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Position Paper

Bribes and the Ballot Box: How Israel's 2026 Budget Serves the Governing Coalition

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November 2025

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Arab Center for Applied Social Research

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This paper is one in series of position papers that is jointly published by Mada al-Carmel and the Arab Center Washington DC (ACW)

November 2025

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Introduction

As always at the end of the year, the Israeli government will soon present its economic and financial agenda for 2026 in the form of a draft budget and an Economic Arrangements Law that will serve as the economic action plan for the new fiscal year. However, 2026 will be different from every year since the formation of the current governing coalition in 2022. It is an election year and this will be the last budget before Israelis go to the polls.

This paper examines what we know so far about the 2026 Economic Arrangements Law and the budget proposal. It argues that Israel's governing coalition is seeking to exploit the "political business cycle" for its own electoral advantage. In essence, the government wants to increase spending and cut taxes—without any attempt to balance the budget—in a crude attempt to buy voters' support in the 2026 elections.

In 2025, the government made a series of fiscal cuts and raised taxes to cover an increase in the military budget amid declining revenues. It raised value-added tax (VAT) by 1 percent, froze the annual income tax brackets, and increased the national insurance tax. After imposing higher taxes on all citizens for the last two years, the government now wants to cut taxes for specific segments of the population while imposing new taxes on other groups in the middle and upper classes. The intention is to avoid angering large constituencies of Israeli society by imposing what would be considered acceptable and required taxes.

Governments commonly use budgets and economic policy to improve their prospects for re-election. In the 1970s, William Nordhaus introduced the "political business cycle" model, which posits that governments seek to improve their chances of winning the next election by stimulating the economy.[1] They typically do so by increasing public spending or loosening monetary policy to reduce unemployment and raise economic growth rates in the short term, in addition to lowering taxes—even if their policies later lead to higher inflation or economic imbalances. This dynamic creates a political-economic cycle linked to elections, with engineered pre-election booms often followed by economic downturns or post-election fiscal corrections.

Nordhaus' model has been adopted by numerous researchers examining differences in the behavior of ruling parties based on their ideological identity—both right- and left-wing—as well as the impact of the nature and degree of entrenchment of the democratic system, across different time periods. Despite variations in outcomes and effects according to ruling party ideology or institutional context, most of the academic literature agrees that governments resort to economic tools in election years, particularly the public budget, to influence voters and boost their chances of winning the next election.[2]

In an analysis of 88 cases from several countries between 2000 and 2015 that examined the impact of elections on government fiscal and budget policies, Andrew Q. Phillips found a slight but statistically significant increase in both government spending and public debt immediately before elections, together with a decrease in revenues, particularly from taxes, and an increase in the budget deficit over the same period.[3] His analysis shows that the impact of the "political business cycle" varies by institutional context, with these effects most pronounced in emerging democracies with weak institutions. Assaf Shmuel's study supported this conclusion, finding that political budget cycles are most pronounced in fragile democracies and weak authoritarian regimes, while they are almost non-existent in established democracies or stable authoritarian regimes.[4]

One of the most prominent examples of using economic policy for electoral purposes is the case of Hungarian Prime Minister Viktor Orbán, a close friend of Israeli Prime Minister Benjamin Netanyahu, who announced ahead of the 2022 elections that his government would return $2 billion in income taxes to families and also increase the minimum wage.[5] Orbán again used the "electoral budget" ahead of the spring 2026 elections, announcing an economic plan that would over time provide billions of dollars in tax breaks for mothers and retirees. The announcement came after the ruling party's popularity had plummeted in public opinion polls.[6]

Ahead of the 2014 presidential election in Brazil, President Dilma Rousseff's government significantly increased spending on social programs and infrastructure projects in an effort to boost its popularity and win voter support. This spending meant that government effectively abandoned its goal of reducing the budget deficit that year.[7] Similarly, ahead of the 2019 elections in India, Prime Minister Narendra Modi's government adopted an "interim budget" that included expansionary fiscal measures in the form of additional funds to support farmers and employment programs in rural areas to appeal to voters.[8] In Ireland, the government also implemented so-called "electoral budget" under the pressure of political competition in 2024, announcing an expansionary budget for 2025 that exceeded established spending limits in an attempt to gain popular support ahead of the election.[9]

Budget and Financial Resources in the Service of Israel's Governing Coalition

In early November 2025, Israel's Ministry of Finance presented the draft Economic Arrangements Law for the 2026 fiscal year—including a package of tax changes and reforms that either reduce or raise taxes on different segments of the population—which the government seeks to implement during the next year. A review of these proposals clearly shows that the Israeli government is implementing financial and economic populism through the state budget and the arrangements law—even if partially—to create the impression that the economy is improving ahead of the elections. Many observers expect these policies to influence voter behavior and benefit the ruling coalition in the elections—especially Finance Minister Bezalel Smotrich, whose party is currently in danger of failing to meet the electoral threshold.

Reducing Income Taxes

The package proposed in the arrangements law includes tax cuts for employees with middle and high incomes by widening the tax brackets for grades 8 and 9 of the income ladder (whose per capita monthly income ranges between 16,000 and 25,000 New Israeli Shekels [NIS]); i.e., for the middle and upper income groups.[10] The Ministry of Finance estimates that tax cuts for grades 8 and 9 alone will cost the treasury about NIS 5 billion annually.[11]

Imposing New Taxes

The Ministry of Finance prepared a proposal to offset the reduction which builds on recommendations from a professional committee of the Tax Authority in coordination with the Chief Economist of the Ministry of Finance. The proposal has two objectives. Since land is one of the scarcest and most expensive resources in Israel, the first is to impose a tax on privately-owned, undeveloped real estate designated for housing, at a rate of 1.5 percent of the value of the land per year.[12] The second objective of the tax is to encourage speculators to stop holding on to undeveloped land in the expectation of future price increases.[13]

Estimates suggest that the new property tax will primarily affect a small number of wealthy families who are the largest private landowners in Israel, as well as some Palestinian Arabs who own large tracts of land intended for construction. The tax can be considered a populist measure taken against the wealthy segments of society. The tax increase is acceptable to most Israelis as they will not be directly impacted.

In principle, the tax is expected to generate billions of shekels each year. But implementation will prove difficult. Undeveloped land was subjected to a property tax in Israel until 2000 but was later frozen due to practical problems over issues such as land valuation. Now, questions are again now being raised about how to value land without accurate data on sale price or profit margin, and about the principle of taxing property that has not generated profits. Although the draft law proposes solutions to these problems, they are seen as weak and insufficient. The proposal does not seem fully developed and there are serious questions about its feasibility.

The Ministry of Finance is also proposing to raise taxes on tourism, despite the sharp decline in the volume of inbound tourists since October 7, 2023. The ministry has reintroduced a proposal to abolish the VAT exemption on tourism services, which it had proposed last year but dropped due to opposition from Tourism Minister Haim Katz.[14] If the proposal is approved, the Ministry of Finance expects it to generate about NIS 2.5 billion, even though tourism in Israel is suffering from both the repercussions of the war and the rising cost of living. An 18 percent tax hike on tourism services will not make Israel more attractive to the average tourist. The estimate that the measure will raise NIS 2.5 billion therefore seems unrealistic.[15]

The ministry also plans to impose a carbon tax on air travel fuel consumption, in line with international practices, as well as adjusting aircraft consumption rates to comply with international standards. The move will drive up the prices of flights from Israel and will likely face stiff opposition from the Israeli airline lobby.

The ministry further proposes to comprehensively reform the tax and regulation of liquid tobacco products (e-cigarettes) to reduce their use, especially among the youth, and to combat the black market. According to the Ministry of Finance, these reforms are expected to generate about half a billion shekels a year.[16] The plans include a flat tax of NIS 1 on each millimeter of e-vaporizer, in line with the average implemented by the Organization for Economic Cooperation and Development countries, in addition to a tax of NIS 30 on each vaporizer, empty or full. It also proposes to abolish the VAT exemption on e-cigarettes sold in the city of Eilat.

Create a "Rental Apartment Registry"

Israel's Ministry of Finance is seeking to revive the initiative to create a "database of rental apartments" by imposing a new obligation on landlords to report their rental income, even when that income is below the taxable limit.[17]

The ministry's rationale is that the new requirement will effectively increase tax collection from landlords whose incomes exceed the tax exemption ceiling but who are currently avoiding paying the tax in the absence of a blanket reporting obligation. According to the ministry's estimates, these reforms are expected to increase state revenue by NIS 50 million to NIS 130 million annually in the future.[18]

Political opposition has aborted proposals of this kind in the past. The argument was apartment owners would pay for the additional tax burden by increasing rental prices. Abolishing the tax exemption ceiling would therefore harm tenants. Opponents also argued that imposing reporting duties on citizens without tax obligations would produce unjustified and unnecessary bureaucratic complications.

Avi Simhon, Chair of the National Economic Council and close advisor to Netanyahu, recently proposed that the government provide financial compensation to families affected by higher bank interest rates leading to increased monthly mortgage payments over the past year. The proposal aims to help people who bought apartments prior to 2022, when interest rates were low. Since then, monthly premiums have risen sharply, in many cases by thousands of shekels per month, which has become a real burden for many families.

Simhon proposed that the Ministry of Finance should help mortgage holders with their payments and impose new taxes on banks to cover the new spending. Simhon proposed a formula to reimburse part of the interest rate increase to loan holders, with retroactive effect for up to ten years.[19]

The proposal faces strong professional opposition from the Ministry of Finance and from the Bank of Israel, which was not consulted or even invited to discuss the measure.[20] The Ministry of Finance believes that the proposal constitutes "a step that contradicts the Bank of Israel's monetary policy," and could practically weaken its effectiveness. If implemented, the proposal could create pressure for further interest rate hikes or for high interest rates to remain higher for longer. Senior Ministry of Finance officials also fear that this move could undermine the central bank's independence, weaken institutions, and undermine the effectiveness of monetary policy, which could negatively impact investor confidence.

The Bank of Israel considered this proposal "completely devoid of any economic logic" and carries "enormous potential damage" to Israel's economy, as well as to its image and international standing.[21] Economically, the bank explained, the actual burden on borrowers did not increase significantly if it were calculated as a ratio of the monthly mortgage payment to income. An analysis that considers the increase in borrowers' incomes and debt level shows that this ratio did not rise but rather fell before the increase in interest rates.[22]

Other criticism of Simhon's proposal is that it focuses on a narrow group of borrowers defined by the interest rate on their loans, not the effect of inflation itself. Borrowers who took out price index-linked mortgages (which increase with inflation) suffered much more than others.[23] Borrowers who chose to refinance their mortgages and extend their repayment period in order to reduce their monthly payments would not be eligible for subsidies, even though they, like others, were affected by rising interest rates.[24]

Citizens who took out high-cost loans to establish or run businesses, particularly small stakeholders who have been severely affected by higher interest rates, will see no benefit from Simhon's proposal. The proposal further differentiates between mortgage holders and other categories of borrowers, such as credit card and consumer loans users, who have already paid higher interest rates. The proposal also potentially benefits apartment owners, who have already benefited from the increase in real estate values, but not tenants, who will not receive any support.[25]

The proposal therefore draws arbitrary boundaries between different categories of people, even though all of them have been impacted equally by higher interest rates.[26]

Conclusion

The main proposals in Israel's Economic Arrangements Law make it clear that the government is seeking to satisfy as many citizens as possible in an election year through fiscal policies and targeted tax reforms, while limiting the burden. By drafting the arrangements law and the new budget proposal without serious professional preparation or in-depth debate in a country that claims to have advanced and independent economic institutions, Netanyahu's government has revealed the extent to which its policies are improvised, rather than economically rational. This pattern reinforces the impression that the Ministry of Finance's proposals are part of a broader trajectory of classic electoral economics, which is an open attempt to woo voters with checks, grants, and financial support. In fact, such policies are little more than electoral bribes to different socio-economic groups with the express purpose of influencing their decisions at the ballot box.

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