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Ministry of Finance

Decision-making processes: Meeting the deficit target for 2018; revenues forecast for 2019; salary increases for a lack of job security

Abstract

Decision Making Processes at the Ministry of Finance

Meeting the deficit target for 2018; revenues forecast for 2019; salary increases for a lack of job security

Background

The state budget is the principal tool for implementing the government's economic policy and is of decisive importance for national economic and social processes.

The state budget is managed on a cash basis, i.e. revenues and expenditures in the state budget are recognized on the actual date of payment or actual date of receipt of proceeds.

The budget deficit is the gap between the state's revenues and its expenditures, and its size affects the onus of interest payments paid from the state budget. The law determines a multi-year fiscal rule ("deficit ceiling") that defines the maximum yearly deficit rate in the budget as a percentage of the GDP. Therefore, the timing of actual revenues and expenditures matters greatly, especially toward the end of the year.

In November 2018, the government decided on a wage increase for the security services - the Israel Police, the Israel Security Agency and the Mossad - to compensate for the lack of job security in that employment sector. This decision meant an expenditure of NIS 22 billion from the state budget.

Key figures

NIS 377.5 billion

government expenditures in 2018

2.9%

of GDP = NIS 38.9 billion: the deficit in practice in 2018 = the deficit ceiling set by law

14%

the increase in revenues from direct taxes in December 2018 compared to December 2017

NIS 1.5 billion

the decrease in expenditures in the fourth quarter of 2018 compared with the same quarter of 2017

26%

the increase in government ministry expenditures in January 2019 compared to January 2018

NIS 22 billion

the cost of the framework for a salary increase due to lack of job security

3.6% of GDP

updated deficit forecast for 2019, reflecting a 0.7% increase compared to the original forecast The forecast was presented to the government in January 2019.

Scope

We examined decision-making processes related to meeting the 2018 deficit target and the preparation of the 2019 forecast. We also examined the decision-making process on the increase compensating for the lack of job security. The decisions were adopted in late 2018 and had a significant budgetary impact.

Key Findings

- The updated 2019 revenue forecast was only presented to the government in January 2019, after the budget for that year had already gone into effect. The updated forecast showed a deficit of 3.6% of the GDP (0.7% above the original forecast) and this impacted the government's ability to meet its target. This was a result of the 2019 budget being exceptional as it was authorized by the Knesset in March 2018 and was based on a revenue forecast conducted in late 2017. The updated forecast for 2019 was authorized by the management of the Ministry of Finance only in late 2018.

- The operations of the Department of the Accountant General and the Tax Authority's tax collection efforts at the end of 2018, which were not found to have been performed in violation of authority or in violation of the law, resulted in compliance with the deficit ceiling of 2.9% of the GDP. However, this was done without an inclusive debate of all the professional entities about the effect of preferring one budget year over the next budget year.

- Taking into account the significant cost of the plan to compensate for lack of job security, which totaled NIS 22 billion, the authorization process of the plan was conducted on a tight schedule and accompanied by a significant budget cut in order to finance it. This will have implications for the state budget in coming years.

- The auditors found that cooperation in decision-making processes at the Ministry of Finance was damaged as a result of sub-optimal relations within the ministry.

The adoption of the numerator (measure of anticipated income and expenses) in 2015 was a welcome step in maintaining fiscal sustainability, but it is necessary to make sure that decisions inconsistent with this mechanism are not taken.

In preparing the 2019 forecast, the Ministry of Finance operated according to the "procedure for preparation of a base forecast for the state budget," which provides that the chief economist is responsible for compiling the forecast.

Key recommendations

- We recommend that macro-economic forecast decisions, which could have an effect on the state economy and the priorities of the government, be based on solid professional foundations and on an examination of the complex of circumstances based on a long term look that examines economic policy, by means of a process of integrative knowledge-sharing among all the professional entities.

- We recommend ensuring that no decisions are taken that are inconsistent with the numerator's underlying principles.

- We recommend that the Ministry of Finance consider formulating supplementary regulations for the directives of Section 40A of the Budget Principles Law, for circumstances in which the government decides to formulate its budget based on early forecasts. The regulations should determine internal conduct in the Ministry of Finance, and determine that the debate in the government takes place at a time that will allow preparations for meeting the deficit targets.

- Without detracting from the authority of the Accountant General and the Tax Authority, we recommend that any decision on incurring expenditure or taking steps to lawfully collect tax for a particular budget year, especially in significant amounts, be taken only after constructing a comprehensive assessment of the economic situation and obtaining the positions of all the relevant professional entities.

- We recommend that the Ministry of Finance complete the debate on the formulation of recommendations with regard to the rate of interest currently employed in the tax system, currently at a rate of 4% including linkage, given the low rates of interest currently prevailing in the economy, while taking into account all the implications, including aspects of positive and negative incentives regarding tax payments and aspects of timing.

- We recommend that the government, through the Minister of Finance, conduct a retrospective analysis of the process that authorized the job security compensation agreement and derive the appropriate lessons. We also recommend that the Ministry of Finance map the issues and subjects currently under legal process, or have the potential for broad economic exposure, and formulate a foundation for debating and taking action on these subjects and bringing them to debate before the government for the purpose of decision making in a timely fashion.

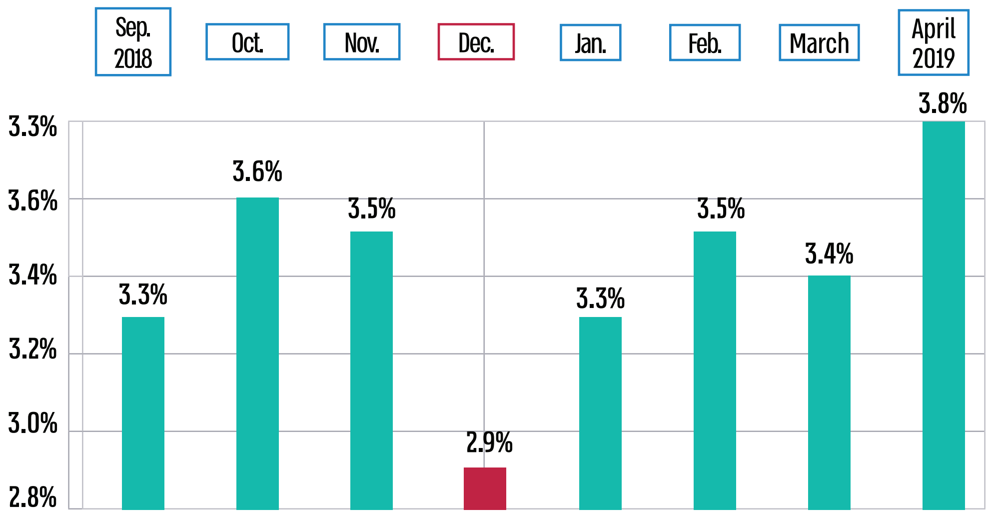
We recommend that the Minister of Finance complete the examination of the structure of authority of the Finance Ministry's Director General and the heads of the different wings, and formulate the structure in a way that optimizes the work of the Ministry of Finance.

Summary

The Ministry of Finance plays a central role in strengthening the Israeli economy. The professional echelons must lay the infrastructure required to assist the elected echelons in implementing Ministry policy, including producing relevant and timely forecasts and integrating payment and collection efforts, while examining the effect of the deficit from a macro-economic perspective.

Lessons should be learned from the government's handling of the wage increase agreement compensating for lack of job security with a forward-looking perspective; agreements and disclosures of considerable economic significance should be mapped; and regular debates of these issues should be held and decisions made in a timely manner.

The development o f the state budget deficit as a percentage of the GDP from 09/18 to 04/19



The budget deficit as a percentage of the GDP in 2013-2018 versus the deficit target