



State Comptroller of Israel | Local Government Audit | 2021

Systemic Audit

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# **The Financial Resilience of the Local Authorities**





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## Background

There were 255 local authorities<sup>1</sup> in Israel in 2018. Local authorities are elected democratic bodies subject to the oversight of the central government in many areas. Local authorities provide their residents with state services, such as education, welfare and immigration integration, and local services, such as cleaning and sanitation, municipal supervision and planning. Financial resilience of the local authorities is necessary for them to be able to provide their residents with services at an adequate level and it ensures that the local authorities' autonomy and freedom of action is maintained according to their powers, since the Ministry of Interior has planning authority to intervene in their day-to-day management under circumstances in which the financial resilience is undermined and in financial crisis.

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<sup>1</sup> Two industrial local authorities not included.



## Key figures

**NIS 68.2  
billion**

Total expenditure of local authorities in the regular budget in 2018 – an increase of 64% compared to 2008, when expenditure was NIS 41.6 billion.

**NIS 3.7  
billion**

The cumulative deficit in all local authorities at the end of 2018 (average rate of 5.9%). This is an improvement, since the deficit amounted to NIS 4.7 billion (an average rate of 12.6%) in 2008.

**NIS 9.7  
billion**

Property tax debts that can be collected by local authorities as of the end of 2018.

**NIS 3.3  
billion**

Total balance grants given to local authorities in 2018. 80% of the local authorities were eligible for the grant to balance their budget.

**23.8%**

The average rate of loan burden in relation to revenues in all local authorities in 2018 – a decrease of 13.8% compared to 2008.

**55.6%**

The average rate of self-generated revenues from total revenues in all local authorities in 2018 decreased by 8.1% compared to 2008.

**91%**

The average rate of net property tax collection from the current charges in all local authorities in 2018 – an increase of 7% compared to 2008.

**25%**

The rate of increase in the average property tax rate per square meter for all types of assets between 2008 and 2018, the consumer price index rose by 17% during that period.

## Audit actions



From April to December 2020, the Office of the State Comptroller audited the financial resilience of the local authorities in Israel by analyzing a financial database in the Ministry of Interior regarding all the local authorities. The audit referred to the data for the years 2008–2018, and aimed to examine the changing trends of several financial criteria and resilience, such as the rate of self-generated revenues, the current deficit rate and the collection rate. The Office of the State Comptroller also examined the financial structure of the local authorities, their ability to deal with monetary changes and their reporting to the public on financial issues. The audit was conducted at the Ministry of Interior, and supplementary examination was conducted at the Ministry of Finance and at two local authorities.



## Key findings



**Cumulative Deficit During an Election Year** – 27 local authorities ended 2018 – a year in which local elections were held – with an exceptional current deficit, compared with the three years preceding it; in 2013, in which elections were also held, they numbered 34.



**Non-Residential Property Tax Charges** – A 2016 study by the Ministry of Interior showed a link between financial stability and the rate of non-residential property tax charges. The audit found that there is inequality between local authorities in charging non-residential property taxes: about 40% of the total non-residential property taxes are collected in the local authorities belonging to the top quintile (each quintile includes approximately 20% of the population), compared to 3.5% in local authorities belonging to the bottom quintile.



**Expenditure on Local Services per Resident** – The average expenditure on local services per resident in the bottom quintile of the local authorities (mostly local authorities from the non-Jewish sector) was NIS 699 in 2018, in the second quintile it was 61% higher and stood at NIS 1,126, and the expenditure was NIS 2,101 in the top quintile – three times higher than in the bottom quintile and twice as high as in the second quintile. The balance grant was found to cover a significant portion of the expenditure of local authorities in the bottom quintile, and yet their expenditure on local services is low relative to other local authorities. Therefore, the balance grant of a total amount of NIS 3.3 billion granted in 2018 does not enable reduction of the gaps.



**Rate of Self-Generated Revenues** – The goal of the Ministry of Interior was that the self-generated revenues will be 62%. The rate of self-generated revenues out of total revenues in all local authorities was 55.6% in 2018 – a decrease of 8.1% compared to 2008: in local authorities of socio-economic rankings 1–4 the rate of self-generated revenues in 2018 was 36.8%, and in local authorities in the non-Jewish sector – 20.9% – a decrease of 10.2% and 8.9% respectively compared to 2008.



**Bylaws** – An examination of bylaws that allow local authorities to collect fees indicated that there are certain areas where there is a significant disparity between local authorities in the Jewish sector and local authorities in the non-Jewish sector, such that in 69% of local authorities in the non-Jewish sector, for example, there are bylaws dealing with advertisements and signs, compared with 93% of local authorities in the Jewish sector.



**The Property Tax Method** – Approximately 80% of the local authorities' self-generated revenues comes from property taxes. In Israel, the charge for property is



based on rates set in 1985, which are updated in accordance with a formula. Contrary to what is customary in many OECD countries, the charge is determined according to the size and use of the property and not according to its value; a report by the OECD from September 2020 recommended changing the charging method used in Israel. The audit found that the existing method poses financial risks for the local authorities, does not make it possible to reduce disparities between local authorities, and has distortions that create inequality between residents. Resolutions by the Government of Israel from 2006 and 2016 to act to change the property tax system have not been implemented; a committee established in 2016 to change the property tax system has not yet published its recommendations.



**Property Tax Debts** – The volume of property tax debts to local authorities, which the local authorities estimate can be collected, amounted to NIS 9.7 billion in 2018. The collection of these debts, and even some of them, may significantly reduce the cumulative deficit of all local authorities.



**Dealing with Changes, Long-Term Planning and Risk Mapping** – there is a large gap between the local authorities and the government regarding the availability of tools to deal with unforeseen economic changes; local authorities have strict fiscal constraints.



**Transparency** – The government has a duty to publish detailed information on its budget, but the local authorities are only obliged to publish concise information. It was found that out of 12 local authorities whose websites were examined, seven publish detailed information on the budget to the public and the rest publish the concise information. The government is also obliged to publish information on contractual engagements with suppliers quarterly, but such an obligation is not imposed on the local authorities, and it has been found that none of the local authorities examined publishes such information.









**Cumulative Deficit Rate** – The average cumulative deficit rate in all local authorities decreased from 12.6% in 2008 to 5.6% in 2018. However, it was found that seven local authorities had a consistently high (over 30%) cumulative deficit during the period examined. In addition, in 2018, nine local authorities did not meet the criterion that the credit balance combined with the cumulative deficit will not exceed 60% of their revenues, compared with 94 that did not meet this criterion in 2008.

**Current Ratio** – The current ratio in all local authorities has improved and has increased from 0.56 in 2008 to 0.89 in 2018. There has been a significant improvement in the non-Jewish sector.



**Net Property Tax Collection Rate** – The average rate of property tax collection in all local authorities increased from 84% in 2008 to 91% in 2018. The largest improvement occurred in the non-Jewish sector.

## Key recommendations

-  It is recommended that the Ministry of Interior examine ways to reduce the phenomenon of the high current deficit in the authorities in a local authority election year, which may harm the financial strength of those local authorities, and to issue guidelines on the subject for coming election years.
-  It is recommended that the Ministry of Interior formulate a national plan to reduce the disparities between local authorities by focusing on the inequality in non-residential property tax charges, given the great disparities among local authorities in non-residential property taxes charges.
-  It is recommended that the Ministry of Interior monitor the implementation of its goals for 2018 regarding the rate of self-generated revenues in all local authorities and instruct them to formulate budgetary plans for the development of self-generated revenues accordingly.
-  It is recommended that the Ministry of Interior, the Ministry of Finance and the Office of the Prime Minister of Israel complete the examination of property tax reform in accordance with the government resolutions of 2006 and 2016, in view of the ongoing distortion of the property tax system and the expected financial risks to local authorities as well as in view of that which is customary in the OECD countries and the recommendations of the OECD report of 2020. It is proposed that in the context of the examination, consideration be given to the gaps between local authorities, differences of property value in the various authorities, limitations of the physical-spatial planning capacity, and the financial risks of local authorities. It is further recommended to examine the model for updating property tax rates in a multi-year perspective, taking into account the burden added beyond the increase in the consumer price index.
-  It is recommended that the Ministry of Interior examine, in exceptional circumstances, the provision of tools to local authorities to deal with unforeseen economic changes so that the services to the resident, some of which they are required by law to provide, will not be negatively affected.
-  It is recommended that the Ministry of Interior consider publishing guidelines to increase transparency and promote publication on the internet of detailed reports of all local government budgets and their contractual engagements, in light of the disparity between transparency of government ministries as opposed to local authorities.



### Expenditure on Local Services per Resident, 2018.



NIS 2,101

Top  
quintile

NIS 1,487

4<sup>th</sup>  
quintile

NIS 1,262

3<sup>rd</sup>  
quintile

NIS 1,126

2<sup>nd</sup>  
quintile

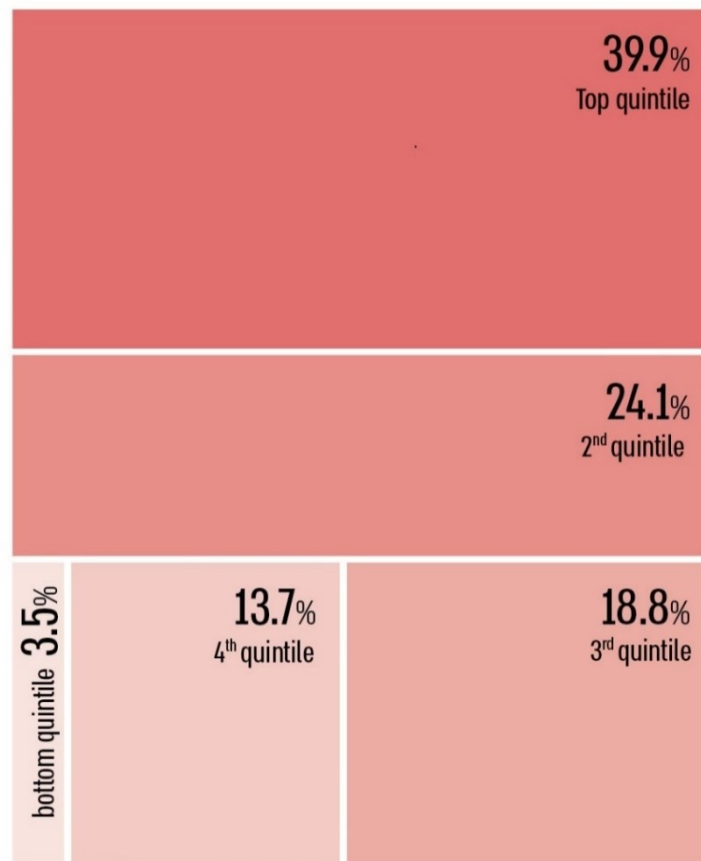
NIS 699

Bottom  
quintile





### The Rate of Each Quintile in the Population in Non-Residential Property Tax Charging, 2018.



## Summary

There has been a major improvement in the decade audited in a number of financial indicators that reflect the financial resilience of the local authorities. At the same time, 80% of the local authorities are unable to finance their own expenses and need a balance grant. There has also been a decline in the rate of self-generated revenues, but this is mainly due to an increase in revenue from government sources in respect of state services.

The report found large gaps in the resources that local authorities have and their ability to provide services to their residents. Additionally, the authorities' funding methods involve risks and lack the tools to help local authorities deal with threats to their resilience. The challenge



facing the Ministry of Interior and the local authorities in Israel as we enter the third decade of the twenty-first century is to reduce the gaps between local authorities, examine their self-generated revenue rate, diversify their sources of income and act to improve financial stability along with improving service to residents.