

TOWARD A BALANCED FISCAL POLICY FOR ISRAEL IN THE POST-COVID ERA*

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Abstract

This article proposes a new fiscal policy for the post-COVID-19 era, intended to balance fiscal discipline and appropriate solutions to the needs of Israeli society. The proposed framework establishes two targets: the debt-to-GDP ratio and the public expenditure-to-GDP ratio, which the government will set at the beginning of its term. The budget will be determined each year based on these targets, in order to ensure their achievement within a defined period of time. These targets will be injected into two new equations, one for total expenditure and the other for the annual deficit, which will be used to derive the size of the annual budget and the tax burden. Prior to the crisis, the ratio of public expenditure to GDP was about 40 percent in Israel versus 41.8 percent in the OECD and 49.1 percent in the reference countries. We believe there is a need to raise the public expenditure-to-GDP ratio target, in view of the prolonged decline in the level of basic public services, and also in view of the needs that have arisen as a result of the pandemic, while at the same time maintaining a responsible debt-to-GDP ratio that is in accord with the global economic environment.

1. INTRODUCTION

The COVID-19 pandemic brought on the worst economic crisis ever experienced in Israel or elsewhere in the world, abruptly ending a long period of positive macroeconomic performance. Israel was in a favorable starting position when the crisis began: a debt-to-GDP

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ratio of 60 percent; unemployment of less than 4 percent; high foreign currency reserves; negligible inflation; and a resilient financial system. Nonetheless, a prolonged political crisis undermined the ability of the government to formulate economic policy, encouraged populist measures, and as a result, 2020 passed without an approved budget. No less problematic was that the crisis began toward the end of an era characterized by an anachronistic economic vision and fiscal regime. These were manifested in a decline in basic public services, such as healthcare and education, which forced households to make up the difference from their own pockets—and for many of them, this was a heavy burden.

The COVID-19 crisis led to a breach of the constraints on fiscal policy, such that at least in the short to medium terms it will continue to be highly expansionary. This is necessary in order both to support businesses that were adversely affected by the pandemic and families that lost their income, and to jumpstart economic activity and eventually growth as well. It is too early to assess what side effects this will incur. What will happen as a result of the large increase in the national debt? Is there a danger that inflation will return after a long period in which it was under control? Additional, similar, questions can be asked. Whatever the case, after a long period during which the government's weight in the economy declined, it is highly likely that we will witness greater government involvement in the economy from this point onward.

The goal of this article is to propose a consistent and sustainable fiscal policy that will serve as a roadmap for the government of Israel in the post-pandemic era, once the acute phase of the crisis is behind us and the economy has returned to a stable and reasonable level. It is particularly important at this point—when the traditional fiscal framework has been abandoned in response to the circumstances—that a course is charted to return the economy to a responsible policy framework, one that can deal with the new reality and at the same time serve the country's long-term goals.

The main component of the proposed policy is the distinction between fiscal policy *targets* for the medium and long term, and fiscal policy *rules* that are used to implement policy when formulating the annual budget. In particular, the government will need to determine targets for the debt-to-GDP ratio (D/Y) and for the public expenditure-to-GDP ratio (G/Y) that it will commit to achieve within a defined period (such as 5 years). Two new formulas for fiscal rules—one for the total deficit and the other for total expenditure—will determine the size of the budget so as to ensure realization of the government's targets. As described below, the governments of Israel have usually not adopted such explicit targets, and when they did, the rules focused only on the debt-to-GDP ratio. However, since the early 2000s, the governments have in practice also reduced the weight of public expenditure within GDP. Although the result was a large improvement in macroeconomic parameters, there was, in contrast, significant deterioration in the level of public services, without any real public discussion of the issue and without any balancing mechanism proposed.

The need for a new policy has become more acute as a result of the COVID-19 crisis, which exposed to an even greater extent the failures that resulted from the previous policy.

This is particularly evident in the areas of education and healthcare, where problems have been left to fester over the last decade. For example, during the pandemic, the issue of class size (which has been with us for many years) became critical, as it was extremely difficult to teach a class while preventing mass infection. This compounds other problems, such as the widening gaps between pupils from different socioeconomic backgrounds in general, and in particular, disparities in access to computers and in digital literacy. In the context of healthcare, the ongoing failure became particularly evident in view of the chronic shortage of hospital beds and medical staff. The pandemic therefore served as a warning along the lines of “the emperor’s new clothes”, and thus may constitute an opportunity for a paradigm shift and the adoption of a fiscal trajectory that is tailored to the urgent needs of Israeli society.

The article is structured as follows: Section 2 surveys the development of fiscal policy since the 1985 Stabilization Program, with a focus on failures that prevented it from translating macroeconomic success into improved welfare for the public as a whole in Israel and the consequent need for a new policy. Section 3 presents the principles of the proposed approach, which directs fiscal policy toward two main targets: the desired public expenditure-to GDP ratio (G/Y) so that it will be able to provide essential public services, and the debt-to-GDP ratio (D/Y), which will ensure economic resilience and stability. Section 4 discusses the necessity of fiscal rules, and in particular those that are intended to limit deficit bias. Section 5 reviews the use of fiscal rules in Israel and the targets that they served over time. Section 6 presents the new formulas for total expenditure and the level of the deficit. Section 7 discusses the setting of G/Y and D/Y policy targets and the calculation of expected growth, which serve as parameters in the fiscal rule formulas. Section 8 illustrates the implementation of the policy based on a scenario for the post-COVID-19 era. Section 9 presents the supplementary measures required to heighten the effectivity of government expenditure as it increases, and is followed by the conclusion in Section 10.

2. NEEDED: A PARADIGM SHIFT IN FISCAL POLICY

The economic history of the State of Israel is characterized by numerous changes in direction, which were usually the result of remaining too long with an economic policy that once worked but since became outdated and anachronistic. The lack of willingness or ability to recognize the need for change would lead to a crisis, which in turn would lead to a new policy, and the cycle would start again. The best example is the crisis in the early 1980s, which resulted in the 1985 Stabilization Program. This dialectic-like process to a large extent resulted from the fact that Israel underwent several major upheavals during the early stages of its existence, ranging from a huge increase in its population to wars to far-reaching changes in the geopolitical environment. Nonetheless, dogmatism, rigidity, and political considerations played no less important a role in holding back change, and only the onset of a major crisis made change possible.

There are more than a few countries—such as Britain under Thatcher, Sweden and India in the 1990s, and of course China in recent decades—that shed economic paradigms that had outlived their usefulness and adopted new ones in their place, without undermining the stability of their main institutions. In contrast, there are many countries that have failed time and again to implement essential reforms because they are unable to overcome entrenched interests and institutional inertia. The resulting tension in those countries sometimes led to political upheaval and a turnaround in policy, which only exacerbated the lack of stability and prevented the necessary reforms. South America provides many examples of this phenomenon. Israel is somewhere in the middle. It tends to cling to its economic preconceptions for too long, but, at the same time, when the crisis arrives, it usually demonstrates an impressive ability to innovate. However, it is uncertain whether in the future we will know how to overcome such crises while preventing major harm to the economy and to the institutional-political system. Therefore, the need already exists for a reappraisal.

The starting point of the analysis is that the fiscal approach that dominated economic policy in Israel for many years has exhausted itself, and had it not been for the COVID-19 pandemic, might itself have led to a crisis. Its beginning can be traced to the 1985 Stabilization Program, which constituted one of the most important turning points for Israel's economy and dramatically improved the performance of the economy and the management of economic policy over a period of three decades. The ending of the hyperinflation¹ prevalent during the first half of the 1980s was only the first phase in a gradual and prolonged process that completely transformed the nature of the economic regime in Israel:² a concentrated and closed economy with little competition, whether internal or external, evolved into an economy that follows the rules of market economics and incentivizes the development of Israel's comparative advantage, namely technological innovation. Apart from the numerous structural reforms implemented to this end, the decisive move on the macroeconomic level was the imposition of rigid fiscal discipline. The bitter experience of the "lost" decade made it clear that one could not rely on the good intentions of politicians but only on the professionals at the Ministry of Finance who have the necessary abilities, commitment, and motivation. Moreover, the Budget Department in the Ministry of Finance was given powerful tools to protect the public purse, to the dismay of other ministries and those above them.

The 2001–03 crisis following the outbreak of the second intifada and the burst dot.com bubble prepared the way for the next stage of the process, which was accelerated by the appointment of Benjamin Netanyahu as Minister of Finance. Netanyahu is the one who introduced the image of the "thin man carrying the fat man," where the government is the fat man who is well-fed and inefficient, and a burden on the thin man, namely, the business sector, which is unable to grow because of the heavy weight on its shoulders. This image lies

¹ For a comprehensive analysis of the response to inflation, see Razin (2019).

² See Ben-Bassat et al. (2020).

at the foundation of a comprehensive strategy to downsize the government and to privatize as many of its services as possible, while at the same time lowering taxes, in order to both incentivize the business sector and “starve the beast,” i.e., continue to reduce the size of the government.

This strategy met with great success, at least according to its declared goals. Thus, the share of the government in GDP declined sharply, from about 50 percent at the beginning of the 2000s to about 40 percent already in 2014; the tax burden shrank in parallel; a significant portion of government services were privatized; and so on. These developments made an important contribution to the prosperity of the business sector, and in particular the dizzying success of the high-tech sector. The consistent fiscal discipline contributed its share, and the combination of all these factors led to the consolidation of Israel’s economic status in the international arena. This was particularly evident during the Great Recession that began in 2008 and adversely affected most advanced economies, while bypassing the Israeli economy (apart from a short-lived slowdown in 2009).

However, the conceptual rigidity and lack of desire to examine the widespread social consequences of this process led Israel again to the brink of a crisis. In contrast to 1985 and 2001–03, this time the overall economic picture was much more complex: the macroeconomic indices were very healthy (growth, the debt-to-GDP ratio, and inflation) and some even reached historic highs (such as the employment rate, the size of the foreign currency reserves, and Israel’s international credit rating), and therefore in theory there was no cause for concern and the course could be maintained. However, in contrast, over the last decade, there has been a consistent decline of basic civilian services, especially housing, healthcare, and transportation.³ Furthermore, even if the level of poverty and the inequality index have declined somewhat in recent years, according to these indices, Israel continues to be among the worst-performing OECD countries, which incurs serious implications for social cohesion and national resilience.

In view of these disturbing trends, there is a need to reexamine the approach that calls for continuing to reduce the share of government in GDP, since it is clear that what was correct when it was at 50 percent may not be correct when it is 40 percent. Moreover, during 2017–19, the Ministry of Finance adopted a number of “populist” fiscal measures⁴, which involved a significant deviation in total expenditure and a threat to fiscal discipline (Figure 1). Although these measures serve purposes that were themselves worthwhile, in the absence of an overall macroeconomic program, clear orders of preference, and a long-term and

³ This is well illustrated by the prolonged rise in housing prices (see the [Housing Prices Index](#)). In healthcare, this is manifested in a number of indices; see, for example, Weiss (2020), p. 23 on the longer waiting times in emergency rooms. In transportation, it is manifested in growing congestion on the roads (see Trajtenberg & Zer-Aviv, 2020).

⁴ These were included in Finance Minister Moshe Kahlon’s “Net Family” program, which reduced customs duties, improved the negative income tax, increased the credit points for parents of young children, and more.

consistent fiscal trajectory, there is no escape from viewing fiscal policy as having had a large populist component. This was followed by the onset of the COVID-19 crisis, which loosened the reins of fiscal restraint, but at the same time exposed the failures of an anachronistic fiscal approach to an even greater extent.

3. PRINCIPLES OF THE PROPOSED POLICY

From the outset, it should be remembered that government's supreme role is to provide the public services required by its citizens, while at the same time minimizing the harm to incentives from the taxes imposed to finance those services. Therefore, the level of government expenditure has always been a primary focus for any government and has also been a major issue of debate, as reflected in the variation between countries in the public expenditure-to GDP ratio (G/Y). Therefore, it might have been expected that the process of fiscal policy formulation would involve an in-depth discussion of the optimal G/Y target, but this has not been the case. The annual (lately biannual) discussion of the state budget in Israel has centered mainly on specific budget issues, which involved give-and-take with the various ministries. Meanwhile the "budget framework" is determined by fiscal rules and is rarely discussed, certainly not with an eye to the long term.

In addition to the government's role in supplying public services, it is also responsible for maintaining economic stability and resilience over time. This task requires fiscal responsibility, i.e., keeping budget deficits small relative to GDP, such that the economy can successfully finance the debt that will be created over time as a result. A high debt-to-GDP ratio (D/Y) raises national risk, increases the price of credit, and imposes a debt-financing burden on future generations. The questions as to the optimal debt-to-GDP and in what time frame it should be reached should form the foundation of fiscal policy as a whole, together with the question of the level of G/Y .

Given government expenditure, it is tax revenues that determine the size of the deficit and the debt, since the deficit is the difference between them. In determining the level of taxation and its components, the government should take several factors into consideration, some of which are conflicting: first, the pure fiscal aspect of total tax collection, which determines the size of the current deficit and affects the level of the debt; second, the effect of taxation on the incentives of various players, i.e., workers, businesses, domestic and foreign investors, and more, in part due to the fact that high tax rates are liable to harm those incentives and therefore economic growth; and third, considerations of equity, which are reflected in both the universality of the tax system and its distributional implications, where accepted wisdom is that taxation should be progressive, i.e., it should reduce inequality. However, progressive taxation requires high marginal tax rates, which may harm growth.⁵

⁵ For more details on the tax system, see Trajtenberg and Popliker (2020).

Fiscal policy therefore includes three main variables: government expenditure (G), taxes⁶ (T), and debt (D) (as a consequence of the budget deficit). However, the government only has two degrees of freedom (since the deficit, d , results from the difference between G and T). In other words, it cannot set targets for all three of the variables, since by setting two it is essentially setting the third. Thus, for example, if the government determines the size of the permitted deficit and the rate of increase in government expenditure, then it has determined the tax revenues that are needed in order to achieve the deficit target.

Therefore, informed and responsible fiscal policy requires first and foremost an examination of the entire fiscal picture, at whose center are the G, T, and D trajectories over time, and the setting of targets that are consistent and feasible. Since it is possible to determine only two of the targets, consideration when choosing them should be given to the likelihood of the outcome with respect to the derived fiscal variable. Thus, for example, if ambitious targets are set for G/Y and D/Y such that their achievement involves a sharp increase in tax rates, then they will not be feasible, or alternatively, the economy will pay a high price in terms of slower growth.

These considerations lead to the heart of the policy we are proposing: at the beginning of the government's term it will have to set targets for G/Y and D/Y, which it will commit to achieve within a defined period (such as the length of the expected term of the government, namely 4-5 years). In order to implement this policy, the government will use the new formulas for the two fiscal rules governing total expenditure and the deficit, which are presented below, in the annual determination of the state budget. The targets for G/Y and D/Y that the government will determine at the outset of its term will be inputted into these formulas, thus ensuring that the implementation of the rules will indeed achieve the targets within the defined period. This represents a major innovation relative to fiscal rules in general and relative to those in use so far in Israel in particular⁷, since the latter were formulated without determining overall targets or were formulated in relation to the D/Y target only. Furthermore, no attention was given to determination of the period within which the target is to be achieved, to the mechanism for revision, or to consistency between the fiscal variables.

As a result of the 2001–03 crisis, the government set as one of its main goals the achievement of a sharp reduction of D/Y from its dangerous level of over 90 percent, which was a result of the crisis, and in addition significant reduction of G/Y. The fiscal rules that were selected served those goals well. With respect to the debt-to-GDP ratio, the Maastricht Treaty specified $D/Y = 60$ percent as the target for the EU countries already in 1992. Israel adopted this target as well, even though it was not anchored in any formal decision. In contrast, no explicit target was adopted for G/Y, although the formulas for total expenditure

⁶ The term that will be used in equation 3 represents "net taxes"; i.e., it excludes other government income sources.

⁷ The concept of a "target" in the context of a "deficit target" is materially different from its meaning when it refers to the attempt to achieve particular values of G/Y and D/Y, which reflect a long-term well-defined strategy.

that were adopted led to a prolonged reduction in G/Y , since government expenditure was constrained to grow at a lower rate than the rate of growth in GDP.

In this way, a lack of symmetry was created between G/Y and D/Y , where D/Y was treated preferentially and explicitly appeared in some of the formulas for the fiscal rules that were adopted, while those same rules lead deterministically to a reduction in G/Y without any stopping point. Thus, prior to the pandemic Israel reached a situation where the share of government expenditure in GDP was about 40 percent, which is lower than the OECD average.⁸ The gap is well-reflected in the ongoing erosion of services in healthcare, education, transportation, and more. Furthermore, and in parallel to the reduction in G/Y , the government decided on a multiyear path for reducing taxes in a way that the deficit target prevented G from resuming its growth.

This situation lies at the foundation of the great paradox of the Israeli economy prior to the pandemic: a healthy macroeconomic situation, but without that success reflected in the welfare of most households in Israel. Many found it difficult to manage the economic burden imposed on them due to the partial withdrawal of the government from the provision of public services. This can best be seen in the social justice protests of 2011, which was evidence of these difficulties, particularly for young families. A G/Y ratio of 40 percent is not simply an abstract statistic, but in fact is a primary factor underlying this paradox, which without the pandemic might have developed into a dangerous crisis in and of itself. From time to time, usually as a result of a public protest⁹, the government is forced to deal with the tension between success on the macro level and the economic distress of a large proportion of the public. However, in the absence of fiscal vision and strategy, the government was not able to even hold a serious discussion on the issues underlying the protests. When proposals were made for fiscal measures of popular appeal, such as a reduction in taxes, these were discussed without taking into consideration their implications for G/Y , even when a deviation in one direction or the other from the deficit target became apparent.¹⁰ It is not surprising, therefore, that the policy measures adopted were often found to be ineffective, or to be “too little, too late.”

The policy proposed here is intended to end unwise and even dangerous policymaking. Although during the pandemic economic policy was justifiably focused on the immediate challenges, after the acute phase of the pandemic is over there is a need to look at the overall

⁸ The OECD average was 41.8 percent prior to the COVID-19 crisis, while the average for countries similar to Israel (the “reference countries”) was 49.1 percent. For further details, see Section 7.1.

⁹ Such as, for example, the demand for a second assistant in preschools in 2012-13; the “sardine protest” with respect to the large class size; the protests by the disabled; and more.

¹⁰ “Should VAT be reduced by one percent?” “Should the corporate tax be reduced?” From time to time, such proposals are put forward (and some of them implemented) without taking into consideration their systemic implications, and in particular the effect on the overall targets for G/Y and D/Y .

fiscal picture and to set fiscal targets for the medium and long terms, as well as create the mechanism that will ensure their achievement. Similarly, economic growth was severely affected during the crisis, while at the same time the economic environment experienced rapid and far-reaching changes, such as those in work and employment behavior, the penetration of digital technology, the slowing of globalization, the need to respond to climate change, and more. Thus, it will not be possible to limit fiscal policy to the determination of optimal levels for G/Y and D/Y and to base fiscal policy only on macroeconomic considerations; rather the type and composition of government expenditure, as well as of taxes, will also have to play an important role.

4. THE ROLE OF FISCAL RULES

The economic literature deals at length with the question of how to meet fiscal *targets* efficiently. One of the main tools in this context is the use of fiscal *rules*, that is, constraints imposed by the government on its determination of the main budget parameters. At the heart of the discussion of the need for such rules is the idea of a tradeoff between the rigid commitments they create and the flexibility in setting policy based on the government's discretion (i.e., rules vs. discretion¹¹). There is no doubt that discretion allows for localized fine-tuning in response to a changing reality; yet at the same time, that flexibility opens the door to misuse, particularly in light of the fact that the government has a bias toward increasing the deficit, a phenomenon known as "deficit bias."

Deficit bias results from the attempt by elected governments to please voters by providing short-term benefits (whether by reducing taxes or increasing expenditure), where the negative consequences in the future are viewed as sufficiently far off that voters will not take them into account. In other words, voters do not internalize the future costs of current budget deficits, which will ultimately require painful austerity measures. Therefore, policy "benefit" measures in the form of tax cuts or expenditure increases are usually very popular, and as a result elected officials are tempted to adopt them, particularly prior to elections. This also means that elected officials tend to manage fiscal policy asymmetrically, since it is easier for them to garner political support for expansionary policy during a period of recession than to adopt a contractionary policy during periods of economic prosperity (Leibfritz et al., 1994).

Another explanation for deficit bias focuses on the political polarity and strategic considerations of the government, which is afraid of losing power, given the major differences between its preferences regarding the mix of public expenditure and those of rival parties. The party in power ostensibly faces uncertainty regarding its chances of reelection and will prefer to increase expenditure in areas that are important to it (without making cuts

¹¹ Thus, for example, Dahan and Strawczynski (2013) claim that fiscal rules may lead to a reduction in the weight of transfer payments within total expenditure, in a way that will adversely affect weaker members of society and will exacerbate inequality.

in other areas), out of fear that it will not be able to do so in the future. As a result, the higher the likelihood of not being reelected, the larger will be the variation in priorities between the various parties and the magnitude of deficit bias (Alesina & Tabellina, 1990).

A plethora of lobbyists and pressure groups that work toward increasing government expenditure in the specific areas that interest them will contribute to deficit bias, since they do not take the full budget picture into account and therefore are willing to invest resources in convincing elected officials to increase the interested budget expenditure. Moreover, given that all of them adopt this behavior, each lobbyist has an even greater incentive to obtain a larger share of the budget in the immediate term, since it is clear that if the government meets all the demands in the present, there will be cuts in the future. There is a broad spectrum of pressure groups that operate in democratic regimes, including various parts of the business sector, geographic regions and population groups, chambers of commerce, unions, and more. Deficit bias is expected to be even greater in coalitional regimes, particularly when they are characterized by a multiplicity of sectoral parties and by a large variation in interests (Velasco, 1999).

There is, therefore, a solid foundation for the assumption that fiscal policy based on the government's discretion may lead to systematic deficits, which in turn will increase the debt-to-GDP ratio. This supports setting limits on government discretion by defining fiscal rules. Many empirical studies have examined the efficacy of various types of rules, and the findings support their necessity. Thus, for example, Debrun et al. (2008) look at the effect of fiscal rules in 25 EU countries and find that their use indeed reinforces fiscal discipline. Moreover, to the extent that the rules adopted are more comprehensive and stringent, so there is a more positive effect on seasonally adjusted budget performance. Badinger and Reuter (2017) make use of data for 74 countries during the period 1985–2012, and also find that countries that have stricter rules are characterized by lower deficits, and furthermore, have lower rates of interest on their bonds and less output volatility. Moreover, Kriwoluzky et al. (2020) find that countries with fiscal rules are better able to respond to crises, which they demonstrate using a number of parameters, including rate of growth, private consumption, and investment.

a. The Need for an Expenditure Rule

There are two fiscal rules used in many countries, including Israel: a deficit rule and a budget expenditure rule. The deficit rule states that the difference between the state's revenues and its expenditures is not to exceed a defined ceiling, which is expressed as a percentage of GDP. The expenditure rule specifies a ceiling on the rate of growth in budget expenditure from year to year. Theoretically, if the goal of the fiscal rules is to maintain fiscal discipline, then the deficit rule is apparently sufficient, since it directly limits deficit bias and thus also prevents the growth of the debt-to-GDP ratio. However, the expenditure rule has an inherent advantage that justifies its use in addition to the deficit rule.

First, the expenditure rule can be implemented and enforced with relative ease, since by law public expenditure is predetermined in the budget proposal, and therefore the government

is obligated to adhere to it under almost any conditions. In contrast, the government does not have full control over tax revenue, and therefore complying with the deficit rule is dependent to a large extent on the level of economic activity. Moreover, it is difficult and even undesirable to change the tax rates in the short term in response to fluctuations in government revenues in order to adhere to the deficit rule. Frequent changes in taxation increase uncertainty in the economy and may play a procyclical role (Ljungman, 2008). Furthermore, deficit bias is often manifested in larger public expenditure, and therefore an expenditure rule deals directly with this type of bias. Thus, if the goal is not only to maintain fiscal discipline but also to reduce public expenditure (as was the case in Israel), then an expenditure rule serves both goals simultaneously.

Numerous empirical studies have indeed demonstrated the importance of an expenditure rule as a central component of the fiscal toolbox. Thus, for example, Cordes et al. (2015) examine the effectivity of an expenditure rule in 29 countries and find that the level of compliance with an expenditure rule is much higher than in the case of a deficit rule. Furthermore, Wierdsma (2008) finds that the adoption of an expenditure rule is evidence of political willingness to effectively deal with a high G/Y ratio, where countries that have a higher ratio tend to adopt a more rigid expenditure rule. Guichard et al. (2007) examine the use of fiscal rules in the OECD countries and find that in general they contribute to the process of fiscal consolidation, and even more so in the case of expenditure rules.¹²

As of 2015, 15 of the OECD countries had an expenditure rule. Among those, Spain, Poland, Luxembourg, and Latvia have an expenditure rule that constrains the growth in public expenditure to less than the rate of growth in GDP (IMF, 2017a).¹³ Moreover, starting in 2011, an expenditure benchmark went into effect in the 22 EU states that are members of the OECD, based on the Stability and Growth Pact (SGP). According to this rule, in countries that do not reach the medium-term budgetary objective, the rate of growth in public expenditure cannot exceed the medium-term potential rate of growth in GDP¹⁴, unless the growth in expenditure is based on additional revenue sources. In contrast, countries that have not reached the target cannot deviate from a lower rate of growth, while countries that have exceeded the budget target are not required to comply with the expenditure rule (EU, 2018).

The manner in which the EU expenditure rule is formulated is evidence of the position it has adopted with respect to public expenditure and the debt-to-GDP ratio. Thus, on the one hand, each country can choose a target for public expenditure as a percentage of GDP according to its needs and goals. On the other hand, the countries are responsible for

¹² Similarly, Holm-Hadulla et al. (2012) analyze the use of an expenditure rule in EU countries and find that this helps to limit the pro-cyclical tendency of governments to deviate from the planned budget.

¹³ The data do not include South Korea and Turkey.

¹⁴ The medium-term potential rate of growth is calculated as the average growth rate over ten years: the growth rate for the last five years, the growth rate for the current year, and the forecasted growth rate for the subsequent four years.

maintaining fiscal discipline and ensuring that they have sufficient sources of revenue to cover that expenditure and thus meet the budget target defined for them. Therefore, the EU imposes stricter limits on the growth in public expenditure in the case of countries that do not achieve their budget target, until that country again approaches the target. Since the EU expenditure rule went into effect, compliance among the member countries has increased steadily, such that in 2016, 11 of the 15 EU countries that were subject to the expenditure rule were in compliance with the ceiling determined for them (Van Nispen, 2017).

IMF (2017b)¹⁵ presents the main criteria whereby fiscal rules are to be formulated in order to limit deficit bias while maintaining a counter-cyclical fiscal policy:

- Debt sustainability, i.e., maintaining the debt at the required level over time
- Stabilization, in the sense of reducing volatility by means of counter-cyclical tools

Furthermore, the document describes the optimal characteristics of fiscal tools that will enhance their effectivity:

- Simplicity, in order that they be easily understood by decision makers and the public
- Operational guidance, in order to translate the rule into clear policy during the budgeting process
- Resilience, so that the rule can be maintained over time and to support fiscal credibility
- Ease of monitoring and enforcement of the rules

The document also states that there may be a tradeoff between the various rules. For example, rules that emphasize the maintenance of stability will tend to be formulated in a more complex manner, which will be at the expense of simplicity. In order to minimize the tradeoff, it is proposed that the expenditure rule be formulated so as to be counter-cyclical and thus supportive of stability, by constructing it as a function of the economy's potential growth rate.

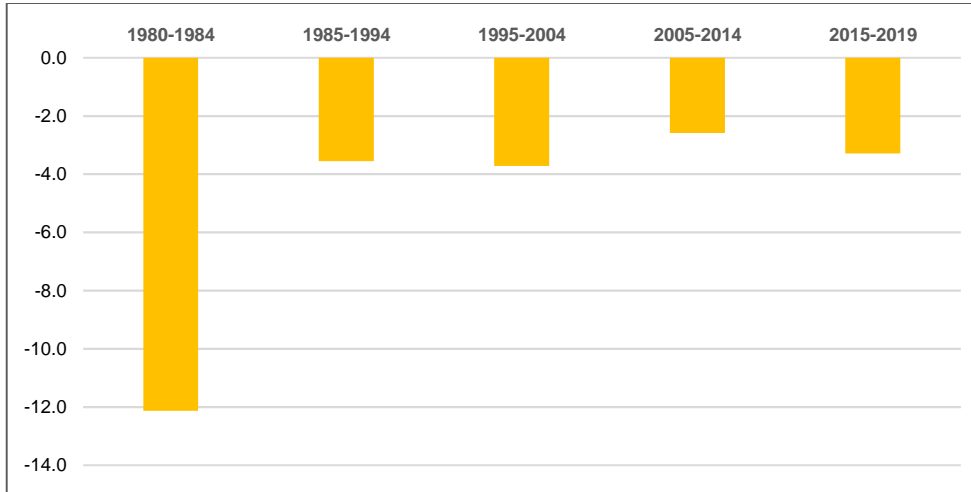
5. THE FISCAL RULES IN ISRAEL, 1985–2019

The 1985 Stabilization Program constituted a turning point in fiscal policy, by putting an end to the budget chaos that had prevailed during most of the previous decade. Figure 1 illustrates this clearly: while during the first half of the 1980s, deficits fluctuated around 12 percent, during the subsequent decade they dropped to 4–5 percent, which was reflected in a dramatic decline in the debt-to-GDP ratio, from a peak of 280 percent to about 100 percent 10 years later (Figure 2). However, during the 1990s the budget deficit settled at a level that did not allow for any significant additional reduction in the debt-to-GDP ratio, which remained high relative to the debt levels in the advanced economies (about 90 percent in Israel vs. about 60 percent in the OECD). Furthermore, during this period inflation also remained high and

¹⁵ This document relies to a large extent on Kopits and Symansky (1998).

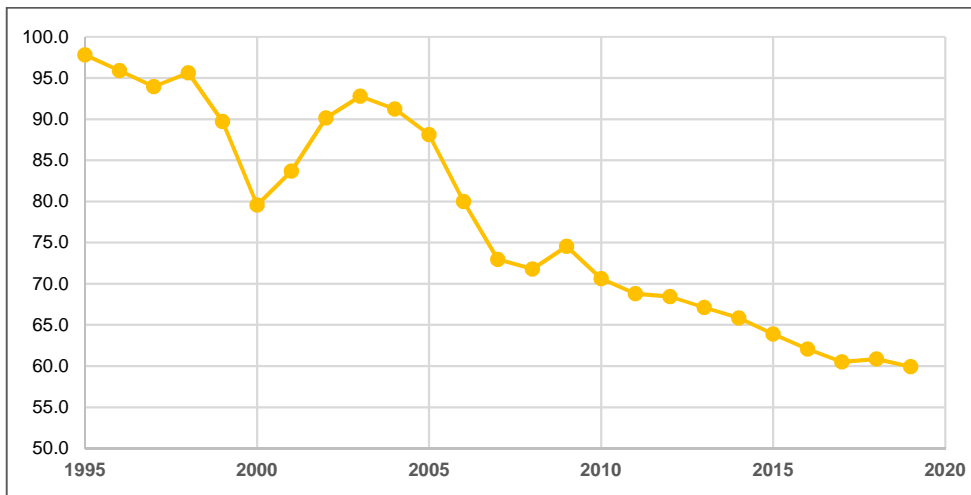
stabilized at double-digit levels. This occurred while Israel was dealing with the absorption of a large wave of immigration from the former Soviet Union, which was expected to incur a large increase in government expenditure.

Figure 1
Budget Deficit, Percent of GDP, Averages for 1980–2019



Source: Bank of Israel, Annual Report for 2019, Statistical Appendix, Table 6.A.3.

Figure 2
Public Debt, Percent of GDP, 1995–2019



Source: Bank of Israel, Annual Report for 2019, Statistical Appendix, Table 6.A.3.

As a result, it was decided during the budget discussions in 1992 to adopt a fiscal rule that would reduce the budget deficit in subsequent years by setting a downward path for the deficit limit, which was anchored in a law for budget reduction. Its goal, among other objectives, was to signal that the expected budget deficit (as a result of the large expenditure on the absorption of immigration) is not an indication of lessened fiscal discipline, in contrast to what occurred during the period prior to the 1985 Stabilization Program. Between 1992 and 2003, the government met most of the deficit targets that were set; however, this was primarily a result of the fact that the deficit limit became a moving target. Thus, it was revised upward seven times during this period, since the deficit ceilings were overly ambitious from the start.

The frequent changes in the deficit target undermined the effectivity of this fiscal rule in further reducing the debt-to-GDP ratio, such that the debt even rose significantly between 2000 and 2003 (Figure 2). The lack of political stability (which was reflected in frequent changes in government) also contributed to this situation, since each new government saw itself as being only partially obligated by the deficit targets that the previous government had adopted. Another factor in the deficit rule's lack of effectivity during that period was its procyclical nature, which together with its downward path over the years made it difficult to comply with in a period of unexpected economic slowdown.¹⁶

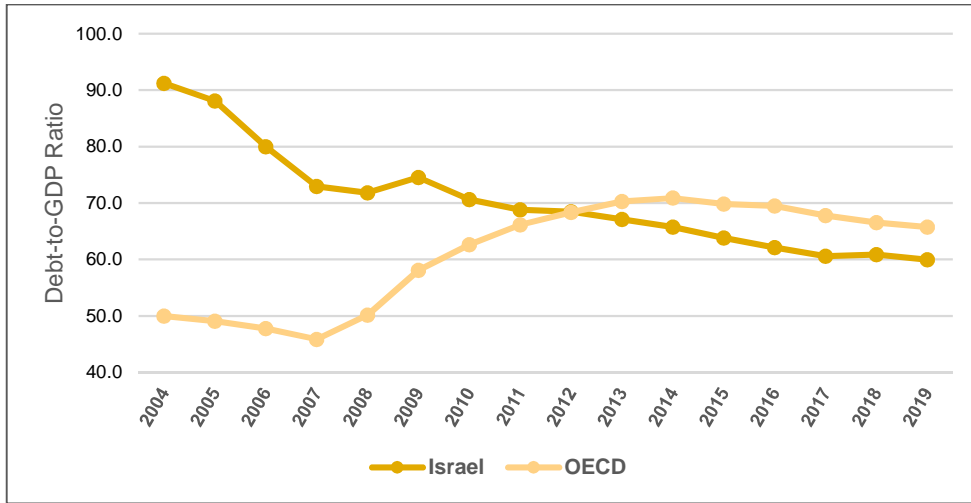
The crisis of 2001–03 led to significantly tighter fiscal discipline, including the government's adoption in 2004 for the first time of an expenditure rule—in addition to a deficit rule. Joining the need to control the deficit and in this way reduce the debt-to-GDP ratio, this rule was also adopted in order to reduce the size of the government relative to GDP. According to the terms used during that period, in order to achieve fiscal discipline it was not enough to “tighten the belt” by adhering to a deficit rule; it was also necessary to “wear suspenders,” namely to adopt an expenditure rule.

The expenditure rule indeed helped to reduce significantly the weight of public expenditure in GDP, which fell sharply from close to 50 percent in the early 2000s to about 40 percent in 2019, as well as lower the debt-to-GDP ratio to a level of about 60 percent (Figure 3 and 4). The global economic recession in 2008 led to the opposite trend in most of the OECD countries, such that in recent years Israel was distinguished by its low level of debt.¹⁷

¹⁶ Our survey of these developments is based primarily on Ben Bassat and Dahan (2006).

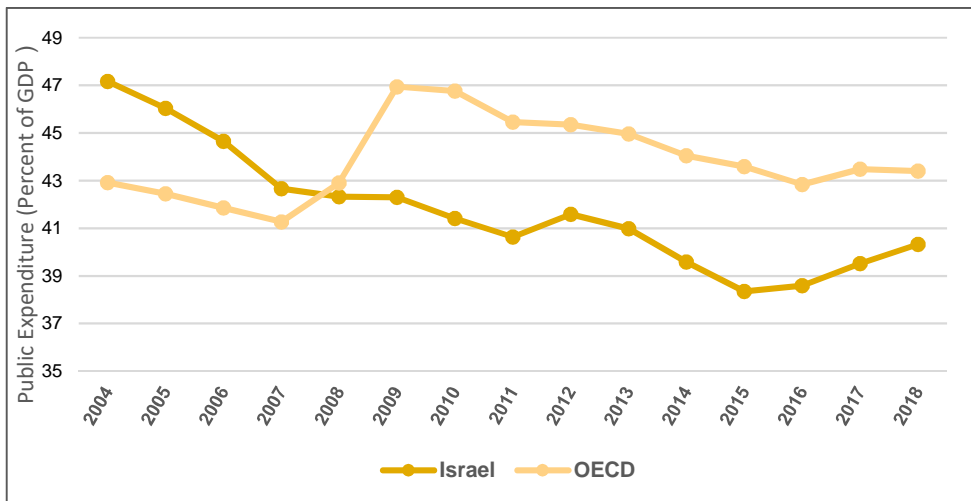
¹⁷ In response to the crisis, many countries decided to deviate from the limits established by their fiscal rules, whether by non-compliance or by modifying the rules to the reality of the crisis, which required the adoption of anti-cyclical policy measures (Schaechter et al., 2012).

Figure 3
Debt-to-GDP Ratio Relative to the OECD Countries, 2004–19



Source: IMF (2020c).

Figure 4
Public Expenditure Relative to the OECD Countries, Percent of GDP, 2004–19



Source: IMF (2020b).¹⁸

¹⁸ These IMF data are not fully consistent with the [OECD data](#) that are published there (see the link below); however, according to both sources, the gap between Israel and the OECD average is about 1.5–2.0 percentage points, as of 2019.

However, the expenditure rule adopted in 2004 was overly rigid and arbitrary: at first a ceiling of 1 percent was adopted, and in 2006 it was raised to 1.7 percent—the approximate rate of population growth—without relating to any long-term fiscal target or defined economic parameter. Not surprisingly, the rule was frequently violated, primarily due to budget overruns that were recorded separately (“boxes” in the language of the Ministry of Finance); naturally, this did not contribute to confidence in policy or to stability. The use of such a rigid ceiling can be justified during a crisis, when it provides tighter control of the size of the budget and therefore limits the increase in the deficit. However this is not the case during a period of relative stability, which calls for a clear target for the G/Y ratio that will guide fiscal policy together with the debt target.

The National Economic Council within the Prime Minister’s Office warned of this already in 2007, and proposed the adoption of a rule that would reflect a long-term view and would be grounded in transparent economic considerations. The rationale was that if the economy arrives at a reasonable level of the debt-to-GDP ratio, then public expenditure should grow at the rate of growth in GDP. The justification is that public services provided by the state are for the most part “normal goods,” and furthermore, many are characterized by unitary or larger income elasticity of demand. In other words, their demand grows at least as fast as GDP. There are clearly budget components that are not necessarily contingent on the level of GDP (particularly those related to the civilian ministries); on the other hand, there are budget components whose income elasticity is greater than unitary, such as healthcare and culture. Therefore, as a first approximation and in a situation in which the D/Y target is sustainable, attempting to set the growth in G to equal the growth in Y is the correct strategy, with the goal of keeping the ratio between them constant. Any reasonable version of an expenditure rule must thus include the growth rate of the economy, where the long-term rate (the “growth environment”) should be used, with the goal of avoiding procyclical policy and frequent policy changes.

The second anchor proposed by the National Economic Council for the expenditure rule was to set the debt-to-GDP ratio target clearly, such that as the economy approaches that target, budget restraint would be loosened on the expenditure side. Therefore, the formula proposed in 2009 and adopted formally as part of the approval of the 2011 budget was as follows:

The restraint coefficient X the growth environment = the rate of growth in expenditure

$$\frac{\Delta G_{t+1}}{G_t} = \bar{g}_Y \times \left[1 - \frac{(D/Y)_t - 60\%}{60\%} \right]$$

The value of 60 percent appearing in the formula is the target proposed at that time for the debt-to-GDP ratio, such that when D/Y converges to that level, the restraint coefficient would be equal to 1, and thus the rate of growth in expenditure would be equal to the economy’s growth environment (National Economic Council, 2009).

However, the expenditure rule was changed again in 2013, and was first applied in its new form in the 2015 budget. The new format was as follows:

$$\frac{50\%}{\text{Current debt-to-GDP ratio}} + \text{the rate of population growth} = \text{the rate of growth in expenditure}$$

Thus, for example, according to the relevant parameters (a rate of population growth of 1.96 percent during the years 2014–16 and a debt-to-GDP ratio of 61.2 percent in 2017), the ceiling on the growth in expenditure for 2019 was 2.78 percent (Knesset Research and Information center, 2018).

$$\frac{50\%}{61.2\%} + 1.96\% = 2.78\%$$

Unfortunately, this formula veered from clear economic considerations and reflects an arbitrary attempt to return to a path of public expenditure reduction, without being grounded in long-term targets, whether they be the desired G/Y or even the D/Y ratio. Thus, setting a ratio of 50 percent for D/Y in the formula is arbitrary and not based on any solid economic analysis, and was not preceded by any professional discussion.¹⁹ Furthermore, constructing the formula to be based on the rate of population growth has no real economic justification. It is unfortunate that an issue this important is subject to short-term manipulations that undermine not only the execution of fiscal policy itself but also its credibility.

This equation was essentially abandoned in recent years, even before the pandemic. Thus, for example, in 2019, the increase in public expenditure was 5.5 percent, well above the ceiling of 2.8 percent according to the expenditure rule (Bank of Israel, 2020a). Although there was justification for increasing public expenditure, the change in policy should have been based on the formulation of new rules that reflect the needs of the economy and are based on a clear rationale, rather than being the result of short-term and largely political considerations unconnected to any long-term vision. In abandoning the expenditure rule in such a manner, the government endangered the fiscal discipline that had been achieved with such great effort and which up to that point had constituted a basis for the economy's strength and stability.

Economic policy since then has, as a whole, been largely focused on dealing with the COVID-19 crisis. However, once the acute phase of the crisis passes, the government must deal with its repercussions and in particular the sharp rise in the debt-to-GDP ratio, as well as the deep-rooted problems in the provision of neglected public services. Therefore, there is now even greater need to adopt a fiscal policy that is anchored in clear and explicit targets, with respect to both G/Y and D/Y, as well as formulas for rules that will serve those goals in a clear and transparent manner.

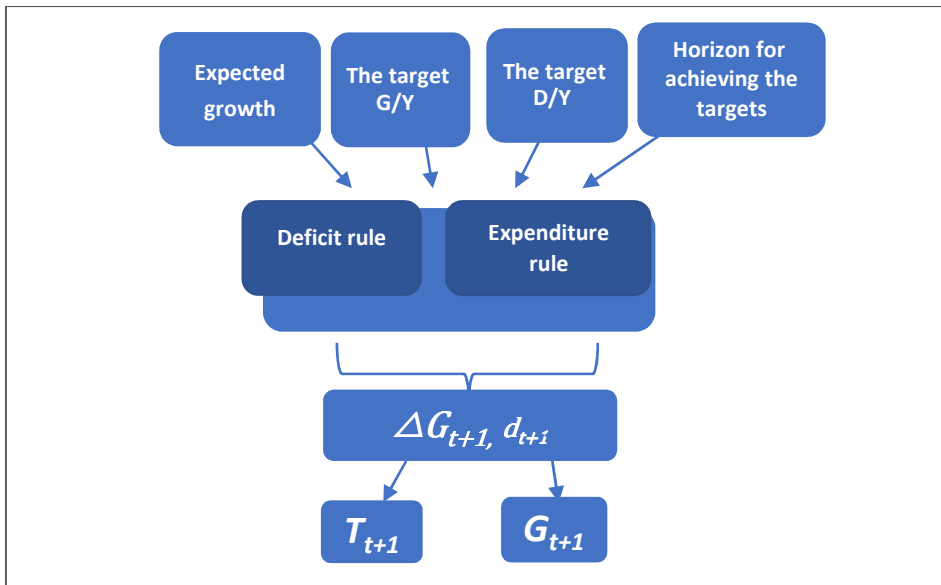
¹⁹ See Section 7.2 for the determination of the optimal debt-to-GDP ratio.

6. THE NEW FISCAL RULES

The proposed fiscal policy involves the adoption of two overall targets: G/Y and D/Y , which the government will be committed to reach within a defined period of time. They will be included as parameters in the new formulas for the deficit rule and the expenditure rule. The goal is that any government entering office will hold an in-depth professional discussion of this issue and will set targets accordingly. Furthermore, the new fiscal rules require the determination of “expected growth,” i.e., an estimate of the expected long-term rate of economic growth.

Figure 5 presents schematically the manner in which this policy is meant to be implemented in each year t when deciding on the budget framework for $t+1$. First, the government will decide on the fiscal targets and the time frame for achieving them and will calculate the relevant expected growth for the period. These values will be inputted into the formulas for the expenditure rule and the deficit rule alongside current values for G/Y and D/Y . The solution of the formulas will generate the fiscal parameters for $t+1$, i.e., the rate of growth in public expenditure, and accordingly G_{t+1} , and the rate of the deficit d_{t+1} , and based on them it will be possible to calculate the required tax revenues, since $d_{t+1} = \frac{T_{t+1} - G_{t+1}}{Y_{t+1}}$.

Figure 5
Determining the Fiscal Parameters



a. The Expenditure Rule Formula

The expenditure rule formula contains the elements presented in Figure 5, where the underlying intuition can be presented as follows:

$\frac{\Delta G_{t+1}}{G_t}$ = expected growth + the time coefficient X {the distance from the expenditure target – the distance from the debt target}

The complete formula is now:

$$(1) \quad \frac{\Delta G_{t+1}}{G_t} = \bar{g}_Y + 4 \left(\frac{t+1}{\bar{t}-1} \right) \times \left\{ \alpha \left[\overline{\left(\frac{G}{Y} \right)} - \left(\frac{G_t}{Y_t} \right) \right] - (1-\alpha) \left[\left(\frac{D_t}{Y_t} \right) - \overline{\left(\frac{D}{Y} \right)} \right] \right\}$$

- \bar{g}_Y : the growth environment;
- \bar{t} : the number of years until the achievement of the targets
- $\overline{\left(\frac{G}{Y} \right)}$: the target for the government's weight in GDP
- $\overline{\left(\frac{D}{Y} \right)}$: the debt-to-GDP ratio target
- $\left(\frac{t+1}{\bar{t}-1} \right)$: the time coefficient

The numerator $t+1$ is the index of the following year that the rule relates to (in other words, the growth in public expenditure in the budget for the following year); the denominator is the time horizon for achieving the target \bar{t} minus one. Assume that this horizon is five years; then the value of the time horizon in the first year is 0.25, in the second year it is 0.5, and so on. In other words, in the beginning, the formula assigns a low weight to deviations from the targets (when they will probably be the largest) and that weight increases each year. This gradually leads to the necessary changes in public expenditure and the deficit, and therefore also in taxes, which is one of the outcomes that we seek to establish. Multiplying the time horizon by 4 ensures convergence of the targets in the target year \bar{t} .²⁰

- $1 > \alpha > 0$: the weight of the public-expenditure-to-GDP target relative to the debt-to-GDP target, which reflects the relative importance attributed by the government to each. Thus, $\alpha = 0.5$ attributes the same importance to each, while a larger α attributes greater weight to the distance from the public expenditure target.

The formula operates in such a way that as long as public expenditure relative to GDP is lower than the target set for it, its rate of increase will be greater than the rate of growth, and thus the weight of public expenditure in GDP will grow. However, if the debt-to-GDP ratio is higher than the target, this will moderate the rate of growth in expenditure and may even

²⁰ This is an algebraic result for which we do not currently have a satisfactory intuitive explanation.

change its direction. If and when the government meets both fiscal targets, the rate of growth in government expenditure will equal the growth environment and thus will ensure that the expenditure-to-GDP ratio remains constant over time.

b. The Formula for the Deficit Rule

$$(2) \quad d_{t+1} = \left(\frac{\bar{g}_Y}{1 + \bar{g}_Y} \times \frac{D_t}{Y_t} \right) - \left(\frac{t+1}{\bar{t}-1} \right) \times \left(\frac{D_t}{Y_t} - \overline{\left(\frac{D}{Y} \right)} \right)$$

The term $\left(\frac{\bar{g}_Y}{1 + \bar{g}_Y} \times \frac{D_t}{Y_t} \right)$ is the result of an algebraic manipulation that yields the deficit rate that leaves the debt-to-GDP ratio unchanged, and therefore when the second term of the formula $\left(\frac{t+1}{\bar{t}-1} \right) \times \left(\frac{D_t}{Y_t} - \overline{\left(\frac{D}{Y} \right)} \right)$ becomes zero (when the debt-to-GDP target is reached), the deficit stabilizes at a rate that leaves D/Y unchanged.

These two rules together determine another fiscal component, namely the weight of tax revenue in GDP:

$$(3) \quad \frac{T_{t+1}}{Y_{t+1}} = \frac{G_t + \Delta G_{t+1}}{Y_{t+1}} - d_{t+1}$$

There can be no certainty with regard to future tax revenue and therefore the government must set tax rates so that *expected* revenue will be equal to T_{t+1} as derived from (3). This is not substantially different from the current situation, since in any case the budget is based on forecasted revenue; the difference is that here not only are we dealing with a forecast but we are also setting the tax rate such that the expected revenue will match the defined course.

There is a lack of symmetry between the formulas: while the deficit rule formula includes only the D/Y target, the expenditure rule includes both the G/Y target and the D/Y target. The inclusion of D/Y in the expenditure rule formula is necessary in order to arrive at a fiscal policy that will better balance the two targets, which are often in opposition. Furthermore, it provides the government with an additional tool for fiscal restraint by way of a reduction in expenditure, in the event of exogenous shocks that are liable to increase the actual deficit to beyond its planned level and to lead, in turn, to an uncontrolled increase in the debt. This is due to the fact that the government has a limited ability to use the second tool for restraint, i.e., an increase in tax rates, in real time, and the results of this usually appear belatedly. Moreover, in the case that the government seeks to simultaneously reduce the debt and increase public expenditure, the inclusion of the debt target in the expenditure rule ensures a more moderate increase in taxes. This is because the inclusion of the debt target constrains the growth in public expenditure in the initial years, and accordingly also the level of taxation required to finance it. In this way, the increase in taxes in the initial years will be directed

primarily toward reducing the debt, and only in subsequent years will it be directed toward financing the increase in public expenditure.²¹

7. DETERMINING THE TARGETS AND EXPECTED GROWTH

As illustrated in Figure 5, the first step in implementing the proposed framework is to decide on targets for G/Y and D/Y and the time frame for achieving them and to calculate the relevant expected growth for that time period. This section discusses the correct method for setting these targets. However, although we are using specific parameter values for coming years in our illustration, it is not our intention to set these targets in stone, since there is a high level of uncertainty as to the economic situation during the post-pandemic era. Therefore, the main part of the discussion will be devoted to providing the foundation for setting these targets in the medium term, without committing to any specific values.

a. Determining the G/Y target

There is no doubt that determining the optimal level of public expenditure relative to GDP is one of the most complex and contentious issues in the social economic domain. This is due to the fact that it involves conflicting values: the collective role of providing public goods vs. individual freedom, the dynamic nature of the business sector vs. the inertia and conservatism that characterizes the public sector, and so on. These differences in viewpoint have always existed and have assumed different forms, although most of the 20th century was characterized by a clear trend: the expansion of the role of government and the increase in its weight within GDP—from a small percent prior to the First World War to levels of 35–50 percent in recent decades. However, if at one time the debate was primarily ideological—in the sense of the Social Democratic left, which overall supports expansion versus the capitalistic right, which supports consolidation—today this political-conceptual distinction is less clear. This is due to the fact that the advantages and disadvantages of the various approaches are fairly well-known and understood, and therefore policy goals are determined according to each country's characteristics (cultural, demographic, etc.) and its specific political circumstances, rather than purely ideological considerations.

Consequently, there is in fact both a need and a justification for a broad professional discussion of the issue, in at least two contexts: first, a comparison to the reference countries; and second, an examination of the actual provision of the main public services (such as healthcare and education) relative to the needs of the population, as well as a clarification of the effect on the population's welfare if it is asked to bear the costs of filling the gaps between what there is and what should be.

²¹ It is possible to come up with alternative ways to include the preference for a moderate increase in taxes, such as, for example, the inclusion of a time coefficient in the formula, or by way of the coefficient α .

The fact that Israel has been a member of the OECD for more than a decade makes it easier to carry out the comparison, since there is a shared and consistent database for this purpose. There are currently 37 countries in the OECD; however, it is important to compare Israel's G/Y ratio not only to the average of all OECD members but also that of countries "similar" to Israel (the reference countries) in the relevant dimensions, and in particular with respect to size and GDP per capita.

With respect to size, it is generally believed that there are economies of scale in public expenditure that may result in an inverse relationship between a country's size and its G/Y ratio, rather than being the result of differences in fiscal policy.²² The types of public expenditure in which economies of scale may exist relate primarily to what are known as "staff ministries", whose scope is not in general dependent on the size of the population or at least not proportional to it. Thus, for example, the size of the Prime Minister's Office (or the President's Office), the Ministry of Finance, part of the justice system (such as the Public Prosecutor and the Supreme Court), the Ministry for Environmental Protection, and more are not meant to increase in size in direct proportion to population growth, but rather at a significantly slower pace.

Therefore, it can be expected that in countries with a large population, the component within G that is connected to staff ministries will lead to a lower G/Y ratio than in countries with a smaller population (others things being equal, of course). In contrast, there are public services that are fully correlated with population size, such as education, healthcare, long-term care, and more, which is liable to offset the effect of the staff ministries on G/Y. Alesina and Wacziarg (1998) show that the coefficient of population size in a regression where G/Y is the dependent variable is negative and statistically significant, with a long list of other variables that are controlled for,²³ and the result remains valid whether or not expenditure on education is included. In other words, economies of scale are important in determining G/Y as a function of size. We therefore chose countries whose populations are within a range of 50± percent of Israel's (which is about 8.8 million). The smallest country in the group is Finland, with a population of 5.5 million, while the largest is Belgium, with a population of 11.5 million.

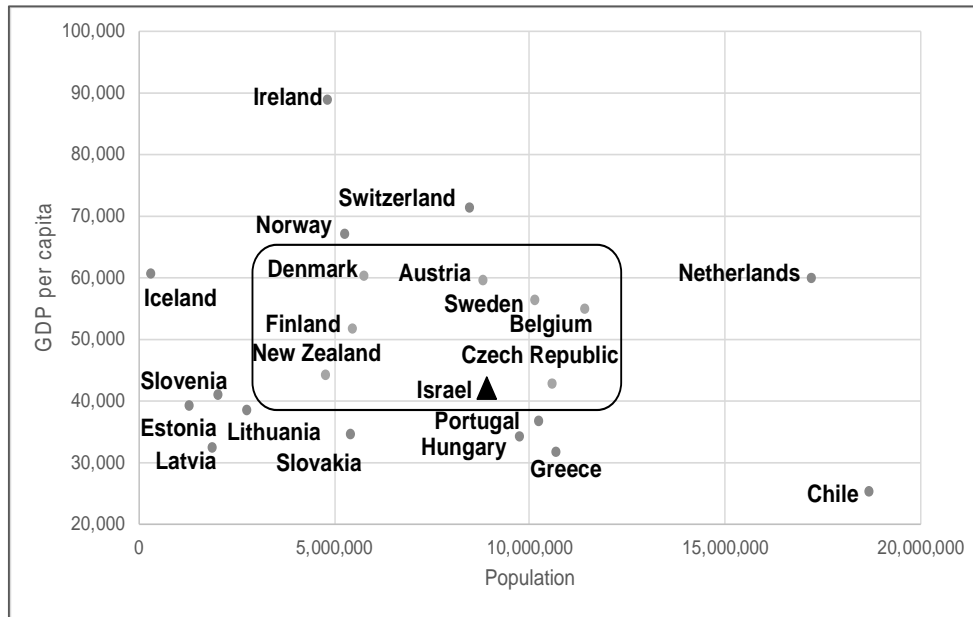
The second characteristic here is output per capita, which is likely to affect the demand for public services by way of a number of channels, and in particular if the income elasticity of demand for these services is greater than unitary. However, and in contrast to population size, the aim is to compare Israel to countries with a GDP per capita that is similar or higher than that of Israel (up to 50 percent), since it can be assumed that these countries reached those higher levels due to prudent fiscal policy, among other factors. Furthermore, we

²² Either GDP (Y) or population (N) can be used as an index of a country's size; however, in order to be comparable to other empirical studies that have examined these relationships, we will use population size.

²³ See also Alesina (2003) for a more general discussion of the importance of a country's size.

verified that their GDP per capita has been higher than the OECD average during the last 15 years, which is an indicator of whether their economic success has been consistent over time. As can be seen in Figure 6, there are six countries that meet these criteria: Sweden, Austria, Denmark, Belgium, Finland, the Czech Republic, and New Zealand.²⁴ Figure 7 compares them to Israel and the OECD average over time.

Figure 6
OECD Countries by GDP per Capita and Population²⁵

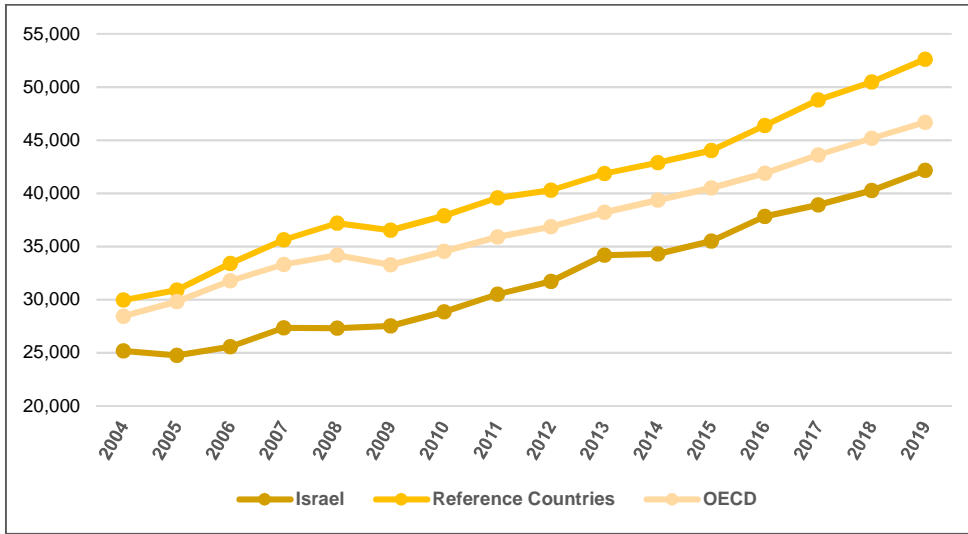


Source: GDP per capita according to the OECD site; population size according to the World Bank site.

²⁴ Other policy papers that discuss economic policy in Israel make comparisons to a similar group of reference countries. See, for example, Eckstein, Lifshitz, and Larom (2017), who compare between Israel and Sweden, Denmark, Austria, Finland, Switzerland, Ireland, and Holland.

²⁵ The data for GDP per capita are for 2019 and the population figures are for 2018. In order to present the data, the graph does not include countries whose population is larger than 20 million, nor countries whose GDP per capita is higher than \$90,000.

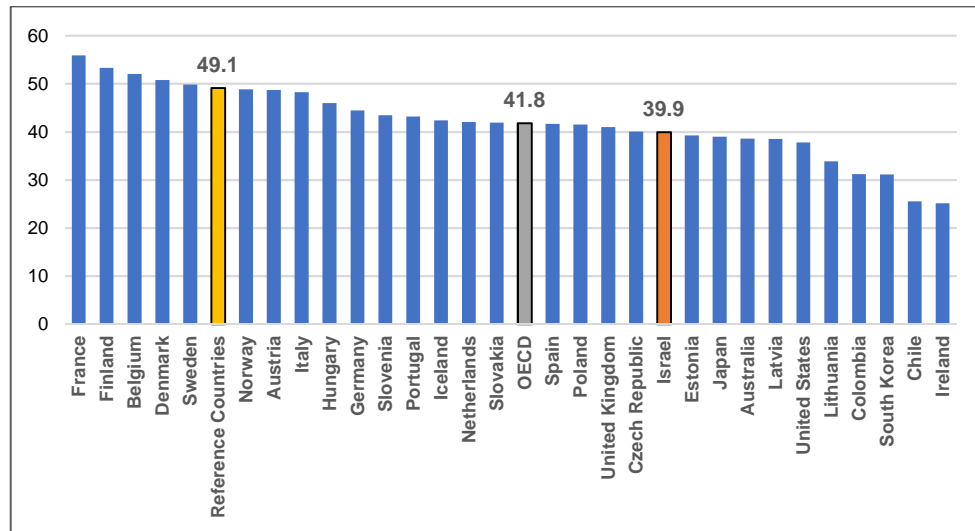
Figure 7
GDP per Capita in Dollars, 2004–19



Source: OECD (2020), [Gross Domestic Product \(GDP\) \(indicator\)](#).

The expenditure of the general government in Israel relative to GDP is lower by approximately 2 percentage points than the OECD average, and by about 9 percentage points relative to the average of the reference countries (Figure 8). Israel's defense spending is significantly higher than in the rest of the OECD countries and therefore the differences in civilian expenditure are even larger.

Figure 8
General Government Expenditure, Percent of GDP, 2018



Source: OECD (2021), General government spending (indicator). doi: 10.1787/a31cbf4d-en. The data for Israel and the Netherlands are for 2019. The reference countries do not include New Zealand due to a lack of data.

As described above, the long-term policy of reducing the size of the public sector in Israel, based on the “fat man and thin man” metaphor, led to an increasingly heavy burden on families, who were forced to finance from their own pocket services that the government had cut or no longer provided. Thus, for example, the fees paid by parents to schools grew in size despite the fact that according to law, the country is meant to provide compulsory education free of charge.²⁶ In healthcare, supplementary insurance and other forms of private expenditure continued to expand in order to finance a growing proportion of services that the healthcare system was meant to provide on its own and universally, based on healthcare fees and the state budget alone.²⁷ The huge lag in infrastructure investment, and particularly in the development of efficient public transportation, forces most households to purchase private vehicles (often two to a household) and to bear the high cost of maintaining them.²⁸

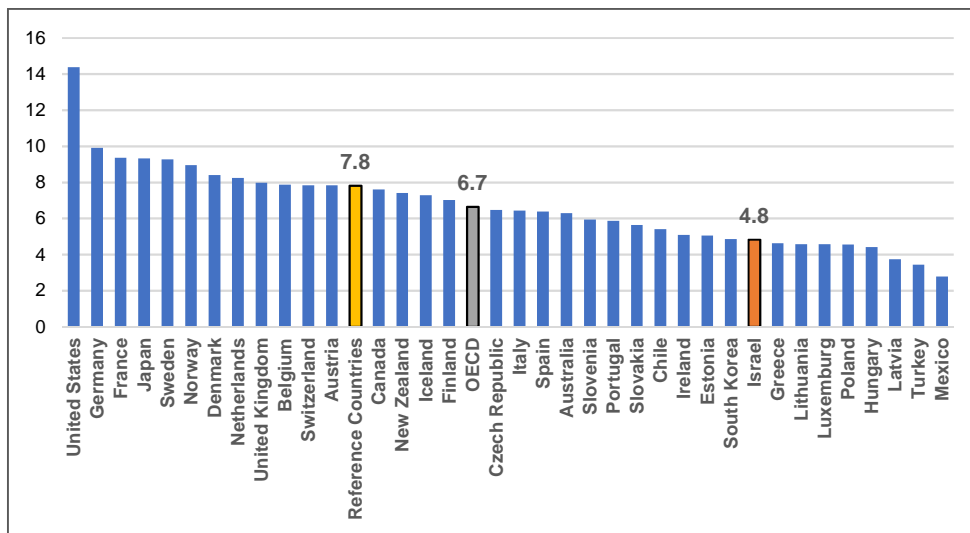
²⁶ See, for example, the sharp rise in private expenditure on education since the early 2000s, <https://data.oecd.org/chart/610Q>.

²⁷ See Weiss (2020), p. 33, on the rise in supplementary and private sector insurance during the past decade.

²⁸ Partly in the form of the numerous taxes imposed on vehicles. Although they contribute to the state budget and thus to producing a positive macro outcome, at the same time they represent a burden on households.

The downsizing of the government is reflected not only in quantity but also in the quality of services provided by the government. Some of the most important services lag behind those the OECD countries and in some cases the gap has widened over time, particularly due to the insufficient resources invested relative to population growth. This is true for the education system, which scores poorly on the PISA test, and for the healthcare system, which can be seen in the gradual process of decline due an acute shortage of physicians, nurses, and hospital beds (Trajtenberg, 2020) and the growing waiting times for tests and essential treatments²⁹, even though the system is highly ranked according to aggregate indicators (in particular, life expectancy). In the domain of transportation, congestion on the roads and the growing traffic jams have become an acute problem that imposes a high cost on the economy and on society, and the situation will only worsen in coming years (Trajtenberg & Zer-Aviv, 2020). The connection between these failures and the reduced size of government is clearly reflected in comparison to other countries: public expenditure on healthcare in Israel is 1.9 percentage points less than the OECD average and 3 percentage points lower than the average of the reference countries (Figure 9), while public investment in Israel during 2015–19 was 1.1 percent of GDP lower than in the OECD and 1.2 percent of GDP lower than in the reference countries (Figure 10).

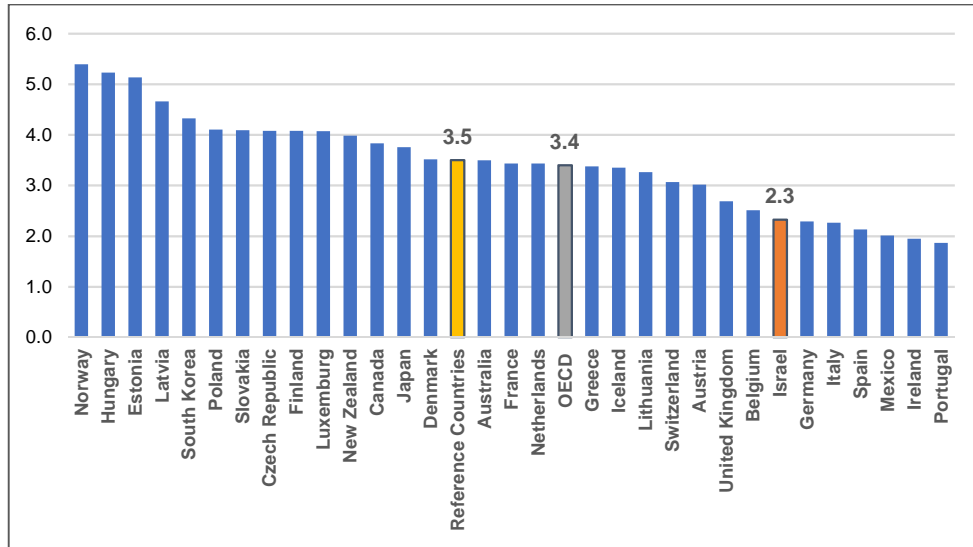
Figure 9
Public Expenditure on Healthcare, Percent of GDP, 2019



Source: OECD (2020), [Health spending](#) (indicator). The reference countries do not include New Zealand due a lack of data.

²⁹ There has been a consistent and significant upward trend in emergency room waiting times over the past decade. See Weiss (2020), p. 23.

Figure 10
Public Investment, Percent of GDP, 2015–19



Source: OECD (2020). The reference countries do not include Sweden due a lack of data.

The evident conclusion is that the government should increase the G/Y ratio relative to its level prior to the pandemic, by making this a long-term goal rather than a temporary measure to deal with a crisis. However, an increase in government expenditure is not a purely macroeconomic issue; the mix of the additional expenditure is also critical to the growth of the economy in the post-COVID-19 era and to the country's ability to deal with major crises, particularly the climate crisis and soaring inequality. In this context, one of the main recommendations in an IMF document published in October 2020 is to increase public expenditure in order to encourage growth and recovery from the crisis:

Public investment can have a powerful impact on GDP growth and employment during periods of high uncertainty—which is a defining feature of the current crisis. For advanced and emerging market economies, the fiscal multiplier peaks at over 2 in two years. Increasing public investment by 1 percent of GDP in these economies would create 7 million jobs directly, and between 20 million and 33 million jobs overall when considering the indirect macroeconomic effects.

(IMF Policies for Recovery, October 2020)

In particular, they recommend investment in healthcare, social housing, digitization, and environmental protection in order to create a more resilient and inclusive economy. Similarly, the OECD recommends that Israel increase its investment in R&D in the context of dealing

with the climate crisis, and in particular, social technology, large-scale energy storage, and double use of land. They also recommend that the government increase investment in infrastructure and particularly public transportation (OECD, 2020).

Even if it is clear that increasing public expenditure is unavoidable, it is not possible to currently recommend a specific target, since it is dependent to a great extent on the economic situation that prevails during the period when the targets are determined. The next section illustrates how the rules work using a target of $G/Y = 43$ percent. It can be assumed that the average of the OECD countries will be even higher and this will certainly be the case in the reference countries; however, we stress that we are not recommending a specific number for this target except for purposes of illustration.

b. Determining a Target for D/Y

It was general practice to relate to a debt-to-GDP ratio of 60 percent, as specified in the Maastricht Treaty, as the target that Israel should seek to achieve, without any discussion or justification beyond that. However, in recent years there have been two important developments in this context. First, most countries exceeded that target to a large extent as a result of the crisis in 2008 and still exceed it. Second, Israel achieved that target in 2018, but the pandemic upset the goal since it has already led to a large jump in the debt-to-GDP ratio. Thus, according to the Bank of Israel forecast for 2020, the debt ratio for 2020 is expected to be in the range of 73–75 percent, while in 2021 it will be in the range of 76–83 percent (Bank of Israel, 2020b).³⁰ Therefore, there is a need to reassess the optimal medium-term debt target, since a target of 60 percent is clearly no longer relevant in the reality created by the pandemic.

A country's credit rating is determined to a large extent by its ranking relative to other relevant countries (while taking into account idiosyncratic risk), and therefore it is worthwhile choosing Israel's debt-to-GDP ratio for coming years relative to the reference countries, while also taking into account the expected level of debt for all the OECD countries. The emerging trend for the OECD's level of debt indicates that it will stabilize in coming years at around 80 percent as compared to 65.8 percent in 2019, while that in the reference countries will stabilize at 66 percent as compared to 50.6 percent in 2019 (IMF, 2020c). These large jumps in the level of debt are due to both negative growth and fiscal incentivization during the pandemic. At the same time, these estimates are liable to change significantly during 2021, since the future course of the COVID-19 pandemic involves a high degree of uncertainty.

In view of the above, and for purposes of illustration, a D/Y target was chosen in the range between the OECD average and the reference countries average, as follows:

$$\left[\frac{60\% (D/Y)_{Israel}}{65.8\% (D/Y)_{OECD}} \right]_{2019} = 0.91, \left[\frac{(D/Y)_{Israel}}{(D/Y)_{Reference}} \leq \frac{60\%}{50\%} \right]_{2019} = 1.2$$

³⁰ According to the IMF forecast, the ratio will be 76.5 percent in 2020 and 80 percent in 2021. See IMF (2020c).

Therefore, $73\% = 0.91 \times 80\% < [(D/Y)_{\text{Israel}}]_{-2025} < 1.2 \times 66\% = 79\%$.

In other words, the target will be within the range of 73–79 percent and in view of considerations related to the likely pace of tax increases, we chose a target of 78 percent for the illustration below, although, as mentioned, this should not be viewed as a normative prescription.

c. Determining the Time frame for Reaching the Fiscal Targets

There is an unavoidable tension between the need to set a realistic horizon for achieving the fiscal target and the need to detach fiscal decisions from short-term political considerations, to whatever extent possible. Establishing a reasonable time frame from an economic perspective but one that is too far away (according to the political clock) is liable to result in the surrender of the government to immediate pressures and to defer the measures needed to reach the targets. In contrast, setting too limited a time frame will result in insufficiently ambitious targets or, alternatively, unrealistic ones. Thus, for example, Israel has a long history of setting ambitious deficit targets according to too short a time frame, so that the targets are deferred year after year. This leads to a lack of credibility and undermines the concept of a “fiscal target.” Yet at the same time, the lack of political stability, as well as unexpected developments in the economic environment, is liable to obstruct the achievement of longer-term goals.³¹ Therefore, we present scenarios based on a time horizon of five years for the achievement of the targets, although the model of course can be used for longer time horizons.

d. Expected Growth

In Section 5, we outlined the rationale for the expenditure rule being a function, inter alia, of the rate of growth, with the goal of achieving the G/Y target within the time period to be determined. However, the expenditure rule cannot be a function of the current rate of growth or that expected in the subsequent year, since this will create dangerous procyclical fluctuations. Therefore, we must rely on “expected growth,” namely the average rate of growth expected to prevail over time, which is meant to support an anti-cyclical fiscal policy, while at the same time facilitating the effort to achieve the G/Y target.

Since the proposed fiscal policy is aimed at achieving targets within about five years, the estimated expectation of growth will be based on the best forecast of the average rate of growth for at least that time horizon and even beyond. However, in general, it is very difficult to forecast growth beyond a horizon of one to two years, since economic activity is continually subject to a broad range of domestic and foreign economic forces, as well as

³¹ In a similar context, see for example the report of the Brodet Committee on the defense budget published in 2007, following the Second Lebanon War. The report determined the path for the defense budget for five years and targets for ten years; however, in actuality the framework was observed for only about three years.

powerful exogenous shocks. Therefore, the most reliable data on which to base such a calculation are, on the one hand, past growth rates and, on the other hand, forecasted growth rates for coming years.

A clear advantage of past data is of course that they are actuals, and if the economy is sufficiently stable then their average over time can serve as a basis for the expected trend. The disadvantage is equally clear: the larger the gap, the less relevant past data becomes, and the more difficult it is to assume stability. Therefore, relying on average growth rates in previous years is liable to lock in fiscal policy at a level of public expenditure that is not appropriate to the economic situation that will prevail in the future. The opposite dilemma is encountered when we rely more on forecasted growth rates: although these are likely to be relevant from the point of view of timing, they are less certain, since the forecasting error increases exponentially as time passes. The one-year-ahead forecast of growth is located between these two dilemmas, but this is just one data item that cannot on its own point to a trend.

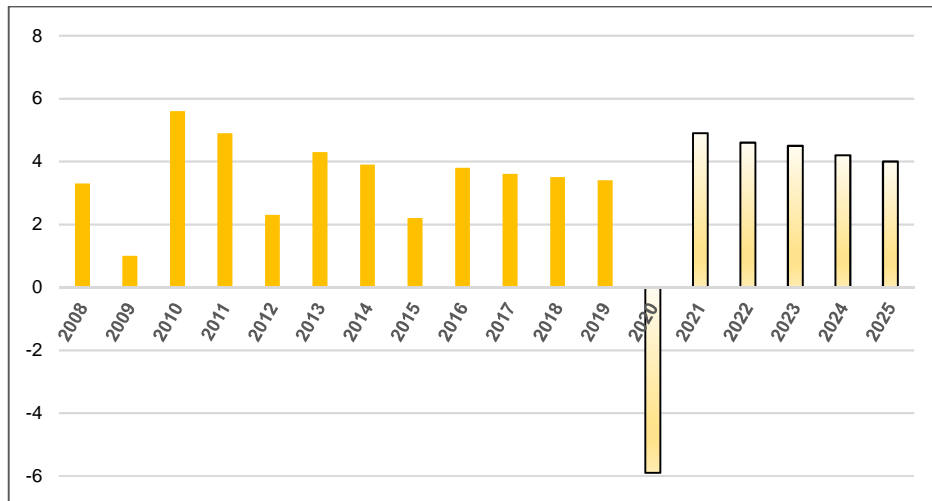
In the expenditure rule formula in use during 2011–14, the calculation of the growth environment was carried out by averaging the average rate of growth during the previous 10 years and the short-term rate of growth calculated as the average of current growth and growth in the previous year (National Economic Council, 2009). In contrast, to create the overall inclusive expenditure rule, the EU calculates the forecasted rate of growth as the average between the actual rate of growth during the previous five years, forecasted growth in the current year, and forecasted growth for the subsequent four years. The advantage of this method is that it relies on current economic data and their expected trends, though at the cost of greater uncertainty. At the end of the day, it is clear that an optimal calculation of expected growth will include three components: past, current, and future rates of growth. The discussion below focuses on the relative weight to be attributed to each.

The severity and uniqueness of the COVID-19 crisis have reduced the relevance of pre-crisis data while at the same increasing uncertainty with respect to forecasts of the future. Although international organizations, such as the IMF, publish such forecasts (Figure 11), they are based primarily on the (reasonable) assumption that following the period of negative growth economies will recover and will return—within one to three years—to previous levels of GDP, and even beyond, if the global economy as a whole recovers relatively quickly.

In view of the difficulty in arriving at a reasonable estimate of expected growth, there is no way to avoid the adoption of a fiscal policy for 2021 that is focused on the immediate to short term. This should be a responsible policy, of course, but one that cannot claim to be based on long-term targets. The proposed path for achieving the fiscal target will be implemented starting in 2022 and it can be assumed that prior to the implementation of new rules, the economic picture will be clearer. In other words, the actual and the expected rates of growth will be more reliable and will better represent the economy's potential for growth in the medium to long term. At this point, and in the absence of any other data, we will use

the average rate of growth during the period 2017–19 in the illustration and the forecasted rate of growth for the period 2023–25 (Figure 11), i.e., 3.9 percent.

Figure 11
Growth Rate in Israel, 2008–25



Source: IMF (2020c).

8. THE PROPOSED FISCAL POLICY: A POST-COVID SCENARIO

What follows is an illustration of the proposed fiscal policy, with the use of the expenditure and deficit rules. Starting values are posited for the decision variables that the government will need to determine when deciding on the fiscal trajectory for coming years. To this end, it is assumed that at the end of 2021, the debt-to-GDP ratio will stand at 80 percent, the public expenditure-to-output ratio will be 41 percent, and tax revenues will be 37 percent.³² In addition, we posit a value of 3.9 percent for the expected rate of growth (according to the reasoning in Section 7.4), and assume that it remains constant for five years (as mentioned, we do not take into account the large deviation in the rate of growth as a result of the pandemic). The targets used are 78 percent for the debt-to-GDP ratio and 43 percent for the public expenditure-to-GDP ratio. With respect to the weights on the targets, we use $\alpha = 0.5$, i.e., equal weighting of the expenditure target and the deficit target, since that is the default;

³² There is high uncertainty surrounding these variables and therefore they should not be treated as actual estimates or forecasts, but rather as reasonable values in light of what we know so far. Again, they are used here only for purposes of illustration.

if the government has different preferences then that will be reflected in a deviation from this value. Therefore, the formula for the expenditure rule will be:

$$(3) \quad \frac{\Delta G_{t+1}}{G_t} = 0.039 + 4 \left[\frac{t+1}{5-1} \right] \times \left\{ 0.5 \left[0.43 - \left(\frac{G_t}{Y_t} \right) \right] - 0.5 \left[\left(\frac{D_t}{Y_t} \right) - 0.78 \right] \right\}$$

And in particular, during the first year of implementing the new fiscal framework, public expenditure will grow by:

$$(3)' \quad 3.9\% = 0.039 + 1 \times \{0.5[0.43 - 0.41] - 0.5 [0.80 - 0.78]\} \\ = 0.039 + 0.01 - 0.01$$

In other words, in order for G/Y , the weight of public expenditure within GDP, not to decline any further, G must grow by at least 3.9 percent, i.e., the expected growth rate. As is evident, the gap from the expenditure target is offset—totally by coincidence—by the gap from the debt target, and therefore expenditure during the first year increases at the same rate as expected growth. We now substitute the relevant values into the formula for the deficit rule:

$$(4) \quad d_{t+1} = \left(\frac{0.039}{1+0.039} \times \frac{D_t}{Y_t} \right) - \left(\frac{t+1}{5-1} \right) \times \left(\frac{D_t}{Y_t} - 0.78 \right)$$

Thus, during the first year the permitted deficit will be 2.5 percent:

$$(4)' \quad d_{t+1} = (0.037 \times 0.78) - \left(\frac{1}{4} \right) \times (0.80 - 0.78) = \mathbf{0.025}$$

Based on these two formulas, it is possible to derive the required tax burden during the first year:

$$(5) \quad \frac{T_{t+1}}{Y_{t+1}} = \frac{G_t + \Delta G_{t+1}}{Y_{t+1}} - d_{t+1} = 0.385$$

In other words, the tax rate must be determined during the first year of the fiscal framework such that tax revenues will be 38.5 percent of GDP, as opposed to 37 percent at the starting point.

Figures 12 to 16 present the paths of the fiscal variables during the five years following the adoption of the framework. Thus, the rate of growth in expenditure increases during the initial years and accordingly brings about a gradual rise in G/Y , with the rate of increase declining in the final year in order to stabilize public expenditure at 43 percent at the end of five years. The deficit rate, which is 4 percent when the policy is formulated, due to the gap between G/Y and T/Y , is also low during the initial years in order to bring about a reduction in the debt, and then subsequently rises gradually to a level of 2.9 percent, which stabilizes the debt-to-GDP ratio at 78 percent. With respect to tax revenues, during the first year a

significant increase in tax rates is needed in order to reduce the debt by about 1.5 percent, while in the fifth year tax revenues reach a level that ensures that the debt will be stabilized at its target.

Figure 12
The Rate of Growth in Public Expenditure

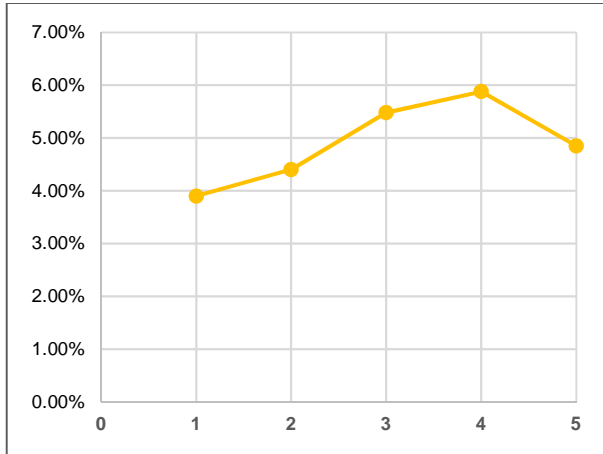


Figure 13
Public Expenditure as a Percentage of GDP

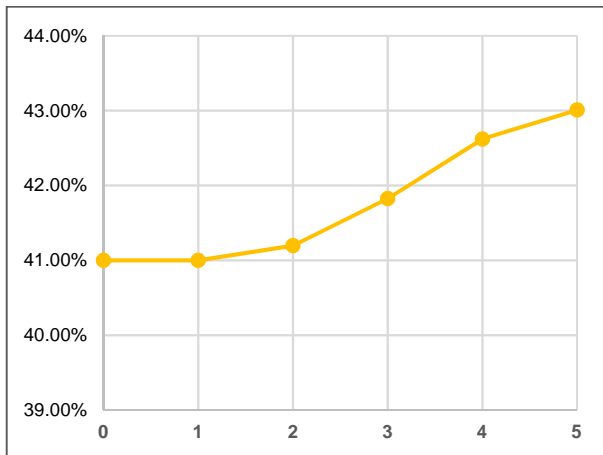


Figure 14
The Deficit Rate

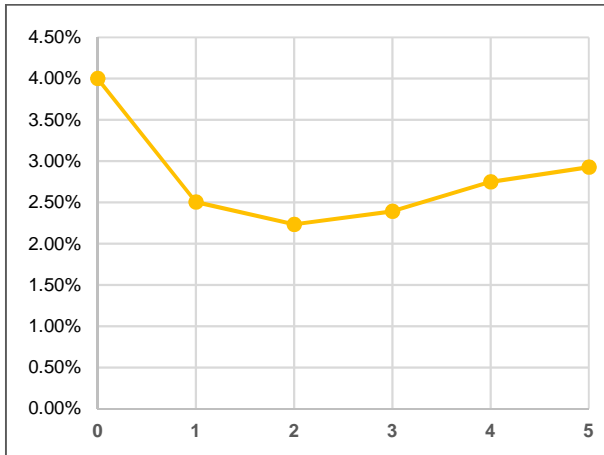


Figure 15
The Debt-to-GDP Ratio

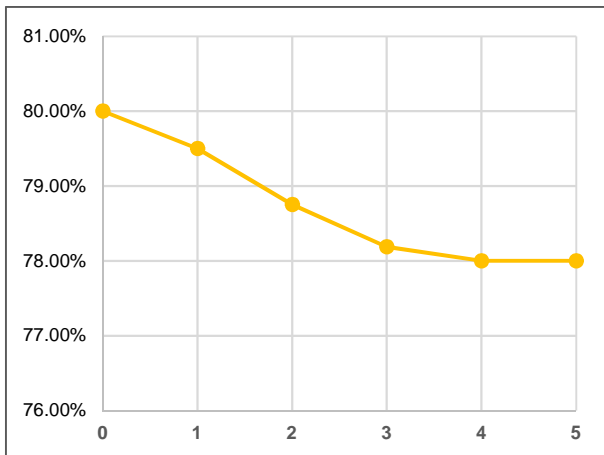
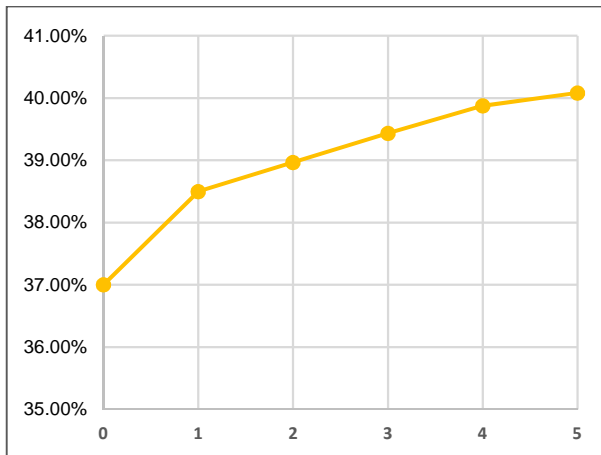


Figure 16
Tax Revenues as a Percentage of GDP



Achieving the aforementioned targets involves a gradual increase in tax collection, where the required increase in tax revenues during the first year is 1.5 percent of GDP (Figure 16: from T/Y of 37 percent to T/Y of 38.5 percent). This is a significant increase that will be difficult to implement politically. Elsewhere we discuss the expansion of the tax system in Israel and in particular for the purpose of carrying out a comprehensive reform, which should be implemented now in view of the need for a large increase in tax revenue (Trajtenberg & Popliker, 2020). If such a reform is implemented, then in the first year tax revenue will grow by 1.4 percent of GDP, without any increase in income tax rates; therefore, the scenario presented here is indeed feasible. However, even if one feels that an addition of 1.5 percent of GDP to tax revenues is excessive, it is still possible to adopt the framework, though with somewhat different targets. Table 1 presents the growth required in tax revenues according to various targets, where the increase of 1.5 percent is obtained in the case of the aforementioned targets of $G/Y = 43$ percent and $D/Y = 78$ percent.

Table 1
The required increase in tax revenue in the first year according to various targets
 (percent of GDP)

D/Y Target (starting point of 80 percent)	G/Y Target (starting point of 41 percent)		
	42	42.5	43
76	1.4	1.5	1.6
78	1.3	1.4	1.5
80	1.2	1.3	1.4

If, in contrast, we set a less demanding expenditure target, such as, for example, $G/Y = 42$ percent, then tax revenues have to grow by 1.3 percent of GDP, and even less than that if we also set D/Y at 80 percent. These calculations illustrate the tradeoff between the two targets, and between them and the need to raise taxes. It is possible to create a kind of “target menu” that will assist the government in choosing the most desirable option, while taking into account the fiscal implications and economic-political feasibility of each scenario. This illustrates even more clearly that adopting any fiscal measure requires looking at the entire fiscal picture, and in this way a mirror is placed in front of the government, contributing to the maintenance of budget discipline.

Apart from the ability to examine how various targets impact the fiscal variables, it is also possible to attribute various weights to the distance from the debt target or from the expenditure target in the expenditure rule. These weights reflect the importance attributed to the distance from each target and accordingly affect the path of the fiscal variables. Thus, for example, in the scenario presented here, with $\alpha = 0.5$, i.e., equal importance attributed to both the expenditure target and the debt target, there is no increase in G/Y in the first year, due to the fact that the distance from the D/Y target is offset by the distance from the G/Y target. However, to the extent that the government attributes greater weight to the distance from the expenditure target, i.e., the larger the value of α , so the rate of growth in expenditure will be higher, which will be achieved at the price of a larger required increase in tax revenue.³³ The weights in the formula of the expenditure rule therefore constitute another tool that the government can use to determine policy, since they can be used to actualize the government’s order of priorities, and in particular, its priorities with regard to the timing of changes over the course of the fiscal program.

9. GOVERNMENT EFFECTIVITY

Even if the need for a higher G/Y target is clear, increasing public expenditure per se is not a guarantee for narrowing the gap in the provision of essential public services. Moreover, if the budget is increased without complementary measures, this may become a double-edged sword, since the injection of additional resources into existing programs or mechanisms that are not particularly effective will only maintain inefficiency while obstructing alternative solutions.³⁴ Furthermore, in many contexts a wiser and more efficient use of existing

³³ Thus, for example, if the government wants to increase G/Y more significantly during the initial years of the program, it can set $\alpha = 0.7$, which will bring about an increase in expenditure of 4.7 percent in the first year (as opposed to 3.9 percent when $\alpha = 0.5$). However, this will require raising taxes by 1.8 percent of GDP (as opposed to 1.5 percent).

³⁴ There are indeed indications that the effectivity of Israel’s government is not low relative to other countries. For further details on government effectivity relative to the OECD countries, see Dahan (2016).

resources could improve the situation significantly without any additional budget. The fact that the current starting point is one of a “thin” public sector constitutes an excellent opportunity to examine the activity of the government ministries and the results of programs and interventions that rely on support from the state budget. It is also an opportunity to condition the injection of additional resources on proving effectivity, as well as the creation of a permanent mechanism that will do so on a continuing basis. In other words, the gradual increase in G/Y toward the target to be decided on should be contingent on and supplementary to a deep-rooted process that will ensure that these public resources indeed achieve their purpose.

There is currently growing awareness in many countries of this need, and there are several approaches and methods that can be adopted:

- The development of tools for examining and improving the effectivity of the public sector in general and the government in particular, based on the “Moneyball” approach.³⁵ It involves the following elements:
 - Building a foundation of knowledge with respect to work methods, policy measures, and programs that will achieve the most effective outcomes, so that policymakers will be able to make optimal decisions.
 - Controlled investment of tax revenue in work methods, policy measures, and programs that is based on data, evidence, and assessment in order to demonstrate their effectivity.
 - Non-budgeting of work methods, policy measures, and programs that have consistently failed to achieve results that can be quantified.
- Broad use of experiments to evaluate the effectivity of interventions based on randomized controlled trials (RCT), namely, research in which policy tools or intervention programs are implemented on a random sample taken from the target population, followed by comparison to a control group. These studies should also be accompanied by an evaluation of the ability to “scale up,” namely, whether it is possible to extend the policy to the entire target population without losing effectivity, if it has been proven in an RCT.
- Evaluating the potential of new digital technologies to improve and even bring about far-reaching change in the way that the government ministries and the public sector as a whole operate, while transforming it into a dynamic and proactive sector (OECD, 2019). This may lead to methods of operation and solutions that do not necessarily involve additional budget, but rather the implementation of innovative methods for delivering services. This will result in significant budget savings that allows for the expansion of different and more effective activity. The following are some examples:
 - A comprehensive reform of vehicle taxation, which will collect payment from every driver according to the time and location of trips and the number of passengers in the

³⁵ See <http://moneyballforgov.com/> and <https://results4america.org/about-us/>.

vehicle, and at the same time will lower existing taxes as part of a zero sum game. Such a reform can reduce congestion to a significant extent in the short to medium term, without the need for massive investment in infrastructure and public transportation (Trajtenberg & Zer-Aviv, 2020).

- Due to the rapid growth of the population in Israel and the lag that still exists in the building of schools, there is an ongoing shortage of classrooms. At the same time, teaching methods are undergoing far-reaching change, with one of the emerging directions the disappearance of the traditional “classroom” as the anchor of the school. Furthermore, it is clear that digital systems are becoming increasingly important in education at all levels and in all subjects, and therefore physical investments and all of the tools currently in use in the education system must be adapted to these developments. A not insignificant number of these changes involve lower costs than the existing methods; in any event, increasing the budgets of “more of the same” should be avoided.
- Zero-based budgeting (ZBB): According to this method, every budget item should be reexamined when building an annual or multiyear budget, including its necessity, rationale, effectivity, and so on. In other words, it should not be taken for granted that the previous budget serves as the basis for the current budget, such that only additions or cuts on the margin are considered. Rather, the entire budget should be reexamined. This is not easily implemented, and in the case of ministries where the lion’s share of the budget goes to salaries (such as the Ministry of Education), an in-depth evaluation will necessarily relate to only a small proportion of the budget. Nonetheless, it is certainly possible to build a multiyear plan so that a small number of ministries are evaluated each year according to this method, and therefore most of the ministries will be examined in such a process over the term of a government.

The process of formulating and approving the state budget in Israel involves the allocation of budget additions based on the order of priorities of the Budget Department and on the political bargaining among the ministers, while at the same time, cuts that are usually made on the margins and do not reflect an in-depth evaluation of public expenditure. We believe that if long-term and significant growth in G/Y is adopted as a target and in a consistent manner, it will support the adoption of a process for in-depth evaluation of government activity, which will include all of its programs, as described above. This will bring about a far-reaching improvement in the effectivity of the public sector, because for both the political echelons (i.e., the ministers) and the professional bureaucrats in the various ministries the possibility of obtaining additional resources if the expenditure is proven to be effective will constitute a powerful incentive for the adoption of these methods. In any case, the addition of built-in methods for evaluating effectivity and the accompanying implementation of changes should be an integral part of the new fiscal policy, rather than a separate component whose chances of implementation are highly doubtful.

10. CONCLUSION

One of the most notable features of the Israeli economy prior to the pandemic was the dissonance between healthy macroeconomic performance on the one hand, and the poor state of social services and heavy burden on households on the other hand. This contradiction is the result of retaining a fiscal policy that was correct at one time—and was even dictated by reality—but became less and less relevant and even harmful over time, as reflected in the social justice protests of 2011. Contributing to this was the government's unwillingness to examine the broader fiscal picture when deciding on the budget each year and dogmatic adherence to outdated rules.

The policy proposed here combines and balances in a structured manner the need to provide important civilian services, such as healthcare and education, and the need to maintain fiscal responsibility. This is accomplished by setting a rigid target also for the debt-to-GDP ratio. It is possible therefore to focus on both goals, provided this is done within a framework of explicit and transparent targets and rules whose impact can be monitored over time.

To this end, we need to abandon the “fat man/thin man” analogy, i.e., that the government is bloated while the business sector is emaciated, a metaphor that no longer reflects reality. Prior to the pandemic, public expenditure in Israel was lower than in most of the advanced economies, the tax burden was relatively low, and the share of the government in delivering basic services was smaller than desired. Once the COVID-19 crisis has passed, there will be a need to change direction in this context as well, as part of a fiscal policy that aspires to achieve long-term targets. At the same time, effort should be invested in increasing the effectivity of government expenditure, which often does not fulfill its purpose and therefore constitutes a burden on the economy. A long-term program to increase G/Y constitutes an excellent opportunity to evaluate the efficiency of the government ministries, where budget additions will be conditional on an evaluation of the effectivity of existing programs and programs that the ministries would like to initiate.

In contrast, it might be claimed that the proposed policy overly restricts the government's ability to maneuver in the long term and that the formulas for the fiscal rules are overly complex. However, even prior to the pandemic, the government's fiscal maneuvering room was quite limited; the difference is that this occurred without any genuine discussion and without relating to long-term targets. With respect to the complexity of the formulas, what is important in the final analysis is the bottom line, i.e., the fiscal parameters that are obtained from the formulas in order to formulate the state budget each year, including the rate of increase in public expenditure, the deficit rate, and tax revenues. The complexity is encountered only by the professional echelons.

The pandemic exposed more clearly the large gaps that had developed over time between social needs and the public services actually delivered, particularly in the realms of healthcare and education. Furthermore, the crisis undermined the accepted norms of fiscal policy and led to a learning process of trial and error in the tools that were employed during the crisis.

It can be hoped that the COVID-19 crisis will also act as a catalyst for the reexamination of this policy, not only to satisfy short-term needs, but also from a broader perspective. When this occurs, the adoption of the program proposed here will contribute to the assimilation of a far more systematic and balanced fiscal approach.

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