

CHAPTER I

MAIN ECONOMIC DEVELOPMENTS IN 1957

THE INTENSIFIED economic activity in 1957 led to a substantial growth in production and in employment. The largest increase was in building construction, which rose during the period under review by 32 per cent in real terms. Output in industry rose by 15 per cent and in agriculture by 10 per cent. The number of employed rose by 55,000 as compared with the previous year. Table I-1 shows the main indicators of economic development for 1955-1957.

Increased demand, both by the Government and by the public, was one of the main factors responsible for the increase in production and employment. A review of economic developments over the whole of 1957 with respect to liquidity and the flow of Government receipts and payments on the one hand, and private income and demand of the public on the other hand, is necessary for an analysis of this factor.

In the early part of 1957, there was a considerable flow of liquid assets to the public, through an increase in the money supply. There were several reasons for this increase. First, the substantial loans granted by the banking system to the Government for payment for goods and services purchased from the public during the Sinai campaign. Secondly, there were two seasonal factors causing an increase in the supply of money—an increase in the balances of foreign exchange, and the expansion of bank credit to the public. As a result, during the January-April period there was a rapid increase in the money supply, which rose at an average rate of 1.8 per cent per month.

Furthermore, there was apparently an outflow of savings from the public, accumulated in the form of liquid assets prior to the improvement in the security situation. In the early part of 1957, the public increased its expenditure on consumption and on purchases of apartments. This was in contrast to the period of the tense security situation from 1955 until after the Sinai campaign when expenditure by the public somewhat declined.

The reasons outlined above led to an increase in liquidity and to intensified economic activity. Furthermore, the pace of dwelling construction for immigrants was stepped up following the increase in the number of immigrants in the early part of the year.

The component of domestic materials and labour being relatively high in both building construction and in the branches supplying this industry with goods and services, the boom in building construction was an important factor in the increase of economic activity.

TABLE I-1
Indicators of Economic Development, 1955-1957

	<i>Percentage increase or decrease (-)</i>		
	<i>1954 to 1955</i>	<i>1955 to 1956</i>	<i>1956 to 1957</i>
1. Resources and their use—at constant prices			
Total resources	9	12	8
Gross national product	10	10	11
Output in:			
Agriculture	8	16	10
Industry	12	9	15
Building construction	35	- 9	32
Private consumption	8	6	9
Private consumption per capita	3.8	1.5	3.3
Public consumption ^a	10	41	-15
Gross investment	19	7	21
Imports (goods and services)	6.8	18.1	- 0.2
Exports (goods and services)	1.3	15.0	19.0
Deficit on current account	9.9	19.6	- 9.9
Import of goods	5.6	3.2	11.4
Export of goods	- 3.8	14.8	20.6
Trade deficit	9.6	- 1.0	7.5
2. Population and employment			
Average population	3.6	4.5	5.6
Employment	5	3	9
3. Prices and wages			
Average earnings	10	13	9.0
Consumers' price index	5.9	6.4	6.5
National income	19	21	19
National income per capita	14.7	15.5	12.6
Private income	^b	20	20
Private disposable income	^b	19	20
Private disposable income per capita	^b	13.9	13.6
4. Finance			
Money supply (average)	20.5	17.9	19.6
Bank credit to the public ^c	10.5	17	19

SOURCE: Prepared by the Bank of Israel on the basis of data supplied by various sources.

^a Public consumption includes all current expenditure, with the exception of transfer payments by the public sector. However, "output" of the public sector includes only expenditure on purchases made at home.

^b Not available.

^c End of year.

The supply of money also continued to rise after January-April and thus contributed to a high level of economic activity during the year as a whole. As a result of the expansion of credit to the public, the supply of money rose at the rapid pace of 1 per cent between May and August. During the last months of the year, the rate of increase in the money supply slowed down considerably. Between May and August, the Government was in need of credit from the banking system to meet the considerable payments to the public and, in particular, to finance the intensified building construction. Credit to the public continued to rise during this period. On the other hand, balances of foreign exchange declined by the end of the year, due to the high level of imports in 1957. This offset the impact on the money supply of the credit expansion to the Government and to the public.

The increase in the supply of money would have been even more rapid were it not for the large increase in time deposits over the year as a whole (including deposits under saving schemes). Even though time deposits are less liquid than the money supply, it cannot be assumed that the rise in time deposits reduced the liquidity of the public to any appreciable extent.

The supply of money was 20 per cent higher in 1957, on the average, than in the previous year. Its increase was the result of Government deficit financing and of the credit expansion to the public.

Government transactions were an important factor in the increase of liquidity. Collection of direct and indirect taxes from the public was raised; the amount of Government bonds subscribed was considerable. There was also an increase in unrequited receipts from abroad, in spite of an unexpected delay in some of them. However, the increase in receipts was inadequate to cover the heavy payments of the Government to the public, both for debts contracted during the period of the Sinai campaign and for intensified financing of building expenditure. Consequently, the Government resorted to substantial borrowing.

The intensified economic activity and the rise in personal transfers from abroad (mainly personal restitution payments from Germany) increased aggregate private income by about 20 per cent. The Government and the local authorities reduced private income by an increase in the collection of direct taxes. The main reason for this increase was that, in 1957, the defence tax was collected over the whole year; whereas, in 1956, collection began only in April. Thus the increase in direct taxes reduced the amount of private income, not, however, the rate of increase in disposable income which also went up by 20 per cent. As a result, the demand of the public increased.

The rise in demand was accompanied by a real increase in output due to the following causes:

- (i) The increased supply of domestic raw materials from agriculture, mining and industry; the same was true for the import of raw materials.
- (ii) The addition of several thousands in employment, as a result of greater

immigration and the increase in the adult population. In some branches, there was also an increase in output per worker.

(iii) The maturing of investments made in previous years and the intensified use of existing productive capacity.

The high level of economic activity led to a rise in imports. As the greatest increase in output occurred in building construction which, similar to the branches supplying this industry with goods and services, has a relatively low import component, outlays of foreign exchange required for additional import were not very high in absolute figures. However, expenditure on the import of raw materials for other industries rose considerably. This was also true for the import of liquid fuel. Imports of capital goods, particularly of ships and aircrafts, rose considerably. At current prices, the total import of goods rose by \$65 million between 1956 and 1957 and, at constant 1957 prices, by \$46 million.

There was a substantial increase in exports of agricultural and industrial goods by about \$29 million, at current prices or 27 per cent. However, foreign exchange outlays for imports exceeded the increase in receipts from exports. The reason for this was the greater real increase in imports over exports and the ascending price trends which necessarily leads to an increase in net expenditure in an economy where imports exceed exports. As a result, the trade deficit rose by \$36 million. Nonetheless, the deficit on current account declined by \$18 million due to the large fall in imports for defence. This decline rendered possible the financing of additional imports for civilian use. In spite of this, there was an increase in foreign exchange commitments. Foreign exchange balances rose at the beginning of the year and fell towards the end of the period under review.

The growth of the gross national product increased the real resources available. Moreover, the volume of resources diverted to public consumption declined owing to the alleviated defence burden. The increase in resources derived from the gross national product and from the reduction in defence expenditure amounted to IL. 400 million at 1957 prices. Exports of goods and services rose by IL. 65 million and net investment by IL. 150 million. Investment increased in all sectors, but the largest increase was in building construction. Investment in ships and aircraft rose at a particularly high rate. Private consumption rose by about IL. 185 million, due to the total increase of 9 per cent in consumption; the per capita increase was 3.5 per cent. The greatest rate of increase in private consumption was recorded by durable goods.

The accelerated economic activity was related, as outlined above, to a high level of imports which curbed, to some extent, the expected influence of intensified demand on the domestic price level. Nonetheless, prices rose by about 8 per cent. The rate of increase in the price level was, however, decelerated by the subsidy payments of the Government which resulted in a reduced rate of increase in the consumers' price index. This in turn led to a deceleration of the rate of

increase in wages and in the prices of services and, indirectly, to that of the general price level.

For several years, the gross national product has been growing at the rapid annual rate of 10 per cent; there is also a high level of employment. These phenomena have been accompanied by permanent inflation. However, inflationary developments in 1956 were partly the result of autonomous factors—an increase in production costs and in particular of wages. Hence, the money supply had to be expanded in order to avoid an increase in unemployment. In 1957, on the other hand, inflation originated primarily in increased monetary demand mainly as a result of a considerable expansion in the supply of money. It would, therefore, appear that in 1957 there was demand inflation.

Owing to intensified demand in 1957, the considerable wage rise of 1956 and the additional rise of 1957 were effected without causing, as had been feared, a considerable increase in unemployment.

Wages were again increased in 1957, as were some other production costs, including import prices. These were, however, but secondary phenomena of the increase in demand in 1957. Furthermore, the imposition of additional indirect taxes and the duties levied in 1957 on import goods and other commodities did not considerably affect the general price level, the rise of which is primarily rooted in the increase in demand.

As to the long-term interests of the economy, progress was registered in 1957 in the following fields:—

(i) A large increase in investment. In 1957, the share of investment in the use of total resources exceeded not only that of 1956 (when there was a substantial rise in public consumption expenditure owing to the defence burden), but also that of 1955. Investment increased in all sectors, including agriculture, industry and transport. The main increase was in building construction and services, the contribution of which towards a future improvement in the balance of payments is small, relative to investment in agriculture and in industry.

(ii) Although there was a substantial increase in investment, the import surplus of goods and services did not rise as a result of the reduction in defence expenditure. In contrast to previous years, the level of net investment in 1957 was not lower than that of capital imports.

These developments reflect some progress. It should, however, be borne in mind that a great part of domestic investment financed by home resources consisted of investment in housing. The contribution of private saving to new investment in agriculture and industry has, so far, been rather limited.

(iii) As in previous years, the import component of private consumption continued to decline. This was particularly felt in the reduction in food imports, largely rendered possible by a considerable increase in the supplies of domestic agricultural produce.

(iv) In spite of the fact that 110,000 immigrants arrived in 1956 and in 1957, employment was provided for almost all of them within a comparatively

short time. This also applied to the increase in the adult resident population. However, insofar as the increase in employment was connected with the stepped-up building activity and its impact on industry, transport and other sectors, this rise was largely of a temporary character.

On the other hand, there were also some undesirable and harmful developments. These originated in the inflationary pressures which have been prevailing for a number of years and which have had a cumulative effect on the structure of the economy. The outstanding developments in this respect may be summarized as follows:

(i) The increase in output did not in itself sufficiently contribute to a more favourable balance of payments. In spite of the increased share of exports in the use of resources, their rise was inadequate in view of the expected decline, in the coming years, in foreign exchange receipts.

Moreover, not only was there no increase in foreign exchange reserves, but they even declined somewhat. Their sum total still remains very small in the light of the requirements of the Israel economy.

(ii) The widening gap between the domestic price level and the import and export prices. Measures adopted to counteract these developments included export premia on the one hand, and the levying of imposts on the other hand. However, imposts levied were not sufficiently high. The reason for this was their possible effect on the consumers' price index, and also the opposition emanating from various interest groups. A complex system of subsidies and imposts was created, whereby they are fixed or levied in accordance with administrative measures which are unevenly applied to the commodities concerned, thus disturbing the regular and efficient operation of the economy.

(iii) Owing to inflationary developments, the Government curbed the rise in the consumers' price index through subsidies on agricultural products, mainly vegetables, fruit, milk and eggs as well as on imported food. These subsidies increased the relative profitability of these products: as a result, their production greatly expanded, at the expense of a possible increase in the output of industrial crops, the contribution of which to a more favourable balance of payments exceeds by far that of fruit, vegetables, livestock and poultry products. In view of the fact that investment in these agricultural branches was made in the light of their relative profitability, these subsidies exert an undesirable influence on the structure of agriculture.

Another unwelcome development whose effect on the monetary field has been considerable is the granting of almost all loans for investment in equipment and fixed assets from the Development Budget, while for purposes of working capital, enterprises have to resort to inflationary financing, generated by too great an expansion of bank credit. As a result, enterprises are in permanent financial difficulties, notwithstanding the continued expansion of bank credit and, in point of fact, because of this very expansion.

These distortions were largely the result of an economic policy which, in some

fields, paid too much attention to short-term considerations and did not make adequate allowance for the economy's requirements in the long run, when capital transfers from abroad will decline considerably.

The influence of these distortions will have a long-term effect, as they are bound to affect investment and thus the future pattern of production and employment. In these circumstances, a high level of real income and employment is dependent on stepped-up production for the domestic market, leading in turn to the continued rise in imports and to the increase in the deficit on current account.

The balancing of budgets, both of Government and of public institutions, the increase in indirect taxes and in imposts on import commodities, a slower rate of credit expansion to the public, and the prevention of too rapid a rise in building construction, other than immigrant housing—all these might have created the essential conditions for a considerable increase in production and employment at a more or less stable price level, while at the same time favourably affecting the balance of payments. It may be assumed that these and similar measures, including those designed to increase productivity and efficiency, might have accelerated the rate of increase in exports and decreased the import component in output, while channelling investments accordingly. The long-term interests of the economy would have been furthered to a much greater extent by such means, ensuring a high and increasing level of output and of real income in the long run.