

CHAPTER I

MAIN ECONOMIC DEVELOPMENTS IN 1963

THE YEAR 1963 exhibited contrary trends at different periods. During the first half of the year, the beneficial effects of devaluation were clearly felt, particularly as regards the balance of payments; these effects actually began to be noticeable already in October 1962. However, in the second half of 1963 the positive trend began to weaken, primarily because of the monetary expansion. This expansion was due to large-scale foreign currency conversion, capital imports having received a powerful impetus from the devaluation.

Moreover, under pressure of monetary expansion, full employment, and the intensification of economic activity—all of which increased domestic demand—every attempt to safeguard the positive achievements of devaluation met with great difficulties. During the second half of the year, the detrimental effects of the monetary expansion of the January–May period began to manifest themselves, imports beginning to expand while exports contracted.

During the year 1963 as a whole, the deficit on current account in the balance of payments decreased by 11 per cent, and totalled \$ 407 million, or \$ 48 million less than in 1962. The development of exports followed the pattern of previous years. Income from exports rose by \$ 101 million, or some 20 per cent, reaching \$ 605 million. On the other hand, the development of imports departed from the pattern of previous years to a significant extent. Imports increased more slowly than local production: expenditure on imports rose by \$ 54 million, or only 6 per cent, totalling \$ 1,012 million. However, this positive development in the balance of payments was partly due to special factors: a considerable rise in proceeds from citrus exports caused by the particularly favorable weather, the utilization of stocks of imported goods stored during previous years (chiefly in anticipation of devaluation), and a decline in Government imports. Moreover, developments in the balance of payments were not uniform throughout the year: the downturn in imports, which began in the second half of 1962, came to an end in the early months of 1963. In March, imports resumed their upward movement, and it gathered momentum in the last months of the year and the early part of 1964. The reverse was true of exports: during the first half of 1963 exports increased rapidly (this applies to industrial goods no less than to citrus), while during the second half their growth was impeded by the expansion of the local market following the rise in incomes and the money supply.

The inflow of capital imports continued during 1963 at the record rate attained after the 1962 devaluation. There was a striking increase of \$ 72 mil-

lion in private transfers and private investment. The decline in the deficit on current account in the balance of payments and the expansion of capital imports together caused a rapid accumulation of foreign currency, despite the advance repayment of \$ 50 million in foreign liabilities by the Government.

The excessive rate of monetary expansion in 1963 unquestionably constitutes a potential source of strong pressure on prices. The money supply rose during the year at an average rate of 2 per cent per month, and between the beginning

Table I-1
INDICATORS OF ECONOMIC DEVELOPMENT, 1959-63

	Per cent increase or decrease (-)			
	From 1959 to 1960	From 1960 to 1961	From 1961 to 1962	From 1962 to 1963
Resources and uses				
(at constant prices)				
Total resources	9.5	13.7	12.6	8.7
Gross national product	8.4	10.5	12.2	10.7
Private consumption	8.5	10.0	11.5	9.5
Private consumption per capita	5.6	6.4	6.7	5.4
Public consumption	10.9	17.8	10.7	9.6
Gross investment	3.2	18.0	13.5	1.0
Foreign trade—goods and services				
(in dollars)				
Imports	15	23	12	6
Exports	25	18	8	20
Import surplus	6	28	5	-11
Population and employment				
Average population	2.7	3.4	4.5	4.0
Number of employed	3.2	4.8	5.7	4.9
Prices and national income				
(nominal)				
Wages per normal hour of work	5	10	12	11
National product	3	9	7	8
Consumer price index (annual average)	2	7	10	7
National income	12	19	20	23
National income per capita	10	15	14	18
Finance				
Money supply (annual average)	14	18	17	31
Bank credit to the public (annual average)	26	24	17	20

and the end of the year, it went up by IL 353 million, or 28 per cent. The increase in the average annual level reached 31 per cent.

The main source of this rapid monetary expansion was foreign currency conversion. The continuation of large-scale capital imports during 1963, together with the conspicuous improvement in the balance on current account toward the end of 1962 and at the beginning of 1963, increased the volume of foreign currency conversion, in particular during the first half of the year reviewed. The net accumulation of foreign currency in the banking system totalled \$ 74 million.

In consequence of the above developments, there was a tremendous increase in the volume of liquid assets available to banking institutions, which would have resulted in a large-scale expansion of credit and a still faster growth of the money supply had the Bank of Israel not taken steps to counter its effects. The Government's net debt to the banking system, after deducting credit from the Bank of Israel for the advance repayment of foreign liabilities (which does not contribute to monetary expansion), declined somewhat.

The Bank of Israel raised the liquidity ratio for banking institutions by 0.5 per cent per month during the first ten months of the year. Moreover, it did not grant the full quota of exemptions under the 22 per cent of controlled credit not subject to the liquidity regulations. Consequently, the effective liquidity ratio rose from 39.4 per cent at the end of 1962 to 46.6 per cent at the end of 1963, and the average annual liquidity ratio—from 36.7 to 42.4 per cent.

Ordinary bank credit to the public¹ expanded by IL 160 million during the year reviewed. Part of this increase, however, was due to the substitution, through export financing funds, of local credit for that previously obtained from abroad—an operation which actually does not increase aggregate net credit, and thus has no expansionary monetary impact. The additional ordinary bank credit granted to the public in 1963 was mainly for financing exports through the fund established by the Bank of Israel in conjunction with the Government and the banks. The outstanding balance of this fund rose from IL 31 million at the end of 1962 to IL 145 million at the end of 1963. The Bank of Israel and the Government participate in the fund to the extent of 40 per cent; another 30 per cent constitutes controlled credit exempted by the Bank of Israel from the liquidity requirements, while the remaining 30 per cent is supplied from the free resources of the banks. Since the Bank of Israel and the Government charge a very low rate of interest (2 per cent per annum) on their quota in the fund, credits granted by the fund to exporters carry interest of only 6 per cent per annum.

The pressure of demand was not fully reflected by increases in the prices of commodities and services during the year reviewed. The average rise in the domestic price level reached 7 per cent as compared with the average level in

¹ Excluding credit from deposits of provident funds granted through banking institutions.

1962. This partly reflects price increases that occurred in the latter part of 1962. Between the beginning and the end of 1963, the prices of most commodities and services from current production rose much more moderately. Direct intervention by the Government and the policy of import liberalization prevented the prices of industrial products from climbing. Prices of services went up by 5 per cent during the year. On the other hand, there was a steep rise in the prices of real estate and shares—markets which were not subject to price control, and to which a considerable part of the demand increment was diverted. However, neither these developments nor the wage-freeze policy could prevent wage increases resulting from demand pressure in the labor market. These increases were reflected in production costs, and in due course are likely to affect the volume of exports.

The temporary curbs on prices and wages imposed by administrative means and direct Government intervention will probably cause an accumulation of even more intense inflationary pressures in these spheres in the future, giving rise to a process of suppressed inflation—i.e. price restraint accompanied by a growing rate of monetary expansion.

The rapid growth of the national product continued during the year reviewed, totalling some 10 to 11 per cent. This was slightly less than in 1962, when the expansion was particularly striking, but matches the average for the last several years. The increase in product per gainfully employed was likewise somewhat slower—5.5 per cent in 1963 as compared with 6.1 per cent in 1962. As regards the development of individual economic sectors, there was a marked decline in the growth rate in construction and transportation. In the construction sector, the area of public immigrant housing starts decreased after the creation of a reserve of empty dwellings. The slower pace of development in transportation was felt chiefly in civil aviation and road haulage. Industry and agriculture continued to advance—even somewhat more rapidly than in 1962. Net agricultural product rose by some 10 or 11 per cent, as against 8 per cent in 1962; this was largely due to the excellent citrus harvest. Industrial output expanded by 14 to 15 per cent. There was a marked acceleration of industrial production during the last months of 1963, owing to the rising local demand for industrial goods. In the commerce and service sectors, output continued to rise parallel to the growth of the national product.

The continued rapid expansion of the national product was made possible by a 4.9 per cent increase in the number of gainfully employed. The fact that the number of gainfully employed rose somewhat more slowly than in 1962, when it went up by 5.3 per cent, was due to two factors: the slightly slower growth of the population, and a small decrease in the labor force participation rate. On the other hand, the number of unemployed continued to decline, and in many areas a shortage of skilled and even unskilled workers was felt.

The average population of Israel increased in 1963 by 92,000, or 4.0 per cent, as compared with a growth of 4.5 per cent in 1962. The slower rise was

due to the continued decline in the rate of natural increase among all sections of the population, while immigration was more or less at the same level. The labor force participation rate fell somewhat among persons of working age. This was due to the higher percentage of youths and elderly persons in the population and to the withdrawal from the labor force of women and youths of the Arab communities because of fewer employment opportunities on family farms following the blight of the tobacco crop.

The decline in unemployment continued, its level contracting from 3.8 per cent of the total labor force to 3.5 per cent. The drop in unemployment did not encompass all districts. In contrast to the shortage of skilled and unskilled labor in the main population centers, where most of the country's economic activities are concentrated, there is still serious unemployment in the more remote parts of Israel, especially in development areas.

The big demand for labor led to an increase of 11 per cent in hourly wages, though a wage-freeze policy had been adopted for the year and the official wage rates in force since 1961 remained unchanged. The raising of the cost-of-living allowance rate was responsible for 60 per cent of the increase in hourly wages, as compared with one-third in each of the three preceding years. Another factor pushing up wages was the pressure of demand for labor, which led to increases in most economic sectors and a great many trades. The wage level rose particularly fast in the commerce sector and in personal services, where many places of employment are still not unionized. In the public services, on the other hand, the wage freeze appears to have been more effective, and the rise in pay was consequently smaller.

The appreciable expansion of the national product was also due in part to the growth of some 10 per cent in the economy's capital stock, and that of 6 per cent in the stock per gainfully employed. On the other hand, gross investment in fixed assets expanded more slowly in 1963—by a mere 2 per cent. This deceleration was chiefly due to the smaller volume of public immigrant-housing construction. Investment in private building rose by 9 per cent, and that in other economic sectors by 5 per cent. Investment in farms continued to decline during the year reviewed. There was also a contraction of investment in mining and quarrying and in electric power. In contrast, investment in the National Water Carrier, transportation, industry, and services expanded. Investment in inventories was 10 per cent smaller than in 1962.

Private consumption per capita went up by 5–6 per cent, a little less than in 1961 and 1962 when the annual increase was 6 per cent. The slower rise in 1963 reflects, on the one hand, the upward trend in the rate of saving out of real disposable private income which has marked the last few years, and on the other hand, the slightly smaller growth rate in real income during the year reviewed. However, there was a very big increase in purchases of durable goods, especially furniture and motor vehicles. Travel abroad also expanded at an unprecedented rate. Per capita food consumption grew by only 3 per

cent. These developments reflect a rise in living standards, and constitute part of a long-run downward trend in the weight of food within total consumption and a rise in the weight of services and durable goods.

The increase in public consumption totalled 9–10 per cent—a little less than in each of the three preceding years. Public sector investment also slowed down. The demand surplus of the public sector (the Government, National Institutions, and local authorities) decreased slightly as compared with 1962, when it reached a particularly high level. This decline wholly reflects the smaller demand surplus of the Government. Government dissaving decreased considerably after having risen in 1962.

These developments were mainly connected with the slower expansion of Government expenditure following cuts in Government imports, the policy of freezing basic wages, and the smaller volume of public housing construction. Tax revenue grew at a slightly lower rate, chiefly because indirect tax rates on various consumer goods were reduced in order to prevent price increases. Consequently, there was also a slight decline in the relative share of taxes in national income.

The rate of saving out of national income rose by 2 per cent in 1962 and by 3 per cent in 1963. Saving in the private sector remained at approximately its 1962 level—7 per cent of its disposable domestic income. On the other hand, there was a conspicuous improvement in the saving of the public sector, which helped to raise the overall rate of saving in the economy.

The year 1963 was characterized by positive general developments, partly due to the devaluation (the benefits of which, however, were gradually dissipated), and partly owing to several special factors, particularly in respect of foreign trade. However, the inflationary pressures have not weakened, and they continue to press against the barriers erected by monetary policy and reduce the effectiveness of administrative measures intended to prevent the undermining of the wage and price levels. The general picture reflects the tremendous difficulty of holding prices and wages in check simultaneously with an increase in living standards, investment, and economic activity.

The crucial problem facing the economy at the end of 1963 was, how far is it possible to assure a balanced economy, maintain stable prices, and persevere with a sound income policy during a period of feverish economic activity, when enormous pressures are exerted against a limited quantity of physical productive factors and the expansion of output depends less on the aggregate capacity of the productive factors than on those factors in short supply which are creating bottlenecks in the productive system.

Moreover, intense economic activity and expansion of output themselves produce the additional income used to purchase the output. Consequently, increasing production cannot by itself help to restrain inflation, unless it is accompanied by a reduction of liquidity and compensatory fiscal and monetary measures to check the growth of the money supply and increase saving.