

## CHAPTER II

# PRODUCT AND DOMESTIC DEMAND

### 1. MAIN DEVELOPMENTS

Domestic uses (excluding direct defense imports) declined in 1985, for the second year running, after expanding rapidly in 1981-83. This was reflected on the resources side by a marked decrease in the civilian import surplus, while GDP rose 2.8 percent, compared with 1.7 percent in 1984 and an average of 1.5 percent in 1982-83.

Real economic activity did not follow an even course in 1985. In the first six months domestic uses were about the same as in the second half of 1984 (with a slight downward tendency). In the third quarter they fell sharply after the introduction of the economic stabilization program, but in the next quarter they regained their level at the beginning of the year (see Figure II-1). GDP traced a different path—a rise in the first half and a downturn in the second. The first half of 1985 witnessed a continuation of the general trends evident in the second half of the previous year—export-led GDP growth, stable domestic uses, and sagging civilian imports. The stabilization program initiated at the beginning of July transformed the economic scene:<sup>1</sup> all domestic demand components shrank appreciably in the third quarter of the year, resulting primarily in a smaller import and some contraction of GDP, while exports advanced only marginally. But in the fourth quarter, as already noted, domestic uses rebounded strongly, and by year's end they were back to their average level in 1984 and the first half of 1985. The upswing was most striking in private consumption and more moderate in investment, while public domestic consumption continued to edge down. The incremental domestic demand was channeled entirely to imports, with exports remaining flat. Consequently, GDP continued to fall off.<sup>2</sup> On balance it can be said that the slackening of domestic demand in the third quarter of 1985 was for the most part short-lived—a

<sup>1</sup> The economic stabilization program led to a speedy reduction of inflation and an appreciable increase in real interest on sheqel assets, while the nominal exchange rate held steady at NIS1.5 per dollar.

<sup>2</sup> Quarterly variations in GDP must be treated with reserve because of the low reliability of quarter-to-quarter inventory changes. The estimated decline in GDP in the fourth quarter of 1985 was therefore probably biased downward, while in the third quarter it was probably biased upward. GDP was apparently lower in the second half of the year than in the first: the fourth-quarter recovery of domestic demand was import-intensive, and so domestic output did not grow.

Table II-1  
RESOURCES AND USE OF RESOURCES, 1984-85

	At current prices, NIS million		Percent annual change							
			Quantity					Price		
	1984	1985	1969-72	1973-85	1982	1983	1984	1985	1984	1985
<b>Resources</b>										
GDP at market prices	7,069	25,967	11.1	3.2	0.5	2.5	1.7	2.8	379.7	257.2
Imports <sup>a</sup>	4,223	16,402	10.9	4.0	3.8	6.3	-0.5	-2.0	415.8	296.2
<i>of which</i> Civilian imports	3,657	13,966	10.2	4.0	11.3	11.1	-3.5	-4.9	405.6	301.4
Total resources	<b>11,292</b>	<b>42,368</b>	11.0	3.4	1.8	4.0	0.8	0.9	393.1	272.0
<b>Use of resources</b>										
Private consumption	4,264	16,554	7.2	4.3	6.6	7.8	-6.8	-0.4	387.4	290.0
Public consumption										
Total	2,396	8,627	10.1	2.8	-8.0	-5.7	6.6	3.8	409.1	246.9
Excl. direct defense imports	1,829	6,192	8.7	2.5	3.1	2.1	0.3	-1.8	395.9	244.8
Gross domestic investment										
Total investment	1,558	4,751	18.4	-1.6	13.8	10.3	-7.6	-13.4	385.2	252.1
Fixed investment	1,480	4,964	19.3	-1.0	4.2	13.9	-12.8	-10.1	391.8	273.3
<i>subtotal: Domestic resource use</i>										
excl. direct defense imports	7,652	27,497	10.2	2.5	7.2	7.0	-5.5	-3.4	389.6	272.1
Exports <sup>a</sup>	3,074	12,435	13.2	6.0	-2.6	2.2	13.8	7.5	395.7	276.4
Total resource use excl. direct defense imports	10,726	39,932	10.8	3.4	4.3	5.7	-0.4	-0.1	389.6	272.7
Total use of resources	<b>11,292</b>	<b>42,368</b>	11.0	3.4	1.8	4.0	0.8	0.9	393.1	272.0
Net factor payments to rest of world	384	1,268	11.0	10.1	32.5	10.9	28.4	-9.3	434.4	264.5
GNP at market prices	6,686	24,698	11.1	2.9	-0.6	2.1	0.3	3.6	378.4	256.5
Business sector GDP at market prices <sup>b</sup>	4,859	18,320	12.4	2.8	-0.7	2.7	1.7	3.8	374.3	263.2

<sup>a</sup> Imports c.i.f., exports f.o.b., including respectively factor payments to and from abroad and valued at effective exchange rates.

<sup>b</sup> Defined as GDP less product of public services, private nonprofit institutions, and housing services.

SOURCE: Central Bureau of Statistics.

conclusion supported by partial indicators, which show that the private sector's domestic resource use and the civilian import surplus kept on expanding in the first quarter of 1986.

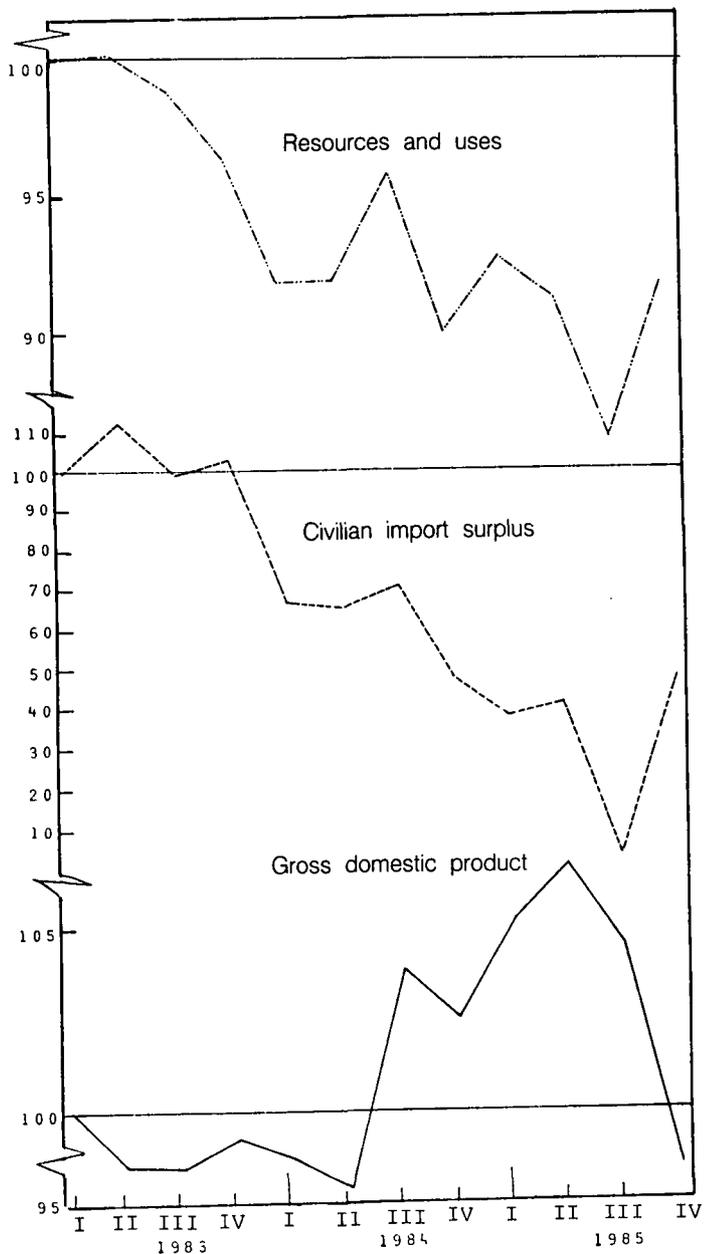
Economic policy in 1985 was dominated by the stabilization program, which was introduced at the beginning of July after it became clear that the package deals (tripartite agreements between the government, Histadrut, and the employers' organization) failed to check the advance of prices and the inflationary process seemed likely to gather momentum again. The new overall plan was designed to deal simultaneously with the two most crucial problems facing the economy—high inflation and balance of payments financing difficulties. To quickly tone down inflation, an effort was made to synchronize the principal economic variables by a nominal freeze of the exchange rate and prices (the latter after a large one-time upward adjustment), a nominal freeze of credit, suspension of the cost-of-living allowance arrangement and other wage agreements, and conclusion of a special agreement which resulted in a significant real erosion of wages. These measures were accompanied by a severe fiscal and monetary restraint. The fiscal restraint was achieved by a direct reduction of government activity, the lowering of real wages in the public services by more than the national average, the slashing of domestic production subsidies and export incentives, and the hiking of taxes. Fiscal policy also aimed to dampen domestic demand, which in turn was designed to help slow inflation while further narrowing the civilian import surplus. The paring of the public deficit (due to the fiscal measures adopted) facilitated the implementation of a stringent monetary policy; this found expression primarily in high real interest rates, which discouraged speculative stockbuilding.

The rapid impact of these policy measures is explained by the atmosphere of restraint and credibility created by the stabilization program from the very start, after it became clear to the public that this was an overall plan which the government was resolved to implement. The initiation of the process of dismissing public sector workers was another sign of the serious intention to carry out the plan. In addition, the tough fiscal measures introduced in April 1985 (the beginning of the fiscal year), especially with respect to taxation and the subsidization of domestic production, may have begun to leave their impress in the middle of the year. Part of the decrease in private consumption apparently reflected the uncertainty that prevailed immediately upon the introduction of the new strategy, but its effect was transitory (as attested by the upswing in private consumption in the fourth quarter of 1985 and the beginning of 1986).

The sagging of domestic uses in 1985 was therefore largely an outcome of official policy, which depressed demand directly controlled by the government by 2.4 percent (after a 2 percent drop in 1984). The decrease encompassed public domestic consumption (mainly defense) and consumption of nonprofit institution services, as well as public sector and nonprofit institution investment; it directly accounted for 23 percent of the total decline in domestic uses this year, compared with only 11 percent in 1984.

The sharply lower inventory investment, which reflected the running down

**Figure II-1**  
**RESOURCES AND USES, CIVILIAN IMPORT SURPLUS, AND GDP, 1983-85**  
 (indexes: 1983I = 100; quarterly seasonally adjusted data)



of nondiamond stocks,<sup>3</sup> also accounted for 23 percent of the contraction of domestic uses. The main cause of the dwindling of nondiamond stocks was the very tight monetary policy introduced in the second half of the year, especially the high real interest. The inventory disinvestment, which was probably a temporary phenomenon, had a negative effect on the business sector, as it prevented a more gradual adjustment of economic activity to the declining demand. (From the aspect of the stabilization plan, the initial high real interest also had a positive effect in that it quickly dampened domestic demand, thereby helping to bring down inflation.)

Government policy also reduced domestic demand in the private sector (excluding inventory investment), which fell 2.8 percent (after an 8.7 percent decrease last year). The main manifestations of this policy were a sharp drop in disposable private income and monetary restraint. The appreciable real shrinkage of disposable private income, and to some extent also the very high real interest, led to a further decrease in private consumption per capita and depressed housing demand below the past few years' downtrend (a reflection of the long-run adjustment to the fall in net immigration during the past decade).

Besides these factors, the moderate decline in private sector nondwelling investment (for the second straight year) was a correction of the overinvestment in 1982-83, which contained a speculative element. Another factor that may have dampened nondwelling investment was uncertainty about domestic demand prospects.

The precipitate drop in disposable private income, despite the real expansion of GNP, was mainly due to the following policy measures:

(a) The upping of the effective exchange rate for imports by more than for exports shaved 3.5 percent from real disposable private income.<sup>4</sup>

(b) The erosion of public sector wages (in purchasing power terms) by more than the national average reduced total real disposable private income by 2 percent.

(c) The marked stiffening of taxes (direct and indirect) and the cutting of domestic production subsidies were responsible for another 4 percent decrease.

It should be noted that the government's fiscal policy also depressed somewhat the share of capital in national income (despite the steep fall in real wages).

To sum up, economic policy in the year reviewed directly reduced the domestic uses of the public sector and nonprofit institutions, and indirectly made a big dent in real disposable income (the return to both labor and capital). Together with the tight monetary policy, this depressed per capita private consumption, deepened the slump in housing, and dampened inventory investment.

<sup>3</sup> The diamond industry, which markets nearly all its output abroad, obtains relatively cheap foreign currency financing, and so it was not affected by the high domestic interest rates in 1985.

<sup>4</sup> This figure was obtained by comparing actual income with its level assuming that export prices (in sheqel terms and at the effective exchange rate) rose to the same extent as import prices.

In 1985, as in the previous year, the growth of GDP was mainly due to the expansion of exports, although they contributed less than in 1984. The contractionary effect of the downtrend in domestic demand was also smaller than in 1984, and consequently the GDP gain was a little bigger this year—2.8 percent as against 1.7 percent in 1984. The business sector fared better yet, posting a 3.8 percent increase compared with 1.7 percent in 1984. It was the real depreciation of the sheqel over the past two years, supported by the weakening of domestic demand and the labor market, that permitted the export-led growth of business sector product. By contrast, in the two preceding years (1982–83) business sector product drifted up only marginally (an average of 1 percent a year) despite a more buoyant domestic demand. This was because the policy of slowing the depreciation of the sheqel was not synchronized with other prices, notably wages, nor was it concerted with a tight fiscal policy; the outcome was a real appreciation of the sheqel, which diverted the incremental domestic demand to imports and checked the expansion of exports. The sluggish growth of business sector product in recent years (1982–85) may also have

**Table II-2**  
**PRODUCT AND PRODUCTIVITY OF THE BUSINESS SECTOR, 1961–85**  
(real average annual rate of change, percent)

	1961– 1972	1973– 1985	1975– 1977	1978– 1981	1982– 1985	1982	1983	1984	1985
<b>Product<sup>a</sup></b>									
Estimate A	10.0	2.8	1.7	4.4	1.9	-0.7	2.7	1.7	3.8
Estimate B	9.1	3.0	2.5	3.7	2.2	2.6	4.4	0.1	2.3
<b>Factor input</b>									
Labor (man-hours)	3.6	1.1	0.8	2.2	1.4	0.1	3.2	2.4	-0.2
<b>Capital stock<sup>b</sup></b>									
Gross	8.7	5.0	6.1	4.1	3.4	2.9	3.1	4.7	3.1
Net	8.0	3.9	4.5	2.4	2.6	1.5	2.2	4.9	1.9
<b>Productivity</b>									
<b>Product/man-hours</b>									
Estimate A	6.3	1.7	0.9	2.2	0.5	-0.8	-0.4	-0.7	4.0
Estimate B	5.4	1.9	1.7	1.5	0.9	2.4	1.2	-2.3	2.5
<b>Capital stock<sup>b</sup>/man-hours</b>									
Gross	5.0	3.9	5.2	1.8	2.0	2.8	-0.1	2.2	3.3
Net	4.2	2.8	3.7	0.2	1.2	1.4	-0.9	2.4	2.1
<b>Total productivity<sup>c</sup></b>									
Estimate A	4.5	0.4	-0.8	1.5	-0.1	-1.7	-0.5	-1.4	2.9
Estimate B	3.7	0.6	0.0	0.9	0.2	1.6	1.2	-2.9	1.4

<sup>a</sup> Estimate A is estimated from the expenditure side (national accounts). Estimate B is based on various indicators of output volume by industry.

<sup>b</sup> Beginning-of-year stock.

<sup>c</sup> The weights are 0.68 for labor and 0.32 for capital, based on distributive shares of gross national income (long-run average) and inspection of the 1977/78 input-output table.

been due to supply constraints, primarily a high, variable rate of inflation and frequent changes in economic policy.

Examination of the long-run trend shows that business sector GDP per capita was flat in recent years, and during the past decade it edged up only marginally. This underscores the gravity of Israel's stagnant economy: without growth (and without a sustained rise in unilateral transfer payments from abroad), the long-run rise in living standards implies an increase in the external debt per capita, as actually happened in 1981-83.

The narrowing of the civilian import surplus in 1985 resulted from a 5 percent drop in import volume and a 7.5 percent advance in exports. The downturn in imports is explained by the reduction of domestic uses, the smaller inventory investment, and a rise in the relative price of imports. Two factors were mainly responsible for this year's positive export performance: (a) a certain real depreciation of the sheqel, i.e. a rise in the relative price of exports (from the producers' perspective), whose effect was reinforced by the slackening of domestic demand and the labor market; and (b) the continued expansion of world trade, albeit more slowly than last year., (2.7 as against 8.5 percent).

**Table II-3**  
**BUSINESS SECTOR GDP AT FACTOR COST, BY FINAL USE,<sup>a</sup> 1975-85**  
(percent)

	Consumption		Fixed investment	Change in stocks	Subtotal	Exports	Total
	Private	Public					
<b>Composition of product</b>							
1975-81	38.0	9.0	17.2	0.3	64.5	35.5	100.0
1982	39.3	8.2	13.9	-0.2	61.2	38.8	100.0
1983	39.9	8.0	14.1	-0.3	61.7	38.3	100.0
1984	37.2	7.8	12.3	0.2	57.5	42.5	100.0
1985	37.7	7.4	11.3	0.0	56.4	43.6	100.0
<b>Contribution to change in product</b>							
1975-77	1.4	-0.8	-2.6	0.1	-1.9	4.5	2.6
1978-81	1.2	0.3	0.1	-0.2	1.4	2.5	3.9
1982	2.5	0.1	-0.3	0.1	2.4	-0.4	2.0
1983	2.0	0.1	0.7	-0.2	2.6	1.0	3.6
1984	-1.8	-0.1	-1.5	0.6	-2.8	5.0	2.2
1985	1.1	-0.3	-0.8	-0.2	-0.2	2.0	1.8

<sup>a</sup> I.e. GDP excluding housing services and services of public sector and private nonprofit institutions. The breakdown shown here (based on input-output data) differs from the final-use data as follows: private consumption does not include compensation of employees of private nonprofit institutions and imputed rent; public consumption does not include compensation of employees; exports do not include factor payments from abroad.

SOURCE: The Bank of Israel's input-output table based on CBS input coefficients for 1977/78 and the national expenditure estimates of the CBS.

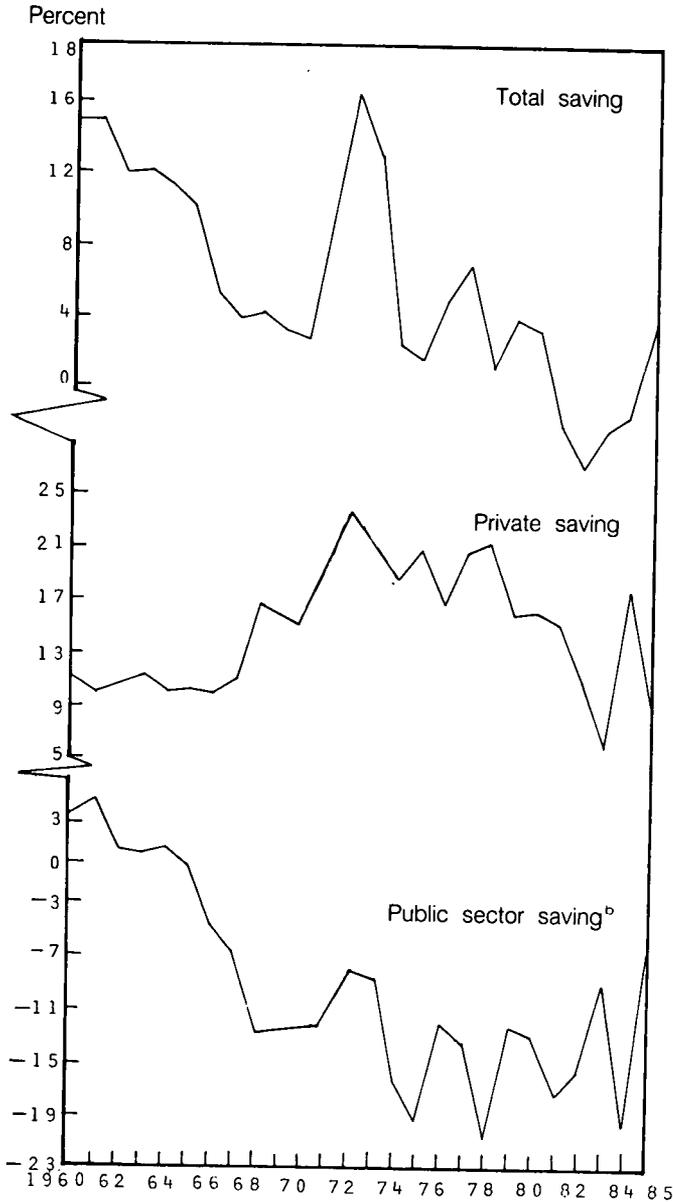
The composition of domestic resource use underwent a change in the last two years. The civilian import surplus as a proportion of GDP was, at 6 percent in 1985, far below the 21 percent peak reached in 1983 and even the 1976-81 average (10 percent); in other words, it dipped to an especially low level in 1985, by much more than the cyclical correction. Only about half the quantitative decrease in the surplus<sup>5</sup> (approximately 1 percent of GDP) in each of the last two years reflected an increase in the gross national saving rate, while the other half reflected a smaller investment in fixed assets and inventories. There was a strong cyclical element in the reduced investment, and so the narrowing of the civilian import surplus can to some extent be regarded as a temporary phenomenon. The upswing in the national saving rate (as variously defined) in the last two years brought it back to its long-run average positive level (see Figure II-2), after it had been negative in 1981-84.

Total private consumption did not change much in 1985, despite the marked contraction of real disposable income. As a result, the rate of private saving from disposable income from all sources dipped to 27 percent, after standing at 33 percent in 1984 and 32 percent during the past decade. Private consumption adjusts mainly to the disposable income trend; since this is inherently a relatively slow process, the absence of an immediate adjustment to the change in current disposable income is not surprising. Moreover, the drop in disposable income was largely caused by the sharply higher rate of net taxation, which was unusually volatile in recent years (in 1984, for example, it declined after rising in the two preceding years). It is therefore reasonable to assume that the public was very uncertain about the permanency of the increased taxation, and consequently it did not fully adjust its consumption spending to the change in disposable income.

The last economic crisis, in 1983-84, and the efforts to remedy the situation in the past two years were clearly mirrored in the growth of national saving. The real net national saving rate dipped sharply in 1981-83 and turned negative, mainly because of the expansionary fiscal policy pursued from 1981 to mid-1983. Under this policy the depreciation of the sheqel (at the effective exchange rate) was slowed, resulting in a real appreciation until the middle of 1983; this was reinforced by the public's heavier purchase of foreign currency from the government. In 1981 the drop in the relative price of imports resulted primarily from the reduction of import taxes, especially on consumer durables. One manifestation of the expansionary fiscal policy was a much higher rate of government dissaving that year. The following year saw a slight improvement, but the rate of dissaving was still higher than in the past—about 15.5 percent of income from all sources, compared with 14 percent in 1976-80. The further decline in the relative price of imports (especially consumer durables) and the expectation of a large devaluation heightened demand for imported consumer goods. This was accentuated by the abundant liquidity in the economy, and so the private saving rate fell in 1982-83. Another contrib-

<sup>5</sup> By definition this is equal to the difference between national saving from domestic sources and investment in fixed assets and inventories.

**Figure II-2**  
**NATIONAL SAVING RATE, 1960-85<sup>a</sup>**



<sup>a</sup> Private and public sector saving as a percent of GNP at market prices plus unilateral transfers.

<sup>b</sup> Import taxes and export incentives appear in the foreign trade account as absorption and injection respectively. Accordingly, in the public saving calculation they are not included in income.

utory factor In 1983 was the fear of a possible impairment of financial assets because of the protracted balance of payments deterioration. The economic policy and the consequent poorer saving performance resulted in a very brisk domestic demand and the swelling of Israel's current account deficit during this period. The government's long- and medium-term borrowing did not suffice to cover the deficit, and so it had to resort to short-term sources of finance (\$2.5-3 billion in 1982-84).

In 1984 the picture changed. The net national saving rate turned up a bit, and in the following year it moved up faster yet. The timing of this cyclical turnabout was determined primarily by the bank share crisis (which was largely triggered by the aforementioned economic policy) and the change in exchange rate policy (a relative increase in import and export prices). The collapse of bank share prices eroded the public's financial wealth and its liquidity. Private consumption adjusted to the lower level of wealth, which was more in line with the economy's available resources. The dearer imports discouraged speculative purchases of such goods.

In the last two years the government also took direct action to boost national saving: in 1984 it froze public domestic consumption, and in 1985 it reduced it 2 percent in real terms. The hiking of taxes this year may also have helped to push up the national saving rate somewhat, but its short-run impact was probably relatively weak, especially because of the steepness of the increase in taxes and their volatility.<sup>6</sup>

To sum up, public sector dissaving shrank considerably, from an average of 15 percent of income from all sources in 1981-84 to 5 percent in 1985. In the past there were also isolated years which saw an appreciable reduction of the sector's negative saving (see Figure II-2). The question arises, will the government succeed in sustaining this trend long enough to effect a structural change in the real sphere? In this context it should be stressed that this year's better saving performance was largely due to the sharp increase in gross taxes (which were already high), and it is doubtful if this solution will promote the renewal of growth in the future.<sup>7</sup>

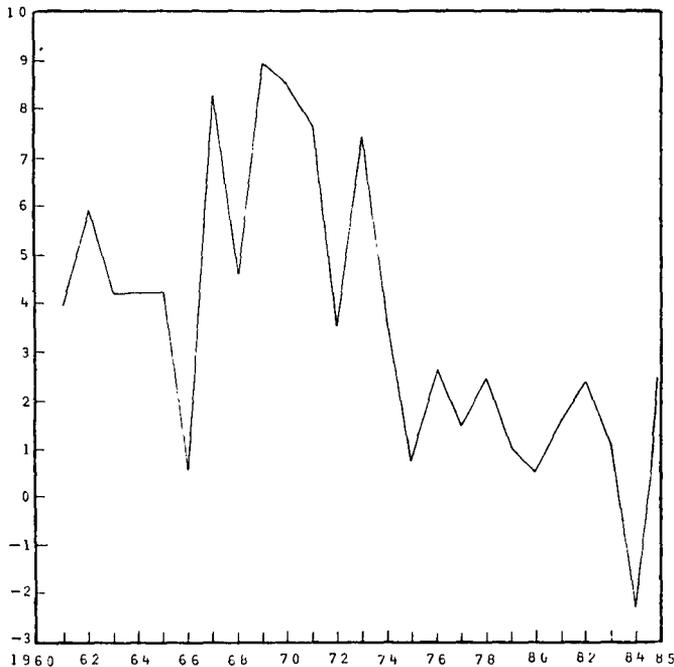
## 2. BUSINESS SECTOR PRODUCT

The business sector product expanded a little more strongly in the year reviewed—3.8 percent as against 1.7 percent in 1984, 1 percent p.a. in 1982-83, and 4.4 percent p.a. in 1978-81. As in 1984, the advance was spear-headed by exports. The more moderate weakening of domestic demand this year also permitted product to expand more rapidly (see Table II-3).

<sup>6</sup> Some claim that taxation does not influence private consumption even in the long run, and that individuals determine their consumption in accordance with the economy's income from all sources less public consumption.

<sup>7</sup> Total taxes on GDP and income tax rose from an average 45 percent rate in 1981-83 to 50 percent in 1985 (after falling to 40 percent in 1984). In addition, special taxes were imposed in 1985, such as a one-time property levy (whose extension is being mooted).

**Figure II-3**  
**BUSINESS SECTOR PRODUCT PER MANHOUR, 1960-85<sup>a</sup>**  
 (percent real annual change)



<sup>a</sup> Estimate based on various indicators of output volume by industry.

Examination of the long-run trend shows some slackening of growth in recent years, from an average of 4.5 percent in 1978-81 to 2 percent in 1982-85. Several factors were responsible for the slowdown:

(a) High inflation and the frequent changes in economic policy, which increased uncertainty and apparently deterred producers from stepping up their operations.

(b) The steady real appreciation of the sheqel in 1981-83, which diverted a growing portion of domestic demand to imports and hurt exports.

(c) The disincentive effect of high tax rates (this was not confined to recent years).

Despite the marked contraction of GDP in the second half of the year and the understandable lag in adjusting productive factors to this development, all indicators show that on balance there was a respectable productivity gain in 1985. But in discussing productivity a multiyear analysis is more meaningful, and the long-run picture is different: a virtual standstill in 1982-85 following a sluggish rise in 1978-81. The rapid acceleration of inflation in recent years may have been the principal cause of the productivity slowdown, for it induced a shift in emphasis from efficient production to financial management.

### 3. DISPOSABLE INCOME

Even though GNP rose 3.6 percent in real terms in 1985, disposable income fell by a steep 9 percent. This wide divergence in growth rates (13 percent) is mainly explained by the stringent fiscal policy implemented this year, especially in the second half.

The heavier indirect taxation and the slashing of domestic production subsidies, the higher price of imported consumer goods, and the erosion of public sector wages combined to push up the price of private consumption in relation to GNP by an unprecedented 9.5 percent. This was reflected by an 8.7 percent drop in gross private income from economic activity (in purchasing power terms). The real increase in direct taxes depressed disposable income from domestic sources by a hefty 9.2 percent.

Although the divergence between the GNP and disposable income growth rates was of unparalleled magnitude, the existence of a large differential was not unique to 1985. The past decade witnessed sharp, frequent swings in fiscal policy, and this caused sharp variations in disposable income, which exceeded the variations in GNP. The volatility of disposable income found expression more in the rate of private saving than in private consumption; in other words, the frequent veering of fiscal policy impaired its effectiveness, at least in the short run, in restraining private consumption.

The tight fiscal policy in the year reviewed bit deeply into both wage and nonwage disposable income, with the consequence that income distribution was virtually unchanged: the weight of disposable wage income and current transfer payments in total disposable income came to 56.4 percent in 1985, as against 56 percent in 1984, 58.6 percent in 1982-83, and 54.2 percent in 1979-81.

### 4. PRIVATE CONSUMPTION AND SAVING

Private consumption was flat in 1985 (implying a 2.2 percent decline in the per capita level). This was the net outcome of contrasting trends: the tumbling of automobile sales and spending by Israelis abroad (29 and 23 percent respectively), a slightly smaller consumption of services, and stability (or a mild rise) in other items.

The much smaller number of Israelis going abroad is largely explained by the hiking of the travel tax to \$300 per passenger during the summer months (the peak tourist season). This tax has influenced the composition of consumption more than its long-run trend.

Total private consumption, as already mentioned, hardly changed in 1985, while disposable income shrank 9 percent. This shaved a substantial 6 percentage points from the rate of private saving, depressing it far below its average, relatively stable level in 1973-81, as well as last year's figure (which was similar to the long-run average). This suggests that the effect of the tight policy

**Table II-4**  
**DISPOSABLE INCOME, 1982-85**

	Millions of current NIS				Real annual change, percent <sup>a</sup>			
	1982	1983	1984	1985	1982	1983	1984	1985
1. National income	439.8	1,115.0	5,408.6	18,957.7	-0.5	3.6	-0.5	-10.1
2. Public sector income from property and entrepreneurship	8.6	17.6	91.0	246.9	-49.8	-16.2	5.8	-30.5
3. Depreciation	77.5	187.6	980.6	3,707.2	3.6	-1.1	7.3	-3.0
4. Gross private income from economic activity (1 - 2 + 3)	508.7	1,284.9	6,298.1	22,418.1	1.8	3.2	0.6	-8.7
5. Direct taxes	135.4	336.5	1,369.0	6,118.7	2.0	1.5	-16.5	14.6
Income tax <sup>b</sup>	96.4	242.5	949.7	4,344.3	3.5	2.7	-19.7	17.3
National insurance contributions <sup>c</sup>	39.0	94.0	419.3	1,774.5	-1.3	-1.5	-8.5	8.5
6. Net compulsory loans <sup>d</sup>	2.9	3.1	-59.0	-100.5				
7. Net transfer payments <sup>c,e</sup>	95.7	216.8	1,137.1	5,288.7	5.8	-7.5	7.6	19.3
8. Gross private disposable income from domestic sources (4 - 5 - 6 + 7)	466.0	1,162.1	6,125.2	21,688.6	1.2	1.9	8.1	-9.2
9. Personal transfers from abroad	25.7	51.4	222.0	921.2	-8.1	-18.5	-11.3	6.4
10. Loan subsidy <sup>f</sup>	14.5	29.6	133.1	448.5	-11.3	-16.6	-7.8	-13.6
11. Direct loan subsidy	12.8	25.8	123.3	441.0	-5.3	-17.4	-1.8	-8.3
12. Nonrecurring property levy	—	—	—	157.2	—	—	—	—
Gross private disposable income from all sources								
13. Aggregate A (8 + 9)	491.8	1,213.4	6,347.2	22,609.8	0.7	0.8	7.3	-8.7
14. Aggregate B (13 - 10 + 11)	490.0	1,209.6	6,337.4	22,602.3	0.9	0.8	7.5	-8.5
15. Aggregate C (14 - 12)	490.0	1,209.6	6,337.4	22,445.1	0.9	0.8	7.5	-9.0

<sup>a</sup> See note c in Table II-A1.

<sup>b</sup> Includes surtax on inventories.

<sup>c</sup> Employer contributions to National Insurance are included in both direct taxes and transfers.

<sup>d</sup> Net of repayment.

<sup>e</sup> Includes interest on the domestic public debt, this year adjusted to reflect real long-term interest (see Chapter V).

<sup>f</sup> See note b in Table II-A1.

SOURCE: Central Bureau of Statistics.

may not have fully run its course, especially as private consumption adjusts only gradually to changes in current disposable income. In determining its consumption, the public takes into consideration only the permanent changes in its income, and in recent years it attributed increasingly less weight to current disposable income in assessing the expected disposable income trend. This, as already pointed out, is explained by the sharp, frequent veering of fiscal policy, which led to sharp variations in disposable income and to disparate disposable income and GNP growth rates. The public saw that the government was not following a consistent fiscal policy, and so it gave less and less weight to the changes in tax rates. In other words, the importance of current disposable income in determining current private consumption gradually diminished, and this of course caused the private saving rate to oscillate more noticeably in recent years (1982-85) than in the past (1975-81 — see Figures II-2 and II-4). The public's large, highly liquid financial portfolio enabled it to ignore the variations in disposable income and to adjust its consumption to the expected trend.

Moreover, 1985 was the second consecutive year of shrinking per capita consumption. Over these two years the cumulative decrease amounted to 11 percent, which brought real consumption per capita back to its mid-1981 level. This may have slowed the adjustment of private consumption to the private disposable income trend, since individuals find it hard to greatly lower their standard of living in such a relatively short time.

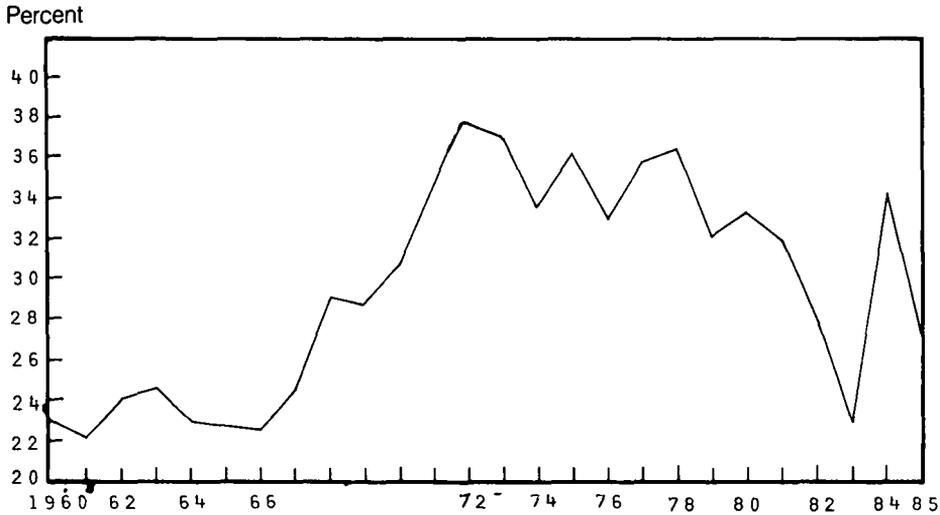
The average national saving rate in recent years (1982-85) was, as stated, below its relatively stable level in 1975-81. The highly erratic performance of the saving rate in recent years makes it hard at this stage to determine whether the low level is temporary, or whether it reflects a downward trend. Two factors are liable to depress the long-run trend. One is the size of the internal debt and difficulties in rolling it over. This may have caused apprehension about the government's ability (or intention) to redeem it. Given the relative liquidity of the debt, these jitters may have altered the public's consumption pattern and depressed the rate of private saving: the public increased its investment in consumer durables as well as its spending on other goods and services (foreign travel, internal tourism, entertainment, more expensive brands of food

**Table II-5**  
**SAVING RATIOS, 1982-85<sup>a</sup>**  
(percent)

Ratio of saving to	1982	1983	1984	1985
Gross domestic disposable income	23.7	19.2	30.4	23.7
Total disposable income A	27.7	22.7	32.8	26.8
Total disposable income B	27.4	22.4	32.7	26.8

<sup>a</sup> Saving ratio = (disposable income - private consumption) ÷ disposable income. The disposable income variants entering the calculations here are respectively from lines 8, 13, and 14 in Table II-4.

**Figure II-4**  
**PRIVATE SAVING RATE, 1960-85<sup>a</sup>**



<sup>a</sup> Private saving as a percent of gross disposable income from all sources. The disposable income series has been revised because of a change in the definition of public sector interest payments on its internal debt (see note f to Table II-4).

and beverages, etc.). The second factor that can influence the long-run saving trend is the demographic one. The weight of the young age groups has declined in the past few years. There are some who contend that these groups have a higher rate of saving than the others; hence the downturn in their weight in the population may have depressed the private saving rate.

A quarterly analysis reveals that private consumption did not develop in an even manner over the year. The first half was relatively stable compared with the last six months of 1984. This may have reflected the completion of the process of adjusting consumers' spending to the lower level of wealth after the bank share crisis. In the third quarter the level fell by a steep 6 percent following the initiation of the overall economic plan, but in the next quarter it rebounded (by 10 percent) and more than offset the previous decline. The up-trend apparently carried over through the first quarter of 1986—a surprising development considering the low rate of saving in 1985.

**Table II-6**  
**PRIVATE CONSUMPTION, 1982-85**

	1982	1983	1984	1985
<b>At current prices (NIS million)</b>				
Goods for current consumption	143.5	367.6	1,693.8	7,054.8
Food, beverages, and tobacco	87.0	236.5	1,131.8	4,783.2
Other	56.5	131.2	562.0	2,271.6
Services <sup>a</sup>	73.9	197.3	910.7	3,747.0
Consumption of Israelis abroad	16.8	45.8	236.4	769.3
<i>less</i> Consumption of foreigners in Israel	24.3	64.3	338.4	1,437.6
Subtotal	<b>209.9</b>	<b>546.4</b>	<b>2,502.5</b>	<b>10,113.6</b>
Durables	39.5	109.8	379.9	1,301.8
Services of private nonprofit institutions	41.8	108.8	537.6	1,805.9
Housing services	64.5	173.3	843.8	3,312.7
Total	<b>355.7</b>	<b>938.4</b>	<b>4,264.0</b>	<b>16,554.0</b>
Total excluding durables	<b>316.3</b>	<b>828.6</b>	<b>3,884.0</b>	<b>15,252.2</b>
<b>Quantity (percent annual change)</b>				
Goods for current consumption	5.5	5.5	-3.2	3.9
Food, beverages, and tobacco	5.3	7.0	0.3	3.1
Other	6.0	2.7	-9.7	5.5
Services <sup>a</sup>	5.1	7.7	-3.7	-0.9
Consumption of Israelis abroad	3.5	21.6	-4.9	-27.3
Consumption of foreigners in Israel	-12.8	3.2	11.1	8.6
Subtotal	7.5	7.8	-4.9	-1.1
Durables	11.0	18.1	-32.0	-1.4
Services of private nonprofit institutions	0.5	1.5	2.1	-0.9
Housing services	4.2	3.4	3.4	3.0
Total	6.6	7.8	-6.8	-0.4
Total excluding durables	6.0	6.2	-2.6	-0.3
<b>Prices (percent annual change)</b>				
Goods for current consumption	117.5	142.9	376.1	300.9
Food, beverages, and tobacco	117.3	153.9	377.1	310.0
Other	117.8	126.0	374.7	283.0
Services <sup>a</sup>	122.6	147.9	379.5	315.0
Consumption of Israelis abroad	107.3	123.9	442.6	347.9
Consumption of foreigners in Israel	126.0	156.8	373.7	291.3
Subtotal	118.0	141.5	381.7	309.6
Durables	105.0	135.5	409.2	247.6
Services of private nonprofit institutions	120.5	156.3	383.9	239.1
Housing services	121.4	159.8	370.7	281.1
Total	117.0	144.8	387.4	290.0
Total excluding durables	118.7	146.6	381.4	294.0

<sup>a</sup> Excluding housing services and services of private nonprofit institutions.

SOURCE: Central Bureau of Statistics.

**Table II-7**  
**GROSS DOMESTIC INVESTMENT BY TYPE OF CAPITAL GOOD, 1981-85**

	Current NIS million			Percent annual change						
				Quantity			Price			
	1983	1984	1985	1981	1982	1983	1984	1985	1984	1985
<b>Nondwelling construction</b>										
Structures	32.6	111.1	468.7	-8.9	-1.1	9.3	-5.3	-6.1	259.3	349.4
Earthworks	28.7	138.3	352.3	-0.3	-2.2	1.9	-22.0	-2.6	517.4	161.3
Total	61.4	249.4	820.9	-5.1	-1.6	5.9	-12.8	-4.7	365.7	245.3
<b>Machinery and equipment</b>										
Transport										
Ships and aircraft	9.2	29.4	-7.6							
Other	34.4	113.2	444.3	8.7	36.2	29.8	-37.4	-9.2	426.3	332.0
Other machinery and equipment	135.2	631.7	2,444.4	6.9	9.7	24.9	-8.2	-0.6	408.7	289.3
Imported	93.0	444.0	1,728.9	5.9	17.4	28.5	-6.7	-5.2	411.7	310.8
Locally produced	42.2	187.7	715.5	8.5	-3.4	17.4	-11.5	10.6	402.2	244.9
<i>subtotal: Nondwelling investment</i>	<b>240.2</b>	<b>1,023.7</b>	<b>3,702.0</b>	5.0	9.4	25.0	-14.7	-8.5	399.6	295.1
Excl. ships and aircraft	<b>231.0</b>	<b>994.3</b>	<b>3,709.6</b>	3.0	9.4	20.3	-14.2	-2.7	401.7	283.4
Dwellings	104.9	456.0	1,262.3	1.8	-3.9	-5.4	-8.4	-13.7	374.7	220.7
Private	85.1	376.1	1,062.1	4.5	3.0	-1.3	-6.5	-12.7	373.2	223.6
Public	19.9	79.9	200.2	-4.7	-21.7	-19.3	-16.4	-18.1	381.0	206.0
Total fixed investment	<b>345.1</b>	<b>1,479.7</b>	<b>4,964.3</b>	3.7	4.2	13.9	-12.8	-10.1	391.8	273.3
Change in stocks	2.7	78.6	-213.0							
Total gross domestic investment	<b>347.8</b>	<b>1,558.4</b>	<b>4,751.3</b>	-5.8	13.8	10.3	-7.6	-13.4	385.2	252.1

SOURCE: Central Bureau of Statistics.