

CHAPTER I

MAIN ECONOMIC DEVELOPMENTS

THE GROWTH of the national product slowed down in 1965, while the adverse balance in the country's goods and services account decreased, following a marked rise in 1964. In the monetary sphere, the money supply also expanded at a lower rate than in 1964, continuing the previous year's trend, but the rise of prices gathered momentum.

After several years of intense economic activity, during which the real national product grew at the very rapid rate of 10 to 12 percent per annum, the increase came to only 7 percent in 1965. This was due only in small part to the slower growth of the population and the labor force, and in the main to the following: the contraction of investment in fixed assets and inventories following an appreciable rise in 1964, the slackening of construction activity, developments on the supply side which reduced the real agricultural product, and other factors which slowed down the growth of aggregate domestic demand. On the other hand, there was a big increase in public consumption. Aggregate demand went up by only 4.8 percent, compared with 12.8 percent in 1964.

The slower growth of the national product was accompanied by a decline in the import surplus. Following the steep rise of 31 percent in 1964, there was a decrease of 9 percent in 1965—from \$ 569 million to \$ 521 million, or by \$ 48 million. Imports increased in 1965 by \$ 46 million, or only some 4 percent, as against 17 percent in 1964. Commodity imports remained virtually unchanged in 1965, all of the increment being accounted for by services.

The stability of commodity imports was due on the one hand to a certain easing of demand for imports following the deceleration of economic activity, and on the other hand to the reduction of liquidity in the economy, which tended to diminish the demand for imported products after the marked expansion of the previous year. Moreover, there was a decrease in imports of certain items which for various reasons—some economic and some merely fortuitous timing (as in the case of ships)—were imported on a much larger scale in 1964.

Income from exports rose in 1965 by \$ 94 million, or 14.5 percent, as compared with some 8 percent in 1964. The acceleration was wholly accounted for by agricultural produce, especially citrus. Sales of diamonds and other industrial items went up more slowly than in 1964.

At constant prices, exports added up to 9.0 percent more than in 1964, and

imports to 1.7 percent more. Export prices advanced faster than import prices. About one-fifth of the decline in the import surplus can be ascribed to the improvement in Israel's terms of trade.

Total capital imports (transfers and long- and medium-term loans) contracted slightly, from \$ 604 million in 1964 to \$ 596 million. Receipts on account of personal restitution from West Germany and investments from abroad fell off, while loan receipts went up. Moreover, there was a big increase in short-term credit from abroad. The reduction of the import surplus and the expansion of foreign short-term credit were reflected by a marked growth of over \$ 106 million in the country's foreign exchange reserves in 1965.

Net foreign currency assets of the banking system expanded by \$ 73 million, compared with \$ 14 million in 1964.¹ However, in 1965 there was a considerable increase of nearly \$ 57 million in Pazak and Tamam deposits, so that the amount of foreign currency converted into means of payments was relatively small.

Bank credit to the public was expanded by IL 136 million, and bank credit to the Government by IL 55 million, both figures being lower than in 1964.

Between the beginning and the end of 1965, the money supply moved up by 11 percent. The average level, however, was only 9 percent higher than in 1964. This was the lowest growth rate in recent years; in 1964 the average level went up 13 percent.

The slower expansion of the money supply and the increase in the national product and price level combined to reduce some of the excess liquidity in the economy, which had increased very rapidly in 1962 and 1963. The tighter money situation was also reflected by a certain rise in the interest rate, a more moderate expansion of the bill brokerage trade, and a drop in the outstanding balance of the Government Short-Term Loan.

Despite the slower monetary expansion, prices climbed more rapidly. The consumer price index moved up by 8 percent between the beginning and the end of 1965, as compared with 5 percent during 1964. The faster rise of prices also affected public consumption prices. Investment prices went up at the same rate as in 1964, while GNP prices rose by approximately 10 percent, as compared with 5 percent in 1964. The advance of industrial prices following a period of relative stability was particularly noticeable.

The upward movement of prices was connected with the continuation of demand pressures during the first half of the year reviewed. These pressures stemmed from the lagged effect of the accelerated monetary expansion of 1963, which was not fully reflected by increases in the prices of goods and services in previous years. The faster rise of prices during 1965 was also due in part to the easing of administrative restraints on industrial prices and to

¹ Total foreign currency assets, less deposits of nonresidents and other foreign liabilities of Israel's banking system.

the Government's policy of paring subsidies, which led to increases in consumer prices. The higher public consumption prices resulted from the big wage increases granted in the public sector.

The slower growth of the real product was reflected chiefly in agriculture and construction. In agriculture there was a decrease of 2 to 3 percent, following a substantial gain of 17 percent in the previous year. This was due partly to deliberate cutbacks in production and investment intended to prevent a decline in profitability, and partly to a decline in factor productivity; the latter can be provisionally attributed, in part, to the lower utilization of livestock structures and the drop in average yields as compared with the previous year.

The construction sector passed from a state of intensified activity at the beginning of the year to a marked deceleration at the end. On balance, there was only a small increase in new construction put in place, in contrast to the very rapid expansion of previous years. The slowdown was reflected in the weakening of demand for housing, which resulted in a smaller area of starts—especially in public residential construction, following an appreciable rise in 1964—and in a smaller volume of construction for the agricultural and industrial sectors.

Industrial output was 10 percent higher than in 1964—this too a slower growth rate than in previous years. In part, the deceleration reflected the smaller demand for building materials and durable consumer goods as well as the reduced supply of agricultural food products, and in part it was connected with the slower expansion of industrial exports as a result of limitations on the supply side.

In the service sectors growth continued on the scale of previous years. Transportation output expanded more slowly, but there were rapid increases in the public services and the nonprofit institution sector.

The slower growth of the national product was connected with the relatively small increase in gainful employment—3.1 percent as against 4.6 percent in 1964. The latter development was due to the lower percentage increase in the population and to the slackening of pressure in the labor market, which brought down the labor force participation rate and increased the number of persons seeking work. The product per gainfully employed went up by some 4 percent, as compared with an annual rise of 7 percent in the two preceding years.

The average population expanded by 3.4 percent, compared with 4.0 percent in 1964. The slowdown resulted from the contraction of immigration. Between the beginning and the end of 1965, the population went up by 73,000, or 2.9 percent, as against 96,000, or 4.0 percent, in 1964.

The growth of the working-age population was likewise more sluggish. The easing of demand for labor apparently caused marginal workers to leave the labor force, depressing somewhat the labor force participation rate. The civilian labor force itself increased by 3.2 percent in 1965. Another consequence of

the reduced demand for labor was the slightly smaller rise—3.1 percent—in the number of gainfully employed. The number of persons seeking work accordingly went up by about 1,000—almost all of this during the second half of 1965. Data on daily average registered unemployment, on the other hand, show a moderate decline in unemployment, though this was followed by a rise at the beginning of 1966.

The year reviewed saw an exceptionally large gain of about 26 percent in wages per employee in the public sector, while in other sectors the rise was approximately the same as in previous years. Altogether, hourly wages averaged 16 percent more than in 1964, in contrast to increases of 11 to 12 percent in each of the three preceding years. The mounting pressure of demand for labor in 1962–64 resulted in a wide gap between the wage increments actually paid and those provided for in institutional arrangements. Following the easing of demand for labor in 1965, the average percentage increase in wages in most sectors only slightly exceeded that laid down in institutional arrangements.

Gross capital stock grew by 10 percent in 1965, about the same rate as in the previous year. As a result of both the big rise in investment in 1964, which augmented the economy's capital stock at the beginning of 1965, and the smaller percentage growth of gainful employment, capital stock per gainfully employed went up by 8 percent, as contrasted with 6 percent in 1964.

Real gross investment contracted by 6 percent, after having expanded at the extraordinarily rapid rate of 22 percent in 1964. Part of the decline in 1965 must be ascribed to sharp fluctuations in two items: inventories and ships.

Other investment items showed an increase of 2 percent, as against 14 percent in 1964. There was a striking decrease in mining and quarrying, as the Dead Sea Work's expansion program neared completion. Capital outlay in agriculture and irrigation continued downward, while that on residential construction was up some 3 percent, reflecting the completion of the large number of units started in 1964. The figure for the transportation and communications sector was about 13 percent lower. There was a big drop in shipping, and a smaller one in communications and ports. On the other hand, expenditure on the road network was appreciably larger.

Real private consumption increased by 8.5 percent, and per capita by some 5 percent. These rates are smaller than in previous years, and can be ascribed to the slower rise of real incomes. There was a pronounced deceleration in purchases of durable consumer goods, the increase here being only 5 percent in contrast to 23 percent in 1964. The biggest decrease was in private cars, but purchases of household equipment also slowed down appreciably.

Consumption of foodstuffs supplied by agriculture likewise expanded at a lower rate, owing to the contraction of supplies and the rise of prices. Consumption of services was up some 11 per cent; there was a rise in most com-

ponent items, but especially in services provided by nonprofit institutions, due to the intense activity of political parties during an election year.

There was a big increase in public sector outlay, especially by the Government and the local authorities (expenditure of the National Institutions decreased slightly). Most of the rise was connected with the higher wages and retroactive adjustments paid during the year. On the other hand, the growth of tax revenue was relatively small—17 percent, or less than in any of the four preceding years.

Table I-1
INDICATORS OF ECONOMIC DEVELOPMENT, 1962-65
(percentages)

	Increase or decrease (-) as against previous year			
	1962	1963	1964	1965
Resources and uses				
(at constant prices)				
Total resources	12.2	8.0	12.8	4.8
Gross national product	11.9	11.6	10.3	7.0
Private consumption	11.9	10.6	11.1	8.3
Private consumption per capita	7.1	6.3	6.8	4.7
Public consumption	11.1	6.6	4.8	11.0
Gross investment	13.6	3.5	21.9	-6.1
Foreign trade—goods and services				
(in dollars)				
Imports	12	6	18	4
Exports	18	21	8	14
Import surplus	5	-11	31	-9
Population and employment				
Average population	4.5	4.0	4.0	3.4
Number of employed	5.7	5.1	4.6	3.1
Prices and national income				
(nominal)				
Wages per normal hour				
of work	12	11	11	16
GNP prices	7	8	5	10
Consumer price index				
(annual average)	10	7	5	8
National income	19	25	16	18
National income per capita	14	20	12	14
Finance				
Money supply (annual average)	17	31	13	9
Bank credit to the public				
(annual average)	18	20	20	10

These developments were reflected by a rise in the demand surplus of the public sector (by some IL 100 million) and by a drop in its saving figure.

There was also an increase in the net flow of credit from the public sector to other domestic sectors. This must be ascribed to the larger amount of credit granted by the public sector on the one hand, and to the reduction of its domestic loan receipts (Short-Term Loan) and collections on account of debts on the other.

The expansion of the demand surplus and the larger volume of credit supplied to the economy led to a greater resort to borrowing. This applies in particular to foreign loans, receipts from this source reaching IL 480 million at the end of 1965, or IL 184 million more than in 1964.

The structure of credit flows between the various domestic sectors shows that, despite the increase in credit from the public sector, the business sector apparently received a smaller amount than in 1964 (incremental credit from the banking system, in particular, was appreciably smaller). Households received a little more than in 1964, but this was offset by the additional credit which they granted to the financial sectors, in the form of Pazak and Tamam deposits with the banking system, contributions to provident funds, and premium payments to insurance companies.

The rate of saving out of net national product declined from 5.8 percent in 1964 to 4.2 percent. This stemmed from the smaller saving of the public sector and of nonprofit institutions, that of the private sector (households and business) actually rising somewhat.

To sum up, the year 1965—and especially the second half—displayed the characteristics of a transition period, during which the pressure of demand—typical of the Israeli economy in recent years—was accompanied by other factors driving up prices. Toward the end of the year the demand pressure gradually subsided, and as economic activity slackened, signs of a mild increase in unemployment began to appear (a trend carrying over into the early months of 1966), while the cost push on prices made itself felt to a growing degree.

Nevertheless, the weakening of demand in the home market, which caused an improvement in the balance of payments by slowing down imports, has not succeeded so far in diverting to export the productive factors released by the reduction of demand and the exposure of less efficient branches of production to competing imports. Although in recent years productivity has been rising, mounting costs have reduced the profitability of exports, discouraging the expansion of investments and production capacity in the export branches. If costs continue upward, these trends may be further accentuated.

In the long run, an improvement in the balance of payments and the more efficient utilization of the economy's available productive factors depends on the expansion of exports and the continued exposure of less efficient branches of production to the competition of imports.