

CHAPTER VI

THE PRINCIPAL ECONOMIC SECTORS

1. MAIN DEVELOPMENTS

In 1985 the gross domestic product of the business sector rose by some 2 percent — a rate about equal to the average of the preceding five years, but slightly higher than in 1984.¹ The changes in labor productivity and total productivity in the business sector were also within the range of the slight annual fluctuations round the average that have prevailed since 1979 — about 1 percent for labor productivity and zero for total productivity. In 1985 there was no increase at all in business sector labor input, while the input of capital continued to rise at a real annual rate of 3 percent.

The business sector's total activity in 1985 was marked by a sharp downturn in the third quarter, following the introduction of the stabilization program. The contraction was most conspicuous in industrial output, but occurred also in construction and other sectors, as shown by various quarterly indicators of economic activity.² In the last quarter there seems to have been some recovery which continued into early 1986. The downturn of output in the third quarter of 1985 was the result of the intentional curb on domestic demand which was part of the stabilization program, but to some degree it also reflected a mood of caution in the face of uncertainty with which the public reacted to the program.

Sectoral developments in 1985 reflected the changes in demand for various products: the substantial rise in exports of the last two years was the main reason why industrial output continued to grow faster than the business sector average. (In the last two years, the volume of exports of goods and services, which stagnated in the two preceding years, increased by 10 percent a year.) Over 55 percent of product originating in industry is directly or indirectly destined for export, while the corresponding figure for other sectors is 36 percent. The share of industry in business sector GDP therefore continued to rise, returning to its 1977–78 level of 30 percent (at 1980 prices).

While exports increased, domestic demand continued to contract in the last two years — particularly in construction. Competition between construction firms in-

¹ The change in the GDP is measured from the product side. This differs slightly from the expenditure-side estimates of the national accounts. For a further explanation, see Chapter II in the present Annual Report, and note 1 in the Chapter VI of the 1984 volume. Generally, for periods longer than five years, the differences between the estimates are not significant.

² This can also be seen from a seasonally adjusted quarterly index that combines a variety of quarterly by-industry indicators of real domestic product. The combined index weights each industry by its share in total GDP. Its main components are the indexes of industrial output, labor input in trade and services, building starts and completions, agricultural exports, food consumption, revenue of transport (at constant prices) and electricity generation.

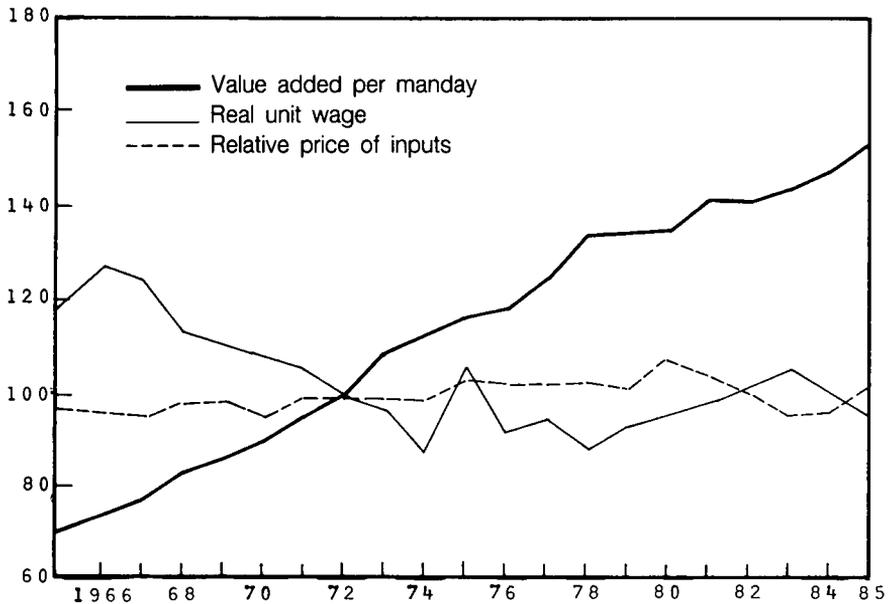
creased and profitability declined as the volume of factor inputs failed to adjust to the contraction of output. The share of construction in business sector GDP fell to no more than 11 percent from 14 percent between 1977 and 1981, and close to 20 percent in the early 1970s (see Table VI-A2). These developments in construction clearly have repercussions on the building materials industry and on road haulage. The factors involved are related to the long-run slowdown in the growth rate of the 20–29 age group and to the diminishing number of immigrants. Among the short-term factors was last year's sharp fall in real disposable income, particularly after the stabilization program was launched.

The growth of industrial exports in 1985 (mainly transport equipment, electronic equipment, chemicals, and diamonds) and tourist services was due to the expansion of world trade on the one hand and, on the other, to domestic developments. Among the latter was a decline in the demand for defense goods, a fall in the profitability of domestic sales, and the end of the Lebanon war, which led to a rise in the number of foreign tourists. This, however, had only a slight effect on the total output of transport. The increase in aviation services was offset by a decline in shipping, particularly carriage of freight between foreign ports. The combined result was that the share of transport remained at 14 percent of business sector product. The increase in tourism, foreign as well as domestic (the number of bednights of foreign and local tourists rose by 20 percent) in turn led to a rise in the product and the labor input of trade and services. Tourism mainly affects the services of hotels and catering, excursion services, travel agencies, and the souvenir trade. It is still too early to evaluate the effect of the slowdown of inflation on the level of activity in financial, business, and legal services. If price stability continues in 1986, the activity of banks, auditors and accountants, financial advisers, and similar services will presumably contract.

Agricultural product grew very rapidly in 1985, so that its share in business sector GDP rose from 9 to 10 percent; indeed in the last six years it has grown at twice the average business sector growth rate. Unless the agricultural estimates are particularly biased, this means that agriculture is more efficient than other industries; in fact, it is the only industry for which an appreciable rise in productivity was recorded. This may be the result of efficient and flexible allocation of labor between work on and off the farm.

While most industrial economies recovered since 1983, Israel's business sector product grew by 2 percent in 1985, similar to the annual average since the second oil crisis in 1979. This is about equal to average population growth in this period, so that in the last six years per capita product has virtually stagnated. Such a prolonged period of zero growth indicates that the economy is suffering from basic structural problems. This highlights the importance of the stabilization program adopted in mid-year, which had the goal of removing one of the main obstacles to renewed economic growth — the high rate of inflation. It is, of course, still too early to say whether this goal has been attained; although not a sufficient condition for substantial and sustained growth, it is a necessary one. Other conditions emerge from analysis of the main causes of the stagnation of growth and total productivity. In addition to inflation, the constantly changing fiscal policy, with respect to both taxes and subsidies may play a focal role. This policy is characterized by high

Figure VI-1
INDUSTRY: REAL VALUE ADDED AND RELATIVE PRICES OF INPUTS,^a 1966-85
 (Index, 1972 = 100)



^a Index of input prices ÷ index of output prices.

taxation, which in 1985 again reached some 50 percent of GNP at market cost. This high rate of taxation also shows up in the large gap between the gross wages paid by employers and the take-home pay of employees. This gap prevents labor productivity and output from rising, because it distorts the allocation of resources: labor has been taxed heavily while capital has been heavily subsidized. The competitiveness of exports could be increased by narrowing the difference between gross and net wages. Since 1979, sharp fluctuations in subsidies have increased uncertainty and instability in the production system, and have hampered business planning by firms. Moreover, approved investments (in fixed assets) have been excessively subsidized, while firms not eligible for approval have faced a shortage and a very high cost of capital. Taken together with the heavy taxation of labor, this encourages overinvestment and often leads to under-utilization of capital, for example, construction equipment, transport equipment, and hotels. The predominance of single-shift work in industry is also evidence of the low rate of capital utilization. In 1985 too, capital stock grew faster than product, and by the end of the year there was evidently unemployed capital as well as unemployed labor, indicating that substantial economic growth is possible in the short run without a significant increase of investment beyond that needed for replacement and for the development of new products.

Table VI-1
BUSINESS SECTOR INDICATORS, 1960-85
(annual average real change, percent)

	1960- 1965	1965- 1972	1972- 1979	1979- 1985	1982	1983	1984	1985
Product ^a	8.9	9.2	3.9	2.1	2.7	4.4	0.1	2.3
Labor input ^b	4.6	2.7	0.8	1.1	0.3	3.4	2.4	0.0
Capital stock ^c	10.4	7.5	6.3	3.6	2.9	3.1	4.7	3.1
Investment	8.2	7.5	-0.3	0.8	9.6	26.8	-15.4	-8.8
Labor productivity ^d	4.2	6.4	3.1	1.0	2.4	1.0	-2.3	2.3
Capital intensity ^e	5.6	4.7	5.5	2.4	2.6	-0.3	2.2	3.1
Total productivity ^f	2.5	5.0	1.4	0.2	1.7	1.1	-3.0	1.3
Exports	..	..	7.0	5.6	-3.7	1.1	17.7	10.6
Credit ^g	..	..	..	3.9	35.8	-7.4	-10.7	8.8
Energy consumption ^h	..	..	3.3	2.2	4.0	1.2	-0.3	-1.1

^a GDP at factor cost.

^b Man-hours (labor force survey data).

^c Beginning-of-year stock.

^d Product per man-hour.

^e Capital stock per man-hour.

^f Product per unit of factor input (average weight of labor is 68 percent).

^g Medium and long term credit flows (includes recycling). For net credit see Table VIII-A18.

^h 'Final' use of energy (see note c to Table VI-A11) in tons of oil equivalent. The data apply to the whole economy.

Rapid and sustained growth depends, as stated, on substantial long-term structural change. Resources must be shifted from the public sector to the private business sector. Although such a process requires several years, it is essential to set it going without delay, and to find ways to gradually overcome the opposition to it by vested interests.

One year of budget balance, as in 1985, does not represent a genuine and permanent structural change, since it promises nothing for the future and does not embody a shift of real resources from the public sector, namely a significant reduction in the workforce employed in it and in public consumption. The public sector's share of the available factors of production must be reduced, the tax burden must be lightened, and the government's complete control of the capital market must be gradually diminished. As shown by Table VI-A1, the share of the public services in both employment and the fixed capital stock has been growing. Reducing the weight of the public sector—for example, back to the dimensions of the early 1970s—requires a shift of some 20 percent of public services employees to the business sector. This of course needs several years of expansion and rising demand for labor in the business sector. Contraction of the public sector does not necessarily entail a corresponding reduction in the services supplied. There is no lack of evidence for the existence of superfluous and duplicated functions and for operational inefficiency in the public services—deficiencies which, if corrected, could lead to a

considerable reduction of public sector employment. The stabilization program does not seem to have led to concrete measures aimed at bringing about the desired structural change (see also Chapter V).

Production-cost developments in the business sector were not favorable in 1985. The real unit cost of labor rose by 6–7 percent. The prices of raw materials (mostly imported) rose by 4–5 percent more than the prices of industrial output. The real rate of interest on short-term nondirected local-currency credit (which finances production for the domestic market) averaged 100 percent per annum and has been at about this level since the beginning of 1984.

These developments naturally led to a fall in the profitability of firms producing for the domestic market. While this may release more resources for exports, it may also increase the number of business failures and bankruptcies. Fragmentary data from the Registrar of Companies do indicate a substantial rise in the number of bankruptcies and company liquidations (some 40 percent). In some firms, bankruptcy was only averted with the help of government assistance.

At the beginning 1986, there was a reduction in the cost of two inputs—world oil prices fell precipitously, which may eventually reduce the cost of other inputs; and the real interest rate fell substantially.

2. AGRICULTURE

The product of agriculture is subject to the vagaries of climate. A particularly good year,³ 1983, was followed by a bad one (see Table VI-2); in 1985 conditions were somewhat better, although rainfall was again insufficient and there were other unfavorable circumstances. The volume of output increased by a mere 2 percent, with crop output up by 6 percent, but livestock output falling by 2¹/₂ percent. World market conditions this year favored citrus, which was able to enjoy (apparently temporarily) reduced competition in the European markets. As against this, cotton growers suffered from the steep fall of world cotton prices, as well as from natural damage.

Output prices rose faster than input prices. This improvement in the terms of trade substantially raised agricultural product, leading to a 21 percent rise in real income of agriculture (deflated by the Consumer Price Index). The terms of trade of agriculture have now increased for three years running. Assuming that the data are reliable this amounts to a 52 percent rise in real income. This, however, includes the return on loan capital, and from the viewpoint of agriculture, the interest paid to lenders should be deducted from income. In the last two years, interest rates have risen considerably, but in the absence of reliable data on credit and interest flows, it is impossible to ascertain what happened to farm incomes. Moreover, the heterogeneity of agriculture must be taken into account (thus, for example, moshavim—cooperative villages—which specialize in broilers do not necessarily benefit from the success of citrus); this may explain the contrast between the 21 percent increase

³ Unless otherwise stated, the data refer to agricultural years (ending September 30 of the stated year).

Table VI-2
INDICATORS OF GROWTH IN AGRICULTURE, 1973-85^a
(real annual change, percent)

	1972-78	1978-81	1982	1983	1984	1985
Total output ^b	5.0	2.8	7.4	5.5	-1.4	2.0
Purchased inputs	3.4	1.6	3.2	4.7	4.9	-1.3
Gross product	6.3	4.8	12.7	6.2	-4.3	6.0
Total income from agriculture	3.7	5.8	3.5	18.3	6.5	20.8
Factor input						
Labor ^c	-1.6	-0.3	-7.0	1.1	3.0	6.2
Capital stock ^d	4.8	3.6	2.4	2.5	2.7	1.6
Capital-labor ratio ^e	6.5	3.9	10.0	1.1	-0.3	-4.3
Productivity						
Product-labor ratio ^e	8.0	5.1	21.2	4.9	-7.1	-0.2
Total productivity ^f	5.3	3.3	16.4	4.5	-7.0	1.6
Exports ^g	8.6	-0.1	15.5	-3.2	6.7	-2.2
Citrus	2.3	-1.9	-4.6	-8.4	-13.3	-6.5
Other	17.9	1.6	29.6	23.0	16.9	-0.8
Prices						
Output prices ^h	35	108.3	95.4	139.7	278.1	414.0
Purchased input prices	38	112.0	103.3	123.4	260.0	377.8
Terms of trade ⁱ	-12 ^j	-3.0 ^j	-3.9 ^j	7.3	5.0	7.6

^a Agricultural years ending September of stated year. The figures underlying the 1982-84 calculations are at prices of April of each year. Owing to changes in methods of estimating product and prices introduced by the CBS (starting in 1982), the data for the last three years are not strictly comparable to the earlier data.

^b Excluding inputs to agriculture; at producer prices.

^c Calculated from figures in millions of man-hours. Includes residents of Judea-Samaria and the Gaza District employed in Israel.

^d Gross capital stock (beginning of year).

^e Per man-hour.

^f Product per unit of factor input (the average weight of labor is 59 percent).

^g Based on data in 1972 dollars (foreign trade statistics of the CBS). Does not include exports to Judea-Samaria and the Gaza District.

^h Producer prices; excludes inputs to agriculture.

ⁱ Percent change in index of relative prices (output ÷ input).

^j Total change over the period.

SOURCE: Based on data of the Central Bureau of Statistics.

in real farm income in 1985, and the reports about the difficulties encountered by farmers and about the economic collapse of many moshavim.

The stabilization program caught the agricultural sector only in the last quarter of the agricultural year 1984/85, so that little of its impact is reflected in the year under review. It is of interest to note that the increase in input prices resulting from the stabilization program — such as the rise in the price of water, the elimination of subsidies to local-currency credits, and the reduction of export subsidies, which imply reduced profitability — has probably been offset by the rise of the European currencies against the US dollar and the sheqel (which is pegged to the dollar).

Climatic and foreign-price effects aside, there was again little growth. The sector's main constraint is not insufficient productive capacity (despite the shortage of water), but slack demand for its products. For the export market, new crops, such as subtropical fruit, spices, medicinal herbs, seeds and seedlings, as well as calves, are in their initial stages, but the quantities involved are still negligible. There has for years been no breakthrough of a new export product in commercially significant quantities (such as happened with avocado or flowers). Preliminary data on 1986 indicate that it may turn out to be a good year for exports, but this seems once again to be the result of a fortuitous combination of climatic conditions in Israel, in the countries competing with it, and in its markets, together with the favorable effect of the strengthening of the European currencies. Given the sharp competition abroad, only a significant breakthrough in agricultural research and development can bring about resumed growth. The general budgetary constraints of course also reduce government allocations to agricultural R&D. In addition, it has in recent years emerged that the fruits of this research — which farmers receive gratis — are subsequently often exported abroad for private gain. This might lead to the conclusion that organized Israeli agriculture can well maintain its own basic and applied research and development on a commercial basis.

In view of the existing constraints on the growth of agriculture, some restructuring of the rural economy is needed to raise productivity and the incomes of farmers remaining in the sector. Such a process is in fact under way, primarily in the kibbutzim but also in many moshavim, an increasing proportion of whose inhabitants find work outside agriculture. Nevertheless, there seems to be a need for outside intervention to speed up and ease the process. This year there was for the first time serious discussion of "buying out" agricultural settlements and transferring their productive resources (land, water rights, and production quotas) to those remaining in agriculture.

3. INDUSTRY

The stabilization program of mid-1985 had a decisive impact on industry. Industrial product rose by 3 percent in 1985 (annual average), but the entire increase occurred in the first six months. In the second half of the year, the program curbed domestic demand and industrial expansion was halted: industrial exports rose by 1 percent, but this was not sufficient to offset the decline in domestic demand, so that industrial production declined by 3 percent from the first to the second half of 1985.

Real labor cost per manday fell by 2 percent in 1985;⁴ since output rose by 2 percent, unit labor costs declined by 4 percent. As against this, industry's terms of trade (output relative to input prices) deteriorated, as for several years past. This year's deterioration was due to the rise in the price of imported inputs, following the

⁴ Real labor cost is the nominal wagebill deflated by the price index of industrial output. The estimates have here been corrected for the bias resulting from the fact that wages are paid at the end of the month during which the labor cost is incurred. Without the correction, the decline would have been greater.

devaluations in the first six months and the large devaluation at the outset of the stabilization program in July (world prices fell by about 5 percent).

The data suggest some decline in pre-tax profitability. Among the factors responsible were (a) the rise in the real marginal interest rate (mainly in the second half of the year); this raised the financing costs of firms producing mainly for the local market, which rely heavily on nondirected credit; and (b) the rise in real tax rates connected with the slowdown in inflation.

In the second half of the year, the stabilization program brought about a substantial (6 percent) decline in real labor cost, but since industrial output contracted at the same time, unit labor cost fell by only 4 percent. Since industry's terms of trade remained constant, the distributive share of labor also fell by 4 percent. This suggests that the price stability of the second half of 1985 was genuine and not merely the result of price controls. This stability may be upset by the increase in labor cost of early 1986; however, oil and raw materials prices fell steeply, and real interest rates declined.

As far as industry is concerned, the year's most prominent development was the decline in the demand for producer durables and military goods. Demand for

Table VI-3
INDICATORS OF GROWTH IN INDUSTRY, 1967-85^a
(real annual change, percent)

	1967- 1972	1972- 1978	1978- 1984	1983	1984	1985		
						Jan.- Dec.	Jan.- June ^b	July- Dec. ^b
Industrial production	15.1	4.9	2.9	3.5	4.9	2.7	3.2	-3.2
Labor input (mandays)	9.1	-0.1	1.3	1.5	2.1	-0.2	-0.3	-1.7
Number of employed	8.0	1.8	1.5	1.7	0.9	-0.3	0.7	-2.8
Gross investment ^c	28.2	3.2	4.5	17.3	1.5	1.2	..	..
Gross capital stock ^d	6.5	7.7	5.3	4.9	5.5	4.7	..	..
Industrial production per manday	5.5	5.0	1.6	1.9	2.8	2.8	3.5	-1.5
Total productivity	7.0	1.9	0.0	0.6	1.3	0.8	..	..
Industrial exports	16.6	11.4	9.0	-0.7	19.8	7.5	3.6	1.3
Unit wagebill ^e	-4.2	-1.7	2.1	4.7	-2.9	-3.6	-0.6	-3.7
Input prices relative to output prices	1.0	0.5	-1.0	2.2	-0.3	4.1	..	..

^a Excluding diamonds. The labor input figures are from the industrial production indexes of the CBS. Industrial production (from the same source) is added value at fixed prices. The indexes for 1968-78 are adjusted for full-time equivalent labor input.

^b Rates of changes are from July-December 1984 to January-June 1985 and from January-June to July-December 1985.

^c Excluding motor vehicles.

^d Beginning-of-year stock.

^e Deflated by index of output prices.

SOURCE: Based on data of the Central Bureau of Statistics.

consumer goods rose by 4 percent; the rise was confined to the first half of the year and to local products, since the demand for imported consumer goods fell owing to a 9 percent rise in their relative price. Demand for exports also rose, by 8 percent, mainly in the first six months of 1985. This too can be ascribed to relative price movements, supported by exchange rate movements abroad. The shift from labor-intensive to skill-intensive exports, which has been a feature of the past ten years, continued this year too.

One of the main reasons for the slowdown in industrial product growth was the decline in defense consumption as the budget for domestic military purchases was cut and the war in the Lebanon came to its end. Another cause was the decline (10 percent) in fixed investment, which reduced product originating in producer durables by some 4 percent, reflecting mainly the reduction in purchases by the construction sector.

4. CONSTRUCTION

The recession prevailing in the construction sector for several years deepened in 1985. Output shrank by 6 percent, following a similar contraction in the previous year. The steep (17 percent) decline in the area of building starts does not yet show up in the data on output, but has already made itself felt in heightened competition and declining profitability (see Table VI-4). Past experience shows that the industry is slow to adapt to changes in demand (partly, as a result of the long construction period), and that a sharp contraction can plunge it into crisis. Thus several large construction firms got into financial difficulties; others, with lower capital adequacy, collapsed altogether. The ratio of building starts to completions is an indicator of the current level of building activity in relation to its capacity. In 1985 this ratio fell to 83 percent—similar to that of two previous troughs, in 1966-67 and in 1976-77.

Real investment in dwellings again fell in 1985 (by 14 percent) or by 30 percent since 1981. Public sector dwelling investment declined by more, but not too much significance should be attached to this, since there is considerable substitutability between public and private housing. The decline in housing investment reflects the decline in residential building starts in earlier years. As starts continued to decline in 1985, a further contraction is to be expected next year.

The fall in housing investment and building starts is a response to the shrinking demand for housing. This is partly due to long-term factors, such as slower population growth and changes in age structure; in part, it is the result of the fall in disposable income (by some 10 percent). In 1985, the subsidy component of mortgages for eligible young couples increased, but as against this, the cost of non-directed credit rose and helped to reduce housing purchases.

Real investment in nondwelling structures fell by 5 percent in 1985, following a 13 percent decline in the preceding year. Most of the 1985 decline is related to the crisis in agriculture and to the contraction of infrastructure investments (such as water works), whose volume is determined by general budgetary considerations.

Maintenance and renovation are a sizable component of total construction out-

Table VI-4
INDICATORS OF CONSTRUCTION, 1967-85^a

	Absolute figures		Percent annual change					
	1984	1985	1967-73	1973-79	1979-85	1983	1984	1985
Output (thousands of 1980 NIS)								
Total	17,973	16,869	18.7	-4.4	-2.0	-0.8	-7.4	-6.1
Residential	8,149	7,033	30.1	-7.7	-4.2	-5.4	-8.4	-13.7
Nonresidential	4,022	3,842	11.2	-3.0	-5.3	6.3	-12.6	-4.5
Other ^b	5,802	5,994	9.9	2.2	4.3	1.3	-1.8	3.3
Starts and completions								
Starts (million m. sq.)	4,460	3,705	25.8	-6.6	-7.5	3.0	-8.4	-16.9
Residential	3,015	2,620	31.0	-8.5	-8.1	-4.1	-11.1	-13.1
Nonresidential	1,445	1,085	15.7	-2.1	-6.2	23.8	-2.4	-24.9
Dwelling units (thousands)								
Starts	23.3	19.5	28.5	-11.8	-10.6	-8.1	-11.1	-16.2
Completions	27.4	24.6	11.2	-7.5	-3.5	-8.6	-10.1	-10.3
Employed persons (thousands)								
Total	122.8	114.7	15.3	-2.8	-0.6	6.3	-5.9	-6.6
Israelis	79.1	72.3	9.7	-3.5	-2.1	8.0	-8.2	-8.6
From Judea-Samaria and the Gaza District	43.7	42.4	..	-0.7	2.5	3.2	-1.4	-3.0
Stock of construction equipment (thousands of 1980 NIS)^c								
	3,772	3,594	2.3	4.6	0.5	-2.1	0.0	-4.7
Price index of residential construction inputs								
			8.7	38.0	177.2	134.7	388.4	246.0

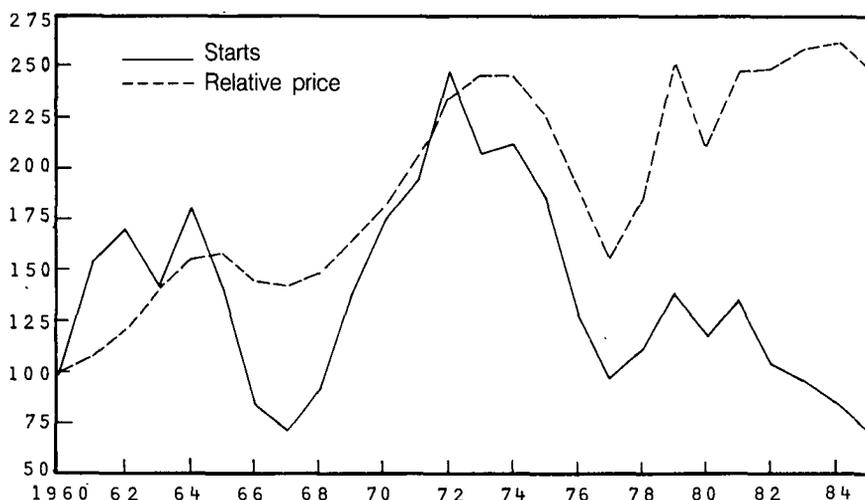
^a Calculations are from less rounded figures.

^b Includes defense construction and a Bank of Israel estimate of maintenance and renovations.

^c Beginning-of-year stock.

SOURCE: Based on data of the Central Bureau of Statistics.

Figure VI-2
DWELLINGS: BUILDING STARTS AND RELATIVE PRICE,^a 1960-85
(Index, 1960 = 100)



^a Dwelling price index ÷ CPI.

put. In the long run, its volume depends on the size and average age of the stock of buildings. These have increased in recent years, and renovation work has grown with them. The decline in the demand for new apartments in the last few years has also increased the demand for renovation.

The total number of employed persons in construction fell by 7 percent in 1985, about as much as output declined. Output per employed person has fallen by 1 percent a year in the last five years. This may in part be due to the rising proportion of employees from Judea-Samaria and Gaza, whose output—and wages—are lower.

The substantial decline in earthworks and road construction again reduced purchases of construction equipment. Since 1981 the gross capital stock of the construction sector has declined by 14 percent (about half the decline in output).

The Housing Market

The long-term demand for housing is a function of population changes, and primarily of the proportion of the 20–29 age group in which the formation of new households is mainly concentrated. In recent years population growth has slowed down considerably; in the 20–29 age group it has even turned negative.⁵ The decline in this age group is the main explanation of the diminishing demand for housing in recent years (see Table VI-A5).

⁵ Estimates of immigration and emigration in 1985 indicate that in the course of the year the number of people in this age group apparently fell still further, as immigration fell and emigration increased.

The demand for housing is also affected by disposable income. Since mortgages account for a considerable proportion of the purchase price and since the capability to repay them is a function of disposable income, demand for housing is more sensitive to changes in disposable income than private consumption. In 1985, disposable income fell by a steep 10 percent in consequence of the stabilization program. The concomitant erosion of real wages and the rise in unemployment increased uncertainty and thus caused the postponement of apartment purchases: in the second half of the year, they were 6 percent below the first-half figure.

In December 1984, mortgages for eligible young couples were increased in real terms. The rate of subsidization embodied in these mortgages rose correspondingly (see Table VI-A4), and there was a substantial rise in apartment purchases at the time.

The cost of housing credit for eligible couples did not keep pace with the rise in the interest rate on nondirected credit (so that the implicit subsidy increased). Nevertheless, the total cost of credit went up, with adverse effects on demand partly offset by the higher mortgage rate (which reduced resort to more expensive supplementary credit).

The 1985 decline in demand resulted in a fall of 5 percent (annual average) in the real price of dwellings (relative to the CPI), or of 15 percent during the year (last quarter of 1985 compared with last quarter of 1984).

5. TRANSPORT AND COMMUNICATIONS

The real output of transport and communications remained unchanged in 1985. The rapid growth that had characterized the sector's output at market prices and its gross product in the preceding two years therefore ceased. In most subsectors, prices, which previously lagged behind the CPI, kept pace with it in 1985. The exception was the steep rise in bus fares.

Developments in transport are the combined result of changes in the domestic and foreign markets: all in all, activity was slack in the year under review. Land transport, which is mainly a function of domestic activity, rose by only 1 percent, similar to the previous year. The output of shipping and aviation, which are affected by both domestic and international activity, fell slightly (a 4.4 percent decline in the output of shipping and port services was partly offset by a 3 percent rise in the output of civil aviation and airport services). Communications services expanded by 4.4 percent; this sector is consistently faced by excess demand, so that it is not highly sensitive to the general level of economic activity.

Imports of transport services fell conspicuously in 1985 while exports remained stable. As a result, there was a considerable surplus in transport services in the balance of payments.⁶ Israeli carriers increased their share of Israeli merchandise

⁶ This is true when merchandise imports are recorded c.i.f., with freight on Israeli carriers recorded as export of transport services. The 1985 surplus on transport account was some \$400 million, compared with about \$200 million in each of the three preceding years. Deducting conveyance of imports by Israeli carriers, the 1985 surplus was some \$100 million, with a similar deficit in each of the three preceding years.

imports this year (thereby contributing to a reduction of imports of transport services), as well as their share of export freights. However, carriage between foreign ports declined, thus reducing exports of transport services. These changes in the composition of the shipping services of the Israeli merchant fleet occurred against the background of the continued recession in international shipping, with falling freight rates and changes in the composition of Israel's imports and exports. There was also a decline in passenger traffic (mainly as a result of the increase in travel tax) in mid-year, while the relative share of freight increased.

Although many subsidies were cut this year, the government's real subsidy to public transport increased by 15 percent, rising from 25 percent of total subsidies in 1984 to 45 percent in 1985. The bus subsidy was intended to encourage the use of public transport at the expense of private cars (to save fuel and reduce urban road congestion) and to assist the low income groups. As can be seen in Table VI-A6), the major part of the bus cooperatives' revenue comes from subsidies. When the stabilization program was introduced, the government at first restricted the flow of subsidies to the bus cooperatives, but they rose again within two months.

As mentioned, the output of communications rose faster than transport output in 1985. The growth rate of communications output is a function of the installation of new telephone lines and of the efficiency at which the system functions. Since telecommunications services were entrusted to an independent public enterprise, the rate at which new lines were laid seems to have speeded up, and the system seems to have become more efficient, although there still is considerable scope for improvement.

The number of employed persons in transport and communications fell by over 3,000 to stabilize at some 86,000 at the end of 1985. Labor input (man-hours) fell by 5 percent, and the sector's share in total employment declined to 6.3 percent — the lowest recorded in the last 10 years. This decline is the result of the sharp fall in employment in land transport (which accounts for nearly half the sector's total employment), a slow decline in the number employed in shipping and aviation (one third) and a slight increase in communications. The combined result was a steep decline in the labor input of the sector.

The gross capital stock remained unchanged, but the net capital stock decreased by 2 percent. This was due chiefly to the net sale of ships and aircraft. Communications investment increased substantially, as installation of new lines was stepped up. The number of motor vehicles rose by 2 percent in 1985, more slowly than in previous years. Investment in roads, which has been declining since 1973, again declined, and is now at the level of the early 1960s. Nevertheless, the gap between the road infrastructure and the number of vehicles, which widened considerably in 1980, narrowed in 1985 as the number of motor vehicles grew only slowly.

With labor input down while output and the capital stock remained unchanged, it follows that both labor productivity and total productivity rose in 1985. The efficiency of resource use has been rising continuously for three years (however, the great diversity of output and production methods used in the sector may reduce the reliability of productivity estimates based on the conventional methods).

Table VI-5
OUTPUT OF TRANSPORT AND COMMUNICATIONS, 1982-85 ^a

	Percent of total		Percent change over preceding year								
	Product ^b 1983	Output 1984	Real output				Price				
			1982	1983	1984	1985	1982	1983	1984	1985	
Land transport	42.6	31.9	2.4	2.9	1.1	1.3					
Buses	15.2	7.4	7.0	0.5	3.1	-1.0	113	119	355	409	
Taxis	4.5	2.6	0.0	-3.0	-6.0	2.0	115	132	339	309	
Trucks	20.5	21.0	1.1	5.5	1.4	1.6	125	138	340	293	
Railways	1.8	0.8	6.5	3.5	-1.6	8.5	104	119	319	306	
Oil pipelines	0.6	0.1	-16.7	-4.7	-1.2	21.0	115	..	..	..
Shipping and ports	23.5	33.0	-4.3	2.5	12.5	-4.4	113	124	302	304	
Shipping	16.4	26.5	-5.9	2.2	14.5	-3.4	113	113	377	297	
Ports	7.1	6.5	3.9	4.0	3.5	-8.7	114	174	282	332	
Civil aviation and airports	19.5	19.1	-5.5	20.0	15.9	2.7	96	126	364	294	
Civil aviation	16.8	17.1	-5.7	20.7	18.0	3.0	95	122	358	296	
Airports	2.7	2.0	-2.3	14.3	-1.9	0.5	105	162	426	281	
Communications	14.4	16.0	1.5	12.9	2.5	4.4	110	108	346	373	
Total output		100.0	-1.5	7.2	7.5	0.2				318	
Total gross product	100.0		0.0	6.5	6.6	0.5					
Gross fixed investment			20.8	37.5	-31.2	-24.8					
Gross capital stock ^c			0.5	1.5	4.2	1.9					
Employed persons			4.4	-1.4	3.0	-3.6					
Labor input (man-hours)			0.7	-0.1	4.3	-4.8					
Total productivity			-0.6	6.8	3.2	2.8					

^a Output and product at market prices.

^b At 1977/78 prices.

^c At beginning of year.

SOURCE: Central Bureau of Statistics and Bank of Israel.

6. TOURISM⁷

The year 1985 was a good one for tourism in Israel. All the indicators point to a substantial increase: the number of tourists rose by 16 percent (much above the average rise in international tourism), the number of hotel bednights increased by 19 percent, and the average rate of hotel occupancy went up. Total revenue from tourism increased by 7 percent, in dollar terms.

This situation did not remain the same throughout the year. In the second half, the number of tourists declined by 3 percent (compared with the first half), and the decline became steeper in early 1986. The calmer security situation after the end of the Lebanon war was presumably among the reasons for the substantial increase in the first half of 1985, whereas the intensification of terrorist attacks in the second half of the year caused it to slow down.

The 20 percent increase in domestic tourism (bednights of Israelis) also helped to increase the output of hotel services and hotel occupancy rates. The substantial shift of Israeli tourism from abroad to domestic resorts was the result of the sharp increase in the cost of foreign travel. In addition, the exchange rates at which hotel rates were calculated for Israelis were frozen in 1985, but while this reduced the cost for Israeli tourists and increased domestic tourism, it meant yet another exchange rate in existence and therefore added to the prevailing price distortions.

7. ENERGY

The steady erosion of oil demand and prices in the world market since the peak of the second oil shock in 1981 turned into a full-fledged crash after the formal ending of the OPEC quota system in December. Since then, members have been free to strive for an (undefined) "appropriate market share." This formula spelled the collapse of the cartel price structure, and in fact, within days of this declaration the slow erosion of oil prices turned into a complete rout. A dramatic slide in spot and future prices was followed by the fall of the increasingly prevalent "net back" prices (crude prices based on the market price of refined products less estimated transport and refinery costs), as well as of "official" contract prices. During the first two or three months of 1986, dollar oil prices fell by some 57 percent from their 1985 level (itself about 25 percent below the peak level of 1980-81). Strong pressures therefore developed to restore cartel quota restrictions, to achieve at least a partial price recovery. But even a partial retention of the price fall of 1985 will certainly stimulate income and growth in Israel.

In 1985 Israel's fuel import prices fell by more than the world trend—by 6 percent (following a rise of 0.6 percent in 1984). Crude oil import prices fell at nearly

⁷ This section deals mainly with tourism to Israel, that is to say, exports of tourist services. When statistics are available, domestic tourism is also discussed. Tourism is not a clearly defined industry, since the spending of tourists is recorded in many sectors—hotel services, catering, retail trade, transport, etc. The product originating in exports of tourism services is estimated at 4 percent of the GNP—similar to their share in Greece, Spain, and Switzerland.

Table VI-6
TOURISM TO ISRAEL, 1982-85

	Thousands		Percent annual change ^a				
	1984	1985	1982-85	1982	1983	1984	1985
Tourist arrivals (excl. cruises)^b	1,095	1,264	5.0	-13.6	15.9	5.0	15.5
<i>By mode of travel</i>							
Air	936	1,079	4.1	-14.5	8.2	9.9	15.3
Charter flights	180	192	-3.9	-25.3	-0.6	7.8	6.7
Scheduled flights	755	887	6.3	-11.0	10.6	10.2	17.5
Land (by country of entry)	141	166	12.5	-6.3	76.5	-17.5	17.6
Lebanon	32	32	—	—	247.4	-50.8	-0.9
Jordan	65	62	-3.8	-36.2	42.2	-1.0	-4.6
Egypt	44	72	22.4	0.9	24.2	10.0	62.7
Sea	18	20	5.7	-5.1	35.1	-9.3	7.5
<i>By selected countries of residence</i>							
Asia and Africa	109	106	14.4	27.4	72.4	-19.9	-2.7
Lebanon	33	31	—	—	255.4	-48.8	-5.7
Jordan	13	15	1.5	-28.7	26.0	6.2	11.2
Egypt	5	5	16.8	52.4	6.1	3.1	11.6
United States and Canada	360	405	10.3	-3.7	26.4	8.0	12.4
Europe	563	677	1.4	-20.5	2.4	8.0	20.2
United Kingdom	110	129	1.4	-13.9	3.8	0.7	17.6
France	119	141	0.7	-12.0	-1.9	1.0	17.8
West Germany	117	146	2.2	-28.3	6.1	14.7	25.1
Scandinavia	54	62	-1.0	-21.5	-13.6	22.6	15.7
Cruise travelers	164	172	15.5	1.7	26.3	32.3	4.7

^a Calculated from less rounded data.

^b Excludes persons arriving from the Lebanon without a tourist visa (residents of southern Lebanon, U.N. military personnel, and diplomats), foreign tourists in transit to Judea-Samaria and the Gaza District, and visits by holders of Israeli passports residing abroad. From May 1985 includes tourists arriving after a stay of one week or less in Sinai (about 2,000 per month).

SOURCE: Central Bureau of Statistics.

the same rate. Israel's dependence on imported oil (net of exports) also declined in 1985 by another 4.2 percent by volume. There was, on the other hand, a further large boost in the volume of coal imports (by some 20 percent). The combined result of these changes was that the level of total energy imports stabilized after its slow decline in the previous two years. The cost of total fuel imports nevertheless declined by 5.2 percent.

Israel's oil dependence in terms of the cost of net oil imports relative to the GDP has been high for years, by comparison with other oil-dependent countries. This is partly explainable by Israel's even greater shortage of domestic energy resources; but part of it raises the possibility of inefficiencies in the composition of oil imports.

The fall in the dollar price of oil imports translates into a fall of about 6 percent in real sheqel terms, due to the stability of the average real dollar exchange rate. (In

contrast, the sharp rise in the real official exchange rate in 1984 raised import prices by 13.5 percent in constant sheqel terms.) Despite this fall in the real price of imports, real fuel and energy prices in the domestic market continued to rise, as a result of a significant increase in net taxes on some products (gasoline and fuel oil), together with a smaller proportionate reduction of the subsidies on other products (heavy fuel oil and kerosene). Most of this net tax increase took the form of an actual shift from deficit to surplus in the balance of the so-called Fuel Equalization Fund.

Electricity consumption of most sectors rose, despite higher electricity rates, continuing the strong trend to substitute electricity for direct fuel uses. However, the total final consumption of energy fell slightly (by 1.1 percent, or 3.2 percent per capita), with a greater fall, of 4 percent (6 percent per capita) in the direct use of petroleum products.

Energy Imports, Prices, and Consumption in Israel

Israel's oil imports in 1985 (see Table VI-7), like those of the world at large, gave evidence of a continuing downtrend: a drop of 1.5 percent in gross oil imports, and 4.2 percent in imports net of exports of refined products. Crude oil imports fell sharply — by 9.7 percent — but this was largely offset by a significant rise in imports of (refined) products. However, the slow reduction in the volume of total fuel imports, noticeable in three out of the last four years, came to a halt in 1985.

The change in the dollar cost of total fuel imports is therefore dominated by the substantial erosion of the average price (by 6.3 percent). The overall value of fuel imports fell from \$1,593 million in 1984 to \$1,510 million in 1985 (compared with nearly \$2,100 million in 1981).

The substitution of coal for oil in electric power generation continued albeit at a slower rate than in the previous two years, which saw the completion of the coal-fired Hadera power station. For the year as a whole, the decline of net oil imports was almost offset by a 20 percent rise of coal imports.

Despite this falling trend, Israel's oil dependence, in terms of the cost of net oil imports relative to GDP, has remained high. In 1984 this ratio was 5.9 percent (compared with 3.7 percent in Italy and Japan). Most of this high dependence (as much as 5.3 percentage points out of the total 5.9) is explicable by Israel's even smaller access to domestic energy resources, such as coal, natural gas, hydro-electric or nuclear energy. There nevertheless remains some suggestion that the cost of Israel's total petroleum consumption is excessive (see for example Table VI-8).

Oil prices charged on the local market are relatively high (after deduction of taxes) and this may reflect the monopolistic position of the Haifa oil refinery in the supply of oil distillates. It should be mentioned in this context that the ministers involved in Israel's fuel economy have recently declared their intention to open oil production and marketing of fuel in Israel to competition (including competitive imports, etc.). Such a reform, however — which is strongly supported by economic considerations — will take time to plan and implement.

The use of fuel per dollar of GNP, and per capita, is still very much lower in Israel than in high-income countries. However, the continuing trend towards an energy-saving economic structure in both developing and developed countries is noticeable also in Israel. Partial data suggest that this trend has continued also in 1985, despite

Table VI-7
MINERAL FUEL IMPORTS—SELECTED INDICATORS, 1980-84^a

	1980	1981	1982	1983	1984	1985
Value						
\$ million						
Total	2,116	2,093	1,914	1,601	1,593	1,510
Crude oil	1,799	1,685	1,789	1,460	1,428	1,209
Percent annual change in quantity						
Total	4.1	-6.2	7.6	-7.0	-1.5	1.1
Crude oil	-4.0	-9.7	22.1	-10.6	-2.6	-9.7
Percent annual change in \$ price						
Total	44.6	2.9	-12.9	-10.0	0.6	-6.3
Crude oil	50.7	3.7	-12.7	-8.7	0.3	-6.2
Percent annual change in IS price of crude oil						
At official exchange rate						
Absolute	206	129	86	111	423	277
Relative to CPI	32	6	-16	-14	13	-7
At effective exchange rate^b						
Absolute	198	130	94	110	400	281
Relative to CPI	29	6	-12	-14	5	-6
Volume ('000 tonnes)^b						
Crude oil	7,399	6,887	8,266	7,326	7,112	6,292
Petroleum products	1,561	1,571	330	89	63	778
Coal	1	361	991	2,136	2,558	3,064
Total ('000 tonnes of oil equivalent) ^c	8,960	8,696	9,248	8,910	8,863	9,092
Exports of petroleum products ('000 tonnes)	522	670	603	561	662	886

^a Changes in quantity and price of total fuel (crude oil, petroleum products, coal) and crude oil are based on Laspeyres indexes.

^b There are regular and substantial exports of petroleum products; imports and domestic consumption are therefore not equal.

^c Approximation. Assumes *inter alia* that 1 unit of coal is roughly equal to 0.66 units of oil.

SOURCE: Based on data of the Central Bureau of Statistics.

Table VI-8
SELECTED RELATIVE FUEL PRICES: REFINERY GATE, ISRAEL
RELATIVE TO SPOT PRICE, ITALY, 1981-85

	Gasoline	Heavy fuel oil
1981	1.13	1.19
1982	1.09	1.12
1983	1.12	1.03
1984	1.09	1.01
1985	1.19	1.12

SOURCE: Data of the Ministry of Energy.

the further fall in the dollar price of imported fuel. This fall was offset — and in real prices on the domestic market, even more than offset — by increases in domestic taxes on fuel, despite the stability of the dollar exchange rate (see Table VI-7 and VI-A.9). Table VI-A10 further supports this conclusion: it shows that positive net tax rates were raised while net subsidies to petroleum products were reduced. The net deficit of the Fuel Equalization Fund, which had in 1984 increased to \$138 million, turned into a surplus of \$34 million in 1985. The difference, \$172 million, is equal to an increase in net taxation.⁸ Table VI-A9 suggests that real prices of fuel products rose considerably (15 percent for gasoline, and some 5–6 percent for other oil distillates and for electricity).

Table VI-A11 provides evidence for continued energy saving in Israel. Total energy consumption (fuel and electricity) in terms of tons of oil equivalent relative to the GNP or to other indicators (such as the number of motor vehicles in the case of gasoline consumption) shows a decline in 1985. Total fuel consumption relative to GDP fell by 3.5 percent, final energy use relative to GDP by 3 percent, and gasoline consumption per motor vehicle by 4 percent (this indicator has risen by 36 percent since 1972).

As in previous years, electricity consumption indicates a continuing trend away from direct use of fuel to its indirect use as electric power. This is a long-term shift in response to the downtrend in electricity rates and to technological change and rising income.⁹

⁸ In addition to the Fuel Equalization Fund, energy is subsidized through the government's absorption of the losses incurred by the Israel Electric Corporation. In 1985 this subsidy was reduced from \$70 million to \$43 million.

⁹ The annual fluctuations in the ratio of electricity consumption to income in this table mainly reflect the changes in disposable income, which in turn result from changes in taxation.