
	Infrastructures	**21,263,416**	**4,591,700**	**37,710,379**	
	==========	=========	=========	=========	
70	Housing	2,145,688	3,624,700	5,176,684	
73	Water plants	1,015,215	102,000	1,077,375	
79	Transport development	18,102,513	865,500	31,456,320	
	Economic sectors	**753,239**	**160,000**	**747,550**	
	==========	=======	=======	=======	
76	Industry	178,419	60,000	255,500	`
78	Tourism development	574,820	100,000	492,050	
	Other expenses	**2,423,695**	**1,870,724**	**1,402,278**	
	==========	========	========	========	
83	Other development expenses	2,423,695	1,870,724	1,402,278	
	Debt repayments	**96,023,000**			
	==========	=========			
84	Debt payments	96,023,000			
	Of which: debt payments to National Insurance	12,731,000			

* Net budget (NIS 460,012,622) less debt repayments (NIS 96,023,000) excluding debt repayments to National Insurance (NIS 12,731,000).

** The Knesset's annual budget proposal is submitted for approval to the House Committee of the Knesset by the Chairman of the Knesset, and is part of the Budget Law.

*** The State Comptroller budget is set by the Finance Committee of the Knesset, and is part of the Budget Law. Details of this budget are published separately, pursuant to the Basic Law: State Comptroller.

Business Enterprises Budget Proposal for the fiscal year 2017

In NIS, thousands

Summary of the Fourth Schedule		Income/ Expenditure	Spending Authorization	Maximum Workforce
	Total revenues	**22,333,294**		
	==========	=========		
89	Prime Minister's office and Ministry of Finance*	319,982		
91	National development	1,000,000		
94	Government hospitals	10,165,905		
95	Hadera Port	41,994		
98	Israel land Administration	10,805,413		
	Total expenses	**22,33,294**	**3,805,000**	**26,838**
	==========	========	========	========
89	Prime Minister's office and Ministry of Finance*	319,982		98
91	National development	1,000,000		
94	Government hospitals	10,165,905		26,073
95	Hadera Port	41,994		5
98	Israel land Administration	10,805,413	3,805,500	662

* Government Press Office and Government Printer

Business Enterprises Budget Proposal for the fiscal year 2018

In NIS, thousands

	Summary of the Second Schedule	Income/ Expenditure	Spending Authorization	Maximum Workforce
	Total revenues	**22,273,038**		
	==========	=========		
89	Prime Minister's office and Ministry of Finance*	321,836		
91	National development	1,000,000		
94	Government hospitals	10,326,132		
95	Hadera Port	41,994		
98	Israel land Administration	10,583,076		
	Total expenses	**22,33,294**	**3,805,000**	**26,838**
	==========	========	========	========
89	Prime Minister's office and Ministry of Finance*	321,836		97
91	National development	1,000,000		
94	Government hospitals	10,326,132		27,481
95	Hadera Port	41,994		5
98	Israel land Administration	10,583,076	4,162,000	666

* Government Press Office and Government Printer

Forecast of State Revenues and Loans for Fiscal Years 2017-2018

In NIS, thousands

		Budget proposal for 2017	Budget proposal for 2018
	Total revenues and loans	446,817,453	460,012,622
	==========	==========	==========
	Revenues for the deficit account	**322,710,000**	**337,850,000**
	Tax revenues	294,530,000	307,230,000
	Other proceeds	28,180,000	30,620,000
	Revenues for financing	**124,107,453**	**122,162,622**
		==========	==========
	Part A: Current receipts	320,241,843	337,537,560
	Part B: Proceeds from loans and capital account	126,575,610	122,475,062
	Part A: Current receipts	**320,241,843**	**337,537,560**
	Taxes and compulsory payments	296,000	308,700,000
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	Income and property taxes	151,930,000	157,830,000
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001	Income tax	124,580,000	129,880,000
002	VAT on nonprofit organizations and financial institutions	13,827,000	14,119,000
003	Betterment tax	4,100,000	4,200,000
004	Purchase tax	8,150,000	8,350,000
005	Sales tax and property tax	900,000	900,000
007	Employers tax	373,000	381,000
	Expenditure taxes	144,070,000	150,870,000
	---	---	---
011	Customs and import duties	3,300,000	3,500,000
012	VAT, including VAT on defense imports	94,670,000	98,770,000
013	Purchase tax	20,100,000	21,500,000
015	Excise tax		
018	Fuel tax	18,700,000	19,600,000
020	Stamp duty		
024	Motor vehicle fees		
025	License fees and other levies	7,300,000	7,500,000
	Interest and earnings	1,250,000	1,150,000

034	Interest in foreign currency	230,000	200,000
035	Interest in NIS	1,020,000	950,000

		Budget proposal for 2017	Budget proposal for 2018
	Royalties	3,150,000	4,830,000

042	Royalties from business enterprises	490,000	530,000
043	Royalties from natural resources	910,000	1,360,000
044	Royalties from government-owned companies	1,240,000	1,300,000
045	Dividends from government-owned companies	510,000	1,640,000
	Miscellaneous revenues	1,600,000	1,890,000

046	Reimbursement on account of previous years' budget		
047	Revenues from various services	1,230,000	1,170,000
050	Government asset utilization fees	310,000	390,000
048	Earmarked revenues in excess of estimates	60,000	330,000
049	Profits realized by the Bank of Israel		
	Carried from Part A	18,241,843	20,967,560
	---	---	---
	Part B: Proceeds from loans and capital account	**126,575,610**	**122,475,062**
	==========	==========	==========
	Repayment of government investments and loans	3,450,000	3,150,000
	---	---	
051	Collection of principal in NIS	2,870,000	2,544,000
053	Collection of principal in foreign currency	430,000	456,000
076	Revenues from sale of state-owned lands	150,000	150,000
	Provisions for pension benefits and severance pay	10,000	10,000
	---	---	---
071	Provisions by economic units	8,403	8,403
072	Provisions by business enterprises	1,597	1,597
073	Provision for pension – companies		
	Capital revenues	890,000	1,140,000
	---	---	---
075	Privatization	890,000	1,140,000
	Domestic loans	128,417,453	126,472,622
	---	---	---
081	Loan from the National Insurance Institute	20,550,000	21,120,000
082	Revenues from emissions and deposits	107,867,453	105,352,622
	Loans and grants from abroad	12,050,000	12,670,000
	---	---	---
900	Independence and development loan	4,940,000	5,070,000
901	Net of: distribution expenses	-200,000	-200,000
	Loans and grants from the USA:		
902	- Defense		
904	- Civilian assistance		
907	- Other loans	7,310,000	7,800,000
908	- Bank loans		
	Carried to Part A	-18,241,843	-20,967,560
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Forecast of Tax Benefits for Fiscal Years 2017-2018

(In NIS, billions)

Subject		2017	2018
Total		61,910	64,040
Part A: Direct Taxes		**51,330**	**52,920**
A.	**Benefits for capital investments and industry**	**6,910**	**6,610**
	1. Encouragement of Capital Investment Law	6,800	6,500
	2. Angels Law	--	--
	3. R&D, gas exploration and film production	--	--
	4. Credit for shift labor	110	110
	5. Encouragement of Industry Law	--	--
	6. Accelerated depreciation	--	--
	7. Participation exemption	--	--
B.	**Benefits to the savings and capital market**	**26,380**	**27,710**
	1. Pension funds (deposits and accruals, net of withdrawal)	21,400	22,470
	- Benefits upon deposits	15,450	16,220
	- Benefits upon accrual	8,100	8,500
	- Less taxation upon withdrawal	-2,150	-2,250
	2. Advanced study funds (deposits and accruals)	4,780	5,040
	- Benefits upon deposits	3,510	3,680
	- Benefits upon accrual	1,270	1,360
	3. Interest income	200	200
	4. Tax on employee stock options in the capital gains track	--	--
C.	**Welfare and population distribution**	**5,900**	**6,070**
	1. Income tax exemption for nonprofit organizations	--	--
	2. Exemption on Ministry of Defense allowances	580	600
	3. Exemption on National Insurance allowances	1,990	2,050
	- Child allowances	1,270	1,300
	- Old-age and survivors benefits	650	680
	- Other benefits	70	70
	4. Credit for new immigrants	30	30
	5. Credit for new immigrants and returning citizens on overseas earnings	--	--
	6. Credit for institutionalization of a relative	50	50
	7. Credit for parents of disabled children	30	30
	8. Credit for charitable donations	440	460
	9. Credit for the blind and disabled	650	680
	10. Credit for residents of development areas	2,020	2,060
	11. credit for employers in Eilat	110	110

Subject		2017	2018
D.	**Household benefits (excluding exemption on child allowances)**	**4,110**	**4,220**
	1. Credit for single-parent families	140	140
	2. Half credit point for women	810	830
	3. Credit for children	3,110	3,200
	4. Credit for non-working spouse	30	30
	5. Credit payers for child support and alimony	20	20
E.	**Miscellaneous income tax benefits**	**3,200**	**3,400**
	1. Exemption on income from gambling, lotteries and prizes	1,700	1,750
	2. Exemption on rentals of residential apartments	1,250	1,300
	3. Encouragement of construction of rental apartments	70	80
	4. Credit for discharged soldiers	80	80
	5. Credit for academics	90	180
	6. Credit for foreign athletes	10	10
F.	**Benefit-recipient funds and institutions**	**--**	**--**
	1. Edmond de Rothschild Caesarea Foundation	--	--
	2. Israel Academy of Sciences and Humanities	--	--
	3. Wolf Foundation	--	--
	4. United States-Israel Binational Science Foundation	--	--
	5. Israeli Center for the Promotion of Human Culture (Van Leer Institute)	--	--
	6. The Ashkelon-Eilat Pipeline Company	--	--
	7.. The Jewish Agency	--	--
G.	**Fringe benefits**	**370**	**390**
	1. Company car	370	390
	2. Parking at workplace	--	--
H.	**Real estate tax benefits**	**4,460**	**4,520**
	1. Purchase tax credits	--	--
	2. Exemption from residential apartments' betterment tax	4,460	4,520
	3. Limited betterment tax for historic assets	--	--
	4. Betterment tax limited to 20% or 25%	--	--

Subject		2017	2018
Part B: Indirect Taxes		**9,820**	**10,320**
A.	**Customs and purchase tax**	**4,510**	**4,720**
	1. Diesel fuel	3,450	3,620
	2. New immigrants	50	50
	3. Returning residents	10	10
	4. Domestic tourists	500	520
	5. Vehicle safety accessories	260	270
	6. Limited tax rate for taxis	200	210
	7. Conditional exemptions	40	40
B.	**Value Added Tax**	**5,310**	**5,600**
	1. Fruit and vegetables	3,130	3,280
	2. New apartments	--	--
	3. Tourism services	930	960
	4. Eilat Law	820	860
	5. Online overseas purchases	430	500
Part C: Fees		**760**	**800**
	1. Use of frequencies by the Defense Sector	550	570
	2. Licensing of disabled vehicles	200	220
	3. Vehicle licensing and drivers license for reservists	10	10

Source: State Revenue Administration

Benefits marked by "**...**" – There is no cost estimate due to inadequate databases.

Triennial Budget Plan for the Years 2018-2020

(In NIS, billion)

	2018	2019	2020
Total government expenditures	**376.7**	**396.4**	**409.8**
Expenditure limited permitted by law	**376.7**	**394.4**	**410.3**
Permitted over-expenditure in accordance with Section 40A of the Budget Foundation Law	0.0	2.0	0.0
---	---	---	---
Adjustments required for meeting the spending requirement	0.0	2.0	0.0
	---	---	---
Expenses required for calculating the deficit target	**376.3**	**394.0**	**409.8**
Forecast of state revenues	**337.8**	**348.1**	**364.8**
---	---	---	---
Projected deficit subject to compliance with the spending requirement	38.6	45.9	45.0
Permitted deficit	38.6	34.0	32.1
---	---	---	---
Measures required for compliance with the deficit target	0.0	11.9	12.9
==========	=======	=======	=======
Overall adjustments required	0.0	13.9	12.4
Permitted deficit in percent of DGP	2.9%	2.5%	2.25%
Resulting deficit (without making adjustments)	2.9%	3.5%	3.1%

PART B
General Overview

The economic policy and budget policy for the fiscal years 2017-2018

The budget proposal for the fiscal years 2017-2018

Analysis of the budgetary expenditure development for the fiscal years 2017-2018

The triennial budget plan

The deficit and its financing in the fiscal years 2017-2018

The economic policy and budget policy for the fiscal years 2017-2018

The Israeli economy has several characteristics which allowed it to weather the last decade's crisis safely and successfully. The relatively young economy has enjoyed impressive employment growth rates, improvement in education in different sectors of the population and has benefited from the advantages of its human capital, resulting in a huge increase in high tech exports as well as overseas sales by new industries. These created an infrastructure for rapid growth, a decrease in unemployment to record low levels, an improvement in the standard of living and an impressive stability in Israel's fiscal and monetary policy, which included a substantial reduction in the debt-GDP ratio, even during the global crisis years, and especially in comparison to other developed countries. These advantages led to higher confidence in Israeli investments by the international community, as well as high and stable credit ratings for Israel, which further contributed to the government's ability to reduce its interest payments and direct public resources towards civilian spending (as a % of public spending) and to improve the public's welfare.

However, the economic challenges of the past few years are different than those that Israel had to deal with in the previous decade and in the period following the global financial crisis. After many years to impressive growth rates, which raised the standard of living, expanded the labor base and improved the fiscal safety net, the last five years have seen lower growth potential, which may be close to exhaustion.

Some of the obstacles to economic growth are not unique to Israel: many developed countries are struggling with low productivity and a near-zero interest rate environment. The decline in trade is a global issue, and has adversely impacted demand for Israeli exports and investments. Israeli, however, is facing additional challenges, such as its demographic composition and geopolitics, the eroding human capital development and a waning fiscal stability and reliability. In addition, it is hard to assess the economy's transition from reliance on foreign trade to reliance on consumption in the past few years and accordingly, the best way to address the issue. For these reasons, following a decade in which Israel has gradually reduced the gap with OECD countries in terms of GDP per capita, in 2015 this gap has widened again.

Another trend corresponding with the slowing growth rates is the rise in social-economic inequality. Income inequality is not diminishing (mainly the gaps in disposable income between the deciles), and capital gaps are growing, as a result of several trends in the last few years, including the rise in the cost of living, particularly housing prices. The concentration of wealth in the hands of a few is closely linked to lack of competition in many industries and the rise in the number of monopoles, which in turn impacts productivity in these sectors and their ability to compete in global markets. In addition, the conditions of doing business in

Israel have deteriorated since 2007, and Israel is ranks among the lowest countries in the OECD.

These trends are worrisome and we regard them as intertwined. A remedy of the failures that contributed to the rising social inequalities is not only just, it is also economically effective. Inequality in Israel is reflected, among others, in a non-optimal use of the potential of all segments of the population. While in recent years we have witnessed a significant improvement in the labor market, many believe that this improvement is about to be exhausted, although the participation rate among the make orthodox Jews is 50 percent only, and among Arab women it is even lower -32 percent. One of the contributory factors is lack of adequate approach to resources that will allow these populations to effectively integrate into the modern labor market, in sectors such as transportation, education and welfare, among others.

We intend to deal with these obstacles in the budget for 2017-2018. The economic plan and budget policy is the government's method of handling structural failures in the economy, and re-assess the distribution of resources according to criteria, which are consistent with its medium-term and long-term strategic goals, as well as handle pressing matters. This bi-annual budget was constructed to resolve these issues, since our responsibility to create meaningful engines, reduce the gaps and increase productivity over the next few years, has never been greater.

This budget and the accompanying economic plan, which includes significant reforms in areas that were defined as the most challenging for the Israeli economy, are intended to effect bold changes that will steer the economy in the right direction, one that will allow all means of production to be effectively utilized and to create an infrastructure for viable growth.

This chapter will review the background for planning the state budget for 2017-2018. We will begin by describing the challenges and opportunities facing the economy, continue with an analysis of the main macro-economic developments and finally lay out our economic plan, which deals with these challenges and threats, amid developments on the domestic and global arenas.

Background: the main macro-economic developments

This section will deal with the past developments that formed the background for understanding the main challenges of the Israeli economy and devising our economic policy.

GDP and domestic uses

The Israeli economy has weathered the global economic crisis in 2008 and 2009. The rapid economic recovery was reflected in a high GDP growth rate of 5.8 percent and 4.2 percent in the years 2010 and 2011, respectively. However, this rate slowed gradually and since the end

of 2011 GDP has grown by an annual pace of 2.5-3 percent, except for 2013, the year in which gas production began from the "Tamar" reserve.

In the years 2015-2016 the Israeli economy continued to grow at the same moderate pace. The national accounts data for 2015 and the first half of 2016 point to an annualized growth rate of 2.5-3 percent, following 3.2 percent in 2014. These data represent the potential growth rate of the Israeli economy, in view of several developments on the domestic front and in the global arena over the past few years.

The slowing in the growth rate stems from several factors: Israel's rapid exit from the global crisis (in 2008-2009), which closed the GDP gap with other developed countries (especially in the Eurozone); the global economic downturn, which in the last few years has been witnessed in emerging markets, and has significantly impacted Israeli exports and domestic competitiveness; and the conclusion of one-time projects, which led to a significant decline in the growth rate of investments. Moreover, the improvement in the labor market over the last decade has come to a halt. Without expansive structural changes that will deal with the unique demographic changes in Israel, the ability to improve unemployment rates, overall productivity and labor productivity will remain limited, and the growth potential of the Israeli economy will remain at its current pace.

The second half of 2016 saw a slight acceleration in the growth rate of all GDP components, except for public consumption. The slowing increase in public consumption is attributable to the delayed approval of the state budget in 2015-2016, which contributed to the rapid growth in public consumption in the last quarter of 2015 and as a result – to a negative growth rate in the first quarter of 2016.

In the first half of 2016, the growth rate of investments in fixed assets accelerated and exports of goods rose after three halves of negative growth.

Consumer spending

Against the backdrop of these developments, consumer spending has become the main growth engine of the Israeli economy. The rapid growth of consumer spending was supported

by several factors (see details below): the positive developments in the labor market, including the high employment rates and the rising wages; the low interest rate environment; and the decrease in the prices of products and services, which led to negative inflation since mid-2014.

The rapid growth of consumer spending also led to the accelerated growth of current consumption, which accounts for 85 percent of consumer spending, and more biased towards domestic production as compared to the consumption of durable goods. In 2015, current consumption recorded the fastest growth pace since 2007, which accelerated in the first half of 2016.

Unlike current consumption, the consumption of durable goods, which accounts for 8 percent of current consumption, recorded zero growth rate in 2015, due to higher purchase of vehicles at the end of 2014, following a change in taxes on motor vehicles at the start of 2015. However, in the second half of 2015, consumption of durables gradually increased, especially the purchase of new cars, a trend that continued in the first half of 2016.

Investments in fixed assets

Investments in fixed assets recorded zero growth rates in 2014-2015, after growing by 4 percent in previous years. The zero growth of investments in the last two years is attributed to the low increase in investments in machinery, equipment and transport vehicles and investment in construction. Investments in machinery, equipment and transport vehicles recorded negative growth in three of the four years between 2012 and 2015. At the same time, investments in residential construction slowed considerably since 2015, while the growth rate of these investments fell from 6.5 percent in 2012-2014 to 2 percent in 2015. The decline in investments stemmed, among others, from the high uncertainty in the real estate market, due to the proposed "Zero VAT" law. Data for the last three quarter of 2015 pointed to an accelerated growth in real estate investments; however, in the first half of 2016 it slowed again, and may have been affected by the rise in mortgage prices.

An analysis of the development in public consumption will be set forth below, in the "Background for the Fiscal Policy" chapter.

Balance of payments and foreign trade

Balance-of-payments data point to continued improvement in the balance-of-payments current account surplus, from the low level recorded at the start of 2012. The main contributory factors to this improvement was the decline in imports of energy materials, due to the production of gas from the Tamar reserve in 2013, and the decline in oil prices as of the second half of 2014.

An analysis of the import and export data shows that in mid-2011, the recovery from the global crisis came to a halt, and since then imports and exports of goods and services (in current dollar terms) have been stagnant. Moreover, at the start of 2014, the growth rate of exports begun to decline, a trend that was curbed at the end of 2015. This was mostly reflected in the exports of goods, while exports of services maintain a steady growth rate, except during the period of Operation "Solid Rock".

The decline in goods exports is attributable to macro-economic and micro-economic factors. The macro factors, which include the slowing growth in global trade and the shekel's real appreciation (see below), do not fully account for the decline in goods exports.

Israeli exports are highly concentrated. In three industries: chemicals, pharmaceuticals and electronic components, which represent close to half of industrial exports (excluding diamonds), there is one dominant corporation. As a result, changes in the exports of these sectors lead to significant changes in the overall industrial exports. In 2015 and at the start of 2016, exports of chemicals and electronic components decreased, probably due to micro-economic factors which are relevant to these industries – decline in chemical prices, drought in South East Asia and the upgrading of Intel's production plant in Kiryat Gat.

Imports of goods have been growing since mid-2015. This trend is evident in every component of goods imports, except for imports of energy products. This is especially true

for imports of investment products, but was also apparent in imports of consumer products and raw materials (excluding energy materials), and in particular raw materials for the machinery and electronics industry. The growth in imports of investment products and in raw materials for the machinery and electronics industry is partly due to the upgrading of Intel's production plants.

The global environment

Over the last few years, the global arena has posed significant challenges to the Israeli economy. The sub-prime meltdown, followed by the Euro debt crisis, pushed down global growth rates, which have not yet recovered to pre-crisis levels. These led the central banks of developed countries to lower interest rates to near zero levels, and several banks have also taken non-conventional expansionary monetary steps, such as quantitative easing and negative interest rates. On the other hand, several emerging markets, including China, recorded high growth rates, and drove global growth almost single-handedly.

Since 2014 developed countries returned to the growth track. In the US, a stable growth rate of 2.0 percent – 2.5 percent has been recorded in the last couple of years, the number of employed persons has increased by 200,000 on a monthly basis, unemployment has fallen blow 5 percent and inflation is approaching the Fed's target rate. Against the backdrop of these developments, the Federal Reserve raised the interest rate at the end of 2015 and there are indications of another interest hike at the end of 2016.

Euro member states, where unemployment has been declining (but still high) have also seen a slight recovery, with an annualized growth rate of 1.5 percent in the last two years. However, the low inflation rate and the significant gap between European counties in terms of economic growth have led the European Central Bank (ECB) to take several monetary steps, including quantitative easing, loans to banks at near zero interest rate and negative interest on deposits.

In contrast to the upturn in developed markets, emerging economies have slowed down in the last few years. In 2012-2015, the Chinese market recorded growth rates of 7-8 percent and it continues to decelerate, compared to an average growth above 10 percent in 2011-2013. The International Monetary Fund (IMF) expects this slowdown to continue over the next few years. The Chinese economy is slowing mainly due to structural changes, as China is transforming from a foreign trade-based economy to an economy based on domestic consumption. Moreover, the large goods exporters, including Russia and Brazil, suffered from recession in the wake of the declining prices of goods in general and oil in particular, as of the second half of 2014.

Amid these developments, the growth rates of global GDP and global trade slowed considerably, due to waning demand on the one hand and challenges regarding the supply of goods, on the other hand. In addition, the effect of the growth in global GDP on the growth in

global trade has moderated considerably, so that even if global GDP returns to the levels recorded before the subprime crisis, global trade growth rates will not match those seen in previous years. This fact explains the repeated IMF updates regarding global trade growth rates.

Another significant factor affecting the Israeli economy is the geopolitical environment. In this context, the decline in "Arab Spring" protests (except for the war in Syria) has lowered geopolitical risks and contributed to the decline in oil price.

Monetary policy and inflation

Concurrent with the slowing rise in Israeli GDP, as of year-end 2013 inflation rates have also declined. Since June 2014, inflation rates have fallen below the Bank of Israel's lower limit of the target range (one percent), and as of September 2014 inflation has been in negative territory. Negative inflation is primarily attributable to the decline in the prices of commodities, especially petroleum, and government actions targeted at lowering the cost of living.

Due to the decelerating growth and inflation rates, the Bank of Israel lowered its interest rate from 1.75 percent in April 2013 to 0.1 percent only in March 2014. Since October 2012 real interest rates have been negative, except in January-March 2016, when inflationary expectations were negative, and interest rates rose to positive levels.

In determining its monetary policy the Bank of Israel is forced to balance between opposing trends. The low growth and inflation rates coupled with the shekel's tendency for appreciation, amid an expansionary monetary policy in many developed counties, create pressures to lower the interest rate. On the other hand, the low interest rate environment encourages investors to take risks and pushes up prices of investment assets (financial and non-financial). This increase is reflected, among others, in rising prices of stocks, bonds (corporate and government) and apartments.

The rise in apartment prices coupled with the near-zero interest rate led to a significant increase in floating-rate mortgages. An interest rate hike could, as a consequence, push down the prices of financial assets, increase the burden of mortgage interest payments, and pose a risk to the financial sector. To prevent the risk, the Bank of Israel has taken several measures, such as limiting the variable component in the new mortgage loans, increasing the banks' loan loss provisions in respect of new mortgages, and limiting the Loan to Value Ration (LTV).

The shekel's appreciation as of the second half of 2012 contributed to the BOI's decision to intervene again in the currency market. Between April 2013 and August 2016, the BOI purchased a total of USD 25 billion. Out of this amount, USD 10 billion (40%) was purchased as part of the plan to offset the impact of gas production in Israel on exchange rates, and the remainder was unplanned dollar purchases, which were intended to curb appreciation pressures on the shekel. As a result of these purchases, Israel's foreign currency balances grew to USD 97.6 billion, which is considered high by global comparison.

The labor market

Israeli labor market data for 2015 and for the first half of 2016 point to continued improvement, albeit at a slowing pace. In the second quarter of 2015 the participation rate has stabilized at 64.1-64.2 percent. Unemployment rate has been on a downward trend and in the third quarter of 2016 fell to a historic low – 4.6 percent (data for July and August 2016). These developments contributed to the steady rise in the rate of employment, which peaked in the third quarter of 2016. Current labor market data place Israel among the countries boasting the best employment rates. This improvement was also recorded for the main employment age.

The favorable developments in the labor market were also reflected in the number of full-time employed persons, the average number of labor hours per employee and the number of involuntary part-time employed persons. However, and despite some improvement in these segments, employment rates among Orthodox men and Arab women are still far below employment rates among the general population. This data constitutes the main demographic challenge for Israel in the next few years (to be detailed below), and poses the main obstacle to high productivity, GDP growth potential and the narrowing of social gaps.

Productivity

According to OECD data, labor productivity in Israel (measured as total output per work hour) is unsatisfactory compared to most developed countries. In 2014, per-hour productivity in Israel was USD 38.1, 23 percent below the average among developed countries. When comparing employee productivity (GDP divided by number of employees) to OECD average, Israeli also lags behind, albeit to a smaller extent, employee productivity in Israel is 17 percent below OECD average. This difference between the two productivity measures is indicative of longer work hours for Israeli employees.

According to economy theory ("conditional convergence") and past experience, countries with relatively low labor productivity are expected to grow at a faster pace and reduce the gap. However, this is not the situation here, as Israel has seen both low productivity and low growth rates in the last few years. In fact, while output per work hour in Israel was 78 percent of output per work hour in the US at the start of the 1990s, in 2014, this ratio was 57 percent only. This issue is highly significant in terms of micro-economy, since employee productivity has a direct and significant impact on the average standard of living, whether by means of net wages or through public services.

Table 1 presents a basic development accounting of GDP per employee in Israel, of several other developed countries and several developing markets. The countries are laid out by productivity per employee and the variables are presented in relation to the US. The data shows that productivity per employee in Israel is 57 percent of per-employee GDP in the US, the human capital measure in Israel (a function of the level of education) is 99 percent of its US equivalent and the capital to GDP ratio is almost identical to that in the US. Overall productivity in Israel (calculated as a residual) is 57 percent of the equivalent US ratio. Since there is no difference in terms of inputs, it is easy to conclude that the gap in per-employee GDP between Israel and the US is almost entirely attributable to the gap in overall productivity, i.e. this is due to inefficiency rather than gaps in inputs. In other words, the gap in per-employee productivity between Israel and the US is not necessarily due to differences in the physical and human capital (even if such difference exists according to other empirical studies), but rather from non-optimal use of the physical and human capital in Israel. The reasons are numerous and include, among others, non-optimal exposure to international trade and low sector competitiveness, as well as the repercussions of the demographic challenge, which leads to partial integration of certain populations in the labor market. This creates a situation where employees' education and skills are not adapted to the changing needs of the labor market, which is also reflected in low wages (the "fine" due to lack of suitable skills for the labor market, reflected in low wages, is much higher in Israel than in other developed countries). In addition, despite significant investments in the high tech industry, the companies that manufacture for the domestic market (including the building section) lag behind their developed counterparts on the technology front.

Table 1: GDP per employee (Basic Development Accounting)

The US = 1.00, 2014

Country	GDP per employee	Capital to GDP ratio	Human capital index	Overall productivity
United States	**1.00**	**1.00**	**1.00**	**1.00**
France	0.83	1.22	0.84	0.81
Italy	0.80	1.40	0.82	0.69
Denmark	0.79	1.17	0.94	0.72
Australia	0.77	1.09	0.94	0.76
Sweden	0.77	0.16	0.91	0.73
Spain	0.77	1.32	0.77	0.75
Canada	0.73	1.12	0.99	0.66
Finland	0.72	1.23	0.92	0.64
Britain	0.72	1.22	1.00	0.58
Portugal	0.58	1.47	0.65	0.60
Israel	**0.57**	**1.00**	**0.99**	**0.57**
Chile	0.43	0.98	0.82	0.54
Argentina	0.43	0.88	0.79	0.61
Algeria	0.40	1.04	0.59	0.66
Bulgaria	0.30	0.90	0.84	0.40
Brazil	0.26	1.19	0.74	0.29

Competition and Cost of Living

One of the concerning phenomena in recent years in Israel, which imposes a challenge to handling with structural reforms, is the increase in cost of living, especially in industries not open for competition, which produce to the local market. Absence of such competition takes its toll within the market, seen by high concentration, low productivity translated into low employee salaries, and high consumer prices. According to OECD data, Israel's cost of living is among the highest in the western world, about 20% above Spain price levels and 30% above Korea, two countries with GDP per capita similar to Israel.

As of 2011, prices for selected industries in Israel were above average in 16 out of 20 when compared to other OECD countries. 2011 was the year when the social protest began and placed cost of living and its implications on top priority for the public. Since then, housing prices in Israel (which together with water and energy prices almost equaled the average level of the developed countries organization) increased by additional 30%.

In recent years Israeli governments have taken several steps in order to open markets for competition and reduce consumer prices. The main factors contributing to the increase in cost of living are trade barriers, such as farmers cap and high customs, strict regulation on businesses and high industry concentration compared to acceptable standards. This is along unique industry challenges such as near-zero interest, which contributed to fast growth in the mortgages taken and increase in demand for apartments, which along with supply shortage contributed to sharp price increase in the housing market.

Example for high concentration can be seen in the food industry, where the market share of the two leading producers/suppliers in Israel is extremely high (above 70% and more) in a vast variety of food categories. The same holds for the banking and finance industry, where 60% of the market is controlled by two groups only. The economic plan introduced below suggests a number of steps and structural changes that set as a goal handling these challenges and opening the Israeli market for competition in many areas where there was inactivity for many years.

Market share of the two leading producers/suppliers in each category

Flour	
Olive oil	
Eggs	
Soy sauces	
Sweet spreads	
Oil	
Canned tomatoes	
Bread and buns	
Frozen potatoes	
Canned tuna	
White soy beverages	
Sweet snacks	
Packaged rice	
Cracker snacks	
Dry pasta	
Frozen vegetables	
Chocolate bars	
Butter	
Fresh milk	
Chips flavored snacks	
Pure instant coffee	
Morning cereal	
Unflavored soft cheeses	
Packaged hummus salads	
Yellow cheese	
Cottage cheese	
Frozen turkey	
Turkish coffee	
Tea	
Yogurt products (‘Leben’ and ‘Eshel’)	
Ketchup	
UHT milk	

Inequality

One of the main challenges facing Israeli economy is high levels of poverty and inequality. When the inequality data prior to direct government intervention is examined (taxes and transfer prices), Israel is located in a reasonable place and inequality level is slightly below (simple) average compared to OECD countries. However, due to the relatively low contribution of direct government policy to minimize poverty and inequality, the inequality level after government intervention is high when compared internationally. There are similar results when examining the extent of poverty data.

Gini index before and after direct government intervention
International comparison, the index is set 0 to 1, higher value represents higher inequality level
Before taxes and transfers
After taxes and transfers

Chile	
Mexico	
United States	
Turkey	
Israel	
Estonia	
UK	
Latvia	
Spain	
Greece	
Portugal	
Australia	
New Zealand	
Japan	
Italy	
Canada	
OECD	
Ireland	
Korea	
Poland	
Switzerland	
France	
Germany	
Hungary	
Netherland	
Luxemburg	
Sweden	
Austria	
Slovakia	
Belgium	
Czech Republic	
Finland	
Slovenia	
Denmark	
Norway	

Iceland	

Last available data, OECD – simple average of 35 countries

Source: OECD

Extent of poverty before and after direct government intervention

International comparison

Before taxes and transfers

After taxes and transfers

Israel	
United States	
Turkey	
Chile	
Mexico	
Estonia	
Japan	
Spain	
Greece	
Korea	
Latvia	
Portugal	
Italy	
Australia	
Canada	
OECD	
Poland	
UK	
Hungary	
Belgium	
New Zealand	
Slovenia	
Germany	
Austria	
Ireland	
Sweden	
Switzerland	
Luxemburg	
Netherland	
Slovakia	
France	
Norway	
Finland	
Czech Republic	
Denmark	

Iceland	

Last available data, OECD – simple average of 35 countries (including Latvia)
Source: OECD

Several factors contribute to the high inequality level in Israel. Some are social and cultural factors, such as the high level of heterogeneity in Israeli society and high number of children per household compared to developed countries. Other factors due to government policy are the relatively low general tax burden, and the relatively high weight of private consuming taxes, which are considered to being taxes that contribute to the increase in inequality. A major part of policy-related factors stem from government decisions from the beginning of the millennium, due to the fiscal crisis and low employment rates that characterized the economy in that period. In order to encourage employment and minimize the large deficit, Israeli government minimized transfer prices. These decisions contributed to a continuing trend of decrease in poverty and inequality based on economic income (prior to taxes and transfer prices). However, the abovementioned steps caused an increase in poverty and inequality based on net income (after taxes and transfer prices), at least in the short run, so that in 2006 the inequality level on this basis reached a record high. Since 2007 there has been a trend of slow decrease in poverty and inequality, and the increase in employment rates and fast growth have started to show their signs.

Gini index for inequality in Israel

Evolvement over time

- Policy effect (index points, right axis)
- Economic income inequality (left axis)
- Net income inequality (left axis)

Source: National Insurance Institute; processed by the Economic Research Department; chained series that correct changes in definitions and samples, excluding data for years 2012-2013. From 2012 onwards there was a change in the poll and the index is calculated including that change.

The strong contribution of increasing the labor market participation rates to minimize poverty and social gaps can be seen clearly: the extent of poverty among households with two full-time earners is less than 1%, whereas the extent of poverty in households with no earners is 68%. The demographic challenge, as such, is of importance also in this context.

Extent of poverty based on number of earners per household

- No earners
- One earner
- Two earners
- Two full-time earners

Source: National Insurance Institute; extent of poverty and social gaps report of 2014

The Demographic Challenge

At the core of the weaknesses and threats are the demographic trends and their implications for Israel's economic growth potential, its future labor market, its long-term budgetary stability and the gaps in Israeli society. Two main demographic developments are foreseen in the coming decades:

- **Population aging process** which will bring to a significant rise in the proportion of those aged 65 and over in the general population, and decrease in those who are at the main working-age group. The graying of the population is expected, among other things, to slow economic growth and significantly boost public expenditure, which is affected by the size of the elderly population in such areas as health and transfer payments.
- **Change in population composition** - In the coming decades a significant change is expected in the proportion of key population sectors. According to Central Bureau of Statistics forecasts, the proportion of the non-Haredi Jewish population is expected to fall from 70% in 2009 to 50% in 2059. The sharp decrease is mainly due to the projected increase in those years in the proportion of the Haredi population, from 10% to 27%, as well as in the proportion of the Arab population, from 20% to 23%. The growth in the percentage of these population segments, which have a low rate of participation in the labor market and relatively low work productivity, in the absence of suitable policy measures, will lead to slower growth and greater inequality and poverty.

Proportion of Arab Sector and Haredi Sector in the Population

- Haredi
- Arab

Source: Central Bureau of Statistics

The above demographic developments, especially the population aging process, have broad impact on the budget expenditure outline. In the diagram below are the results of a simulation conducted by the Economic Research Department in an attempt to quantify the impact of the expected demographic developments on public expenditure in the coming decades. According to the simulation results, the increase in the graying population rate is expected to increase the public expenditure on transfer prices (due to significant increase in old age pension payments) from 7.4% GDP in 2014 to 9.0% GDP in 2054, and the public expenditure on health from 5.3% GDP in 2014 to 6.1% GDP in 2054. This increase in public expenditure is gradual and will be felt also in the coming years.

Public expenditure outline in different sections, in % GDP

Health	
Education and higher education	
Transfer prices	
Budgetary pension	
Cumulative pension	

*The expenditure outline is calculated based on different assumptions, including absence of change in policy, and convergence in the labor market by Arabs and Haredi.
Source: Calculations of the Economic Research Department.
The demographic developments are expected to have a vast macro-economic impact. In recent years the main working-age group (ages 25-64) grew at a significantly faster rate than the general population, resulting in accelerated growth in this period. In the coming decades this trend is expected to reverse, with the main working-age group projected to grow at a slower rate than the general population. This development will impact negatively on the GDP growth rate already in the next decade: the growth potential of the economy in the next two decades will be 1% lower compared to the last 15 years, due solely to the slower growth rate of the working-age sector.

Beyond this, changes in the sectorial composition of the population may have a negative impact on the growth rate, since the Haredi and Arab sectors are characterized today by low employment rates and income levels compared to the non-Haredi Jewish sector. The impact is presented in the diagram below, calculated in simulation to quantify the impact of better convergence of the Arab and Haredi sectors in the economy. In this simulation the assumption is that convergence of Haredi and Arab sectors in the labor market ("convergence" scenario) so that the employment rate and average income of these sectors rises gradually and approaches the average in non-Haredi Jewish sector. This scenario is compared to a "business as usual" scenario where the ratio between the Arab and Haredi sectors, and the non-Haredi Jewish sector is maintained. From this simulation it can be seen that integrating the Arab and Haredi sectors into the labor market has a significant macro-economic impact, and in the long-run convergence in the labor market increases GDP by more than 10%. In 2015 terms, 10% increase is an additional NIS 117 billion for GDP or increase of about NIS 11,500 in GDP per capita.

Contribution of convergence to GDP

- Contribution to GDP (%, right axis)
- GDP – convergence
- GDP – business as usual

Source: Calculations of the Economic Research Department.

The convergence of Haredi and Arab sectors into the labor market has an impact also on inequality, and not only economic growth. Based on the simulation results, closing the gaps in employment rates and income is expected to minimize the economic inequality significantly (prior to taxes and transfer prices), this is compared to a scenario where income gaps remain steady over time. It can be seen from the diagram that the Gini index gap between both scenarios is significant at 2.2 Gini index points.

Convergence contribution: Gini index for economic inequality

- Base scenario
- Non-convergence scenario

Source: Calculations of the Economic Research Department.

Furthermore, in the absence of convergence in the work patterns by the Arab and Haredi sectors in the labor market, the budget deficit is expected to grow, causing divergence of Israel's debt-to-GDP ratio (or alternatively, significantly raising taxes on the working population), as opposed to a scenario of convergence in the labor market. It should be noted that divergence in the debt-to-GDP ratio would mean an inevitable economic crisis necessitating extremely painful fiscal measures. Therefore, the longer this challenge is left unaddressed, the greater will be the social and economic cost of treating it.

Effects of Demography on the Deficit, 2015-2059
Cumulative effect of demographic developments on the deficit*

- Excl. convergence
- Incl. convergence

*Deficit of the general government. Excluding the effect of an increase in interest payments due to higher debt.
Source: Calculations of the Economic Research Department.

There are various means that can be employed to improve long-term budgetary stability and ensure a sustainable fiscal policy (ensuring the government's ability to finance its current and future obligations without constantly increasing the tax burden, maintaining economic growth over time and providing in the future public services and subsidies on a par with those provided today, i.e. preserving intergenerational equity).

A key mean for contending with projected budgetary needs is freeing up of internal budget resources, such as public-debt reduction. Such a measure will enable financing future budgetary expenditures without raising the tax burden. Said action will enable reducing interest costs that bite off a significant chunk of the budget and freeing up these budgets for other needs. Maintaining a long-term downward debt trajectory, for instance, will augment budgetary stability and credibility, allowing the Israeli economy greater latitude to tackle future economic crises.

Other examples for freeing up of resources are reducing the share of defense expenditures in the budget, managing wage expenditure levels in the government and public sectors, and constant examination of existing expenditures accumulated in past programs and adjusting them to current needs and priorities.

To summarize, the continued development of Israel's economic growth engines, advancing structural changes to increase productivity and minimize cost of living, along with improvement in the public sector form of conduct could prevent the

erosion of its economic gains and even steer the country onto a track of high and sustainable growth. In the upcoming budget there is reference to demographic trends, as seen in the broad plan to integrate minorities, which focuses in many life areas, especially the labor market and human capital. Deepening the measures needed to be taken for full and best integration of all populations in Israel is critical for maintaining economic stability and improving growth rate as well as minimizing social gaps.

Economic Policy Objectives

In light of the challenges presented in the previous chapter, the Ministry of Finance has set up a broad economic plan comprised of fiscal objectives and structural changes, intended to provide answers to challenges and threats by utilizing Israel's comparable strengths and advantages and leveraging opportunities. All this by maintaining the fiscal frameworks for the medium and long run, according to the standards set by law and policy objectives formulated to reach them. As such, an analysis of the fiscal policy development and its impact over the past years has been conducted, and a plan was formulated to follow the objectives by use of a variety of available tools, including the multi-year budget plan and ongoing taxing policy.

The three key objectives underlying the State budget for 2017-2018 and the accompanying economic plan are: improving productivity and growth engines, dealing with competition barriers and cost of living, and reducing social gaps. These objectives reflect, in our opinion, the most serious issues facing the economy, and promoting wide structural changes in these areas along with completing fiscal measures, are key to promoting overall growth in the Israeli economy.

The fiscal measures to be taken provide a response to these challenges, and in general encourage growth and productivity (such as lowering corporate tax rates), increase market competitiveness (changes in the BEPS taxation), and promote equal opportunities (accumulated asset tax, severance pay taxation, and regulating Kibbutz members taxation). All these go along the basic objective of maintaining fiscal stabilization, which is imperative for economic growth and government's ability to implement the main objectives of the economic plan in its entirety.

- **Considering competition and cost of living**, the plan includes reforms that will increase competition in many industries within the economy and as such will reduce cost of living within the consumption, communications, and retail and consumer credit markets. A structural change in regulations has been proposed, that sets as a goal to correct competition barriers and tendencies that were created for a few players in the market and to the detriment of the consumer public, the change is expected to promote opening of certain industries for imports and reduction in prices of many products. In addition, additional measures are proposed in the plan, intended to strengthen the public health sector and stop moving resources into the private sector, and in transportation – opening the taxi industry to joint rides, which is expected to reduce prices and significantly improve customer service. In the housing industry, the plan proposes to expand the affordable housing ("Mechir Lamishtaken") plan in order to enlarge the housing supply, and to take steps for more efficient development activities within local municipalities. All these along with taxation measures to be conducted in order to cool demand.
- **In order to promote equal opportunities to all residents**, the plan suggests measures that set as a goal even distribution of resources among local municipalities

by establishing a governmental utilities fund which will allow differential distribution of government budgets in a way that will strengthen the weak municipalities and the suburbs, as well as a plan to incorporate the Arab sector within the economy. In addition, the plan suggests to enlarge the support in the applicable populations in order to improve their quality of living as well as increase the safety nets for self-employed workers and to take care of pension savings for them.

- **In order to increase productivity and promote growth**, the plan includes measures to develop trains in metropolitan areas as well as a plan to make Israel attractive for quality investments by foreign companies by encouraging them to transfer their intellectual property activities to Israel. Proposed measures for transferring the economy to natural gas, due to national strategic interest to reduce dependency in oil for transportation. In addition, a vast and inclusive measure will be promoted for ease of making businesses in Israel, among others, by minimizing the regulatory burden on the business sector.

The Budget Policy and Economic Plan

The fiscal policy

Strengthening Israel's fiscal stability and maintaining government credibility are imperative for exercising the economic plan goals. Under this framework and according to the required corrections set by the deficit reduction and budget expenditure restriction laws, a number of measures are proposed in order to convene the increase in budget expenditure to the set expenditure ceiling.

Background

Over the past decade a significant improvement was seen in Israel's fiscal stability, which was expressed by rapid decline in debt to GDP ratio during the period. The economic plan led from the beginning of the past decade, of balanced budget along reduction of debt to GDP ratio and monetary working space, were strengthening points for Israel at the economic crisis eve. Among others, one of the main factors contributing to the fast recovery from the crisis was the high fiscal stability of the economy on the eve of entering the crisis, which allowed the government full utilization of "automatic stabilizers".

On the contrary, in the past years there is a certain decline in the economy's growth, which caused a slowdown in the fiscal state. Other than fast growth in 2013, which was mainly influenced by the discovery of gas, the economy grew in the past years in a rate little under potential (although the GDP data update upwards several times, a factor that contributed to a limited reduction in debt to GDP ratio)

In addition, in the past years the fiscal policy was influenced significantly by political instability. The late elections in 2015 led to the absence of an approved budget for almost the whole year, so that until mid-November the government offices conducted based on 2014 budget. As a result, the deficit to GDP ratio was in a slightly declining

trend since 2012, and in each of the years 2013-2015 the actual deficit was below deficit ceiling set in the 2013-2014 budget. The decline in budget deficit was later reflected by the declining trend in public debt. The decline in world interest rates and the debt level allowed Israel's government to issue low yield bonds compared to issuance in previous years, which contributed to minimization of public expenditures on interest payments and reduction of public debt.

Main fiscal data
National debt Budget deficit
Source: Ministry of Finance, Central Bureau of Statistics

Absence of approved budget for 2015 until November of that year slowed down significantly the public consumption growth rate in the total GDP at the beginning of 2015, while the budget approval contributed to a sharp increase in the public growth rate in the last quarter of 2015.

Public consumption growth rate
Annually and quarterly rate changes in annual rate

- Annual growth
- Quarterly growth

Source: Central Bureau of Statistics

Although the relatively good results compared to the original budget plan, Israel is maintaining a high budgetary deficit in the past years compared to the international environment and compared to the fact that the economy is at near full employment capacity. This is despite a much better starting point than other developed countries, which many of them are still handling with the crisis damages, especially in the fiscal area. Israel was among the few countries (along Norway, Switzerland, and Singapore) that were able to reduce the debt to GDP ratio during the crisis years and immediately after, and enjoyed many good years of constant improvement in the average citizen's quality of living. Despite these beneficial conditions and a long period of positive business cycle, the structural deficit in Israel is among the highest in OECD counties, and lower only from countries that have economic abilities larger by much from those of Israel (Japan, UK, and the United States). Israel government did not succeed in using the momentum created in order to minimize significantly, as a policy decision, the high budgetary deficit, and preferred to transfer some of the surplus to continuing minimization of the tax burden and increasing budgetary expenditures. Moreover, in continuance with this trend, the government decided in the current budget to postpone one more time the measures for reducing the deficit by two years and set a deficit goal of 2.9% for years 2017-2018. In light of the current growth rate and the Ministry of Finance estimation for the macro status in the coming years, continuing the reduction in debt to GDP ratio in the next years poses a great challenge. Nonetheless, there are several measures planned (efficiency in all governmental offices as well as

minimizing waivers and tax distortions) in order to assist in bringing back the deficit into the declining trend beginning 2019.

The absence of minimization of budgetary deficit led to another significant implication, which is the frequent update of fiscal rules. In each of the last budgets the Ministry of Finance had to present new deficit goals as part of the State's budget approval process, and often was also required to update the expenditure in full, which harmed the government's policy credibility.

The structural deficit (% of GDP), International comparison, 2015

Luxemburg	
Greece	
Estonia	
Korea	
Iceland	
Austria	
Germany	
Switzerland	
Czech Republic	
Norway	
Sweden	
Finland	
Italy	
Portugal	
New Zealand	
Canada	
Netherlands	
Australia	
Belgium	
Slovenia	
Denmark	
Ireland	
Spain	
Hungary	
Poland	
France	
Israel	
United States	
UK	
Japan	

Source: OECD

Along with minimizing the monetary action space (which is not unique to Israel, however in Israel there are additional characteristics that limit the central bank's ability to act in order to stimulate the economy), expanding budgetary conduct in this period may limit the tolls available for policymakers in general when facing the next economic crisis.

Moreover, even in the absence of an external macroeconomic shock, which Israel as a small and open economy is highly exposed to, and given the continuance of beneficial conditions that will allow Israel to continue growing reaching potential, managing the ongoing budgetary deficit affects directly the prioritization of government. This is because as time passes the State will find it difficult to continue reducing the debt to GDP ratio, which may cause an increase in cost of debt funding (in a period where normalization of world interest rates is expected, providing a base to set the local debt rate).

Due to the above said, the importance of maintaining the fiscal rules is of first degree. The "Numerator" law, set in at the beginning of 2016, is an imperative measure taken by the government in the right direction, such that this mechanism is expected to help improve budgetary conduct in the medium run, and as such empower the government's ability to meet the multi-year fiscal goals.

Evolvement of budget components and public expenditure over time

During the decade between 2008-2018, the real budgetary expenditure will grow by 32%, annual average growth of 3.2%. While the growth rate was used as a safety net during the years prior to 2011, which in many ways assisted in strengthening the fiscal stability and reducing the debt to GDP ratio, the slowdown beginning in the last years is threatening the continuance of this trend, especially in light of the actual significant increases that occurred in that period along with the expenditure.

The real growth in budgetary expenditure compared to GDP growth rate

- Growth rate
- Real expenditure increase

* The real growth is calculated based on the average annual change in CPI, and in estimation to years 2017 and 2018. The growth in 2017 excludes a technical change in the defense budget, which listed NIS 9 billion (2.6% out of 7.4% real growth that year) as a conditional expenditure in income, and as such is excluded from the budget. In prior years there may be deviations from the actual real growth due to recording changes. Source: Ministry of Finance, Central Bureau of Statistics

When examining the budget components over the last years, the decline in interest expenditure from total budget is clear, from a level of 14.6% to 10.6% of total budget, a real accumulated decline of about 4.9% over the period (annual average decline of 0.7%). This decline is due to improved debt to GDP ratio and decline in interest rates on new debt. This point emphasizes the importance in freeing up resources that do not contribute to growth and resident welfare within the budget framework for expanding vital public services which encourage growth. Interest expenditure is dictated in the short run by market conditions and overall financing needs, in a way that the State does not have concrete judgment in the allocation decision, however managing a correct budget policy in the medium and long run is imperative for control over these expenditures and minimizing them to the required minimum.

At the same time, the main increases occurred in the health, education and higher education, and welfare. The accumulated average real increase in these sectors was 59.2% over the last ten years, average growth of 4.7% per year.

Main expenditure distribution by sector, of total budget expenditure, 2005-2018
Original budget, NIS billions, current prices

- Interest
- Office headquarters
- Health
- Infrastructure and economy industries
- Welfare and social security
- Education and higher education
- Defense and public order

Source: Ministry of Finance

Observing the broad government's accounting data, which includes total revenue and expenditures of the public sector (including social security, national institutes, non-profit public organizations, and local municipalities), provides better insight on the fiscal trends over the years, compared to examination of the State's budget alone.

When examining the division of public expenditure amongst its main components over time, it is clear that between years 2006-2009 there was a significant increase (about 4% points) in the weight of civil expenditure of the total public expenditure. This increase is mainly due to the fast growth rate of civil expenditure along low growth rate of defense expenditure on the background of stability in the national security status. In years 2010-2013 there was continued growth in the civil expenditure weight, however the growth rate decreased significantly. In years 2014-2016 the weight of civil expenditure was stable, and it may be assumed that operation "Tzuk Eitan" contributed, at least in part, to the stabilization, since the defense expenditure weight from the total public expenditure increased that year. Returning to a declining trend in the defense expenditure in the coming years depends mainly in the government's ability to comply with the multiyear summary signed with the

Ministry of Defense at the end of 2015, which expires in 5 years, as well as in the geopolitical developments in the region and the immediate national threat level for Israeli residents.

The increase in public expenditure over the last decade

- Interest expenditure
- Defense expenditure
- Civil expenditure
- Civil expenditure weight of total public expenditure

Source: Central Bureau of Statistics

One of the main phenomena of the last two decades is minimizing the public expenditure to GDP in about 10%. This minimization was possible due to the decline in defense expenditures and freeing up resources from interest expenditures, which declined significantly over time. Along the stability in defense expenditures, there is doubt as to the government's ability to continue minimizing the interest expenditures, which were due to a low interest rate global environment and as such a sharp decline in Israel's national debt, a trend that slowed down over the last years and is expected to stop temporarily in years 2017 and 2018, in light of the planned deficit.

Development of main components in the public expenditure

- Interest
- Defense
- Civil
- Public

Source: Central Bureau of Statistics

Budgetary Policy Principles

The budget is determined according to fiscal rules set by law. The two rules set by law are: restriction on the expenditure increase which determines the total budget expenditure every year, and the deficit ceiling rule which determines the maximum budget deficit as a percentage of GDP used for planning the annual budget.

Due to difficulties in complying with the above two laws, the "Numerator" rule has been applied since 2016. This is a multiyear mechanism limiting the government's ability to make new budgetary decisions outside the budget approval process without providing a suitable source. The "Numerator" mechanism is expected to strengthen transparency and the ability to control future liabilities, and as such – the stability of budgetary frameworks and fiscal targets in the medium run.

The mechanism has already been found useful in the first 10 months of 2016, even if it created slightly different dynamics in the budget approval process, which has now become the only place where public resources may be allocated. That said, the

adaptation of government and the Knesset to the multiyear mechanism is an ongoing process, with the results expected to be seen only in the medium run. In the short run, in continuation to past years trend, which included frequent update of the fiscal rules in a way that harmed system stability and credibility, there was a need for update in years 2017 and 2018 as well, as specified below.

- **The restriction on expenditure increase rule** – after five years where a rule that set the constant real growth in expenditure has been applied, approaching the 2009 State budget restrictions on the expenditure increase have been set, which will be based on a weighted calculation that considers the average growth over a decade in relation to the actual debt to GDP ratio and the target debt to GDP ratio in the medium run. However, since a major part of growth over the last decade was due to fast increase in working age group population, a dynamic that reversed over the last years and decreased the growth potential in the economy, approaching the 2015-2016 budget, the rule was corrected and set that the allowed budget expenditure increase will be determined by the average population growth over the last three years in addition of the target debt to GDP ratio for the long run of 50% compared to the actual debt to GDP ratio. This expenditure rule resulted in real planned growth expenditure rate to be 2.7% per year. In practice, due to accumulation of past liabilities and coalition agreements there was a need to enlarge the expenditure base starting 2017 by additional 2% (in addition to the permanent 2% of 2015) and in 2018 an additional 0.4% that will be valid for 2018 and 2019 only.

  In light of unexpected developments in the CPI over the last years, which required a correction to the budget base in coming years based on forecast deviations from past years (a correction that was very difficult to execute and as such did not occur), there was a need to reexamine the real expenditure rule's suitability to the way the State's budget is conducted. It was decided that for 2017 and 2018 budget years that the expenditure rule will be nominal in the short run, and will include a convergence mechanism to actual CPI in previous years (in order to prevent undesired real growth in the medium run). The mechanism determines that starting 2019 the allowed increase will be linked to the center inflation target of the Bank of Israel (2%) and in following years will gradually converge the deviations that actually occurred over three years. In the medium and long run (after three years of commence), the mechanism will converge to the three year average of last published CPI.

- **The deficit ceiling rule** – following the corrections along the expenditure and decision to reduce taxes in the budget for years 2017 and 2018, there was a need to correct the deficit ceiling rule once again, which in essence postpones the reduction by two years. As such it was determined that the deficit ceiling for years 2017 and 2018 will increase and stand on 2.9% of GDP instead of 2.5% and 2.0% respectively. Afterwards, the decreasing deficit original path will be applied, according to which the deficit ceiling for 2019 will be 2.5% and following will be a 0.25% decrease per year until reaching 1.5% in 2023. According to the new path, the deficit ceiling will

be 1.5% in 2023 onwards. Although it is expected that in the next two years the debt to GDP ratio will be stable due to postponing the deficit reduction, the return to declining path as of 2019 is vital to strengthening the economy, and complying with it will allow reduction of debt to GDP ratio to 60% approaching the next decade, assuming the growth in the next years to be close to growth potential in the economy, standing at 3%. Non maintaining the path may cause deterioration in the debt to GDP ratio already in the medium-short run, an additional harm to the government's fiscal credibility, and significant minimization of government's ability to react in case of an additional economic crisis. A development of this kind will worsen the negative effect of the crisis and take a high economic and social toll in dealing with it.

The diagram below presents a simulation of evolvement of debt to GDP ratio by the end of the decade, according to three deficit scenarios and under the assumption the growth is similar to the economy's potential growth in the medium run (about 3%). The first scenario shows budget deficit remaining at 2.9%, similar to the original deficit set for years 2015 and 2016, a scenario leading to freeze of the debt to GDP ratio in next years and increase in case of economic crisis (this scenario does not show in the diagram). The second scenario assumes the government will comply with the expenditure restriction, however no additional adjustments will be made along revenues, a scenario where the deficit will increase in the first years and will decrease slowly in the future, and as such will lead to increase in debt to GDP ratio in the first years and then will be leveled. The third scenario assumes compliance with the new deficit path, a scenario allowing decline of debt to GDP ratio under 60% towards the middle of the next decade.

Simulation for debt to GDP ratio for years 2015-2025 according to different deficit scenarios

- Scenario for compliance with deficit target
- Scenario for stabilizing the debt to GDP ratio
- Scenario for decrease in revenues and deficit result

Source: Ministry of Finance

Along the fiscal rules set in order to maintain fiscal stability, the budget composition has a significant influence on the economic stability, Israel's economy future growth, and the services provided to its citizens. Accordingly, the budget is built based on priorities that allow focus for additions according to the economic policy goals, freeing up resources, and making adjustments in the right way economically. Nonetheless, every year there is an increase in government liabilities as a result of combining the existing expenditure plans and from new plans that the government decides upon. Along this growth in liabilities, a reexamination of past liabilities and previous plans is not being held. An absence of such reexamination of existing

expenditures leads to difficulty in the government's offices ability to act according to the priorities and improve achievements in the needed current plans.

Spending review is a useful tool acceptable in developed countries to handling these issues by systematically examining the current expenditures. This examination allows to develop means for savings in expenditures and increasing the efficiency of government expenditure. In general, the goal of this process it to create a fiscal spread to implement new plans, and as such allow adjustments for government activities to changing priorities without harming the fiscal stability. About half of the OECD countries use the examination of expenditures as a tool to reach these goals.

In 2016, Israel started the use of examining expenditures. The central committee for examining expenditures published a procedure for first stage examination of 2017 budget expenditures. This procedure invited all governmental offices to submit proposals for applicable plans for the examination process and set an efficiency target of 0.2% from the overall offices budget base that the offices are required to reach by 2019 the latest.

The committee discussed all proposals submitted and approved the appropriate plans for the examination process, according to the criteria set in the protocol. Based on the analysis done by government offices, the professional estimations presented to the committee include: expenditure breakdown for the plan, success points to examine the plan's achievement, proposals for changing strategy and how to execute them, as well as estimation as to the future savings rate as a result of the efficiency process. In addition, as required by the committee, the government offices presented the total resources and assistance needed from the committee in order to realize the different efficiency plans.

For those plans that the committee has recommended to begin and implement, there is a process building up these days for a detailed efficiency plan. The efficiency plan includes the offices obligation to stand within certain timeframes, milestones, and efficiency outputs as well as commitment and assistance from the expenditure examination committee with resources, subject to proof of need. This plan will be approved in the expenditure examination committee together with setting reporting deadlines regarding progress and public publication of complying with main milestones along the process. The budgetary significance of the completed expenditure examination will be taking place in 2017 budget and onwards, and it is the Ministry of Finance's intent to promote an additional process towards 2018.

Convergence within fiscal frameworks

The budgetary expenditure for 2017 for calculating the expenditure limit stands at NIS 359.7 billion. The nominal increase in the budgetary expenditure for 2017 is 6% relative to the 2016 budget (excluding a technical correction in the form of recording the American aid).

This increase of NIS 20.9 billion consists of a real addition of NIS 9.5 billion (based on the expenditure rule), an addition of NIS 3.7 billion for adjusting the budget to 2017 prices, a one-time addition (box) of NIS 0.8 billion, and a deviation from expenditure limit that adds to the budget base totaling NIS 6.8 billion. As such, the calculation of expenditure limit for 2017 includes a change in the recording of American aid which leads to decrease of the allowed expenditure, in a way that does not affect the budgetary deficit, totaling NIS 8.9 billion in the budget base.

The budgetary expenditure for 2018 for calculating the expenditure limit stands at NIS 376.7 billion. The nominal increase in the budgetary expenditure for 2018 is 4.7% relative to the 2017 budget. The nominal increase is comprised of real addition of NIS 10.1 billion (based on the expenditure rule), increase in prices of NIS 5.4 billion for updating the budget to 2018 prices and one-time deviation from the expenditure limit of NIS 1.6 billion.

The deficit for 2017 is forecast at 2.9% of GDP, assuming 2.7% real growth in 2017 (the nominal GDP forecast for 2017 is NIS 1,250 billion). The deficit for 2018 is forecast at 2.9% of GDP, assuming 2.8% real growth in 2017 (the nominal GDP forecast for 2018 is NIS 1,307 billion).

As part of the budget proposal and in order to stay within the fiscal framework, the government must make adjustments in 2017-2018 both on the revenue side and on the expenditure side totaling NIS 8.3 and 13.5 billion, respectively.

For the purpose of formulating recommendations for the proposed adjustments on the expenditure and revenue sides, while taking feasibility considerations into account, various parameters were examined, such as economic efficiency, contribution to correcting distortions in the allocation of resources in the economy, contribution to growth, and contribution to strengthening weak population sectors and reducing gaps.

The key measures on the expenditure side are: cross border efficiency in government offices, transferring accumulated profits from “Mifal Hapais”, and postponing the salary agreement with the Histadrut by six months. The key measures proposed on the State revenue side are: multiple asset tax, lowering the tax benefit for employer severance pay provision to four times the average salary, comparing the tax and social security payments of Kibbutz members to those of the rest of the population, withdrawing royalties from the Airport Authority, charging dividends from

government corporation, taxing wallet companies, as well as lowering the waiver ceiling on gambling taxation.

In addition, in order to maintain the deficit target it was decided to advance the provision for asset tax funds totaling NIS 0.75 billion for each of the years 2017 and 2018 to 2016 year.

The main increases in State budget for fiscal years 2017 and 2018 were set according to government priorities and include:

- Increase in the Ministry of Defense budget of NIS 7.1 billion for 2018 compared to 2016 (excluding the technical correction in the American aid budget);
- Increase in the Ministry of Health budget of NIS 5.9 billion for 2018 compared to 2016;
- Increase in the Ministry of Transportation budget of NIS 5.1 billion for 2018 compared to 2016;
- Increase in the Social Security budget of NIS 4.6 billion for 2018 compared to 2016;
- Increase in the Ministry of Education budget of NIS 4.4 billion for 2018 compared to 2016;
- Significant increases in the Ministry of Public Safety and Ministry of Social Affairs budgets.

Main increases in State's budget for 2018 compared to 2016
Current prices

- Ministry of Housing and Construction
- Ministry of Health
- Local Municipalities
- Ministry of Transportation
- Ministry of Public Safety
- Ministry of Social Affairs
- Transfers to Social Security
- Defense*
- Veterans
- Pension for Holocaust Survivors
- Higher Education
- Ministry of Education

* Deducting the technical correction
Source: Ministry of Finance

Changes in Taxation Policy

Tax collection in Israel is the main source of State revenues. The manner in which assessments and audits are conducted and collection is enforced directly affect State revenues.

In recent years, public revenues were found to have eroded due to the proliferation of such phenomena as money laundering, tax evasion and improper use of aggressive tax planning that takes advantage of loopholes and gray areas in tax law in order to claim entitlement to tax benefits contrary to the spirit of the law and the legislator's intention. In other words, there is a considerable gap between the reported economic activity and the actual economic activity (hereinafter – "black economy").

Therefore, in addition to expanding the tax base through the cancellation of exemptions, great importance attaches to strengthening enforcement and dealing with Israel's black economy. Reducing the gap between reported activity and actual activity, along with more effective enforcement, should significantly expand the tax base in Israel, thereby increasing the government's resources as well as creating a more just and equitable tax system by reducing the competitive advantage enjoyed by tax-evading businesses over law-abiding businesses.

In 2013 a plan for increased enforcement was approved, which included improvement of the IRS authorities, additional manpower and additional budget. Moreover, under the economic plan framework for years 2015-2016 structural issues within the tax system were handled, in order to bring divisional justice and minimization of phenomena that harm tax collection and as a result harm also the middle class taxpayers. These actions included, among others, reporting obligation to the IRS when performing an action opposed the IRS position and providing a tax benefit; change in IRS reporting method to online reporting; taxing income from “non-competition” payments; correction to the law prohibiting money laundering that will allow transfer of information from the Ministry for money laundering prohibition to the IRS and providing a possibility to determine partial assessment by leaving the option for full assessment to be completed by the taxpayer; and canceling the ability for insurance companies to claim amounts paid to an agent for commission as current expense. Moreover, it was approved in 2016 that fraud according to the Income Tax Ordinance (section 220) will be defined as original felony according to the money laundering prohibition. This amendment will allow improvement in the tax enforcement activities and minimizing the money laundering extent in Israel.

Under the economic plan for 2017-2018 years additional law amendments are brought forward in order to deal with tax evasion and increase the battle against unlawful capital, as well as amendments dealing with structural issues in the tax system that are yet to be addressed. The amendments include, among others, amending the tax law in a way that will prevent individuals from becoming a corporation for the purpose of

avoiding real tax payments (wallet corporation), defining a rebuttable presumption with regards to defining a company's residency, managing international corporations' method for registration and reporting, resolving the method for immaterial asset depreciation for tax purposes, setting up a short mechanism for appreciation tax at the time of sale of residency apartment, as well as resolving the recognition in financing expenses.

In addition, a law proposal to minimize the use of cash in the Israeli economy, as done in other global processes, is sitting with the constitution, law and justice committee.

Following the unusual tax collection trend in 2016 compared to the forecast (which led to an upward update of NIS 5 billion for tax revenue forecast, see chapter 5), it has been decided to continue reducing taxes in the upcoming budget plan as well. These reductions are expected to encourage growth by minimizing negative incentives for work and expansion of economic activity by companies, as acceptable in economic theory. The decision includes gradual reduction of corporate tax by an additional percent for each of the years 2017-2018, until a rate of 23% (from a 25% rate today, further to the reduction made in 2016).

In addition, as part of the overall view of the tax system, the income tax brackets have also been reduced vertically, in a way that will maintain the weight of the higher tax brackets to the effective tax to be paid by company owners, and in a way that will allow for some relief to the lower brackets. This move is possible due to a complementing change in the income tax, which is the increase of the marginal tax imposed on the taxpayer's total income from all sources, above a certain value of assets, from 2% today to 3%, and reducing the threshold of asset value upon which this tax will be imposed.

The overall cost of tax reduction steps is expected to total NIS 2.8 billion. NIS 1.9 billion of them will mature in 2017 (1 billion cost of net tax reduction, and additional NIS 900 million cost of reducing corporate tax rates), and additional NIS 900 million will mature in 2018, with an additional corporate tax rate reduction. In addition, it is planned to advance half of the provision intended to property tax fund in years 2017-2018 to 2016 (NIS 1.5 billion), and spreading the remaining half equally over the two years.

Regulating Kibbutz and Kibbutz Members Taxation for the IRS and Social Security

The Israeli surrounding includes different types of settlements. Among the unique ones are the Kibbutz and communal Moshav. These settlements, that were established prior to Israel becoming a State, were based on different and unusual characteristics from the ordinary settlement, including community and equality both in consumption and ownership of the general population within the properties and assets as well as in

the areas of settlement and work. The uniqueness of these settlements justified at that time the existence of a tax system applicable to them only, and as such a special treatment was set in the Israeli Tax Ordinance, and in the social security law different rules and arrangements as to the Kibbutz status both in collecting social security payments and in pension entitlement.

The crisis' that occurred in the 80's and 90's in the Kibbutz and communal Moshav changed the character of most of them in a way that they are no longer with the same equality characteristics as in the past.

Under the economic plan there is an amendment to the way Kibbutz and Kibbutz members will be taxed, so that a distinction is made between the communal Kibbutz and the renewing Kibbutz. Where there is a major gap between member incomes, it means that the Kibbutz is no longer communal in its entirety, and the taxation will be similar to the rest of Israel's population.

As to the communal Kibbutz, some adjustments were made to the experiment model according to changes that occurred since it was formed.

Optimizing the Legal Gambling Market in Israel and Allocating Revenues to the Public

In October 2015 the Minister of Finance appointed the general manager of the office to stand at the head of the committee that will examine the optimization of the gambling market and a model for allocating its revenues (hereinafter, the "committee"). The committee was requested to examine whether it is possible to optimize the operating expenses of Mifal Hapais and the council for settling sports gambling (hereinafter, the "bodies"), the effect of the legal gambling sector in Israel, the social-economic implications of this sector and the mechanisms for allocating revenues earned by the bodies, and to suggest overall action plans in the legal gambling sector that will be implemented during 2016. The committee has performed a deep analysis of the bodies operating legal gambling in Israel, performed international comparisons with developed countries, and conducted meetings with representatives from all of the above relevant subjects. Following the analysis and meetings conducted, the committee has recommended that the Minister of Finance will set into law, with the agreement of Mifal Hapais, limitations on the bodies' overhead, limit on the legal gambling market size, cancelation of games with tendency for addiction, and additional changes. The implementation of the said changes, which are included in the economic plan for years 2017 and 2018, will reduce the operating expenses of these bodies, so that the transferred portion each year for public uses will grow and will minimize significantly the negative effects of the legal gambling sector in Israel.

Signing a Budgetary Summary with the Ministry of Defense

For years, the State's budget composition is in conflict between the demand to increase defense expenditures and the economy's needed and civil services. It has been found that in recent years there is a structural gap that is deepening in the composition of the defense budget due to a non-sustainable growth in manpower expenses (especially pension, salaries, and rehabilitation) that bites off the budgets directed to the core military occupation – intensification and maintaining fitness and readiness. On November 2015 a summary of principles regarding defense budget was signed between the Ministry of Finance and Defense for years 2015-2020 (hereinafter, the "budgetary summary"), and on May 2016 a principles summary was signed for the way of implementing the budgetary summary. The budgetary summary produces budgetary stability to the defense budget, allowing leading a multiyear plan for the next five years, along structural changes that target efficiency, freeing up resources and ensuring satisfactory budgetary response to the core military occupation.

Below is the main budgetary summary:

- Setting a multiyear plan for years 2016-2020.
- Setting the expenditure budget on salary and pension.
- Implementation of a new model as follows:
  - Changing the officers' model and adding "a second organizational gate" (age 35 and seniority of at least 14 years) under which officers will be released according to annual quotas.
  - Maintain the officers' population as commanding chain while making the organization younger, so that retirement age will be 42 the earliest, and average age will be 43.
  - Maintain the Nagadim as a professional population in all areas. This will cause the age of retirement to increase to 53.
  - Fixation of manpower numbers by ranks.
  - Transferring roles to civil, according to annual civilization caps, which are not in the core military occupation.
  - Setting annual retirement caps to officers and Nagadim.
  - Lowering the average pension payment to officers, not exceeding NIS 12 thousand.
  - Setting cumulative pension agreement in regulations and limiting mediation pension, not to exceed the budgetary pension paid to individuals.
- Fixation of the R&D budget and maintain its real value over years.
- Shortening the military service period to two and a half years as of June 2020.
- Increasing allowance payments to soldiers by 50%.
- Transparency
  - Full transparency between offices
  - Providing direct access to the Ministry of Finance, including all departments, to all available data in the Ministry of Defense and the IDF concerning budget, including salary and pension data, manpower, change report and commitment access.
  - Transferring a quarterly project report of projects with the highest budgetary cost in the defense system.

- Rehabilitation and family
  - Implementation of the Goren committee recommendations
  - Setting the benefits regarding rehabilitation into law
  - Establishing a public committee for rehabilitation of handicapped and families
  - Separating the rehabilitation and families budget from the defense budget

Reducing the Defense Burden

The Ministry of Defense makes use of national resources without taking into account the defense burden due to the alternative cost of these resources, in general: manpower, land, frequencies.

- **Mandatory Military Service** – mandatory military service in Israel stands today on 24 months for women and 32 months for men. In comparison, these are among the longest in the world. The alternative cost of a soldier's time is much higher than the cost of serving in the military – cost mainly due to the influence of the military service on the labor market, estimated at 4.3% GDP per year. According to the budgetary summary, in the Cabinet decision on August 11, 2016 shortening the military service for men to 30 months starting June 2020.
- **Land** – the IDF owns about 39% of all Israel's land. Of the facilities located in metropolitan areas, the majority is in popular residency demand areas. As such there are two main projects that target freeing up land for residency: transfer of Aman and Tikshuv base to the Negev, and Shohan project – economic eviction of IDF bases from high demand areas (government decision 2392 as of January 4, 2015). The mentioned steps will lead to marketing of approximately 60,000 housing units in popular demand areas.
- **Planning Limitations** – the IDF restricts the use of 40% of all Israel land (beyond the land under its ownership) which restrict planning for civil needs. As part of the budgetary summary, an inter-office team has been established to examine the use of national resources, including use of land and planning.
- **Frequencies** – frequencies are resources in shortage and are a vital component in the technological and economic development. As such, frequencies have high economic value. The defense system is making a wide use in a variety of frequencies without paying a fee. Work is conducted for diverting frequency resources to civil use and considering their cost by the Ministry of Defense.

The Economic Plan: Structural Changes

Topic A – Competition and Cost of Living

Reform in Standards

The standards department has a major influence on the Israeli market, which is expressed in two main areas: writing and updating the standards obligating the

business sector and examination obligation according to the standards for goods imported into Israel. The Standards Institution of Israel works in these two areas and is the body in charge of the laws in the standards area.

Within its current framework, certain failures exist with regards to the institution, which have a significant economic meaning to the economy. The first main failure is in the standards committees' composition within the Standards Institution. These committees, which write and process the standards prior to submission in front of governmental factors in order to become an official standard, are controlled many times by business factors with an explicit interest in setting the standard. These business factors make use in the standard, so that it will ensure maintenance of their market leadership in the relevant market, and create entry barriers for imports or local competitors. This control is seen by the roles taken by the chairmen or vice president or a number of representatives that allows dominance in the decision making of the different committees.

Another main failure is the monopoly of the Standards Institution in the market for examining imported products. The Standards law of 1953 states that it is prohibited to manufacture, import or make use in a commodity with an official standard, unless the commodity complies with the standard criteria. The Israeli law states that the Standards Institution of Israel is the sole body to approve compliance with the official standard in order to enter Israel.

The current status harms the business sector greatly, among others, due to the high cost of examinations and relatively low service quality, which includes significant delay in the examination processes. This situation poses a significant import barrier restricting competition, among others, by small and medium importers that are pushed aside due to bureaucracy costs. These costs are transferred to the consumer and contribute directly and indirectly to the economy's cost of living.

From an examination conducted by a governmental team it seems that the direct economy's cost as a result of the Standards Institution monopoly on testing the matching of goods to the applicable standard, is estimated at half a billion NIS per year. This is without taking into account the indirect costs and expanding the product variety from changing the current status.

The reform in standards handles these failures. Under the arrangement law proposal for the State's economy for years 2017-2018, a law proposal will advance putting forward a balanced composition of members in the standards committees while nominating chairmen's at the head of the committees, professional but neutral as much as possible, and increasing transparency and efficiency in the institution's activity. Additionally, an amendment will be suggested that will allow competition in the market of testing matching to the standard, while entering private labs into the market and emphasizing the control means needed to assure public safety. In addition,

the reform is accelerating the international standards adoption process compared to the original or unique Israeli standard.

Reduction in Toiletries and Cosmetics Prices

The Israeli cosmetics market is assessed at NIS 6 billion per year. This market is characterized by high centralization in two sections: the production and import section, and retail section. In the production and import section, while examining several selected products – toothpaste, deodorant, shampoo, tanning products and more, it has been found that the market share of the three leading companies (CR3) ranges between 66-96%. This centralization is due to, among others, heavy regulation on approval for marketing and selling cosmetics. Due to the existing regulation, the time for approval to market a single product is a few months.

In the retail section, the market share of the leading pharmacy chain in a sample of selected products ranges between 16-44%. This centralization is due to, among others, the consumer's inability to compare prices between pharmacy chains and food and retail chains, which also sell a variety of toiletries, hygiene and cosmetics.

Under the arrangements law, two law amendments will be presented to the Knesset, in order to reduce the centralization level in this market, and as a consequence to reduce consumer prices. First the pharmacist's order will be amended in an attempt to create a more simple regulation, based on European regulation, by which there is no prerequisite approval needed for marketing cosmetics, but only an announcement of the business regarding the new cosmetic entry to the market. It should be noted that additional standards will be required after law amendments. In addition, a chapter regarding price transparency will be amended in the law for promoting competition in the food industry, 2014, by which also the pharmacy chains will be required to publish the sold consumer products in the chain branches. This will allow the consumer to make an educated and cheaper shopping of its current consumer basket.

Reduction in Appliances Prices

The home appliance market is assessed at NIS 9 billion per year, and most appliances are imported. The vertical integration phenomena is notable, such that part of the producers or importers are also the owners of the chains and stores of appliances. This situation leads to four major groups controlling about 40% of the market. This market structure is due to existing regulation that makes it difficult to import the products. According to existing regulation, the first time an appliance is imported into Israel, the importer is requested to send the products to the Standards Institution for checking compliance with the required standards (safety standards, power, and more), and in addition to these tests, the Standards Institution performs energy efficiency tests according to the Ministry of National Infrastructure, Energy and Water. Based on the test results, the results are sent to the Ministry of Energy and a permit is issued for

compliance with the energy demands and the applicable labeling is placed on the product, all this prior to the product being actually imported.

This process of testing the product and receiving a permit prior to importing takes a long time, contributes to costs imposed on importers and many times serves as a barrier for small and medium importers, that find it difficult to meet the additional costs.

Consequently, the Ministry of National Infrastructure, Energy and Water, in accordance with the Ministry of Finance, will promote over the upcoming months, law amendments which will replace the prerequisite permit with the importer's statement based on the lab results as to the energy utilization of the product. With this statement the importer will receive an approval or denial to market the product in Israel, and this will save time and expensive resources. As such, the office will be granted with authority to oversee markets and enforce in order to ensure maintenance of the energy utilization in the Israeli economy. Shortening the amount of time for the permits is expected to increase competition in the market and as such increase the variety of products and reduce the cost of living.

Increasing Competition in the Communications Market

The multichannel TV market in Israel is a duopoly of two broadcasting platforms that hold 94% market share of the TV subscribers. As such there is a situation where consumers have minimal choice, pay relatively high prices, and development of various products is delaying. As such it is recommended, under the economic plan, to make law amendments that will allow operation of Idan Plus by a competitive factor, with an intent that it will work for its operation and development to become a competitive substitute to the existing broadcasting platforms. Operation of the channel by a competitive source will bring improvement in quality of broadcast service that are distributed across the country, additional attractive channels, and reduction in costs for its operation. In addition, an amendment is promoted so that the operating factor of Idan Plus will be obligated to broadcast also in the internet, and as such allow the entrance of new TV suppliers. Moreover, it is proposed to conduct regulation on Sports channels, so that those will not be an entry barrier for new players into the multichannel TV market, along with regulation expected to reduce costs of Sports material, so that it will become accessible to the wide public.

These measures' target is to increase competition in the market, which will reduce cost of living and broaden the service and variety of products offered to the public.

An additional sector in Israel's communications industry where a duopoly exists is the landline sector. The duopoly of Bezeq and Hot is the significant factor for absence of competition in this sector (in which Bezeq is a declared monopoly) and it affects the competition in the entire communications market.

As such, Hot and Bezeq present surplus profits in the infrastructure sector, which may be translated into influence on other operation activities in the communications market, such as cellular and TV. In addition, lack of competition in the infrastructure sector creates a negative incentive for investments, and delays technological advancements and improvement of customer service provided to the business sector and Israel households.

For comparison purposes, the differences may be seen between the cellular market, which went through major reform a few years ago and where active competition exists, and between the infrastructure market where there is a said duopoly:

Cellular market share

- Pelephone
- Cellcom
- Partner
- Hot Mobile
- Golan

Landline market share

- Hot
- Bezeq

Source: the companies' financial statements for 2015

As can be seen, while the infrastructure market is divided between two competitors, the cellular market is divided between five competing operators. An additional operator (Exphone Corporation) entered into a joint agreement with Cellcom and is expected to enter the market in the following months. The difference in the level of competition affects, among others, the business results of the companies as follows:

Comparison of EBITDA rates by sector activity

- EBITDA rate

- Hot Mobile
- Golan
- Partner
- Pelephone
- Cellcom
- Hot Cable
- Bezeq Landline

Source: the companies' financial statements for 2015

As such, while Bezeq and Hot enjoy the highest profitability rates in the infrastructure market (Bezeq landline and Hot cable, which includes the TV services), the cellular operators present much lower profitability data. It may be that the profitability rates of Hot Mobile in the cellular sector stem from Hot Cable's ability to cross-subsidize this activity. Additional positive aspects that rise from the competition level in the cellular market are increase in service consumption by the entire public (with emphasis on DATA), reduction in prices, and competition amongst competitors on the quality of customer service.

As such, it is proposed to lower barriers in order to allow competitors to enter the communications market to lay independent infrastructure that will assist in increasing the competition in the broadband infrastructure sector in Israel and will bring significant news to the Israeli public, with an emphasis on technological advancement and for better service to price ratio.

Competition in the Credit and Retail Banking Markets

The retail credit market is characterized by high concentration. Five large banking groups (including credit card companies under their ownership) hold 91% of total household credit not for housing. In the small business credit market the rate of these five groups is even higher. In addition, the banking market is characterized by high concentration. The five banking groups hold 96% of the system's assets. Out of willingness to encourage competition in the retail credit and banking markets and in order to reduce centralization, the Ministry of Finance together with additional factors has promoted over the last two years several meaningful steps:

- Lowering the information barrier in the credit and banking markets – set into law establishing a database for credit data in the Bank of Israel which can be given to every credit provider in the market (via intermediation of credit agencies), credit rating of each potential borrower, and organizing presentation of banking ID to the bank customers, in order to reflect the banking status in an inclusive and organized manner.
- Regulatory reliefs to institutional bodies – cancelling the need for sufficient assurance and enlarging the total amount that can be invested without rating. These steps will ease the entrance of institutional bodies into the retail credit market.
- Separation of the credit card companies – promoting law that will organize the separation of credit card companies from the two largest banks and minimize bank holdings in joint banking service companies, which is a payment system in the credit card market.
- Expanding the capital resources for non-bank credit providers – setting in law that an option will be given to outside of bank credit providers to issue corporate bonds to the public for the purpose of raising capital.
- Decreasing the entry barriers into the banking market in the IT and banking capital demand areas – new instructions given by the supervisor of banks to provide the option for several banks to rely on one IT system and providing the option for one bank to

provide IT services to another bank. New instructions provided by the supervisor of banks with regards to significant decrease in capital demand – initial capital and capital adequacy.

- Establishing a capital market authority – establishing by law. This is to strengthen the independence of regulation in the insurance and pension areas and create a base for accepting new areas that will be oversighted by the capital market authority (the non-bank credit area as specified below).
- Organizing the non-bank credit provider's activity – setting in law the activity of non-bank credit providers. This is to increase legitimate non-bank players and in order to allow then connection to the rest of the financial system and payment systems. The oversight over these credit providers will be done by the new capital market authority.

In the work plan for the coming years several additional steps will be promoted: settling the credit union activity, issuance of non-bank credit cards, and platforms for mass funding to individuals (P2P).

Credit Unions

A credit union is a joint union offering different financial services to the union members, including: deposits, providing credit, managing current accounts, and managing securities portfolio. Establishment of union is expected to contribute to increased competition in the credit and banking market and reduce centralization. In European countries, credit unions consist of 20% of the banking sector. Moreover, the union's business model, which is solely for the benefit of its members, is expected to allow providing financial services at low cost.

Under this credit unions settlement, entry barriers into the market are significantly reduced (for example the equity requirement changes from NIS 75 million to only NIS 3 million). This change will allow credit unions to act and receive a license, something that was prevented from them for a long period of time.

The oversight on the credit unions will be performed by the new capital market authority.

Non-Bank Credit Card Issuer

Non-bank credit card issuer is a non-bank credit provider that offers financial services such as line of credit and credit on the card. Establishing non-bank credit card issuers is expected to increase competition in the credit market and the credit card market and diversify the credit sources within the economy. This step is expected to strengthen the non-bank credit providers, by allowing them to offer two new products to their customers (line of credit and credit on a card).

The settlement of these issuers is based on the European standard – Payment Services Directive II, which its goal is to create a joint and uniform environment across the European Union in the payment services area. Relying on a European standard is expected to ease the entrance of European Union issuers into the Israeli market. The oversight over the non bank credit card providers will be done by the new capital market authority.

Competition in the LPG Sector

Many findings testify that there is lack of competition in the Liquefied Petroleum Gas (LPG) supply, known in Israel as cooking gas, to the home sector. Although the sharp decline in oil prices over the past two years, there was no similar decline for the individual consumer price. Moreover, home consumers pay 4-5 times higher prices than industrial consumers, and this gap is not explained entirely by the different consumption characteristics between sectors. One of the main reasons for the gap is limited competition in the home sector, and under the economic plan for 2017-2018 several steps are planned to ease the entry of small gas suppliers into the market and for customers to move from one provider to another. The main proposed changes are as follows:

- Removing transfer barriers
    - Changing the required majority to transfer a building from one provider to another – in the current situation a majority in writing of all tenants is required in order to transfer from one gas provider to another. As a result, the number of buildings that succeed in transferring is near zero. Under the settlement law the law will be amended so that a majority in tenants meeting will be sufficient.
    - Prohibition of price discrimination – in the current situation the gas companies may offer certain consumers a discount in the LPG prices, while the rest of the building tenants, which in fact consume the same product, pay significantly higher prices. Under the settlement law the gas providers will be obliged to offer an equal price to all building tenants.
    - Relief in releasing the deposit – in the current situation there is a difficulty to receive the deposit paid for a gas tank. In this situation, the consumer prefers to remain with the same company since transferring to a new one will impose an additional deposit payment. Under the settlement law a settlement has been set that will significantly ease transferring the deposit between providers and as such will allow simple transfer between them.
- Removing entry barriers – relief in filling LPG for small providers and increasing the storage for small providers.

Removing transfer and entry barriers is expected to increase competition, reduce LPG prices and allow consumers to choose the best economic alternative for them.

As such, in 2015 regulations were approved (law amendments) (information providing with regards to gas supply). These regulations oblige all gas providers to publicly publish the average prices offered by them. The fuel administration established a website for comparing LPG prices according to division of gas providers, local municipalities, type of gas infrastructure, and types of charges, this in order to increase competition in the industry.

New Service – Joint Taxi Ride

The current law does not allow splitting payment for rides between consumers. This prevents the possibility of joint rides among passengers in the same route, and majority of the rides are with a single passenger. This situation prevents reducing the ride price, leaving the industry with low profitability, and causes surplus of vehicles on the road.

As part of the economic plan it was suggested to add a new service line – "joint taxi rides". Under this service, which will be provided by special taxis, passengers may split the ride payment and join other passengers to the ride to nearby destinations, and as such will be able to save on transportation costs without harming the industry's profitability. In addition to reduction in consumer prices, the service will increase the worthiness of using a taxi in comparison to using the private vehicle, which will reduce traffic.

In order to ensure quality and credible customer service, the service will be provided by reservation in advance only (excluding street pickup), and the service provider will be obligated to present the passenger the estimated price that will be required to pay for the special ride, the time of pickup, and estimated travel time.

Housing Market

Background and Description of the Issues

The trend of increase in housing prices in Israel, which began in the previous decade, is continuing over recent years as well. Since 2007, the real increase in prices summed up to 80%. This price increase is due to significant shortage in supply of housing units and a low interest environment, which leads to low prices for taking out loans, and saving accounts and other investment options becoming less attractive. Although the low interest rates and its implications on the housing market is a global phenomenon, the housing prices increase in Israel is especially notable and the increase in recent years is the most significant among developed countries.

Change in real housing prices since 2007 until first quarter of 2016

Israel	
Sweden	
Austria	
Switzerland	
Canada	
Germany	
Australia	
Luxemburg	
New Zealand	
Norway	
UK	
Japan	
Mexico	
Belgium	
Korea	
OECD Average	
Finland	
France	
Slovakia	
European Union Countries	
United States	
Iceland	
Denmark	
Hungary	
Portugal	
Netherlands	
Slovenia	

Estonia	
Italy	
Ireland	
Spain	
Latvia	
Greece	

Source: OECD

Since 2007 and until the beginning of 2012 there was an increase in private residential housing starts compared to prior years. The increase trend had some fluctuations since 2012, and is still higher than up to 2010. Completing housing construction depends on the amount of beginnings and total actual demand. Since the record in 1997 there has been a constant decline in completing constructions. Since 2007 there has been an increasing trend in completing constructions, however this increase is not sufficient and a gap has been created between the beginnings and completions, which closed only in 2014. In addition, the increase does not make up for the gap created between new completed units and the number of units in demand, which is measured by the natural population growth. Moreover, the low interest environment in the market over the past years is pushing investors towards residential real estate investments. The percentage of more than one apartment owners amongst the population has increased, and demand surplus has been created, in a market where supply does not react quickly enough, which causes sharp price increase.

Construction beginning and completion compared to demand
Annual average, in thousands

- Construction beginnings
- Construction completions
- Demand level based on population growth

- The social protest
- Zero VAT

Source: Central Bureau of Statistics

Reaching the target for lowering housing prices requires promotion of significant policy and structural changes in the housing market. In the second half of 2013 an inter-office team led by the person in charge of budgets has come up with several recommendations on the supply side (the 90 day team); in the planning processes, land redemption, development, marketing, and long term rental. The team's recommendations were adopted by government and implemented in years 2013-2015. Since the new government took place in 2015, it has been decided to concentrate real estate management into a smaller number of factors, and the responsibility over the Planning Authority and Israel Land Authority has been transferred to the authority of

the Minister of Finance. In addition, a special housing department has been set up to be subject to the Minister of Finance. The housing department, budget division, and professional factors in the Israel Land Authority, Ministry of Housing, and Planning Authority, work constantly towards writing a policy to increase the housing supply and its implementation. The policy decisions are reflected in the housing Cabinet, which reached a number of decisions in years 2015-2016, that join the decisions to be implemented in the economic plan for 2017-2018. Below is a short summary of the main government's policy decisions to increase the housing units supply, which implementation has commenced in recent years, and some will be implemented under the economic plan of 2017-2018.

Establishing the national committee for planning and construction in preferable housing areas and the reform in planning and construction

When starting to handle the housing crisis it came clear that the amount of time to advance construction plans in Israel was very long compared to what is done in the world, which led to harming the market flexibility in responding to demand for housing for a long time and caused price increases. As such, a plan to advance housing with more than 20 units took an average of four and half years. In plans with more than 200 units the amount of time was at least six years. Following these data it was decided to focus the effort in the advancing process in the planning area. The first was reform in planning and construction that began in August 2014 and is implemented until today, with the transfer of Planning Authority to the Minister of Finance's authority. The main goal of the reform is to transfer the high workload from the district committees to local councils and free up time for the districts to handle plans with large number of units. The reform implementation caused 20 local councils to become independent local councils that have wider authority in the approval of plans. Another aspect of the reform which is implemented these days is shortening and optimizing the process for granting construction permits, by establishing control centers that gather all governmental factors needed for different approvals in the permit process, and by transferring to an online system.

Another measure with high impact on the number of units planned on the State's lands is establishing a national housing planning institution, with government listening and fast response, with broad authorities for quick approval of plans, while providing responses for infrastructure and local municipalities' needs. The institution is relevant for large scale plans that can be implemented in the short and medium run. Until now the institution has approved 32,000 housing units. Additional plans of 30,000 units have been submitted and expected to be approved by the end of 2016. Additional plans of 140,000 units are taken care of by the committee and are expected to be approved in years 2017-2019.

The new affordable housing ("Mechir Lamishtaken") Plan

Along with the measures taken in the supply side in years 2017-2018, the government contributes to implement the affordable housing ("Mechir Lamishtaken") plan, which works on the demand side. Since 2015 and as part of the effort to ease the possibility for first time house buyers, the government has decided that all lands marketed by the State, will be marketed with significant discount that will lead to a total discount of NIS 200 thousand from the final price. In the suburbs, where land value is lower and a discount in land price will not lead to significant discount in the housing price, additional grants are given to buyers along with a grant that subsidizes the land development expenditure totaling NIS 80-100 thousand, depending on the land price. The marketing is intended to qualified individuals that are not homeowners. Marketing under this system means competition between buyers on the final house price (the lowest offer wins) and not on the land price (the highest offer wins), and by such allows non-homeowners to buy a home in significantly lower prices than currently offered in the market.

Until now 35,000 units were marketed under the plan, and until the end of 2017 additional 70,000 units are expected to be marketed. As of today, the number of qualifying buyers enlisted to the plan is 55,000 and the number of winners is 2,800.

Multiple asset tax

Along with dealing with the supply side, the government is required to also take care of the demand surplus for investment housing in the market. As such, the government has performed some changes in the way it taxes investors in residential housing, in order to chill the demand. As a consequence, the purchase tax for investors has increased once in 2013 and again in July 2015, and now stands on 8% lowest bracket.

According to the settlements law, taxing holders of multiple assets is being promoted. This tax will be imposed on homeowners that hold three or more apartments, at an estimated rate of 1% from the value of each apartment, starting from the third one. According to the IRS available data there are about 50 thousand homeowners that hold 180 thousand assets. In addition, the sharp increase in prices has led to inequality among different layers of society. This tax is expected to contribute to a correct division of income in the economy and minimize inequality. In addition, the tax is expected to be as an incentive for asset holders to sell the asset, which will increase the supply of apartments in the secondary market and will reduce the price level.

This tax is based in the "Georgian Tax" (in the name of economist Henry George), a tax that is imposed on the increase of value in a realty asset. The tax, by its original suggestion of Henry George, is directed to the increase in land value, since it is not affected by economic development or work, but by community activity, public investment, and government. Accordingly, it is unjust that property owners enjoy the increase in value alone, but to share the increase in value with the public via taxation. A tax on holding multiple assets, in correlation to asset value, reflects George's idea.

Roof agreements, strategic agreements, and plans for removing transportation barriers

In order to allow marketing and granting expedited construction permits of significant residential complexes and provide an answer to new residents and local municipalities, the government approved in 2016 a new framework for roof agreements. These agreements are signed with local municipalities that have many housing units built within their jurisdiction. According to the agreements, the local municipality is committed to promote residential plans within its jurisdiction and develop the land in certain timeframes, allow prompt receipt of construction permits, this in light of government commitment to provide a support package that includes budget for the infrastructure relating to new construction and public institutions and education, in accordance with the marketing pace. These type of agreements have been signed with Modiin, Kiryat Gat, Kiryat Bialik, Rosh Ha'ain, Hertzliya, Rishon Lezion, Ashkelon, Yavne, Ramle, Beer Sheva, and Netanya, and include more than 130 thousand housing units. Additional agreements are expected to be signed in the next months with three more municipalities, at least, and additional municipalities during budget years 2017-2018.

In addition, under the implementation of government decision 922 for promoting new construction in minority settlements, the government is acting in 2017-2018 to promote strategic agreements with 15 minority local municipalities. According to the agreements, the government is committing to budget the planning, establishment of public institutions, and develop lands in specific timeframes in these settlements, and in return commitment by the local municipalities to promote residential plans within its jurisdiction and development of land in specific timeframes. As such, as part of the decision to increase investment specifically in minority areas, the government is committed to increase the transferred budgets in order to encourage the new construction in these settlements.

In addition, in an attempt to trace barriers to promote and fulfill residency plans, it seems that many projects are not progressing in the desired pace due to lack of sufficient infrastructure concerning the transportation burden expected to occur in the new neighborhoods. As such, under the transportation plan for 2017-2021 an agreement was signed to resolve the residency barriers in an extent of NIS 5 billion. This plan is expected to remove the barriers for 140 thousand units.

Optimizing the development work in local municipalities by setting cross-reference development fees

Over the last years the government has been working towards enlarging the supply of housing units in the economy. The government is working towards optimizing and accelerating residential development work, which are a condition to provide

construction permits and occupancy. Charging fees and development charges is the monetary source to fund new infrastructure development work. In practice, the approval process for each surcharge and fee in the local law and its update is complex, with only a few of the local municipalities doing so. Although most of the local municipalities have bylaws for paving surcharge, only a few have imposed a surcharge to develop open public areas, and only half imposed a surcharge to develop urban tunneling. It is clear from the above mentioned that this procedure is a barrier to promoting land development procedures by local municipalities, and as such is difficult for government to increase housing supply. Consequently, according to the settlements law, an arrangement is being progressed by which the charging of surcharge will go from the local level to national level and development surcharges will be set cross-border according to topographic characteristics of the land. This measure is expected to remove the barrier significantly for construction progress on private land and mixed land that is due to non-charging of development surcharges and lack of existing bylaws.

The authority for urban renewal

The urban renewal, in consideration of increasing supply, means increasing new housing units in old areas with low density. Increasing supply of housing units by urban renewal has many advantages, since it is characterized by low infrastructure costs, maintaining open areas and increasing land use optimization, which is especially important based on the lack of available land for construction. As such, the plans for urban renewal contribute significantly to social welfare of the old neighborhoods, by improving the living standards and public areas.

In order to increase the extent of urban renewal plans, and as a consequence increase the supply of housing units, the Knesset has approved a law that instructs establishment of an authority for urban renewal, subject to the Minister of Residency, that will be an active and promoting factor to promote urban renewal plans. The authority's success will be examined by the number of realized projects following the authority's activity, due to its specialization in urban renewal.

As part of the authority's role, it will act to trace potential areas for urban renewal and build professional tools to advance the topic, both for minimizing the entrepreneur risk in these plans and giving tools for assistance in tenant organization. The authority will adopt successful models for promoting urban renewal operated by local municipalities and will be able to support the municipalities and planning committees in charge of, in order to promote the topic. In addition, the authority will act as a gathering factor of all government activities in the urban renewal topic and as an advisory factor to government. As part of the budget proposal for 2017-2018 the authority's intended activity is included in the budget.

Optimizing the mechanism for updates and adjustments of statutory conditions

As part of the government's effort to remove barriers to increase housing supply, one of the main difficulties in realizing residential plans is regulations set by the planning institutions. As such the amount of time between the regulations entry and realization of plan in practice, may cause the regulation to become irrelevant, either by finding an alternative solution or the regulation become inapplicable. For example, there are plans that include instructions as to connection to a certain waste facility, however with time it is decided to construct a new one that can collect the sewage more efficiently. In addition, often there are regulations that do not consider cost efficiency, and so solutions that are not practical economically or inefficient are chosen. Hence, in order to optimize the existing process in district committees it is suggested to amend the planning and construction law (1965), so that requests will not be discussed a month and half after submission, and will transfer to a higher planning institution's care such as the national subcommittee for planning and construction.

Developing a long term rental market

The housing market in Israel is characterized by two thirds of the population living in tenant owned apartments, and third living in rented apartments. This market composition is not unusual in comparison to the average OECD countries, however on contrary to those countries there is lack of solutions for long term institutional rental. In the OECD countries these solutions include supplying quality housing services that provide long term stay for the tenants, and as such provide a significant substitute for housing ownership. In addition to the lack of institutional market, it can be noticed that since 2009 rental prices have risen at a significantly low rate compared to the increase in housing prices for ownership (35% compared to 80%, according to the housing prices index compared to housing prices of the Central Bureau of Statistics), which signals, among other things, the population's preference for the ownership housing product.

Since 2013, efforts have been made in developing the corporate long term rental market. In the financial side, by allocating land at great discount, and in the execution side, by establishing an inter-office auction committee in the Ministry of Finance, and afterwards by establishing a governmental company to promote the area named "an apartment for rent". This company is the execution hand of the government for planning, executing and promoting projects intended, among others, for rental housing. In addition, in the planning and construction law, incentives were set in place to encourage establishment of long term housing units under independent initiative, and within the law for encouraging capital investments the incentives were refined for the establishers of these units.

In the law for establishment of preferred areas for housing committee, it has been set that up to 30% of the units in each area that is declared by the government, planning procedures will be advanced by the establishment of preferred areas for housing committee, and intended for long term rental. With the progress of planning activities and the possibility to realize construction in the area, the “apartment for rent” company will improve together with the Ministry of Finance, the economic model for long term rental in these areas.

In addition, in 2016 a memo was published regarding investment in funds for housing realty (the “Ritim law”) which is intended to produce resources for investment funds in long term rental projects. Nonetheless, since the fund is intended to be issued to the public, the law intends to create a security representing the changing realty prices, which will allow investors a replacement for investing in housing.

Evacuation of IDF and IMI bases

One of the central measures to increase housing supply in preferred areas is accelerating the evacuation of IDF and IMI bases. In order to perform this action, agreements have been signed that allow evacuation of the bases and marketing housing units on the cleared land. As such, in the first quarter of 2015 the Shoham 3 agreement has been signed, according to which the IDF will clear approximately 7,400 acres on which 60 thousand housing units will be built, in the following areas – Sde Dov, Zrifin base, Keren Hakiria in Tel Aviv, Tel Hashomer, Sirkin, Zrifin, Adjutant Headquarters, and more. The agreement includes incentives to the defense system for completion of the eviction. Completing these measures is expected to allow construction of tens of thousands of housing units in preferred areas over the next decade. During 2017-2018 the promotion for implementation of these agreements is expected to continue, so that eviction and construction will be held according to the set timeframes.

Topic B – Creating Equal Opportunities

The fund for minimizing gaps in local municipalities

In accordance with the existing law, the State pays utilities at a lower rate, and in immigrant cities it pays in full. The list of immigrant cities was determined in the 50's, and is no longer relevant today (the topic is sitting with the high court – Bagatz). In light of the above mentioned, under the economic plan for 2017-2018 a fund for differential division to local municipalities will be established. The funds resources will come from lowering the government offices utility payments in immigrant cities today and from additional budget, so that the fund amount will be NIS 500 million.

The allocation of the fund's budget to local municipalities will be made based on different criteria, including the socio-economic index and peripheral index as published by the Central Bureau of Statistics as well as based on the financial strength of the municipality, considering among other things the business utility areas per resident. As such, in order to prevent harming the municipalities that receive full utility payments today for being immigrant cities, transfer regulations will be set to minimize the budgetary harm in these municipalities.

The pension savings in Israel

Over the last decades there have been many changes in the Israeli pension system: the pension funds transferred from a defined benefits model to a defined contribution model; joining the budgetary pension has been closed among public officials; pension deposits have become mandatory to all economy's employees, which significantly increased the pension coverage among the Israeli population; the option for capital withdrawal from savings accounts has been limited, and more.

Over the past year and under the economic plan framework for 2017-2018 additional changes are expected in the Israeli pension system, as follows:

- **Applying mandatory pension deposits by self-employed workers** – according to the Central Bureau of Statistics data, a large portion of self-employed workers today, especially low and medium income earners, do not deposit funds to a pension account. In the upcoming economic plan, and as part of a wide initiative meant to assist self-employed to "smooth" their income over the years (details regarding this initiative described below), it has been decided to apply mandatory pension deposits among this population. As such the pension coverage in Israel will be expanded to all workers in the economy.
- **Creating a default fund** – hundreds of thousands of workers in the economy pay the maximum management fees set in law (0.5% of accumulation and 6% of deposits) and as such their income is significantly harmed when reaching retirement age. Starting

November 2016 an employee that will join a new workplace and will not choose a pension fund close to time of employment, will be automatically joined by the employer to one of two default funds selected in an auction by the securities chief, unless the employer entered into an agreement to choose a different default fund in accordance with the set conditions. In both of these funds those who join will enjoy low management fees for a period of at least ten years from the joining period. This step is expected to increase the pension savings by hundreds of thousands of shekels and a significant increase in old age pension. The default fund reform provides a bargaining power to the non-unionized employees that will enjoy for the first time significant benefits in the managing fees similar to the benefits provided thus far to the strong employee unions in the economy.

- **Changing the designated bonds allocation in new funds** – designated bonds are untradeable bonds with government guaranteed yield issued to the pension funds. Holding these in a saver's portfolio provides full certainty on this part of the portfolio. In order to increase certainty in the retirement period and decrease the possible volatility in the pension payment from the time of receipt, it has been decided to change the allocation of designated bonds, so that the senior citizens portfolio will enjoy 60% designated bonds. Savers from the age of 50 will enjoy 30% of designated bonds, and from the younger savers portfolio the allocation of these bonds will decrease gradually.
- **Allocating severance funds to the employee and correcting tax distortions** – the pension saving of employees is comprised of three different parts: employee deposit, employer deposit, and employer severance pay. As of today, the ownership of these funds by the employee is uncertain with regards to the severance pay portion, and under certain agreements the employer may withdraw back the employee's funds in case the employee chooses to resign. As a consequence, the pension savings of the employee can be up to 40% lower, which will significantly harm the employee's income at retirement age.

  Under the economic plan it has been decided that severance payments made to an employee's account will be defined as belonging to the employee, and the employer will not be allowed to withdraw any amounts from that fund. This step will allow employees to enjoy these funds at retirement.

  Moreover, as of today, the individual is given a tax benefit at the time of depositing severance payments with no ceiling. This benefit is opposite to the existing ceilings in all savings alternatives and in contrary to the progressivity of Israel's tax system. As such, the economic plan set a ceiling for providing tax benefits for employer deposits to severance pay, so that individuals with guaranteed income of three times the average market salary, i.e., NIS 29,100 as of August 2016, will pay income tax on the employer deposit for the guaranteed income above the mentioned ceiling. This measure is intended to reduce the tax benefit to 5% of the employees earning the highest salary in the economy, and this is only on the guaranteed salary above the said ceiling.

In addition, during the last year a public committee has been established to examine raising the woman's retirement age. As of today the retirement age for women is 62 and is five years lower than the men's retirement age. The woman's retirement age has a significant impact on her pension allowance from new pension funds as follows:

- An additional year of work means additional deposit to the woman's savings account
- Postponing the retirement by one year means the savings fund accumulates one more year of yield prior to determining the monthly allowance.
- Postponing the retirement by one year decreases the pension years and the allowance numerator by which the total savings are divided by.

The effect of these factors results in the woman's retirement at age 67 instead of age 62 to increase the pension allowance by 50% per month in retirement period.

The committee is expected to submit its final recommendations to the Minister of Finance in the coming days.

- 1995: closing the entry to old funds and opening new funds
- 2000: canceling the option for capital withdrawal in pension and managers insurance
- 2004: closing the entry to budgetary pension
  Raising the retirement age for men and women; arrangement of assistance to old funds
- 2008: extension order to mandatory pension to all employees in the economy; changing the pension to an allowance product
- 2013: canceling the promised coefficient in managers insurance
- 2016-2017: mandatory pension for self-employed; default fund; changing allocation of designated bonds in new funds; pairing severance pay to the employee

Savings and aid to self-employed

The economic plan for years 2017-2018 combines the recommendations brought by the inter-office team established for examining the topic of pension savings and economic safety net provided by the State to the self-employed population. As recommended, the social security rates will decrease, and a mandatory pension deposit will be imposed, and in periods of unemployment it will be allowed to withdraw a third of the accumulated amount or three times the minimum salary in the market, the highest among the two.

This model combines solutions for several significant issues confronting the self-employed population:

- Increasing progressivity in the social security rates for self-employed – this step corrects an historical distortion in the social security rates, where low self-employed

earners paid more than employees with similar income level. As such, it is recommended to reduce the social security rates on the salary not above 60% of the average salary in the market, from 6.72% to 2.87%, along with raising the social security payment by 1.6% on the salary portion above 60% of the average salary in the market. The significance of this step is progressive reduction of social security rates for about 90% of self-employed population, including all self-employed with income lower than NIS 21,000 per month.

- Aid in periods of unemployment – under this model it is recommended that a self-employed individual who closed their business and complied with all conditions, may withdraw third of the accumulated amount for unemployment purposes, or three times the minimum salary in the market, the higher among the two. This saving is intended to aid the self-employed to smooth its income for periods of unemployment and assist in funding establishing a new business for the individual's return to the labor force.
- Absence of pension savings – since a large portion of self-employed do not deposit into a pension fund today, it is recommended that the self-employed will be obliged to deposit payments from income into a pension fund, at a rate of 4.45% on the salary portion not exceeding half the average salary in the market, and 12.55% on the salary portion above half the average salary in the market up to the average salary in the market. In addition, in order to provide an incentive for the long term savings, tax benefits will increase for self-employed to credit the deposit into pension funds at a rate of 0.5% and a benefit will be granted for deposits into education funds, so that the self-employed may deposit 4.5% of income into the education fund and be eligible for tax benefit, unrelated to the deposit, of additional 2.5% into the education fund that is not eligible for tax benefit. This is in order to increase the individual's available income. If the self-employed saver will take advantage of the full tax benefits given against another deposit to a pension saving, beyond the mandatory rates set by law, the savings level will increase significantly.

Extension of supplementary income to the elderly

Under the budget for 2017-2018 it has been decided that additional payment will be given to the supplementary income allowance for the elderly, intended for the especially low income elderly. The addition will be granted based on the family structure and the allowance structure. The additional amounts range between NIS 100 to 320 per month, based on the family structure and age of the beneficiary, for a total of NIS 400 million per year in full maturity. This is after the 2016 budget provided an addition of NIS 600 million for this allowance.

Increasing the holocaust survivors annual grant

It has been decided to increase the holocaust survivors' grant according to section 4 of the holocaust survivors' benefits law, 2007, by NIS 360. The grant will increase to a total of NIS 3,960per year. Total annual cost is NIS 50 million.

Cross-border plan to incorporate the Arab sector in the economy

According to government decision, employment targets were set for the Arab sector for 2020. The employment target set for Arab women ages 25-64 for 2020 is 41%, compared to employment rate for 2015 of 32.3%. The target for Arab men ages 25-64 is 78% compared to employment rate for 2015 of 76.1%.

Following the employment targets, ground work was performed in the government's offices which led to an additional government decision regarding economic development of minority populations for years 2016-2020. The decision states a significant change in the allocation mechanisms from State's budget, so that a significant rate of the budget that does not fall from the rate in the general population was targeted to the benefit of minority population. In addition, changes were made in the education and higher education, infrastructure and transportation, the employment and trade areas, and housing.

The mentioned change in the allocation mechanisms was set following the mapping of gaps in different areas. An example is the public transportation gap, where the average number of weekly bus travel per resident in the Arab sector is 17% only compared to a resident in the Jewish sector. In the education area, the rate of Arabs eligible to a quality high school diploma is 23% only compared to 47% in the rest of the population. These gaps are significant barriers to incorporate the Arab sector into employment and the economy.

In the employment area it has been decided to promote several policy steps with a budgetary cost of hundreds of millions of shekels per year. Among the steps are the establishment and operation of more than 20 occupational directory centers intended to the Arab sector, together with the Joint organization; significant expansion of the public transportation system in Arab settlements; promoting structural steps to improve the education system in the Arab sector; implementation of plans to develop and complete industrial areas and employment in the Arab sector; expanding the IT education system to the Arab youth; assistance in placing the Arab population into high-tech and developing additional plans to encourage employment in the Arab sector. This, along with reserving at least 25% of the construction budget for daycares in minority settlements.

This allocation of resources is due to the understanding that incorporating the Arab population in employment is necessary to increase welfare and improve the quality of life of the minority population itself, and that it directly influences the economy's growth in its entirety by minimizing the social gaps.

Transportation investment in minority settlements

According to the five year plan for roads (further explanation below) a specific budget of NIS 80 million per year was allocated to cross-settlement roads in the minority sector. This budget is added to urban budgets of NIS 220 million per year for urban roads in minority sectors for years 2017-2018. These budgets were intended to implement the government's policy, as decided to incorporate economically the minority population in Israel, to correct the main governmental allocation mechanisms to all the Arab, Druze, and Cherkassy sectors settlements.

Topic C – Productivity Improvement and Growth Engines

As presented in the background chapter, the work productivity in Israel is in the bottom third of OECD countries and stands on three quarters of the average productivity per hour of work in these countries. The meaning of low work productivity is that the salary to be paid to an employee is lower and as a result the standard of living is lower. As such, increasing productivity is key to improve the economy's growth potential, and the most significant data to measure the improvement in standard of living is GDP per capita growth. Over the last years Israel opened a negative gap compared to OECD countries with this data, which means the rest of developed countries see improvement in the residents' standard of living which is higher than the improvement felt by the Israeli resident. The economic plan includes a number of steps intended to increase productivity and create growth engines in the infrastructure, health, education, employment, and business sector in its entirety.

Multiyear investment plan to develop public transportation in metropolitan areas

An international comparison of indexes for quality of public transportation shows a significant gap between Israel and developed countries in the quality of public transportation and services given to the citizen. This gap is expressed by the current infrastructure, the rate of dividing travel between public transportation and private vehicle, and the travel speed of public transportation, in which Israel is significantly behind in all of the above compared to developed countries. This situation, along with an increasing rate of purchasing new vehicles, causes traffic jams, increase in pollution, increase in accidents, and loss of many hours spent on travel by the Israeli citizen. Absence of active measure to be taken by the government may bring Israel to an unprecedented transportation crisis.

Under the economic plan for 2017-2018 it has been decided that a significant investment plan, that has yet to be done, will be executed in the public transportation industry, under which several mass transportation projects will be executed in the three largest metropolitans, along with the private sector, in a total amount of NIS 54 billion:

- Tel Aviv – adding two light rail lines: the green and purple line (on top of the red line), totaling NIS 30 billion.
- Jerusalem – adding the blue line to the light rail (in addition to the red line and its expected extensions), totaling NIS 8.5 billion. The planning of an additional line will continue, the blue line.

- Haifa – the light rail line between Haifa and Nazareth, totaling NIS 5.9 billion, and extension to the existing Metronit lines. In addition, advancing the funicular line from Haifa bay to Haifa University, all totaling NIS 2.9 billion.
- In addition, a heavy rail line – "the east rail" – from Hadera to Lod, totaling NIS 8.1 billion. The line will provide a heavy rail route parallel to the shore rail, will help in confronting with the traffic distress in the Ayalon section and will provide an alternative to heavy loads movement.

In Israel, large scale projects tend to delay compared to the original timeframes, due to, in part, too much regulation. Delay in a project means increasing the inconvenience caused to citizens during the construction works, increase in project costs, and loss of economic efficiency due to delay in system operation. Under the decision, several measures will be taken to remove barriers to execute projects, to increase the governmental execution companies' authority and encourage all bodies involved in the project to work towards project completion, which the government will announce as national infrastructure projects. In addition, in order to increase transparency to the public and other factors in the economy, it is suggested that the timeframe will be publically available, and updated twice a year. Increasing transparency will assist in long tern planning, joining all factors to project completion, and shortening the completion time of these projects.

The five year plan for roads

The development plans for road infrastructure is determined in multiyear plans, which determine the total investment for improving the existing road system, and the investment in new roads in the coming years. At the end of 2016 the multiyear plan ends for Netivei Israel Company for years 2011-2016. Along with that a plan for years 2017-2021 was settled. These plans allow reaching the government targets in the long run, and provide stability to the execution companies when the plan is defined and clear in advance. Included in the plan are expansion of roads in the central of Israel, development of roads in the North and South, as well as a variety of roads to new residential areas.

Developing the land transportation infrastructure includes maintenance and improvement of existing routes and development and pavement of new routes. Development of road infrastructure is directed to several significant destinations, among them, adjusting the national road system to housing needs and development across the country, reducing traffic jams in central routes, upgrading the systems in order to ensure safety, and increasing the service quality for users. On top of these, the importance of investment in infrastructure as a main growth engine for the economy should be noted.

Along with the improvement in service for vehicles by developing roads, the recognition in the world is increasing with regards to improving quality of services to

public transportation users. Expanding the roads in congested areas will never keep up with the pace of population growth and private riding. The right way to handle road congestion is improving the service quality of public transportation and encouraging transfer from private vehicles to mass transit solutions. As a consequence, the government supports increasing the resources invested in public transportation over resources invested in road development. In this budget, aside from the increase in public transportation budget, resources were allocated from the roads budget to public transportation routes and preferred routes.

The local municipalities segment

In about 60% of Israel's local municipalities there are at least 20,000 residents (out of which in the majority there are even less than 10,000 residents), which may affect their ability to provide services to their residents and act for the economic and social development of the municipality.
In an attempt to promote local view of economic and social development and promote cooperation between local municipalities that will increase its economic conduct and improve the level of services given to their residents, it has been recommended to correct the urban union law and allow establishment of urban union for the local municipalities' type. The segment will be able to provide joint services, by economic efficiency and improvement of the level of services, and create opportunities for growth in the region and minimizing the gap. By that the municipalities will be able to take advantage of the segment size that is comprised of several local municipalities, to increase efficiency and savings in resources and to act for economic growth by regional wide sight.

It is suggested to set into law a cooperation mechanism between local municipalities which will allow the municipalities to grant authorities to the segment, so that in topics where authority is granted, the segment will act as a single body. In addition, the segment will be allowed to publish auctions to the member municipalities without the need for each individual municipality to publish independently.

Increasing the Israeli market attractiveness for investments

With an intension to incentive the high tech industry in Israel and take advantage of the opportunity set by the OECD new rules in the intellectual property area, the economic plan suggests to set the new tax rates to be beneficial with companies that will open and register intellectual property in Israel.

The BEBPS rules (Base Erosion Profit Shifting) were intended to prevent the phenomena of profit linking to countries that are tax shelters and set that the profits should be linked to the country where the intellectual property was actually developed. Hence, countries can grant from now on tax benefits for intellectual property developed within its jurisdiction. These rules are both a threat and

opportunity to Israel: on the one hand, many R&D centers of multinational corporations act in Israel and may transfer their activity to other countries with better tax laws. On the other hand, many multinational companies may find Israel attractive as a place to transfer the activity, including registration of the intellectual property.

In order to deal with the threat and cease the opportunity, it was determined that the corporate tax rate on income related to intellectual property, dividend tax deriving from the intellectual property, and capital tax at the time of transferring the property outside of Israel to a related company, will be lowered.

In addition, several changes in the "Moadaf Meyuchad" route will be done, in order to increase attractiveness for investment by large multinational corporations, which are not specifically R&D companies. This is among others by reducing the entry level such as the company's sales cycle as well as reducing the dividend tax.

These steps will lead to expansion of the high tech industry in Israel by deepening R&D, and encouraging innovativeness and as such it is expected that the tax revenue will increase in the long run.

Promoting structural and budgetary changes to continue strengthening the public health system

The health system in Israel is considered one of the advanced, quality, and efficient in the western world. The system provides universal coverage to all the State's residents in a wide geographic layout, by supplying a vast service, medicine, and technology basket.

The health system success shows in the acceptable indices: the life expectancy is significantly higher than the average OECD countries – and is continuing to increase at a fast pace; high life expectancy in good health (functional life expectancy) compared internationally; baby death rate, which is an acceptable index for comparison, is significantly lower compared to the OECD average; the subjective conception of residents as to their health and satisfaction from the systems; the services provided to the community excels in the extent and clinical quality; the universal coverage of the health basket from the medicine and technology aspect is of the widest in the world.

Nonetheless, in the last years the health system is confronted by several main challenges, including significant increase in the private expenditure on health services, which leads to increase in cost of living and harming the public health system, significant increase in salary indices in the health sector compared to other public sectors and business sector, need for strengthening the control in the system, and need to maintain and strengthen the medical quality and service quality of the public system.

Under the 2017-2018 budget several structural changes and budgetary policy measures are promoted, as part of the government policy to act to strengthen the public health system in Israel while placing it in high budgetary and structural priority. As such, a law is being promoted to set new charging rules between the HMO and hospitals that will encourage developing services in the community and increased activity to shorten lines for surgeries; steps are taken to increase the resiliency and economic and managerial control of HMO's and hospitals, including by accepting union workers and creating an incentive system for better management and control; moves have been implemented such as promoting the chill regulation and reform to return the private system back in order alongside strengthening the public system; a measure to promote improvement in the psychiatric hospitalization and community services, including a plan to reduce mechanical limits; the agreement with Assuta Ashdod will be amended so that the hospital will operate without private medical services; a multiyear plan for beds will be implemented with attention to the suburbs and strengthening the geriatric system; slots for additional 150 new interns; the health service basket will increase for increasing the medicine and technology in the basket; the cost of health index will be updated and allocate additional budget to HMO's; measures will be taken to minimize illness; an inter-office plan will be promoted to minimize child injury; the government's decision will be implemented in arranging the medical use of cannabis, and more.

Further advancement of employment targets in the economy

In 2010 the government set ambitious employment targets for 2020, similar to the levels in the most developed countries in the world. Increase in the number of employees is subject to affect GDP growth of 0.5-1% (addition of NIS 3.75-7.5 billion GDP per year). Increasing the employment rate in the economy, in accordance with the employment targets set by the government, is critical for the growth engine in Israel.

Since 2008 there has been an increase in the employee rate and there is an improving trend in Israel's labor market. Moreover, it seems that the rate of increase in most the employment rates is higher than required to comply with the general employment target, but specific improvements are necessary in some population groups especially among Arab women and Haredi men.

Employment rates for ages 25-64 by population groups in years 2008, 2015, and targets for 2020

- General population
- Arab women
- Arab men
- Haredi women

- Haredi men

- Employment targets for 2020 (ages 25-64)
- Employment rates (ages 25-64) – 2015
- Employment rates (ages 25-64) – 2008

Source: Central Bureau of Statistics

Expanding the daycare system

In order to expand the supply of supervised frameworks for children by the Ministry of Labor, in order to encourage parents going out to work and participating in providing for their children, and in accordance with the recommendation set by Trachtenberg committee, over NIS 1 billion to building daycares and expanding the family daycares between years 2011-2016 has been allocated. Under the budget framework for years 2017-2018 permission were allocated for constructing daycares in an amount of NIS 700 million. In addition, the rule for budgeting construction of new daycares has been amended, so that there is significant relief over the bureaucratic barriers and incentives were given for fast construction. These changes are expected to bring significant increase in the supervised and subsidized frameworks. This is along joining of private daycares to the supervised system.

Moreover, the number of government decisions accepted over the past years and allocation of resources for construction of daycares, increased the budget for daycares by 4, from NIS 330 million in 2005 to more than NIS 1.2 billion in 2018.

Transferring the economy to natural gas

The natural gas sector in Israel has significantly developed over the past years. Natural gas is used today as a significant production factor in the electricity and industrial sector, but as of today is not part of the fuels offered in transportation, although natural gas use in transportation is increasing in developed countries in the world. The transfer to natural gas will assist in encouraging investments and developing gas reserves, will reduce local air pollution and minimize greenhouse gas emission, increase the State's income from surplus profits and royalties, and will assist in decreasing dependency on oil. Under the economic plan for 2017-2018 and in continuation to green taxation report 3 that was published last March, a vast plan will be promoted that targets reducing the economy's dependency on imported oil in transportation, to increase the use of local gas which will result in cleaner air.

The approved plan's goal is to handle several barriers in this industry, such as uncertainty as to taxation policy on fuels (excise), shortage in natural gas stations and absence of correlation between division of natural gas and gas stations to fuel to cars and transportation in general. The decision emphasizes an excise path for several

years, in order to create certainty and by such ease the investments for development on the required entrepreneurs.

Under the framework it has been decided to grant benefits to vehicles that will transfer to natural gas and understanding the external implications that are due to use of fuels on excise tax, by providing excise tax benefits on condensed natural gas to remove barriers on new entrants to the alternative oil market. In addition it has been decided that grants will be given to establishing natural gas stations that will be promoted by the Ministry of Finance and Energy. In addition, a plan to for training heavyweight and public transportation drivers will be promoted, in light of the national shortage of such drivers.

Improvement in the way of doing business

Under the economic plan for 2017-2018 the following changes are promoted with their implementation expected to ease the way of doing business in Israel:

Property registration

Under the current situation, registering property is a long and complex process that takes a long time from both sides of the business. In order to ease the registration method, it is suggested that information will be transferred online between the relevant authorities. As such, it is suggested that the Ministry of Finance will accelerate handling the tax in transactions that do not involve appreciation and will ease the criteria to register properties of active companies in cases where tax payment exists. These steps are expected to reduce the regulatory burden in registering a property and by that to expedite the registration process and save costs for both sides of the transaction.

Opening a business

Opening a business is a necessary procedure in an economic activity in the modern economy. The purpose of the amendment under the economic plan is to shorten and ease bureaucracy involved in the process. The process commits, among others, permits of the corporation authority (for setting up the corporation), Tax authority (VAT – opening a file, IRS – opening a file for tax purposes and opening a deductions file for the employer), and social security (opening a deductions file). This amendment will allow the corporation, at its request, to perform all actions in one place.

Contract enforcement

The contract enforcement process in Israel is long compared to other places in the world. As such, it is suggested to increase the amount from which it is possible to collect debts via the short route in the execution office and to make the use of the route mandatory for companies that act against other companies in cases that the debt amount is not higher than NIS 200,000. As such, it is suggested to transfer the appeal committees to a single negotiator in order to operational optimize the process.

Reducing regulation for business licensing

In Israel today there are about 130 thousand licensed businesses (according to business licensing department in the Ministry of Interior for 2014 on 235 local municipalities), of which 31% - about 40 thousand businesses act without a business license. The main reasons for lack of business license following noncompliance with the licensing law are: failure to comply with the fire department requirements – 29%, failure to comply with planning and construction requirements – 26%, and the rest - failure to comply with requirements of other offices (health, police, environmental protection, finance, agriculture, and more).

The difficulty in receiving a business license is due to the complex process where the requestor is expected to receive permits from different offices prior to receiving the business license from the local municipality. In addition, there are additional conditions from the planning and construction areas that are not directly related to issuing the business license. The delays and difficulties involved in the process are a burden to entrepreneurs requesting to open a business in Israel. The entrepreneurs are forced to invest time and funds that were not anticipated in advance. In addition, business that are delayed from receiving the license due to conditions not directly related to the goal of business licensing law, are hurt due to the inputs and resources required to receive the business license and due to their inability to participate in auctions of State bodies.

Under the economic plan, it is suggested to act in order to establish an organized procedure for receiving permits from government offices, and to cancel the conditions not related to business license. Below are the main changes:

- Canceling the need for issuing a permit for unusual usage when the requested usage matches the plan, and accordingly – cancelling the appraisal levy.
- Establishing control centers for providing the necessary permits today from the different government offices.
- Reliance on the business owner statement that it complies with the fire safety standards - for business with low risk as to be determined by the national fire safety authority. In accordance, granting a full waiver from payment of fees to the national fire safety authority for those businesses.

Budget Proposal for Fiscal Years 2017-2018

Expenditure Frameworks

- The gross state budget proposal for fiscal years 2017-2018, including the revenue dependent expenditure, totals NIS 491.7 billion in fiscal year 2017 and NIS 502.0 billion in fiscal year 2018.

- The budgetary expenditure for calculating the expenditure limit in fiscal years 2017-2018 stands at NIS 359.7 billion in fiscal year 2017 and at NIS 376.7 billion in fiscal year 2018, including one-time additions.

- The budgetary expenditure for 2017, as defined for calculating the expenditure limit, is 6.0% higher in real terms than the budgetary expenditure for calculating the expenditure limit for 2016 (ignoring the technical correction in the American assistance budget). Said real growth consists of an increase of NIS 9.5 billion as a derivative of the total expenditure, an addition of NIS 3.7 billion due to adjustment of the budget to 2017 prices, a one-time expenditure (box) of NIS 0.8 billion, and a deviation from the expenditure limit added to the budget base of NIS 8.6 billion. In addition, the expenditure limit calculation for 2017 includes a change in the reporting method of the American assistance which leads to decrease of the allowed expenditure, in a way that does not affect the budgetary deficit, of NIS 8.9 billion of budget base.

- The budgetary expenditure for 2018, as defined for calculating the expenditure limit, is
  4.7 % higher in real terms than the budgetary expenditure for calculating the expenditure limit for 2017. Said real growth consists of an increase of NIS 10.1 billion as a derivative of the total expenditure, price increase of NIS 5.4 billion due to adjustment of the budget to 2018 prices and a nonpermanent correction to the expenditure limit of NIS 1.6 billion.

Changes in the Budget Proposal

The budgetary expenditure for calculating the expenditure limit grew in 2017 and 2018 by nominal 6.0% and 4.7% respectively. Net of the one-time amount in 2018 budget, the budget for calculating the expenditure limit in 2018 grew by 4.3%. In accordance with the government's policy, the main increases in the state budget for 2017-2018 are in the areas of defense, health, transportation, homeland security, social security, and welfare.

Below are the main changes in the budget proposal for fiscal years 2017-2018 relative to the previous year:

In net expense terms, the main State budget increases for 2017-2018 were set according to government's priorities and include: defense budgetary increase (by NIS 7.1 billion for 2018 relative to 2016, ignoring the technical correction in the American assistance budget); health budgetary increase (by NIS 5.9 billion for 2018 relative to 2016); transportation budgetary increase (by NIS 5.1 billion for 2018 relative to 2016); social security transfers increase (by NIS 4.6 billion for 2018 relative to 2016); education budgetary increase (by NIS 4.4 billion for 2018 relative to 2016), and homeland security budgetary increase (by NIS 1.5 billion for 2018 relative to 2016).

Civil expenditure for fiscal year 2017 will increase by 4.4% relative to the Budget Law for 2016. In fiscal year 2018 the civil expenditure will increase by 3.8% relative to the budget proposal for fiscal year 2017.

Defense expenditure for fiscal year 2017 will increase by 21.8% relative to the Budget Law for 2016. In fiscal year 2018 defense expenditure will increase by 0.2% relative to the budget proposal for fiscal year 2017. The increase in defense expenditure in 2017 is affected by the budgetary agreement between Ministry of Finance and Ministry of Defense and the method for reporting budget for classifies units.

Interest payments will decrease in fiscal year 2017 by NIS 1 billion relative to the Budget Law for 2016. In fiscal year 2018 interest payments will increase by NIS 1.3 billion relative to the budget proposal for 2017. Maintaining relatively similar interest payments between the years and even a decrease allows transfer of budgets from the allowed increase in expenditures for civil uses.

Transfer and support payments will increase in fiscal year 2017 by 8.2% relative to the Budget Law for 2016. In fiscal year 2018 transfer and support payments will increase by 4.4% relative to the budget proposal for 2017. The growth in transfer and support payments in fiscal years 2016-2018 stems mainly from the government's policy of increasing the income guarantee allowance for elderly, increasing the holocaust survivors annual grant, seniority additions to the old age pension to the immigrant population, increase in overall handicapped allowances, incorporating new technologies and medications in the health services basket, implementation of national plans in health and hospitals, free education for children ages 3-4, minimizing number of students per class, minimizing budget gaps in the education system, signing a five year plan for the higher education system by increasing budgets and providing additions to culture and sports budgets.

Investments and credit granted will increase in fiscal year 2017 by 15.0% relative to the Budget Law for 2016. In fiscal year 2018 investments and credit granted will decrease by 3.4% relative to the budget proposal for fiscal year 2017. The budget increase for 2017 includes accelerated expectation in the development of mass transit systems, especially the light rail project in Tel Aviv and the budgetary significance of the five year plan for road development.

Principal payments (loan principal repayments), excluding principal repayments to the National Insurance Institute, will increase in fiscal year 2017 by 12.9% relative to the

Budget Law for 2016. In fiscal year 2018 principal payments, excluding principal repayments to the National Insurance Institute, will decrease by 4.4% relative to the budget proposal for 2017. The changes in principal payments are an outcome of the structure of the debt amortization schedules. These payments are not included in the calculation of the deficit and in the calculation of the permitted expenditure under the Deficit Reduction and Budgetary Expenditure Limitation Law, 1992.

Three Year Budget Plan for Years 2018-2020

In accordance with section 40a of the budget foundation law, 1985, along with the State's budget for 2015-2016, the three year plan for years 2017-2019 was submitted to the Knesset towards the end of 2015. This plan was updated according to the law on June 2016.

As part of the budget approval process for 2017, the law obliges submission of the three year budget plan for years 2018-2020.

In accordance with the law, the three year budget plan includes, for each of the budget years included: growth plan, expected governmental expenditure, State's revenue forecast, overall deficit forecast, the allowed expenditure limit, the allowed deficit, and differences between expected governmental expenditure and allowed expenditure limit (hereinafter: the "expenditure side adjustments"), and between overall deficit forecast and allowed deficit (hereinafter: the "deficit adjustments").

In addition, the three year budget plan includes details as to government's fiscal targets, fiscal restrictions set into deficit reduction and budgetary expenditure limit law, 1992 (hereinafter: the "frames law") as well as the main assumptions used to creating the government expenditure estimate and tax income revenue forecast.

Approval of the budget for years 2017-2018 as a two year budget makes it unnecessary to detail the budget data presented above for 2018 as part of the three year plan. As such, this chapter will deal mainly with presentation of part of the three year plan for years 2019-2020 while using 2018 as a reference year for comparison purposes.

It should be noted that the three year budget plan data can also be found in the "Piskaly Digitaly" system in the Ministry of Finance website.

All data presented in this chapter are in current prices if not stated otherwise.

In addition, throughout the chapter, when referencing to the expenditure limit and deficit ceiling allowed by law, it is assumed that the amendment for frames law has been approved, in accordance with the law proposal submitted to the Knesset along with the budget proposal.

The Three Year Plan for 2018-2020

Fiscal stability and maintain the government's fiscal credibility are imperative for the economy's economic stability and government's ability to successfully handle financial shocks. As such, complying with the fiscal rules set into law, will allow operation of an anti-cyclical policy during a financial crisis, and as such will support existing growth in the economy.

Studies done by different international bodies, including the international currency fund, show governments ability in developed economies (and developing economies) to increase expenditures at time of crisis when the opening status prior to the crisis are weaker. As a consequence, GDP losses at time of crisis in an economy with inferior opening fiscal conditions may be significantly higher than an economy that has better prepared in advance to such situation.

According to existing forecasts as to the government's budgetary obligations and State's revenues for years 2019-2020, in order to comply with fiscal limitations, the government will be required to make adjustment measures. In accordance with the known data, in 2019 adjustments will be required both in the expenditure and revenue sides. In 2020. The known liabilities amount is slightly lower than the expenditure limit, and as such convergence measures for converging the deficit ceiling alone will be required, as can be seen in the table below.

It should be emphasized that 2020 is the first year since following the State's liabilities for future years commenced, where subject to not taking any new decisions without a budgetary source and realization of the macroeconomic forecasts and budgetary assumptions specifies in the chapter, no adjustment measures for convergence of the expenditure limit will be required.

	2018 Year	2019 Year	2020 Year
Total government expenditures			
Expenditure limit allowed by law			
Allowed deviation in the expenditure limit, in accordance with section 40a of budget foundation law			
Required adjustments for complying with the expenditure limit			
Expenditure for calculating the deficit limit			
State's revenue forecast			
Predicted deficit considering convergence to expenditure limit			
Allowed deficit			
Required convergence measures for complying with deficit ceiling			
Total required convergence measures			
Allowed deficit in GDP percentage			
Total deficit (excluding adjustment measures)			

In accordance with the deficit reduction and budgetary expenditure limit law and in light of the current macroeconomic forecasts, the average allowed nominal State's budget growth for 2018-2020 will be NIS 16.8 billion, so that the State's budget is expected to increase from NIS 376.7 billion in 2018 to NIS 410.3 in 2020. The mentioned increase reflects a real annual growth in government's expenditures of 2.4%, in accordance to the expenditure limit formula and non-permanent expenditure increases that will be set into the frames law (as well as a change in the linkage method as explained below).

Government expenditures in 2019-2020 take into account overall expenditures the government is committed to, including: legislation related expenditures, government decisions, rulings, agreements binding the government and its offices and budgetary agreements, all these under the assumption that government maintains its current level of activity. Government expenditures take into account also the adjustment reserves of NIS 1.25 billion from 2019 budget base (in 2018 the adjustment reserves are NIS 3.5 billion), which its purpose is to deal with budgetary uncertainty concerning budget approval for 2017-2018 in a two year setting.

Government expenditure for 2019-2020 represents the known liabilities amount, as of this date of publication, assuming that no policy changes initiations and/or response to exogenous events have been made during the relevant budget years. In other words, the data presented assuming compliance with section 40a of the budget foundation law, which states that in the current situation of deviation from fiscal limitations set into law, decisions regarding new liabilities cannot be made without a balancing action (budgetary source).

Without policy change, the average annual government liabilities growth for 2018-2020 is NIS 16.5 billion as of today, so that the government liabilities is expected to increase from NIS 376.7 billion in 2018 to NIS 409.8 billion in 2020.

In order to comply with the expenditure limit set into law the government will be required to make convergence measures on the expenditure side totaling NIS 2.0 billion in 2019 only. These measures are not required at the time of State's budget approval for 2017-2018, this due to transition instructions set by section 40a of budget foundation law, according to which in 2019 fiscal years a convergence to 100.5% of expenditure limit will be required.

It should be noted that the adjustment measures required for 2019 is low compared to adjustment measures required in the past, this in light of the specified changes in the expenditure limit and in light of non-taking new budgetary decisions for 2019 (onwards), without a budgetary source since the section 40a law instructions have been applied.

Even without making the required adjustment for 2019 at the time of budget approval, total expected government expenditures for 2020 are lower than the allowed expenditure limit by about NIS 0.5 billion, and this is, as mentioned above, for the first time since following the government's future liabilities has commenced.

The available expenditure side convergence measures are a reduction in government expenditures in civil and/or defense areas. It should be noted that as the government will take measures for effective optimization, decreasing the government's expenditures will be possible without harming the level of services provided to the citizen. In addition, as the government will set a deficit ceiling lower than set in law today and comply with it, the interest payment burden over the next years will decrease in a manner that a budgetary saving will be created, which will moderate the need to make reductions in either civil or defense budgets.

Beyond the required convergence measures for compliance with the expenditure limit, in order to comply with the deficit ceiling set by law, the government will be required

to make revenue side convergence measures or additional expenditure side convergence measures totaling NIS 11.9 billion for 2019. After completing the mentioned permanent adjustment measures, additional adjustment measures will be required in 2020 totaling NIS 0.5 billion (assuming not exploiting of the existing fiscal gap of NIS 0.5 billion).

The possible revenue side convergence measures are expanding the tax base, which means canceling the existing waivers in the tax system, and increasing the current tax rates.

Government Expenditure in the Medium Run

	2017 expenditures	2018 expenditures	2019 expenditures	2020 expenditures
Total government expenditures				
Defense and public order				
Social services				
Infrastructure				
Headquarter offices				
The economy's industries				
Debt repayments (principal and interest)				
Other expenditures				
Expenditure limit allowed by law				

Main Changes in the Three Year Plan

Below are the changes in total required adjustments in the three year plan years, between publication in June 2016 of the 2017-2019 budget plan (hereinafter: the "previous publication"), and the adjustment now made for 2018-2020 (hereinafter: the "current publication"). As will be clarified below, the change in total adjustments is due to change in assumptions regarding total government expenditures, total revenues, and GDP size in each of the mentioned years.

The GDP size is indirect, since the annual allowed deficit is set as GDP percentage, which means increase in GDP allows for higher deficit and accordingly – minimized the required adjustments in order to comply with the allowed deficit.

	2018	2019	2020
Total required adjustments in previous publication			Not published
Change in expenditure side adjustments			

Change in revenue side adjustments			
Change of problem due to GDP effect			
Total required adjustments in current publication			

The main changes in expenditure and revenue forecasts between the previous and current publications will be specified below, including the method for conducting the convergence into allowed lawful frames.

Convergence into Budget Frameworks for 2019-2020, and Main Changes in Expenditure Side

In accordance with section 40a of budget foundation law, in the three year plan submitted to the Knesset along with the annual budget law, the government's liabilities for each of the budget years included in the three year plan, will not exceed the allowed expenditure limit for that same year.

During the period between the first publication of the three year plan for 2017-2019 and the current publication, the State's budget for 2017-2018 has been approved. As such, as part of the State's budget approval process and for the purpose of convergence into the lawful frames in these years and years 2019-2020, policy decisions have been made that affect the expected expenditure amount for the three years plan years, and data has been clarified with regards to pace of project completion and plans that are at different execution stages. In addition, and as mentioned above, the budget law proposal includes a proposal to increase the allowed expenditure limit and change the linkage mechanism within it.

Below are the main changes in the expenditure side required adjustments as a result of changes in the allowed expenditure limit, and the total expected expenditures for 2018-2020.

	2018	2019	2020
Total expenditure side required adjustments in previous publication			Not published
Change resulting from expenditure limit correction			
Change resulting from total government expenditure			
Total expenditure side required adjustments in current publication			

As can be seen, in 2018, where the budget is submitted to approval by the Knesset, total government expenditure equals the allowed expenditure limit, and as such no adjustments are required in the expenditure side.

Convergence in the extent of NIS 17.6 billion to the expenditure side allowed expenditure limit, is due to a amendment in the deficit reduction and budgetary expenditure limit law, which its purpose is to increase the allowed expenditure limit by NIS 9.8 billion. In addition, compared to 2018 expenditure side adjustment

measures have been made which converge the allowed expenditure limit. These measures are detailed in full in the budgetary policy principles chapter included in this pamphlet.

In 2019 total expenditure side required adjustments decreases by NIS 16.8 billion beyond the total required adjustments in the previous publication. The decrease in total adjustments is due to an additional increase of NIS 0.8 billion in the allowed expenditure limit as a result of change in the method for linking the expenditure limit, as specified in the budgetary policy principles chapter as well as the table below.

For price index used to calculate the expenditure limit, it should be clarified that the methodological change in the linkage method for the expenditure limit will make it unnecessary to perform future price index forecasts to calculate the expenditure limit. However, since years 2020-2021 are defined as transition years, there is still a need to use the price forecasts to calculate the expenditure limit for these years (approaching 2020, an adjustment will be made for actual prices).

	2018	2019	2020
Price index forecast in previous publication			Not published
Price index forecast in current publication			
Price index for expenditure limit calculation			

Total required adjustments for 2019 decreased compared to the requirement in the previous publication due to decrease in expected government expenditure for 2019 in light of permanent adjustment measures conducted at the time of approval of the State budget for 2017-2018 in government, where a cut of 4.5% of governmental offices shopping expenses has been made, a cut in the government amount and salary budget, and an update to the flow of projects and plans in different completion stages.

In addition, for years 2019-2020, for the purpose of convergence into the allowed expenditure limit for these years, it has been decided, at the time of State budget approval by government for years 2017-2018, on a number of steps that will be applied starting 2019: an additional reduction of 0.5% of governmental offices shopping expenses, minimizing the two year budget adjustment reserves from NIS 3.5 billion per year to NIS 1.25 billion per year, and adoption of the report by the government structure adjustment team, which its implementation means savings of NIS 400 million per year. Below are the changes in governmental expenditures for 2018-2020, as expressed in each of the budgetary segments:

	2018	2019	2020
Total governmental expenditure in previous publication			Not published
Defense and public order			
Social services			
Infrastructure			
Headquarter offices			

The economy's industries			
Debt repayments			
Other expenditures			
Change in total adjustments reserves			
Total change between publications due to total expenditures			
Technical registration change in the defense aid agreement			
Total change between publications			
Total governmental expenditure in current publication			

Defense and public order

- The group of offices handling defense and public order includes the Ministry of Defense, the Ministry of Homeland Security, and other defense expenditures. This group does not include the budgetary expenditures for IDF projects in the Negev.
- The original budget expenditure for 2018 for the defense and public order segment is NIS 83.2 billion which consist of 22.1% of total expenditure.
- According to the current government's total liabilities, between 2018-2020 the defense and public order expenditure is expected to increase by NIS 5.5 billion, so that in 2020 will be NIS 88.7 billion, which will represent 21.6% of total government expenditure.

Below are the main expected changes in this expenditure component:

- **Ministry of Defense budget** – on November 24, 2016 a budgetary agreement was signed between the Ministry of Finance and Ministry of Defense for 2015-2020, under which a multiyear path has been set for the defense budget by setting a linkage mechanism due to increase in prices, defining topics that deviate from the defense budget ceiling, intended additions for complying with targets and a compensation mechanism due to new government decisions.
- **Ministry of Homeland Security** – the increase in budget for Ministry of Homeland Security includes increase in police forces in Jerusalem and the Arab sector, police Nagadim and prison service officials salary agreement, increase in educational institute's security, addition in accordance with amendment 42 to the prison ordinance concerning rehabilitation and education for prisoners, multiyear plan to increase fire safety troops, and more. Under the current budgetary decisions, it is assumed that during 2018-2020 this topic will be given an average additional budget of NIS0.4 billion per year (increase in current prices), so that the annual budget for the Ministry of Homeland Security and its bodies will increase by NIS 1.164 billion in three years.

Social services

- The social services expenditure includes: Ministry of Education expenditures, including higher education, Ministry of Health (with additional participation in the health basket), Ministry of Welfare, Ministry of Immigrant Reception, Ministry of Science, Culture, and Sports, and the holocaust survivors rights authority.
- Excluded from this segment are expenditures for social services of other offices such as economy and housing. In addition, the portion of social services' expenditures financed

by taxes directly collected from the public (health and social security taxes), do not appear in the State's budget, and thus not included in this segment.

- The original budget expenditure for 2018 for the social services segment is NIS 160.0 billion which consist of 42.5% of total expenditure.
- According to the current government's total liabilities, between 2018-2020 the social services expenditure is expected to increase by NIS 20.4 billion, so that in 2020 will be NIS 180.4 billion, which will represent 44.0% of total government expenditure.

Below are the main expected changes in this expenditure component:

- **Natural increase in student numbers in the education system:** due to increase in number of students per year and in order to provide service for each student in the education system, it is assumed that during 2018-2020 this topic will receive an average budget addition of NIS 0.8 billion per year, so that the annual budget directed to this topic will increase by NIS 2.3 billion within three years.
- **Real growth in health basket:** under the national social security law, 1995, Israeli citizens are eligible to receive a funded health service basket by three sources: health tax payment, completion of basket cost by State budget, and normative self-contribution (6.45%). The health basket is promoted according to fixed parameters of prices, demography, and technologies, and by additions decided by government. Under the existing budgetary decisions and population growth assumptions, the cost of health index, and health tax collection, it is assumed that for years 2018-2020 this topic will receive an average budget addition of NIS 1.4 billion per year, so that the annual budget directed to this topic will increase by NIS 4.2 billion within three years.
- **Increase of State's participation in social security collection:** due to increase in number of employed participants in the economy and the average salary based on the social security law, the amount of social security taxes collected from the public has increased. According to section 32 of the law, the State's treasury participates in the social security collection, and as a result, it is expected that the State will increase its participation. Under the existing budgetary decisions, it is assumed that for years 2018-2020 this topic will receive an average budget addition of NIS 1.2 billion per year, so that the additional budget directed to this topic will increase by NIS 3.6 billion within three years.
- **Increase in allowances funded by the Ministry of Finance and participation in funding allowances to the uninsured population:** the State's treasury pays, via the National Insurance Institute, allowances that are not under the social security law. Due to increase in the population eligible for these allowances, according to existing agreements and different laws, for years 2018-2020 this topic will receive an average budget addition of NIS 0.16 billion per year, so that the annual budget directed to this topic will increase by NIS 0.5 billion within three years.

Infrastructure

- The offices included in the infrastructure segment are: Ministry of National Infrastructure, Energy, and Water, Ministry of Transpiration and Road Safety, the National Authority for Water and Sewage, and Ministry of Housing and Construction.
- The original budget expenditure for 2018 for the infrastructure segment is NIS 25.6 billion which consist of 6.8% of total expenditure.
- According to the current government's total liabilities, between 2018-2020 the infrastructure expenditure is expected to increase by NIS 3.7 billion, so that in 2020 will be NIS 29.3 billion, which will represent 7.2% of total government expenditure.

Below are the main expected changes in this expenditure component:

- **Increase in execution pace for mass transit projects:** during 2018-2020, there are a number of mass transit projects, which are: the green and purple line in Dan metropolis, expected to reach execution stage, and take a large portion of the budgetary expense, average of NIS 0.5 billion per year. In addition, it is assumed that the green line in Jerusalem will demand an addition of NIS 100 million per year, and the east rail will demand an addition of between NIS 100-200 million per year.
- **Increase in subsidies for public transportation operation:** this budget increase is meant to deal with the natural population growth, to improve the service level, and operate additional train lines that are expected to be completed in the next years. Under the existing budgetary decisions, it is assumed that for years 2018-2020 this topic will receive an average budget addition of NIS 0.2 billion per year, so that the annual budget directed to this topic will increase by NIS 0.6 billion within three years.
- **Maintaining the execution pace of the heavy train projects:** during 2018-2020 several main train projects are expected to reach their peak: train electricity infrastructure, purchase of portable electricity equipment, and upgrading the safety and signal systems. Due to financing of these projects is from out-of-budget sources for 2018, a budgetary addition of more than NIS 0.5 billion will be required for 2019 for project execution. In 2020 the total required budget is expected to remain the same.
- **Increase in Ministry of Housing and Construction's development budgets:** under the government's effort to increase the housing supply, the subsidized activities by the Ministry of Infrastructure Development in suburbs has risen, in accordance with government decisions on the topic. In addition, under the implementation of affordable housing ("Mechir Lamishtaken") plan, the development subsidy granted to settlements where land value does not provide sufficient discount for the plan has risen. As such, the budgetary framework for development budgets in the Ministry of Housing and Construction for 2019-2020 is expected to be NIS 2.8 billion and NIS 2.4 billion, respectively.

Headquarter offices

- The group of administrative offices includes the following: the Prime Minister's office and National Security office, Ministry of Finance, Ministry of Justice, Ministry of Foreign Affairs, Ministry of Interior, and the Population, Immigration and Border Transfer Authority. Included in this segment are government expenditures such as transfers to local municipalities, the Knesset budget, President, State Audit office, and political party funding.
- The original budget expenditure for 2018 for the headquarter office segment is NIS 18.8 billion which consist of 5.0% of total expenditure.
- According to the current government's total liabilities, for years 2018-2020 the headquarter office expenditure is expected to remain steady, so that in 2020 will be NIS 18.9 billion, which will represent 4.6% of total government expenditure.

The economy's industries

- The group of offices included in the economy's industries are: the Ministry of Economy and Industry, Ministry of Tourism, Ministry of Agriculture, Ministry of Environmental Protection, and Ministry of Communications.
- The original budget expenditure for 2018 for the economy's industries segment is NIS 9.5 billion which consist of 2.5% of total expenditure.

- According to the current government's total liabilities, it is assumed for years 2018-2020 the economy's industries expenditure is expected to increase by NIS 0.5 billion, so that in 2020 it will represent 2.5% of total government expenditure.

Below are the main expected changes in this expenditure component:

- Ministry of Economy and Industry – the change in cash expenditures is mainly sue to cash flow gaps between the permission to commit pace and the actual activity derived, including changes in the cash flow grant to Intel corporation.

- Ministry of Agriculture – on the one hand there are many agreements and government decisions, such as decisions regarding the Gaza Strip surrounding and aid to the Southern settlements,, decision for reducing customs for meat and milk, and aid to bell pepper exporters for which their budget is expected to finish these years. On the other hand, further to additional measures decided by government, such as lowering customs for fish, and other agriculture reforms, additional budget is expected. As such, the agricultural budget decreases slightly over these years.

Debt repayments (principal and interest)

- The expenditure is this segment includes interest and principal payments for social security fund.
- The original budget expenditure for 2018 for the debt repayments (principal and interest) segment is NIS 52.5 billion which consist of 13.9% of total expenditure.
- According to the current government's total liabilities, it is assumed for years 2018-2020 the debt repayments (principal and interest) expenditure is expected to increase by NIS 2.9 billion, so that in 2020 it will be NIS 55.5 billion, which represent 13.5% of total government expenditure.

Below are the main expected changes in this expenditure component:

- **Expected increase in interest payments:** according to the current macroeconomic forecasts and in light of the government's allowed deficit in the next years, an increase in interest payments over the next years is expected. It is assumed that for years 2018-2020 the extent of predicted liabilities as of this date will increase by an average of NIS 0.9 billion per year, so that the annual budget directed to this topic will increase by NIS 2.6 billion within three years.
- **Increase in the State's debt repayment amortization schedule to the National Insurance Institute:** according to the current amortization schedule, an increase in the State's debt repayment to the National Insurance Institution is expected over the next years. For years 2018-2020 this topic will receive an average budget addition of NIS 0.5 billion per year, so that the annual budget directed to this topic will increase by NIS 1.5 billion within three years.

Other expenditures

- The expenditure is this segment includes pension and severance pay expenditures, including payment of the old funds, oversight authorities' expenditures, general reserve, as well as other expenditures.
- The original budget expenditure for 2018 for the other expenditures segment is NIS 25.4 billion which consist of 7.2% of total expenditure.

- According to the current government's total liabilities, it is assumed for years 2018-2020 the other expenditures are expected to increase by NIS 1.5 billion, so that in 2020 it will be NIS 28.6 billion, which represent 7.0% of total government expenditure.

Below are the main expected changes in this expenditure component:

- **Organizing the old pension fund's payment:** in accordance with government agreement and amortization schedule set by the in charge of securities, it is assumed that for years 2018-2020 this topic will receive an average budget addition of NIS 0.3 billion per year, so that the annual budget directed to this topic will increase by NIS 0.9 billion within three years.
- **Changes in the retirement age population:** it is assumed that for years 2018-2020 this topic will receive an average budget addition of NIS 0.25 billion per year, so that the annual budget directed to this topic will increase by NIS 0.75 billion within three years.
- **Reserve adjustments for a two year budget:** the reserve adjustments for a two year budget total NIS 3.5 billion for 2018, and we assume that 2019 onwards the reserve will be NIS 1.25 billion. As such, ant adjustment measured taken in 2018 for a two year budget which include increase in expenditure, a reserve for NIS 1.25 billion is maintained for 2019 onwards, that will allow adjustment measures in this extent to be regularly approved (to base).

In addition to real increases in State budget, a major part of total government liabilities increase is due to linking the budget to budget coefficient. The main budget coefficients are: governmental salary, foreign currency (dollar and euro), average market salary, teacher's salary, and pension linked index.

The government salary coefficient is determined based on the known salary agreements, including the multiyear salary agreement with the Histadrut from December 2015 (including its update in August 2016) and based on the assumption of salary increase for government officials based on estimation. This estimation takes into account the historical change rates in salary index by making adjustments to the different price index rates over the last years and the expectation for economic development in Israel and the world.

Government Expenditure Evolution in a Multiyear Comparison

Between years 2018-2020, the expected annual real State budget growth is 2.4%, compared to the annual average real growth of 2.8% for the decade 2007-2017.
As can be seen in the diagram below, the expenditure for defense and public order increased in an annual real rate of 1.5% during the decade 2007-2017, and we assume that in years 2018-2020 the expenditure for defense and public order will increase at a low rate of 1.3% per year.
The expenditure for social services increased in a rapid annual real rate of 5% during the decade 2007-2017, and we assume that in years 2018-2020 the expenditure for this topic will increase at a low rate of 4.2% per year.
The expenditure for infrastructure increased in an annual real rate of 2.6% during the decade 2007-2017, and we assume that in years 2018-2020 the expenditure for this topic will increase at a rapid rate of 5.1% per year.
The expenditure for headquarter offices increased in an annual real rate of 1.0% during the decade 2007-2017, and we assume that in years 2018-2020 the expenditure for this topic will decrease at a rate of 1.7% per year.

The expenditure for economy's industries increased in a rapid annual real rate of 5.8% during the decade 2007-2017, and we assume that in years 2018-2020 the expenditure for this topic will increase at a rate of 0.9 % per year.
During the decade 2007-2017 there was almost no annual real change in the expenditure for debt repayment, and we assume that in years 2018-2020 the expenditure for this topic will increase at a rapid rate of 0.8% per year.
The expenditure for other expenditures increased in an annual real rate of 1.8% during the decade 2007-2017, and we assume that in years 2018-2020 the expenditure for this topic will decrease at a rate of 1.8% per year.
Government Expenditure Evolution in a Multiyear Comparison
(2007-2017 compared to 2018-2020)

- Defense and public order
- Social services
- Infrastructure
- Headquarter offices
- The economy's industries
- Debt repayments
- Other expenditures

- Average annual change 2018-2020
- Average annual change 2007-2017
- Total increase for years 2018-2020
- Total increase for years 2007-2017

Government Revenue in the Medium Run

This part presents the expected State's revenue and growth, beyond the budget scope for 2017-2018. The update refers to years 2019-2020 and has been matches the budget forecasts as made in August 2016 (see part D of this book).

Forecast edit methodology

Due to the long run forecast scope, the government's revenue forecast for 2017-2020 was calculated based on simulation as follows:

- First, a forecast was made for 2017-2018 by using an econometric model that ties State revenue to a variety of economic variables (such as growth, employment, exchange rates, and prices).
- Second, the forecast for 2019-2020 is based on a central scenario that reflects the economy's potential growth in the medium run and other assumptions relating to the increase rate of prices and labor market entrants, while assuming normative flexibility of tax revenue and other revenues.

The revenue forecast is based on a central macroeconomic scenario, by which the growth rate will be slightly lower than the 3% threshold, close to the medium-short run potential. Nonetheless, maturity of the convergence process in the labor market may affect the GDP prices for 2019, which in turn will grow that year at a relatively low rate. The GDP prices are expected to return and grow at a rate similar to the long term average in 2020.
The inflation assumptions predict that the Bank of Israel will act to converge the inflation rate to the government target center (1-3%). The population is expected to grow according to the Central Bureau of Statistics after an upward amendment has been made to the actual data over the last years.

All models use a joint database, make similar assumptions, and rely on a uniform forecast for the macro environment, with changes and adjustments as needed in cases of significant deterioration in the security situation, dramatic changes in the local and/or global economic environment, and take into account changes in legislation that were known at the time of conducting the forecast. The revenue forecast presented in the next section assumes that the tax policy will not change. On the contrary, convergence measures that were set for the budget period only (such as change in time of provisions to asset tax fund) were not considered in the 2019 and onwards forecast.
Below is the summary of main assumptions used to gather the revenue forecast (in percentage):

	Growth	GDP prices	Inflation
2017			
2018			
2019			
2020			

In years 2019-2020 the tax revenue and fees revenue are expected to increase in accordance with the growth rate, while assuming a slightly high flexibility than singular. For the calculation of nominal increases, tax and fees revenue are promoted by combination of the CPI and GDP prices (equal weight along with other revenues are expected to maintain relative stability, but significant changes will occur in classification of these revenues).
Under the budget proposal for 2017-2018 approved by government, there are several measures intended to yield additional revenue needed for convergence to the deficit ceiling. As such, the budget proposal includes changes in recording the revenue structure in some of the different revenue sections. As a result, it has been decided that a record transfer of all revenues due to the defense aid grant to the expenditure framework will be conditioned in the revenue starting 2017. The estimate for total changes due to implication of these measures on the revenues for 2017-2018, their effect is seem in the revenue forecast for 2019-2020 as well.
For the matter of defense aid grant budget, we will note that until and including 2016, part of the grant component was recorded as receipt in the other revenue section, while another part was recorded as designated revenue in the defense budget. In order to better reflect the defense aid grant extent in the State budget and its conditional character in receiving an outside budgetary source to the State budget, it has been decided to change the method for recording, so that starting 2017 onwards the defense aid grant in its entirety will be recorded as designated revenue in the State budget, and accordingly this amount has been deducted from the other revenue section.
Below is the expected collection forecast for the medium-long run (NIS billions):

	Section	2019	2020
Base scenario	- Tax and fees revenue - Other revenue - **Total revenue**		
Including policy measures implementation and changes in legislation	- Tax and fees revenue - Other revenue - **Total revenue**		
	Nominal GDP		

Tax Burden

The governmental tax burden, which represents the weight of total State tax and fees revenue in GDP, was 23% GDP in 2015, and expected to increase to 23.5% GDP in 2016 and not expected to significantly change in the short-medium run (see diagram below). The tax burden evolvement was affected by changes in taxation policy – tax rates decreased during 2003-2009 and since 2010 the trend reversed. As such, collection for years 2012-2015 was affected by one-time revenues due to behavioral changes following policy measures along with revenues received for capital gains from selling large corporations. In addition, over the last years the tax burden is affected by tide in the labor marker, low inflation rates (especially compared to GDP prices), and growth component that supports taxation.

Recording changes that were implemented in 2016 and expected to be implemented in 2017-2018 in the other revenue components, are expected to lead a change in the revenue burden in GDP in the coming period. As such, change in the recording method of National Insurance Institution revenues led to significant and permanent increase in other revenues, of 0.3 % GDP, starting 2016. However, during the years 2017-2020 a decrease is expected in some of the other revenue from GDP, a decrease that reflects the erosion of some of the lenders from the National Insurance Institution as percent of GDP, due to the fact that this component is mainly affected by salary. In addition, the transfer of revenue due to defense aid grant to the expenditure framework conditioned in revenue, starting 2017, creates a permanent decrease in the revenue burden of GDP starting this year. Finally, the expected decrease in total revenue due to interest debt collection, which originates in the continuing minimization of the remaining fund balance, also leads to a decrease in this section of revenue of GDP.

Tax burden and other revenue receipts for years 2000-2015 and forecast for years 2016-2020

(State revenue as GDP percentage, including planned measures)

- Total State revenue burden
- Other revenue burden
- Tax burden

*forecast

State Deficit and Deficit Financing in Fiscal Years 2017-2018

Expenditures and Revenues for the Deficit Calculation

- The budgetary expenditure for calculating the deficit limit stands at NIS 359.4 billion in fiscal year 2017 and at NIS 376.4 billion in fiscal year 2018.
- The forecast of revenues and grants for the years 2017-2018 stands at NIS 322.7 billion in fiscal year 2017 and at NIS 337.9 billion in fiscal year 2018.

Details of the forecast of state revenues from taxes appear in this booklet in the section on state revenues from taxes for 2017-2018.

State Budget Deficit

The overall deficit excluding credit in 2017 is expected to amount to NIS 36.6 billion, equivalent to 2.9% of GDP, based on assumed growth of 2.7% (the forecast GDP for 2017 is NIS 1,249.7 billion).
The overall deficit including net credit in 2017 is expected to amount to NIS 33.7 billion, equivalent to 2.7% of GDP.
The overall deficit excluding credit in 2018 is expected to amount to NIS 38.5 billion, equivalent to 2.9% of GDP, based on assumed growth of 2.8% (the forecast GDP for 2018 is NIS 1,306.8 billion).
The overall deficit including net credit in 2018 is expected to amount to NIS 35.9 billion, equivalent to 2.7% of GDP.

Overall Deficit Financing in Fiscal Years 2017-2018

(In NIS billions)

Deficit Financing Sources	**2017 Total**	**2018 Total**
Revenues from sales of land		
Privatization		
Loans from abroad (net)		
Loans from the public (net)		
Total		

Note: Substitution is possible among the various deficit financing components.

Budget Deficit and Financing

(In NIS thousands)

	2015 Budget Performance	2016 Original Budget	2017 Budget Proposal	2018 Budget Proposal
Part I: Deficit				
Surplus (+) / deficit (-) excluding credit				
Required adjustments to cash basis*				
Total revenues excluding principal collection				
Income and property taxes				
Customs and VAT excluding VAT on defense				
Fees				
VAT on defense imports				
Debt collection – interest				
Loan from National Insurance Institute				
Grants				
Other revenues				
Total expenditures excluding credit granted*				
Administrative ministries				
Social ministries				
Economic ministries				
Defense				
Miscellaneous expenses				
General reserve				
Principal and interest payments to National Insurance Institute				
Net credit				
Credit provided				
Credit repayments				
Surplus (+) / deficit (-) including credit				
Part II: Financing**				
Total loans from abroad – net				
Loans received				
Debt repayments				
Total domestic loans – net				
Loans received				
Debt repayments				
Total capital				

revenues				
Privatization				

* Adjustments required to present the government deficit on cash basis according to changes in the cash balances at the Bank of Israel.
** Substitution is possible between the financing abroad and domestic financing.