



IDI Presents:

17<sup>th</sup> Annual CAESAREA FORUM

## **Macro-Economic Policy in Times of Financial Crisis**

Team chair: Prof. Eran Yashiv

### **Summary of Findings**

Israel Democracy Institute  
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## **Preparatory team**

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## Abstract

The Israeli economy, which is very open to overseas trade, has suffered from the global economic and financial crisis that began in 2007 and greatly escalated as of mid-September 2008. Since the crisis is global, diversifying the risks in different countries was of no use this time. The damage to the economy was expressed, *inter alia*, by a drop of 3.6% (in annual terms) in the GDP in the first quarter of 2009, after a drop of 0.5% in the last quarter of 2008. The drops in business GDP and private consumption were even sharper. **Against this backdrop, Israel's macroeconomic policy requires irregular measures.** It should be noted, however, that the drop in Israel is more moderate than the annual drop in the GDP of 10% in the European Union and 5.7% in the United States in the first quarter (in annual terms).

From the outbreak of the crisis until May 2009, there were three important fiscal developments: A sharp drop in tax collection, a "1/12 budget" due to the failure to pass a budget for 2009, and a 13% drop in the first quarter (in annual terms) in public consumption, according to data provided by the Central Bureau of Statistics. In other words, expenditures and taxes dropped in practice, both as a result of a decrease in economic activity and as a result of budgetary processes. **These developments reflected, *inter alia*, the political situation, including the failure to pass the budget for 2009 and the elections in February 2009.**

In April-May 2009, the new government assembled a two-year budget for 2009 and 2010. The process of assembling the budget was rife with political pressures and led to decisions that deviated from the plans of the Ministry of Finance's Budget Department. **The budget that was passed is more reflective of the drop in tax collection that took place due to the slowdown in economic activity, and less reflective of informed decisions as to the requisite scope and composition of the budget at this time.** The manner in which the budget was passed also expressed undesirable processes.

What should have been done was to determine the expenditure mix and the tax mix that would be most effective for encouraging activity, subject to deficit constraints. Since Israel has a public debt of approximately 80% of its GDP, there is limited room to maneuver on the matter of the deficit. The drop in tax collection has brought the budget to a deficit of about 6% of the GDP, and it would appear that it is difficult to significantly deviate from this number. However, **it does not seem that a new order of priorities has been established,**

**either with regard to expenditures or with regard to taxes, which will reflect the current needs of the economy.**

We should prepare in advance for a scenario in which the actual budgetary deficit in 2009-2010 diverges from the planned framework. **If a further increase in the deficit should emerge, we should consider freezing plans for tax reductions, raising taxes or cutting expenditures.** It should be made clear to the public how the government intends to reduce the debt burden in the coming years, while adopting long-term policy guidelines.