



OXFORD ANALYTICA

ISRAEL

FISCAL TRANSPARENCY

Country Report 2006

Copyright © December 2006

Oxford Analytica Ltd
5 Alfred Street
Oxford OX1 4EH

Any reproduction in whole or in part without
the written consent of Oxford Analytica Ltd
is strictly forbidden.

ISRAEL



COMPLIANCE RATINGS

<i>Fiscal transparency</i>	2006	2005	2004	2003
.....				
Clarity of roles	●●●	●●●	●●●	●●●
Availability of information	●●●	●●●	●●●	●●●
Budget preparation	●●●	●●●	●●●	●●●
Accountability	●●●●	●●●●	●●●●	●●●●
Score	3.25	3.25	3.25	3.25

OUTLOOK & COMMENTARY

The government's commitment to improving fiscal transparency now includes the area of defence spending. For the first time, the 2007 draft budget contains detailed information on the non-classified parts of the defence budget, making them accessible to the entire Knesset and the general public.

This year, following IMF recommendations, the Ministry of Finance and the Central Bureau of Statistics have created a joint working group to promote the compilation of fiscal data according to Government Finance Statistics Manual (GFSM) 2001 methodology.

The government has agreed to explore the possibility of adopting a multi-year budget framework to ensure insulation of future budgets from short-term political pressures. While some ministries have adopted a multi-year approach, some government officials have argued that parts of the bureaucracy, such as the Ministry of Finance and the Ministry of Defence (MoD), should not be bound by a medium-term budget because of a need to retain some flexibility.

EXECUTIVE SUMMARY

3.25 Enacted

The government of Israel's commitment to enhancing fiscal transparency is proving effective, and a number of improvements in information availability have taken place this year. While the defence budget has traditionally been considered opaque, the Ministry of Finance (MoF) has made efforts to strengthen its control over expenditures carried out by the Ministry of Defence (MoD). The 2007 draft budget contains detailed information on the non-classified parts of the defence budget, which amount to approximately one-third of the total defence budget. While in the past these figures were only made accessible to one Knesset committee and a small team in the MoF, this year they have been given to the entire Knesset and have been made publicly available.

Following the IMF recommendation to improve cooperation between the MoF and the Central Bureau of Statistics (CBS), the Budget Department and the Accountant General Department of the MoF, as well as the CBS, have created a joint working group to promote the compilation of fiscal data according to the GFSM 2001 methodology. Although its meetings, which began in February 2006, were interrupted by the Lebanon war and the process of budget preparation, the working group is expected to resume its activity shortly.

To improve the coordination and dissemination of statistics, the frequency of meetings of IMF Special Data Dissemination Standard (SDDS) coordinators from the CBS, MoF and Bank of Israel (BoI) has been increased, and - since February 2006 -- these meetings take place quarterly. Some CBS data are being harmonised to comply with Eurostat protocols and, as of July 2006, national accounts include tax and import data, which were previously published separately. Work is ongoing to ensure that all general government accounts are in line with Eurostat methodology.

The report on budget execution prepared annually by the Accountant General of the MoF has usually been released with a considerable delay. This year, the report has been combined with the financial statement and the publication lag -- which used to be six months -- has been reduced to four months. It is hoped that the delay will be further cut to three months starting from next year. The English version of the Accountant General report is usually made available at a later stage than the Hebrew one. However, information on deficit, revenues and expenditures can be found in both English and Hebrew on the Accountant General's new website, launched in November 2006.

The authorities have agreed to explore the possibility of adopting a multi-year budget framework -- recommended by the IMF -- to help ensure that future budgets are better insulated from political pressures and reflect long-term priorities. Multi-year budget frameworks have been adopted in certain line ministries, but some government officials are convinced that parts of the bureaucracy, notably the MoD and the MoF, need to retain some flexibility and should therefore not be bound by a medium-term expenditure framework.

The government has introduced a computerised accounting system known as 'Merkava'. However, full implementation of this accounting system is expected to take a long time, as not every ministry has adopted it. With the introduction of Merkava, the MoF will be able to get information on the spending of line ministries before rather than after the fact, as ministries will have to input their expenditures into the system before they are executed.

Israel's overall score is unchanged from last year.

1. CLARITY OF ROLES, RESPONSIBILITIES AND OBJECTIVES



Enacted

The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.

Structure, functions and responsibilities of government

Israel's Basic Laws, which have constitutional status, set out the structure, functions and responsibilities of the government. Under these laws, the general government consists of the government ministries, local authorities, non-profit institutions (including universities, secondary schools, sick funds, community centres, museums, research institutes and similar entities) and the National Insurance Institute. The government would like to merge some municipalities in 2007 in order to increase the capacity of local authorities to manage expenditure programmes. However, this might be politically difficult to do, and thus far only twelve municipalities have been merged.¹

The budgetary department of the Ministry of Finance (MoF) is responsible for public expenditure, the coordination of the budget-planning system and multi-annual planning. The Department of the Accountant General (DAG) within the MoF is responsible for budget implementation, control of state liabilities, establishing financial and economic procedures, and managing the government accounts.²

Coordination and management of budgetary activities

Responsibilities between the different levels of government are clearly allocated in law. The coordination and management of budgetary activities are centralised within the MoF, and last year management of the government's domestic loans also shifted from the Bank of Israel to the MoF.³ The Basic Law of the government does not, however, allocate a division of expenditure programme responsibilities between the central government and local authorities. Israel is a centralised state, and over the years, the MoF has developed a strong technical capacity and expertise concerning budgetary activities. This has made it difficult for external analysts to review the budgetary figures that the MoF produces. For example, in 2002, although the MoF's revenue and spending projections came under heavy criticism, no other organisation had the broad range of expertise or technical capacity to challenge the MoF's assumptions. The result was that, within a few months following passage of the budget, two supplementary budgets had to be introduced. The MoF is aware of this problem and has started to amend matters, but no changes have been put in place as yet.

The DAG of the MoF is responsible for ensuring the compliance of budget execution with appropriations.

Mechanisms for the coordination of extra-budgetary funds and activities within the budget are well defined.⁴ An ongoing source of concern to analysts is the government's propensity, in all proposed budgets, to leave large funds under the section labelled 'reserves'. General reserves are usually intended to fund the secret services, which almost automatically receive around two-thirds of the funds allotted. The remainder is allegedly used for security crises and other unforeseen activities. Line ministries' budgets include a 3% reserve to deal with unanticipated crises. However, the 'free' reserve money has usually been used more prosaically to cover sudden increases in spending as a result of political deals in the Knesset (Israel's legislature), or to cover mistakes made by the MoF in overly optimistic

projections. Ministries are often not allowed to spend these reserves until June, halfway through the fiscal year, unless a crisis occurs beforehand. Contingency reserves remain hidden in other budget categories.⁵

The MoF has responded to the political use of reserves by creating a series of false projected expenditures in each budget that can then be used for real contingencies. All the data projections are open and available -- thus satisfying regulations on transparency -- although, since the budget averages about 10,000 line items, the figures are rarely checked by oversight committees. However, not all the inaccurate forecasting of revenues is the fault of the MoF. The government as a whole plays a crucial role. Although big reforms were planned for 2006 by the now-fractured coalition government, progress was delayed due to the general election in March 2006.⁶

Another important source of revenue has been the Israel Lands Authority (ILA). Responsibility for it has passed through no fewer than four ministries. Although the regulations guiding the ILA's activities are publicly available, the criteria used by the ILA's land assessors have never been clearly laid out, and last year's talk of reform did not have any major consequences, given the unstable political situation.

The MoF has provided data to the BoI for its project to assess the medium-term implications of all fiscal legislation. Budget forecasting has improved. The BoI created a multi-year budget, based on budget trends and actual legislation, and published it for the first time in the *2002 Annual Report*. It has been updated each year since, to reflect the passage of new measures. The BoI's multi-year budget study is a 70-page report listing each separate budgetary component and each assumption that goes into it. Beginning with the September 2003 MoF *Outlook* publication, available on the Internet, the MoF is publishing the medium-term budget forecasts and risks analyses, incorporating prices, labour markets and other real variables.

When governments are weak, there has been a strong tendency for small factions to introduce and negotiate the passage of new and expensive spending bills even after the budget has been passed. Knesset members are subject to intense pressure by small lobby groups. For example, this has meant that serious distortions have crept into the taxation and regulatory system. This, in turn, leaves economic analysts with a lack of clarity for months as to how the tax and spending systems will work in the forthcoming year. Two attempts within the last few years to reform the system have failed precisely because the lobbying system was so strong.

However, a new research section in the Knesset has meant that Knesset members can, and increasingly do, seek expert research and advice on fiscal matters.⁷ In addition, any private member's bill that will require the expenditure of more than five million shekels must have the support of 55 members from the 120-member Knesset. The MoF is trying to convince the Knesset to pass a law that would require the latter to approve the state budget no later than 31 December of each year. However, the chances that this law will be approved are small.⁸

Relations between government and public sector agencies

Government activities are clearly distinguished from those of public financial institutions and non-financial public corporations (NFPCs). The NFPC sector is large.⁹ The BoI law, currently under revision, places special emphasis on the independence of the central bank. Fiscal policy is exclusively the responsibility of the government. The BoI's services to the government include making and receiving payments and handling some of its financial activities abroad.¹⁰ The management of the government's domestic loans, previously a task of the BoI, is now with the debt management unit at the Treasury.¹¹ The amounts of credits, advances or overdrafts to the government can be found in the monthly balance sheets of the BoI.¹²

As part of the structural and fiscal reforms of the past three years, there has been a major overhaul of the country's union-run pension funds. Israel's biggest pension funds have been taken out of the management and care of the Histadrut (General Federation of Labour), and two more pension funds, belonging to the banks, were sold last year.¹³

Government involvement in the private sector

The government still owns, or is the majority shareholder of, some large companies in Israel (such as Israel Aircraft Industries and Mekorot), but in 2005 it instigated a privatisation drive. The government companies report quarterly and annually to the Government Companies Authority (GCA), which publishes an abstract of the accounts in its *Annual Report* to the public. Bezeq, Israel Oil Refineries and Bank Leumi now publish quarterly financial reports, as they are publicly traded on the Tel Aviv Stock Exchange.

The government does not privatise when this would lead to a monopoly. On the whole, privatisation is carried out in a transparent manner, and the legal basis for privatisation is detailed in the Government Companies Law. Government regulation of utilities and the private sector is largely transparent.¹⁴ However, as part of the structural and fiscal reforms, the privatisation of public enterprises has picked up pace. El Al, Bezeq and Zim, the Israeli shipping company, as well as the Discount Bank have recently been privatised. The agenda includes the privatisation of the Israel Aircraft Industries, Israel Military Industries (IMI), Israel Oil Refineries and the Israel Post Office Company. There are also proposals for increasing competition among the airlines and for reforming the Israel Electric Corporation (IEC) by splitting the company into three separate companies by function. In early 2006, the MoF and the National Infrastructures Ministry agreed on the re-structuring of the electricity industry, but a legislative amendment postponed the reform and the splitting of IEC to 31 March 2007. As there is opposition from the unions, intensive talks are currently ongoing with the company and the employees' union on the implementation of the structural change. After structural reform of IEC, the next step would be to privatise, but this would take several years.¹⁵

One of the tasks of the GCA is to publish an annual report on government companies. The report contains financial statements for government companies, the percentage of government equity holdings in these companies and the amounts of revenues generated by them for the state. Last year, transparency also improved with the release of more information from companies in the process of privatisation.

There should be a clear legal and administrative framework for fiscal management

Legal framework for budgetary activities

The Basic Law on the State Economy sets out general budgetary procedures and establishes the government's authority to pass an Interim Budget Bill when the budget has not been adopted by the legislature before the start of the fiscal year. This Interim Bill allows the government to spend one-twelfth of the previous year's budget on a monthly basis for three months. If the budget fails to pass at a third reading, new elections must be held within 90 days.¹⁶ The provision for an Interim Bill was employed in 2002 when the Knesset was unable to pass a budget bill by the beginning of the fiscal year. In 2004, 2005 and 2006, there were also delays in the budget, but the Interim Bill was not employed. Instead, a 'continuing budget' was employed taking figures from the old or new budget -- whichever was smaller. The Basic Law allows as much as three months for the budget to be presented (21-42 days to form a coalition if necessary, and 45 days to prepare a new budget).¹⁷

The MoF's Budget Department administers public expenditure and coordinates and facilitates the entire government and public budget-planning system.¹⁸ Procedures concerning the expenditure of public funds are set out as part of the Basic Law on the State Economy and the Basic Law on Government.¹⁹

Both law and precedent guide the preparation of the budget. In normal years, it is submitted to the cabinet in July. Usually two or three cabinet debates are devoted to this purpose. However, even in the best of years, since ministers

are invariably preoccupied with the implications of the budget for their own ministries, there is scant time for a full-scale macroeconomic debate, because the massive document must be submitted to the Knesset by the end of October.

Legal framework for taxation

Taxation has a clear basis in law. All laws, tax ordinances and regulations are openly available and published in *Reshumot* (the state gazette). Information on taxes is comprehensive: it can be found on the government gateway website and is also provided by the State Revenue Administration.²⁰ The tax system is not unduly complicated.²¹

A 2002 abbreviated tax reform bill raised the value-added tax (VAT) and increased social insurance payments. It also taxed certain types of capital gains for the first time and altered the tax framework under which the labour market operates. Implementation of these changes has continued, with additional changes implemented in the last three years. Tax reforms are bearing fruit, as the MoF has seen revenues coming from capital gains and other areas of recent tax reform. There have been improvements in income tax regulations. All regulations are now published on the MoF website.

In July of 2005, the Knesset approved the tax reform proposals of former finance minister Benjamin Netanyahu for, among other items, reductions in VAT, in corporate income tax and in the highest margin of individual income tax; these are to be implemented over a period of five years. The full report of the Committee on the Multi-Year Tax Plan is available on the MoF website.²²

One of the main complaints is the length of time it takes to resolve tax disputes. This does not look likely to improve in the near future.²³

Ethical standards for public servants

The Civil Service Code sets out ethical standards of behaviour for public servants. The code is only available in Hebrew.

2. PUBLIC AVAILABILITY OF INFORMATION



Enacted

The public should be provided with full information on the past, current, and projected fiscal activity of government.

Comprehensive information is available online, though there is a need for more laws and relevant information to be available in English. While the MoF is planning on translating economic laws into English, there are no plans to publish the entire budget in English, as this is not viewed as an efficient use of resources.

Central government operations

The budget documents are comprehensive -- although not detailed -- and cover most fiscal activity by the government. Extra-budgetary data on pensions, the National Insurance Institute and other government enterprises are included in the Budget Proposal document. Estimates of central government tax expenditures are included in the budget documentation. Information on financial assets and on gross and net public debt is published. Detailed information on government equity holdings in public and private enterprises and financial statements of privatisation operations is included in the annual report of the GCA. The CBS publishes quarterly and annual information on the level, maturity and currency composition of gross central government debt, in line with the IMF Special Data Dissemination Standard (SDDS).²⁴ Commentators have noted, however, that there is a habit of publishing data without complete explanations of what the figures mean, and also that the complexity and lack of clarity in the budget makes it difficult to judge whether stated policies are being carried out in practice.²⁵ In order to address this problem, the MoF has started publishing presentations given by its officials to the Knesset to explain the budget. These presentations are in Hebrew.²⁶ Since October 2003, the MoF website also includes the 'yellow notes' publication, an explanatory guide to the budget presented to the legislature.

The CBS publishes quarterly national accounts including data on public consumption and investment.²⁷ The timeliness of quarterly national accounts exceeds the SDDS, which requires publication within a quarter after the reference period. The CBS publishes main quarterly aggregates within 45 days.²⁸ Some CBS data are being harmonised to comply with Eurostat protocols and, as of July 2006, national accounts include tax and import data, which were previously published separately. Work is ongoing to ensure that all general government accounts are in line with Eurostat methodology.²⁹

The Budget Proposal document includes comparative figures on the previous year's budget and realised figures for the year before that, alongside expenditure allocations for the prospective year. Each ministry's 'blue book' budget document compares the previous year's actual expenditure with the current and next year's budgeted expenditures. It does so on a net and gross basis, where net separates out the expenditures not linked to (contingent upon) revenues. There are few projections or assessments in the budget document for the impact of items passed by laws and government decisions, even for the year immediately following the budget year. There is now a draft budget structure included in the Macroeconomic Framework up until 2010, but this document is not published. The Tax Reform Law, which could contribute to large new deficits in forthcoming years, also lacks revenue projections.

Regular publication of data on the execution of the budget is required by law, and a calendar of release dates is announced.³⁰

Revenue projections have been highly inaccurate in the past few years. Previously, revenue projections were overly optimistic, in order to make room for more spending without breaching deficit limits. Since 2003, revenue projections have been overly conservative in an effort to curb the excessive spending seen in previous years. In 2005, the government introduced an amendment to the Deficit Reduction Law establishing ceilings for government expenditure for 2005-2010, which was expected to reduce overly optimistic revenue projections.³¹ Commentators expressed concern that there was no comparative source for data for revenue projections.³² The MoF's *Annual Report* explains the difference between forecasts and outcomes. In the past there were some differences in the estimation of GDP between the MoF and the central bank. They use separate models, but their estimates are now becoming more similar.

Commentators judged the defence budget to be the least transparent of all budget items, as it is separate from the main budget. However, increasing transparency of the defence budget and the strengthening of MoF control over Ministry of Defence (MoD) expenditures are some of the MoF reform priorities for 2007. At present, if the defence ministry wishes to alter its budget, it can do so immediately, only having to obtain de facto authorisation from the MoF and the Knesset Finance Committee. The only existing limiting provision on defence spending is an order from the MoF stipulating that, if the defence ministry wishes to increase spending by more than 90 million Israeli shekels (approximately 19 million US dollars), it must ask in advance. The MoF is suggesting that the MoD de-classify more figures. The 2007 draft budget already contains detailed information on the non-classified parts of the defence budget, which amount to approximately one-third of the total defence budget. While in the past these figures were only made accessible to one Knesset committee and a small team in the MoF, this year they were given to the entire Knesset and were also made publicly available. While previously the MoF appointed all line ministries' accountants, excepting only the MoD, as of 2006 the MoF also appoints the MoD accountant and is therefore able to access more information on the defence budget.³³

The Foundations of the Budget Law (FBL) mandates that the MoF update budgetary estimates by incorporating the in-year adjustments approved by the Knesset. The FBL also mandates that the MoF submit a quarterly report on the deficit and its financing to the Knesset. The DAG produces both monthly and quarterly reports, which include estimates of the deficit and its financing, as well as information on the execution of revenues and expenditures of the central government (although the classification system used deviates from international standards).³⁴ However, a complete update of the budgetary estimates of revenues and expenditure is only carried out annually in the budget execution report, a document that is published in January.³⁵

Israel complies with the System of National Accounts (SNA) of the IMF Government Finance Statistics Manual, although the IMF has specified that the GFSM statistics should be published separately from the National Accounts and with explanations, something that the CBS is working to comply with. The Accountant General is responsible for reporting actual annual expenditures. The report is considered to be credible, but existing legal provisions allow it to be released with a considerable delay. This lag -- which used to be six months -- has currently been reduced to four months, and it is hoped that it will be three months as from next year. Even though the law states that the DAG should publish its report by June each year, in 2005 it reported at the end of April. The 2006 report is expected to be published in March 2007. The English version of the DAG report is usually made available at a later stage than the Hebrew one.

This year, for the first time, the annual report includes budget execution data presented according to the line ministries' comptrollerships. The budget execution data of each executive department are accompanied by an explanation about the rationale under budget execution, if there is such, at the budget programmes level. Information on deficit, revenues and expenditures can be found in both English and Hebrew on the new DAG website -- within the MoF website -- which was launched at the beginning of November 2006. Some analytical articles are still published in Hebrew only.³⁶

Translation of MoF information into English remains an area of weakness, although some progress has been made over the last year. There is a view that the private sector is already providing this service to the investment community.

In 2003, the MoF added Internet-based services for taxpayers, such as the online payment of VAT and fines, and 'know your rights' information for new citizens to its website.

Israel publishes comprehensive quantitative information on most of the central government's contingent liabilities.³⁷

Public sector operations

A number of quasi-governmental organisations, such as the Jewish Agency, Keren Kayemet L'Ysrael (KKL) and Keren Hayesod, perform some quasi-fiscal activities, such as bringing in new Jewish immigrants and building settlement roads. The government and private donors fund these agencies. For a more complete understanding of their functions and sources of revenue it is necessary to consult the annual report each is required to publish. None of these agencies have to follow the same disciplinary measures as the main line ministries, although some of their operations are included in the MoD budget.

A commitment should be made to the timely publication of fiscal information.

Israel is a subscriber to the IMF SDDS for economic and financial statistics and meets its specifications for the coverage, periodicity and timeliness of the data.³⁸

Chapter three of the State Comptroller Law requires the government to publish fiscal data. Further, Article 49c of the FBL states that a quarterly performance estimate of the deficit and its financing must be released at the end of each quarter and submitted to the Knesset Finance Committee.

Debt Reporting

The Budget Proposal document and the government's *Annual Financial Report* contain comprehensive information on government debt and financial assets. Data on central government debt are publicly disclosed quarterly, three months after the end of the reference quarter, in the relevant issue of the CBS monthly *Selected Economic Indicators*.³⁹ The BoI provides annual estimates of the gross and net general government debt with its level and composition, by sub-sectors.⁴⁰

Advance release calendars

In accordance with its commitment to the SDDS, Israel produces advance release calendars across the range of fiscal data that it releases under the provisions of the SDDS. Specifically, the CBS website publishes the advance release calendar for the coming four months at the end of each month, as well as a week-ahead calendar giving precise release dates at the end of every week.⁴¹

3. OPEN BUDGET PREPARATION, EXECUTION AND REPORTING



Enacted

According to the most recent IMF fiscal transparency Reports on the Observance of Standards and Codes (ROSC), the area requiring most improvement is the way in which the budget is prepared and presented. The IMF recommended that the budget documents include a more systematic analysis of the sensitivity of the budget to economic and financial shocks -- an analysis which is carried out internally but not made publicly available -- and additional information on budget execution (including a revised projection for the year in course). Furthermore, the IMF recommended that the expenditure classification should be revised to conform more closely to international standards. The IMF also notes that the general government deficit is not an especially useful fiscal indicator.⁴²

Fiscal policy objectives, macroeconomic framework and risks

Fiscal policy objectives

Fiscal policy objectives, the macroeconomic framework and the policy basis for the budget are set out and analysed in both the final budget document and in the Budget Proposal document. However, the information on fiscal objectives is relatively general. As noted by the IMF, the Annual Budget Law “includes broad functional, economic and program classifications that are considerably less detailed than those set out in the IMF’s *Government Financial Statistics Manual 2001 (GFSM 2001)*”.⁴³

Based on an IMF recommendation, the authorities have agreed to explore the possibility of adopting a multi-year budget framework to help ensure that future budgets are better insulated from political pressures and reflect long-term priorities. Multi-year budget frameworks have been adopted in certain areas and line ministries -- such as infrastructure plans, the Ministry of Immigrant Absorption and the Ministry of Tourism -- but the authorities are convinced that parts of the bureaucracy, notably the MoD and the MoF, need to retain some flexibility and should therefore not be bound by a medium-term expenditure framework.⁴⁴

The government sets a deficit target, which is prescribed by the 1993 Reduction of the Deficit Law. It was hoped that the law would divert some part of the stronger revenues toward reducing the national debt, rather than letting politicians spend the new revenues.⁴⁵ However, this law has been breached in each of the subsequent years since its passage owing to shortfalls in tax revenues, and the sectoral interests for additional transfer payments. In fact, according to officials, the law requires that the budget must be planned with the deficit target in mind, but there is no legal requirement to meet the target.⁴⁶ As the Reduction of the Deficit Law is binding only at the planning stage, not at the expenditure stage, the MoF recognised that it was not working, and it was amended last year. The amendment limited the growth of public expenditure to 1% per annum and the budget deficit to 3% of GDP from 2005-2010. This year, the ceiling on growth of public expenditure has been raised to 1.7%. However, its application lacks transparency, and the expenditure limit in particular faces constant pressure from politicians.⁴⁷

In 2003, confronted by the worst and longest economic recession in Israel's history, the government adopted one of the largest-ever economic reform packages. It contained a number of structural and fiscal reforms that the MoF had tried to persuade politicians to take up for years. In 2005, the economy entered a modest recovery path, and the structure of the economy began to be substantially overhauled. Structural and fiscal economic reform plans included abolishing special tax breaks for rural areas, merging some local councils, reducing payments to local authorities and

increasing municipal taxes. In addition, a major overhaul of the country's union-run pension funds was carried out, as well as increased privatisation.

Macroeconomic framework

The macroeconomic framework has a clear, transparent set of goals, and includes medium- and long-term budgetary goals, such as the expenditure and deficit limits. It is set out in the Major Provisions of the Budget section of the Budget Proposal and now projects as far as 2010. The same section sets out the targets for the coming fiscal year and outlines government policy for major economic and social sectors. The Composition of the Budget section is intended to provide a comprehensive explanation of current expenditure and how it will be used in different economic sectors. However, this section cannot be relied upon as a definitive predictor of government activity. At the mid-term of each fiscal year, funds are invariably transferred from one sector to another to cope with stopgap needs. For example, in 2006, there was a large cut across the board in order to transfer funds to military needs. As these transfers are deemed necessary on a fairly regular basis, there are no formal plans to limit them.

The Budget Framework section of the Budget Proposal contains an explanation of the government's tax policy and its effects on the Israeli economy. Since budget reporting is based almost entirely on cash flow, as the fiscal year draws to a close many payments to suppliers are held up and carried over to the accounts of the following year. In 2002 for example, the government chose not to issue VAT refunds as scheduled on 20 December, but to hold them over until January 2003.

Fiscal risks

The Accountant General has set up a subsidiary office to study liability management. The office has been formed under the MoF debt management unit, which is building a model to analyse fiscal risks and other macroeconomic risks. One category of bonds is still managed by the BoI rather than the MoF's debt management unit. Public debate on the issue tends to focus almost solely on the assessments made by the world's three largest analysts of sovereign debt (Moody's, Standard and Poors, and Fitch).

The MoF has been publishing analysis of fiscal and macroeconomic risks in its *Outlook* publication since 2003. It is considering measures to comply with the IMF recommendation to include more risk analysis in budgets.

Fiscal sustainability

Within the Treasury, there are no fiscal sustainability assessments, such as debt management sensitivity checks or analysis of the sensitivity of the budget estimates to changes in economic or financial conditions. The main fiscal vulnerabilities are not discussed in the budget documents. However, the DAG has established a debt management office, which conducts research on fiscal vulnerability.⁴⁸

The BoI also conducts periodic analyses of fiscal sustainability and its sensitivity to macroeconomic developments. A fiscal sustainability analysis is included in the BoI *Annual Report*. The budget submission is published in BoI periodic publications or in a special press release.⁴⁹

Budget presentation

The complete budget is only published in Hebrew. Net expenditure and revenue-contingent expenditure constitute the gross budget. The National Budget specifies amounts as net expenditure, gross expenditure and revenue-contingent expenditure. Budget items of each expenditure type are also detailed. The Treasury publishes a 'blue book' for each ministry, commenting on its performance. It is moving towards reporting quantified physical results

of expenditure where applicable, such as number of kilometres of roads built. A move to performance-based budgeting would improve transparency and aid parliamentary scrutiny of the budget process, but there are obstacles to measuring productivity in some ministries, and these would need to be overcome if this were to be implemented across the board. The MoF recognises that it will take years to implement performance-based budgeting.⁵⁰

The auditing department of the Ministry of Interior (MoI), the State Comptroller and the MoF's director in charge of salaries monitor the local authorities. A special accountant can restrict funding from the central budget to the local authorities. The financial reports of each authority set out the amount of budgetary transfers from the government. The Budget Proposal document presents the consolidated fiscal position of the general government. While local authorities do not publish full spending reports with explanatory notes, allocations to local governments are included in the state budget. Also, information on past allocations and municipal spending is provided by the MoI, which is in charge of approving every local budget annually. However, this information is provided with a considerable time lag.⁵¹

The *National Budget* includes forecasts for the two years following the budget year. Until 2002 the *National Budget* was published jointly by the BoI and MoF, but this was not the case in 2003 owing to disputes between the BoI and the MoF. This has remained the case, but the ending of joint publication is not seen as a concern either by BoI or MoF officials. In fact, commentators felt this system is better, in that in the past the reports were weaker because officials had to negotiate figures, policy and wording; now each report has clear analysis and projections.⁵² Last year, only the MoF published the *National Budget* for 2006.⁵³

The budget documents detail the government's major policy objectives but do not always report progress in achieving them. However, the explanatory report and the blue books usually report on progress.⁵⁴

From October 2003, the 'yellow notes' publication, an explanatory guide to the budget presented to the legislature has been published on the MoF website. It includes several macroeconomic analyses. The government has started to present details on any missing or inconsistent data and on any discrepancies in the yellow notes at the end of each section in the final budget.⁵⁵

Commentators stated that the budget process is transparent, if not necessarily the budget itself.⁵⁶

Budget execution and monitoring

The Internal Audit Unit audits all ministry units with the assistance of internal departmental audit units. It also monitors the correction of irregularities found in the internal audits and in audits by the State Comptroller. The unit presents its reports to the Director General of the MoF and the directors of the audited units.

Efforts are underway to improve the accountability of local authorities' spending. The government has become stricter in its loans to municipalities and has set up 'recovery plans'; this has led to a reduction of deficits among weaker municipalities. Spending is only increased if the recovery plan is adopted.⁵⁷ Additionally, when a local authority is not managing its budget in a satisfactory way, the MoI appoints an 'accompanied accountant' (that is, an accountant who accompanies the local treasurer), whose signature is required for any financial commitment or expenditure of the local authority.⁵⁸

In a recent ROSC, the IMF recommended that budget documents include some additional information on budget execution, including a revised projection for the current year, information on general government and the financial statements of the larger government companies. The IMF recommends that the FBL be amended to provide a legal basis for this increased information.⁵⁹ Budget execution data are available on the MoF website and, since 2006, are submitted monthly to the Knesset.⁶⁰

As of 2005, ministries are allowed to spend on a monthly basis. They receive a monthly permitted budget from the MoF, which is adjusted quarterly if needed. As of November 2005, ministries are also allowed to see their own budgets for the next year, which has undoubtedly improved their ability to plan.⁶¹ Most ministries under-spend their portion of the annual budget and carry over funds from one year to the following. This has created a debate on how to present this information. While the BoI is inclined to use unspent monies to pay down the debt, the MoF has in the past preferred lowering tax rates. Following the appointment of a new Accountant General in 2006, rivalry has arisen within the MoF on this issue. The new Accountant General intended to make the process more transparent and based more on private sector-style methodologies than it had been in the past, but encountered resistance within the ministry.⁶²

Accounting basis

The central government accounting system produces timely and accurate data.⁶³ Israel's central government transactions are recorded on a cash basis, apart from foreign grants data, which are partly recorded on an accrual basis. In 2004, the government began the process of adopting the International Federation of Accountants (IFAC) Handbook of International Public Sector Accounting Standards. A board has been created for this operation, and they are currently translating the standards. To date, 13 of the 21 standards have been adopted, and the remaining ones are expected to be adopted in 2007. The Accountant General Department's integrated fiscal management system (FMIS) produces a complete and aggregated monthly report on central government activities, which is published on the first day of every month.

In 2003, the government began moving to accrual-based accounting. The MoF has been 'beta testing' an Economics Resources Planning (ERP) software platform, which will allow partial accrual accounting. The current balance sheet includes many previously missing details, thanks to the gradual introduction of accrual-based accounting. Liabilities are now covered in full, and assets are being covered in part; for example infrastructure, investments and army assets are now included. Six ministries produced statements on an accrual basis in 2004, and by the end of 2005, offices in some 15 ministries had adopted accrual-based accounting. The budget continues to be compiled on a cash basis, but the MoF anticipates that by 2007, 80% of the budget will be compiled on an accrual basis. By the end of 2006, 31 offices will have adopted accrual-based accounting, which is expected to be government-wide by 2009. At present, despite the high percentage of the budget compiled on an accrual basis, not all the ministries are involved in the process, and accrual accounting has only been introduced in certain departments. The use of the ERP platform will enhance the accountability of finances and will help link ministries together.⁶⁴

Government pensions are currently not included in measures of the public debt, but the adoption of accrual accounting could see this happen.⁶⁵

As part of the accounting reform the first new financial statement was published in September 2004. The report -- which also includes an auditing critique -- is available online, but only in Hebrew. Improvements are ongoing; for example, last year's report fully explained committed expenditures. In 2006, the budget execution report has been combined with the financial statement, and the resulting report is also available in English, although with some delay relative to the Hebrew version. The report includes more information on government assets and provides separate information on all projects (often settlement projects) worth over 100 million Israeli shekels (22 million US dollars). However, the corporate-style accounting introduced this year by the DAG for the budget execution report is not fully following GFSM standards, and this has made comparisons with previous years quite cumbersome owing to the lack of a 'bridging' mechanism.⁶⁶

The government has introduced a computerised accounting system known as 'Merkava', although full implementation is expected to take a long time. The CBS compiles military accounts separately from government accounts, and the MoD has its own version of Merkava, which might not be fully compatible with the one introduced

elsewhere in the government. With the introduction of Merkava, the MoF will be able to obtain information on line ministries' spending before, rather than after, the fact, as ministries will have to input their expenditures into the system before they are executed.⁶⁷

Procurement and employment

The IMF judges that "procurement policy and procedures are well developed and adequately publicised."⁶⁸ The Government Advertising Agency operates government tenders, which are advertised on the Israeli Government Tenders website in Hebrew only.⁶⁹ The MoF website posts a list of tenders in English.

The Civil Service Commission is responsible for government employment. The commission operates open tenders for jobs in the civil service. However, at higher levels, ministers' personal advisors, such as director generals, spokespeople and political assistants, are still not subject to competitive recruitment procedures.

Of particular concern in 2002 were the attempts by politicians to undermine regulations that limit the appointment of members of party central committees to the boards of directors of government corporations. Under these regulations, which are supervised by a special, independent committee, members of party central committees must prove that they are more qualified than any other candidate before being appointed as a government company director. In 2003, criteria for civil service positions continued to be circumvented. For example, scandals erupted in which appointees were found to have essentially purchased college degrees.

A pilot project was announced in September 2004 by the Accountant General's office at the MoF for an online tender system within the larger framework of the E-Government Project. The online tender system is a trading platform for online government tenders, which aims to increase the transparency of the tender process.⁷⁰ The new system was launched as a joint venture between several government ministries and the Accountant General's office and will serve as the infrastructure for a government procurement and tender platform to be used in coming years.⁷¹

As noted by the IMF in a recent ROSC, "the tax and customs administrations are given adequate legal protection from political interference".⁷²

Fiscal reporting

The Basic Law on the State Economy and the FBL stipulate the criteria for fiscal reporting. These cover such processes as budget preparation and the budget proposal.

The DAG prepares regular financial statements of the government accounts and reports to the Knesset and State Comptroller on all budgetary operations. The Accountant General reports on mid-year budget execution to the Knesset.⁷³

The Knesset Finance Committee is mandated to examine the budget prior to its passage into law. However, the committee has largely failed in its task as overseer of MoF activities and tends to be more politically minded. It lacks its own independent body of experienced investigative experts. It has tended to accept MoF forecasts based on previous budgets, rather than conducting independent assessments of past performance. Moreover, most committee members have demonstrated consistently that their primary concern is continued or expanded funding for their sectoral interests, even at the cost of more important macroeconomic concerns. Nonetheless, in their search for monies to spend, they occasionally stumble upon areas of MoF opacity.

The backroom dealings of the Finance Committee create another layer of opacity. When spending is examined by subject, rather than by institutional structure, the results can lead to considerable confusion. For example, spending

on ultra-orthodox religious institutions is funnelled through no less than four ministries and is distributed into dozens of budgetary subsections. A precedent-setting decision by the Supreme Court in 2002 has alleviated some of the opacity by ending ‘double-budgeting’, so that the same institution can no longer receive financial assistance from two different ministries for the same purpose. This rule is being observed.

The MoF issues reports of expenditure broken down by composition.⁷⁴ A 2004 IMF ROSC recommended the preparation and publication of a more detailed spending plan with medium-term expenditure targets, possibly supplementing them with “semi-annual detailed reports on progress in achieving the government’s public finance goals and the implementation of the various measures and reforms.”⁷⁵

Comparisons between revenue projections and outcomes are made publicly available.⁷⁶

While the CBS compiles a detailed GFSM report for the IMF, the MoF sends very limited data to the IMF. The government is accelerating work aimed at expanding the scope of government finance statistics, which already include all the financial stocks of the central government and most of its non-financial assets.⁷⁷

4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY

●●●● Compliance in progress

Data quality standards

The Central Bureau of Statistics (CBS) collates and publishes all statistical information in Israel. The bureau meets the IMF SDDS for data quality. Effective tools and procedures are in place to assure the reconciliation and internal consistency of fiscal data. Budgetary projections have been less reliable in the last six years than they could have been, though revenue projections were more reasonable in the 2004 budget.

Independent scrutiny of fiscal information

Independent Audit

The State Comptroller's Office performs external audits on central and general government activities. The State Comptroller is independent of the executive branch. The office has access to all necessary information when carrying out its functions. Its audits are based on timely and comprehensive information. It releases two reports per year, one that examines defence and security issues and the other government operations. The State Comptroller's Office also acts as the state's ombudsman. Its annual reports on the execution of the state budget and on the state balance sheet are available in a timely manner in hard copy and on the State Comptroller's website.⁷⁸ Mechanisms are in place to ensure that audited agencies take appropriate action to address the State Comptroller's recommendations.⁷⁹

The DAG has financial oversight over all ministries. Its Internal Audit Unit (IAU) is responsible for the internal audit of the execution of the state budget in all ministries' accounting and finance units. The IAU audits large government entities every two years and smaller ones every four years. All line ministry accountants are actually DAG employees and are thus obliged to report to the DAG.

National Statistics Agency

The CBS follows UN and other codes for national statistics bodies and is viewed as an independent institution. The head of the CBS is proposed by the prime minister and appointed by the government. The CBS's library is open for public use.

The IMF recommended that the CBS and the MoF cooperate more closely on budget classification. As a result, the Budget Department and the Accountant General Department of the MoF, as well as the CBS, created a joint working group on statistical production whose meetings -- started in February 2006, but interrupted by the war and the process of budget preparation -- are expected to resume in the short term. These meetings aim to promote the compilation of fiscal data according to the GFSM 2001 methodology.⁸⁰

To improve the coordination and dissemination of statistics, the frequency of meetings of SDDS coordinators from the CBS, MoF and BoI has been increased and -- since February 2006 -- these meetings take place quarterly.

The CBS has a number of medium-term goals for the next five years. Specifically, it aims to produce quarterly accounts for the SNA and to complete accumulation accounts. It also intends to include government enterprises in the public sector accounts, to introduce accrual accounting through Merkava and to establish a database of public sector data and accounts for internal CBS use. In addition, it aims to compile accounts regionally, as requested by the EU, and to improve information on non-profit institutions, only some of which are currently covered.⁸¹

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following officials during a visit to Israel between 13 and 17 November 2006:

Ministry of Finance

13 November 2006

Marc Luban	OECD Coordinator	
Yossi Gordon	Deputy Director	Budget Department

15 November 2006

Avisar Cohen	Senior Deputy Accountant General	Accountant General's Office
--------------	-------------------------------------	-----------------------------

16 November 2006

Eldad Shidlovsky	Senior Division Manager	Economics and Research Department
Yariv Nehama	Deputy Accountant General	Accountant General's Office
Israel Kaplan	Senior Director	

Bank of Israel

16 November 2006

Eyal Argov	Economist	Research Department
Yehudit Golan	Senior Economist	International Affairs
Adi Brender	Senior Economist	Public Sector Analysis, Research Department
Ahuva Ben Shalom	Chief Analyst	IT Department

ADDITIONAL INTERVIEWS

13 November 2006

Soli Peleg	Senior Director	Macroeconomics Department Central Bureau of Statistics (CBS)
Amir Davidson	Director	General Government and Social Services Accounts Sector Central Bureau of Statistics (CBS)

14 November 2006

June Dilevsky	Assistant Director	Department of International Affairs Israel Securities Authority
---------------	--------------------	--

Yoram Naveh

Deputy Director and
Legal Counsel

Corporation Finance Department
Israel Securities Authority
Israel Securities Authority

Shirelle Guttman-Amira

NOTES

- ¹ Interviews in Israel, 13-17 November 2006.
- ² Ministry of Finance website, 'International Division, Functions of the Ministry and Structures of the Ministry' at: www.mof.gov.il
- ³ Interviews in Israel, 1-4 November 2005.
- ⁴ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ⁵ Interviews in Israel, 13-17 November 2006.
- ⁶ Interviews in Israel, 13-17 November 2006.
- ⁷ Interviews in Israel, 13-17 November 2006.
- ⁸ Interviews in Israel, 13-17 November 2006.
- ⁹ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ¹⁰ Bank of Israel website, 'Bank of Israel: Banker of the Government and Banks', at: www.bankisrael.gov.il.
- ¹¹ Interviews in Israel, 13-17 November 2006.
- ¹² Bank of Israel website, see end of month balance sheets on 'Information and Data' page, at: www.bankisrael.gov.il.
- ¹³ Interviews in Israel, 1-4 November 2005.
- ¹⁴ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ¹⁵ Interviews in Israel, 13-17 November 2006.
- ¹⁶ Ministry of Foreign Affairs website, 'The Basic Law on Government', at: www.mfa.gov.il.
- ¹⁷ Interviews in Israel, 1-4 November 2005.
- ¹⁸ Ministry of Finance - International Division, 'Functions of the Ministry' and 'Structures of the Ministry' at: www.mof.gov.il
- ¹⁹ Ministry of Foreign Affairs website, 'The Basic Law on the State Economy', at: www.mfa.gov.il
- ²⁰ 'Government Gateway: Information and Services' at: www.info.gov.il
- ²¹ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ²² See www.mof.gov.il/beinle/part1August17.pdf
- ²³ Interviews in Israel, 11-14 October 2004.
- ²⁴ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ²⁵ Interviews in Israel, 1-4 November 2005.
- ²⁶ Interviews in Israel, 13-17 November 2006.
- ²⁷ Central Bureau of Statistics, Selected Data (English) at: www.cbs.gov.il
- ²⁸ "Israel: Report on the Observance of Standards and Codes – Data Module, Response by the Authorities, Detailed Assessments Using the Data Quality Assessment Framework (DQAF)," IMF, 2006.
- ²⁹ Interviews in Israel, 13-17 November 2006.
- ³⁰ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ³¹ Interviews in Israel, 1-4 November 2005.
- ³² Interviews in Israel, 11-14 October 2004.
- ³³ Interviews in Israel, 13-17 November 2006.
- ³⁴ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ³⁵ Interviews in Israel, 1-4 November 2005.
- ³⁶ "Financial Information of the Government of Israel December 31, 2005," Ministry of Finance – The Accountant General, 2006, p. 1.
- ³⁷ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ³⁸ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ³⁹ IMF 'Israel: Central government debt,' SDDS website at: dsbb.imf.org
- ⁴⁰ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ⁴¹ "Israel: Report on the Observance of Standards and Codes – Data Module, Response by the Authorities, Detailed Assessments Using the Data Quality Assessment Framework (DQAF)," IMF, 2006.
- ⁴² Israel: 2003 Article IV Consultation—Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion, IMF, June 2004.
- ⁴³ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ⁴⁴ Interviews in Israel, 13-17 November 2006.
- ⁴⁵ Interviews in Israel, 27-29 October 2003.
- ⁴⁶ Interviews in Israel, 11-13 November 2002.

-
- ⁴⁷ Interviews in Israel, 13-17 November 2006.
- ⁴⁸ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ⁴⁹ Interviews in Israel, 1-4 November 2005.
- ⁵⁰ Interviews in Israel, 13-17 November 2006.
- ⁵¹ Interviews in Israel, 13-17 November 2006.
- ⁵² Interviews in Israel, 27-29 October 2003 and 11-14 October 2004.
- ⁵³ Interviews in Israel, 1-4 November 2005.
- ⁵⁴ Interviews in Israel, 27-29 October 2003 and 11-14 October 2004.
- ⁵⁵ Interviews in Israel, 11-14 October 2004.
- ⁵⁶ Interviews in Israel, 11-14 October 2004.
- ⁵⁷ Interviews in Israel, 11-14 October 2004 and 1-4 November 2005.
- ⁵⁸ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ⁵⁹ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ⁶⁰ Interviews in Israel, 13-17 November 2006.
- ⁶¹ Interviews in Israel, 1-4 November 2005.
- ⁶² Interviews in Israel, 13-17 November 2006.
- ⁶³ Interviews in Israel, 27-29 October 2003 and 11-14 November 2004.
- ⁶⁴ Interviews in Israel, 13-17 November 2006.
- ⁶⁵ Interviews in Israel, 1-4 November 2005.
- ⁶⁶ Interviews in Israel, 13-17 November 2006.
- ⁶⁷ Interviews in Israel, 13-17 November 2006.
- ⁶⁸ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ⁶⁹ See: michrazim.lapam.gov.il
- ⁷⁰ See: www.tenders.gov.il
- ⁷¹ Press release, Ministry of Finance, 13 September 2004.
- ⁷² IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ⁷³ Interviews in Israel, 11-13 November 2002.
- ⁷⁴ Interviews in Israel, 13-17 November 2006.
- ⁷⁵ Israel: 2003 Article IV Consultation—Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion, IMF, June 2004.
- ⁷⁶ Interviews in Israel, 11-14 October 2004.
- ⁷⁷ Interviews in Israel, 13-17 November 2006.
- ⁷⁸ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004. See also: www.mevaker.gov.il
- ⁷⁹ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ⁸⁰ Interviews in Israel, 13-17 November 2006.
- ⁸¹ Interviews in Israel, 13-17 November 2006.