



**The Knesset
Research and Information Center
Budgetary Control Department**

Jerusalem, November 10 2009

To the Chairman and Members
of the Knesset Finance Committee,

Re: Examination of the Macroeconomic Assumptions of the Biennial Budget

This document has been written towards the appearance of the Minister of Finance before the Knesset Finance Committee on November 11, 2009. The document includes a short description of the Ministry of Finance forecasts that were used for the preparation of the 2009-2010 budget, compared with the updated data, estimates of the budget deficit expected in 2009, and an initial analysis of the efficiency of the biennial budget. In addition, a survey prepared by the Knesset Research and Information Center, on the experience in the world in the implementation of biennial budgets, is attached.

1. The forecasts of the Ministry of Finance compared to updated data.

One of the marked shortcomings of a biennial budget is **the discrepancy between the budgetary policy and changes in the world and domestic economic environment**. And indeed, in few countries in the world have biennial budgets been implemented, especially due to this shortcoming, and even in states where a biennial budget has been implemented this has been due to a political crisis, and not due to economic justifications.¹

The budget preparation process is based on macroeconomic assumptions prepared by the Ministry of Finance, especially growth rates of macroeconomic variables, such as: Gross Domestic Product, Private and Public Consumption, Gross Domestic Investment, the Export and Import of Goods and Services, the rate of Unemployment and the rate of Inflation. These forecasts serve, amongst other things, for the preparation of expectations regarding the revenue of the State from taxation, and the budget deficit target.

In the Summer of 2008 the Ministry of Finance prepared economic forecasts that served the preparation of the proposed budget for 2009. The dissolution of the 17th Knesset before the 2009

¹ Dr. Susan Hattis Rolef, *Two-Year (Biennial) Budgets* (translation into English), The Knesset Research and Information Center, November 2, 2009

budget was approved led, in April 2009, to the updating of the macro-economic forecasts, which served the preparation of the biennial budget for the years 2009 and 2010.

In the course of the second quarter of 2009 a turning point occurred in the domestic and world economies – the fall in GDP was halted, and in several countries the GDP actually started to increase. This change has had an effect on State revenue from taxation, and subsequently on the budget deficit forecasted for the years 2009 and 2010. Indeed, the change in the economic environment, as of the second quarter of the year 2009, led to the updating of the macroeconomic forecasts by the Bank of Israel and by independent analysts for the years 2009 and 2010.

State revenue in the months January to October 2009 amounted to about 146.5 billion NIS – in other words, revenue at an annual rate of around 175.8 billion NIS, which constitutes **an increase of close to three billion NIS** compared to the partial data regarding 2009, and later forecasts for the year 2010.²

Table 1 – Macroeconomic Variables Used to Prepare the State Budget³

Macroeconomic Variable	2008 in Practice	2009		2010	
		Finance Ministry Forecasts	Partial Data	Finance Ministry Forecasts	Updated Forecasts
Private Consumption	3.6%	0.0%	0.6%	3.1%	3.5%
Public Consumption	2.1%	3.1%	1.6%	2.6%	1.5%
Investment in Fixed Assets	4.4%	-9.8%	-6.9%	0.0%	1.4%
Export of Goods and Services	5.2%	-11.9%	-11.6%	5.4%	6.3%
Import of Goods and Services	2.4%	-12.1%	-14.9%	7.5%	6.9%
Current Account (in billions of dollars)	1.6		7.3		4.8
GDP (Increase in %)	4.0%	-1.0%	0.0%	1.5%	2.5%
GDP (in billions of current NIS)	725.1	745.8	767.8	779.9	
GDP of the Business Sector	4.5%	-2.4%	0.9%	1.2%	2.8%
Rate of Inflation	3.8%	1.1%	3.6%	2.4%	
Rate of Unemployment	6.1%	7.6%	8.1%	8.5%	8.3%
Budget Deficit as % of GDP	2.1%	6.0%	5.4%	5.5%	4.5%
Deficit (in billions of current NIS)	15.2	44.4	41.5	43.0	
Revenue from Taxes (in billions of current NIS)	183.7	172.9	175.8	183.1	

² The Ministry of Finance, *Actual State Revenue from Taxes - October 2009*, November 9, 2009.

³ Data for 2008 – the Central Bureau for Statistics; Ministry of Finance forecasts – *Proposal for the Budget Years 2009-2010*. June 2009; Data and updated forecasts – Bank of Israel *Update of the Macroeconomic Forecasts for the Years 2009-2010*, Inflation Report for the Third Quarter 2009. November 2009; The Central Bureau for Statistics, *Quick Forecasts for the National Accounts for the Year 2009*, October 18, 2009.

Table 1 above provides details of some of the forecasts of the Ministry of Finance for the years 2009 and 2010' compared to the partial data regarding the year 2009 and more updated forecasts for the year 2010.

The data in the table show that in the course of the last few months an improvement has taken place in the macroeconomic variables, including the rate of growth, State revenue from taxes and the budget deficit. According to an updated forecast by the Bank of Israel the budget deficit in 2009 will be around 5.4% of GDP, or around 41.5 billion NIS, compared to a target deficit of around 6% of GDP, or 44.4 billion NIS according to the budget.

A preliminary analysis shows that the preparation of a biennial budget, based on macroeconomic assumptions made a long time before the budget year, could lead to an inefficient budget policy. As stated, a comparative survey shows that in various states in the world use was made of biennial budgets on rare occasions only, especially as a result of political crises.⁴

2. Changes in the Budget

The budget proposal for the years 2009 and 2010 was approved in the Knesset on July 15, 2009. Two and a half months later, on October 1, 2009, the Government adopted a decision concerning a significant change in the budget – a budgetary transfer amounting to around two billion NIS from budget items of the civilian Ministries to the Defense budget and the Health budget (for contending with Swine Flu).

On November 10, 2009, the Knesset Finance Committee approved a budgetary transfer of around one billion NIS. According to the National Budget Director in the Ministry of Finance, the remainder of the budgetary change will take place in the course of 2010, and will be based on the deferment of budgets, the use of budget reserves, and a cut in budget items in which there is under-utilization.

An examination of the cuts in the civilian budgets shows that in some of the items the rate of the cut in relation to the original budgets is significant.⁵ It may be assumed that an across the line cut in the flexible parts of the budget makes it difficult to implement those budget items by the Government Ministries. Furthermore, uniform cuts in the budgets of the Ministries could have a negative effect not only on the manner in which the budget is implemented, but also on the attainment of the various budgetary goals.

Written by Ilan Biton and Ami Zadik

Approved by Ami Zadik, Director of the Budgetary Control Department.

⁴ Regarding the advantages and disadvantages of biennial budgets see: Ami Zadik, *Issues in the Adoption of a Multi-Annual Budget* (Hebrew), The Knesset Research and Information Center.

⁵ A detailed table showing cuts in specific budget items has been deleted from the translation.