

## CHAPTER II

### RESOURCES, USES, AND INCOMES

#### 1. MAIN DEVELOPMENTS

ECONOMIC ACTIVITY began to pick up rapidly in mid-1967, ending a recession that set in in early 1966. Real product for the year was about 2 percent larger on an annual average, and in the final quarter the level stood 6–10 percent higher than in the corresponding period of 1966.<sup>1</sup>

Recovery assumed rapid proportions in the third quarter of 1967, reversing the downturn in economic activity and GNP in the second quarter, a period of prewar tension and hostilities. But signs of GNP growth were already discernible in the first quarter of the year, even though this was mostly due to natural and seasonal factors—bumper harvests, and in particular a highly successful citrus season. But even allowing for this, it seems that the 1966 downward trend was checked in the first quarter of the year reviewed. Presumably, the war and the preceding period of tension held up recovery until the middle of the year or later. The process began with the return of production in industry, construction, and services to the prewar level, which also brought employment up to its previous level. These developments were accompanied by the expansion of aggregate demand, as the Government stepped up defense spending and as development projects whose planning had been expedited in order to alleviate unemployment reached the execution stage. Economic activity thus accelerated very rapidly, especially in the third quarter of the year, and private consumption also shot up.

The most important growth stimulant was the marked expansion of the public sector's demand surplus, which began at the end of 1966, when tax revenue stopped rising and steps were taken to increase employment. This expansion reached its peak after the war, in the third quarter of 1967. The direct and indirect effects of the Government's policies and measures to check unemployment and the decline in investment were reinforced after the war by the changed outlook of the public, which became more optimistic about the economic and security situation—a development which increased both consumption and the readiness to invest. The monetary expansion also began to make itself felt on demand.

Signs of a change in the economic situation were first apparent in the first

<sup>1</sup> See note <sup>1</sup> on p. 14 about the disparity in product figures stemming from the use of different methods of measurement.

quarter of 1967, as public consumption and income originating in the public sector began to move upward. In the same period, the decline in industrial production came to an end. In the second half of 1967 the rising trend spread to other sectors of the economy, including construction (where employment increased also as a result of defense requirements) and tourism, which made a particularly impressive gain.

The recovery was also accompanied by a rise in employment, which, however, failed to match the growth of GNP. Since the country's stock of capital assets expanded at a more sluggish rate in the year reviewed, GNP per factor unit (i.e. factor productivity) went up at a relatively rapid rate, following a decline in 1966.

The recovery was accompanied by a change in income distribution as well. Conditions in the labor market made it possible to keep wages stable for the first time in several years, and employee compensation came to 62 percent of national income in 1967, after having gone up from 60 to 65 percent in the previous year. There was a corresponding rise in the share of nonwage incomes, and the return on capital (expressed as a percentage of the net fixed capital stock) regained the ground lost in 1966, amounting to 12.3 percent—roughly the same as in 1965.

Private consumption per capita held steady on an annual average. Since real per capita income rose slightly in 1967, the ratio between it and consumption came to 87 percent, compared with 89 percent in 1966 and 85 percent in 1965.

The lack of pressure on the demand side (despite the large increase in liquidity) as well as on the costs side (owing to the stability of wages), together with the belief that the recession would continue, kept the price level stable from the middle of 1966 until nearly the end of 1967. The above-mentioned income trends, the stable economic climate (which was expected to persist), and the nonexpansion of consumption were responsible for net private saving regaining its 1965 level of 9 percent of private disposable income, after having dipped to 6 percent in 1966. On the other hand, the big increase in public sector spending at a time when its current tax revenue fell off resulted in a much larger public sector dissaving, which was financed by receipts from abroad and by Bank of Israel credit.

## 2. NATIONAL PRODUCT

Real gross national product, as conventionally measured, grew by 2.2 percent in 1967, compared with 1 percent the year before and an average of 10.3 percent p.a. in 1960–65 (see Table II–1).

An estimate made from the income side shows that product hardly changed in the last two years (see Table II–2); in 1967 agriculture and the public sector made substantial gains, but industry and construction recorded smaller figures.

Table II-1

RESOURCES AND USES, 1966-67<sup>a</sup>

	IL million at current prices		Percent change from 1966 to 1967			Percent annual change in period			
	1966	1967	Quantity <sup>b</sup>	Price	Value	Quantity <sup>c</sup>		Price <sup>c</sup>	
						1960-65	1966-67	1960-65	1966-67
Private consumption	7,909	8,136	1.7	1.1	2.9	10.3	2.4	7.2	4.3
Public consumption	2,643	3,411	28.9	0.1	29.1	10.1	17.6	10.3	5.7
Gross investment	2,504	1,868	-25.7	0.4	-25.4	10.8	-21.8	8.7	0.6
Total domestic demand	13,056	13,415	2.0	0.7	2.7	10.4	0.5	8.1	3.7
Imports									
At official exchange rate	3,819	4,123	5.6	2.3	8.0	12.3	3.3	11.1	2.2
At effective exchange rate	4,104	4,297	3.1	1.6	4.7	11.8	1.1	9.7	2.2
Exports									
At official exchange rate	2,536	2,849	12.7	-0.4	12.3	13.3	12.4	13.1	1.7
At effective exchange rate	2,513	2,909	10.7	4.6	15.8	12.4	11.5	10.7	5.2

Import surplus									
At official exchange rate	1,283	1,274	-2.9	2.2	-0.7	11.1	-9.3	8.9	0.7
At effective exchange rate <sup>d</sup>	1,591	1,388	-9.8	-3.3	-12.8	11.2	-13.6	9.4	-1.6
Gross domestic product at market prices									
With import surplus calculated at official exchange rate	11,854	12,264	2.8	0.7	3.5	10.2	2.0	8.0	4.1
With import surplus calculated at effective exchange rate	11,465	12,027	3.5	1.4	4.9	10.2	2.6	7.9	4.6
Gross national product at market prices									
With import surplus calculated at official exchange rate	11,773	12,141	2.5	0.6	3.1	10.3	1.7	7.9	4.1
With import surplus calculated at effective exchange rate	11,384	11,904	3.2	1.4	4.6	10.3	2.4	7.8	4.6

NOTE: After the Hebrew edition of the Report went to press, the data for 1967 were revised as follows: exports were increased by IL 61 million, imports by IL 102 million, and the import surplus by IL 41 million. The import surplus therefore grew by 0.2 percent, and real GNP (calculated at the official exchange rate) by 2.2 percent (instead of 2.5 percent).

<sup>a</sup> The national accounts cover Israel, including East Jerusalem, as from June 1967. The flow of goods and services between Israel and the administered areas is treated as foreign trade, reflected in the export and import flows. However, most of these transactions were not recorded, and the adjustments made for them in the accounts are necessarily rough. For details and a time series, see the appendix to this Report (in Hebrew only), in particular Tables A-II-1 and A-II-2 and the section "National accounts adjustments to balance of payments data".

<sup>b</sup> At 1966 prices.

<sup>c</sup> Geometric average.

<sup>d</sup> Import-export data do not include factor payments to and factor receipts from the rest of the world. The national accounts published by the Central Bureau of Statistics are based on these definitions, which reflect the value of imports and exports in the domestic market. In the discussion in this chapter imports and exports are evaluated at the official rate of exchange and include factor payments to and factor receipts from the rest of the world. Other national accounts adjustments to balance of payments data are presented in the appendix.

SOURCE: Central Bureau of Statistics (data received up to May 1968).

The statistical limitations of the estimates must be taken into account, but it is probably safe to say that the product did not grow at all in 1966, and grew by only 1 or 2 percent in 1967.<sup>1</sup>

This slight gain in the annual level of GNP was the net outcome of two contrasting movements: a decline in the first half of 1967 and a rise in the second half. The figure reached its lowest point in the second quarter, when it even dipped below the second-quarter level of 1965 and 1966; in the third quarter the trend turned sharply upward, and the average for the second half of the year was above the corresponding 1966 figure. This holds according to both methods of measuring GNP (see Diagram II-1). Measurement according to resource use even yields a higher figure for the second half of 1967 than in the same period of 1965.<sup>2</sup>

Both measurements show that in the first quarter of 1967 GNP was higher than in the last quarter of 1966, and that it declined in the second quarter. However, the fluctuations are sharper when the product is calculated from

<sup>1</sup> GNP as calculated from direct estimates of national income is based on the sectorial origin of value added (see notes to Table II-2). The figure cited in the preceding paragraph is expenditure on gross national product, calculated as the difference between domestic resource use and the import surplus. As a residual, it incorporates errors in both magnitudes. In 1967 the "errors and omissions" item of the balance of payments came to \$114 million—about 3 percent of national product, compared with 0.5 percent in 1966. While these errors and omissions doubtless do not accumulate in the import surplus alone but apply also to capital imports, they may affect the change in the product estimate to a significant degree; their direction in fact tends to confirm the view that the 1967 expenditure on GNP is overstated. Another weakness of the estimate lies in the figures on inventory changes, whose measurement, especially in 1967, is not very reliable. The 1967 consumption and import surplus figures are also weaker than usual because of inadequate recording of the movement of goods and services between Israel and the administered areas.

The estimate of GNP derived from national income data (i.e. GNP by sectorial origin), while it does not suffer from these particular shortcomings, has other deficiencies. In particular, the real growth rates of construction, finance and commerce, and services are biased downward.

Since it was impossible to decide which estimate is more reliable, the analysis in this chapter is based on the first concept of GNP, i.e. expenditure on gross national product, as was done in previous years. However, a possible discrepancy of up to 2 percent in the GNP growth rate should be taken into account in any discussion of incomes, private consumption, etc.

<sup>2</sup> The second measurement (from the income side) does not reflect the fluctuations due to defense outlays, and hence is an inadequate economic indicator. This shortcoming was especially marked in 1967, when defense spending expanded appreciably. If defense were included, the first-quarter rise might be intensified and the contraction of the second quarter moderated, but its impact was probably strongest in the second half of the year. This may account for the divergence in the direction of change of the two series in the first quarter of 1967. The two series also yielded opposite results for the last quarter of 1967, as well as for the first and third quarters of 1966. It is doubtful whether this can be ascribed to the defense factor, other deficiencies of one or both series probably being more important.

Table II-2  
NATIONAL PRODUCT AND ESTIMATED REAL CHANGE, BY SECTORIAL ORIGIN, 1965-67  
(IL million, at current prices)

	1965			1966			Real change in GNP (%) <sup>b</sup>	
	Net national product at factor cost	Depreciation and net indirect taxes on domestic output <sup>a</sup>	Gross national product at market prices (1) + (2)	Net national product at factor cost	Depreciation and net indirect taxes on domestic output <sup>a</sup>	Gross national product at market prices (4) + (5)	1965 to 1966	1966 to 1967
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Agriculture	702.4	-38.7	663.7	707.4	-44.1	663.3	-0.1	20.6
Industry	2,030.9	720.7	2,751.6	2,113.0	809.1	2,922.1	-0.1	-4.5
Construction	837.7	125.8	963.5	725.8	141.1	866.9	-20.0	-21.0
Transportation and communications	685.4	329.6	1,015.0	790.1	369.6	1,159.7	-1.0	0.0
Public sector and nonprofit institutions	1,616.2	105.3	1,721.5	2,002.7	117.8	2,120.5	7.3	11.2
Housing <sup>c</sup>	567.0	507.8	1,074.8	578.8	569.6	1,148.4	7.1	5.4
Finance, commerce, personal services	2,022.4	123.5	2,145.9	2,269.2	138.9	2,408.1	2.1	-2.8
Subtotal	8,462.0	1,874.0	10,336.0	9,187.0	2,102.0	11,289.0	0.4	0.5
Taxes on imports			489.0			484.0		
Gross national product			10,825.0			11,773.0		

<sup>a</sup> The sectorial allocation of depreciation (including some other adjustments) is based on A. L. Gaathon's estimates. The difference between GNP as estimated from the income side and that estimated from the expenditure side ("errors and omissions") was allocated in the same manner. Indirect taxes on domestic output are net of subsidies (domestic and export).

<sup>b</sup> Average change (all sectors) weighted by base-year distribution of gross national product at market prices (columns 3 and 6). The changes in each sector were estimated as follows: agriculture and industry—direct estimates (see Chapters XI and XII); construction—real rate of change in investment in buildings and earthwork; transportation and communications—real rate of change in gross output (see Chapter XIV); public sector and nonprofit institutions—according to total wage bill (the major component), deflated by rise in hourly wages, and estimate of real change in rent; housing—according to real change in stock of dwellings; finance, commerce, and personal services—according to National Insurance wage data, deflated by the rise in hourly wages.

<sup>c</sup> Most of this item is an imputation.

SOURCE: Central Bureau of Statistics.

national income estimates (Diagram II-1 clearly shows the development of the two series and how they diverge).

National product declined throughout most of 1966.<sup>1</sup> It turned upward in the first quarter of 1967, following the expansion of public sector current operations<sup>2</sup> and a big gain (partly of a seasonal nature) in agricultural output. In the second quarter, which includes the war and the preceding tension, civilian demand shrank and production was interrupted, with the result that GNP fell off. In the third quarter most reservists were demobilized, production was reorganized, and with the revival of demand GNP rapidly regained its prewar level.<sup>3</sup> It is not possible to determine accurately by how much GNP grew in the final quarter. According to the national income estimate, the upward movement continued, but more slowly than in the third quarter. Preliminary data for the first quarter of 1968 show that growth was sustained. However, the other measurement indicates that the advancing trend was arrested in the last quarter of 1967 (see Diagram II-1).

Two other, more indirect, indicators of economic activity—labor input<sup>4</sup> and the velocity of demand deposits—in general confirm the product trends outlined above. They show parallel declines from the second quarter of 1966 until the middle of 1967, but diverge in the second half of 1967: whereas employment rose in the third quarter and tapered off in the last (a similar trend as in expenditure on GNP), the velocity of demand deposits continued to diminish in the third quarter and rose only in the final quarter.<sup>5</sup>

<sup>1</sup> The analysis of quarterly movements is unsatisfactory in two respects: (a) the brevity of the time series (four years only) does not permit the identification and elimination of seasonal factors, which apparently affect agricultural output, transportation, and tourism; (b) the two series differ considerably in rates of change and sometimes (in four of the 12 quarters) in the direction of change.

<sup>2</sup> I.e. public consumption and income originating in the public sector, which do not reflect all of the Government's influence on aggregate demand; the latter is also affected by the Government's expenditure on capital account, its net credit outflow to other sectors, and its tax revenue. For a detailed examination of the Government's influence, see Chapter VII.

<sup>3</sup> GNP as calculated from the national accounts did not regain its first-quarter level, which was exceptionally high. The contribution of citrus to the product is relatively large at this time of the year, and therefore the excellent 1966/67 season probably biased the first-quarter estimate upward.

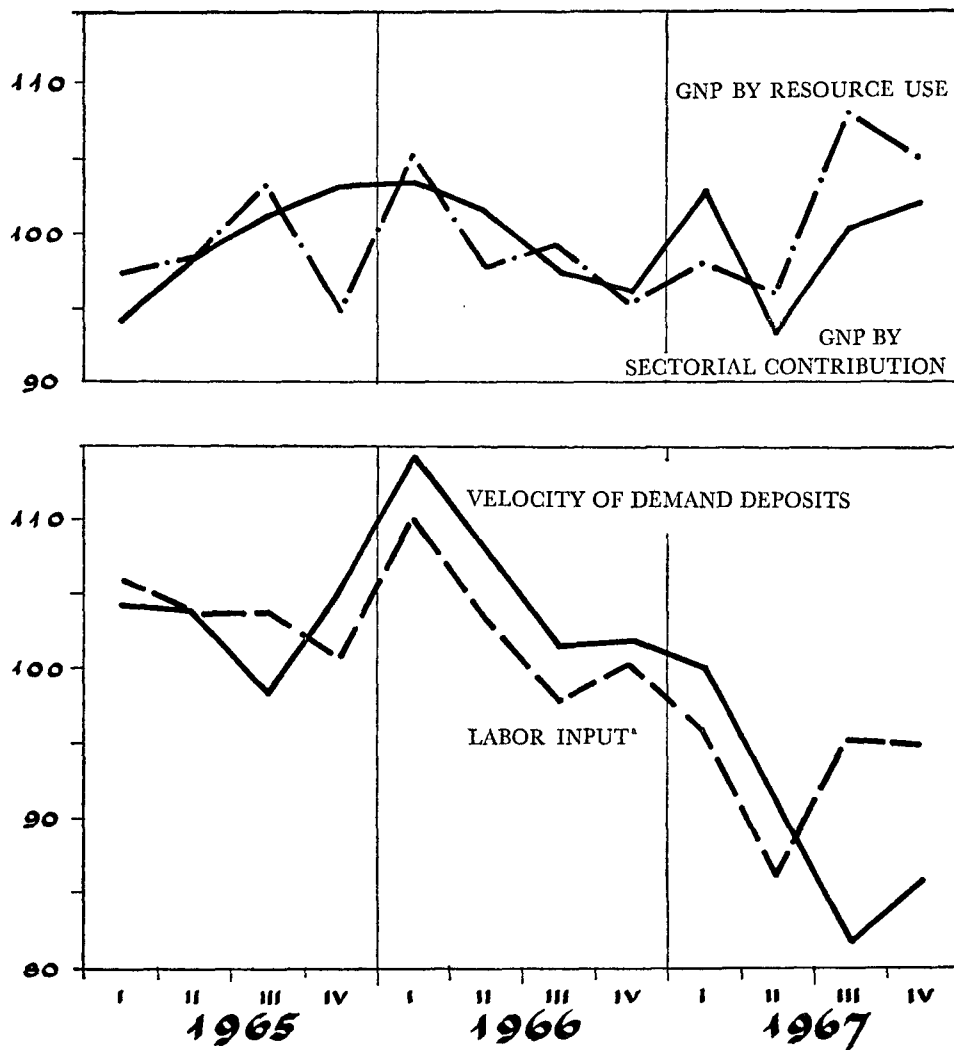
<sup>4</sup> Theoretically, the volume of employment in the economy should be a good yardstick of economic activity and GNP, provided there are no marked changes in output per unit of labor. But this is precisely what happened in 1966 and 1967. Moreover, employment and product are not entirely independent estimates, since income originating in economic activity and some components of the expenditure estimate, such as public consumption and various services, are in practice largely based on wage or employment data.

<sup>5</sup> The velocity of demand deposits and other indicators of current economic activity need not necessarily display identical trends, since the volume of deposits may change for reasons other than changes in production and incomes (e.g. changes in the composition of assets or a general monetary expansion). Debits to demand deposit accounts rose during 1965,

Diagram II-1

GROSS NATIONAL PRODUCT, QUARTERLY, ACCORDING TO VARIOUS INDICATORS, 1965-67

(average for period=100)



<sup>a</sup> Total man-hours according to manpower surveys.



Taking all these indicators together, it appears that the more moderate growth of product in the last two years was due to a decline in at least part of 1966. However, the GNP expenditure series suggests that the decline may have occurred in the second half of 1965, and that product remained more or less stable until the middle of 1967, with only random or seasonal fluctuations. The brevity of the quarterly series, as mentioned, does not enable us to draw definite conclusions concerning the trend during this period. Nevertheless, it is fairly clear that a turning point was reached at the end of 1965 or the beginning of 1966, when the growth of the national product was checked, resuming only in the middle of 1967.

### 3. FACTORS INFLUENCING ECONOMIC DEVELOPMENT

Until 1965 Israel's economy was distinguished by a high rate of activity and a rapid growth of the national product. In 1960-65 real GNP per capita rose by an average of 6 percent per annum, unemployment declined and in 1964 amounted to only 3.3 percent of the labor force, while factor productivity (product per unit of capital and labor) advanced at an annual rate of some 3.5 percent. This vigorous rate of activity can be attributed to the rapid growth of demand, and was accentuated by such factors as immigration, capital imports, and (during part of this period) the expansionary influence of public sector operations. The resulting conditions—rising incomes and expectations of a continued strong increase in demand—further stimulated economic activity. This applies particularly to residential construction and other investments. Since the economy had attained a high degree of liquidity during these years (owing to the monetary expansion of 1962 and 1963), the growth of demand accelerated, a development reflected by mounting prices and a deterioration in the balance of payments.<sup>1</sup>

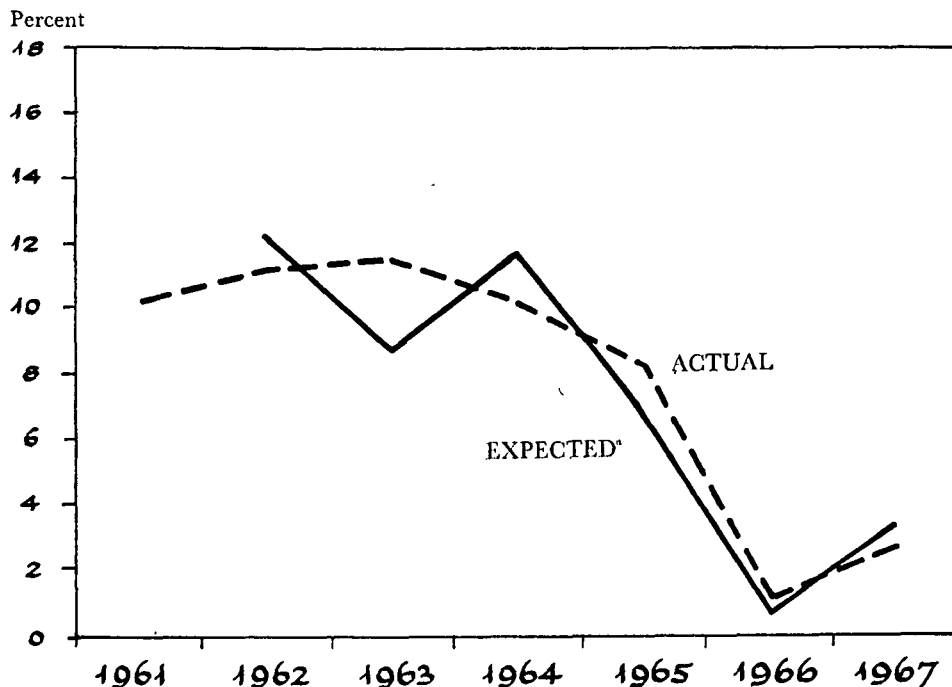
Analysis of the influence on product of the main components of demand (see Diagram II-2) shows that in 1960-64 private investment, the domestic demand surplus of the public sector, transfers from abroad, and the public's consumption habits were responsible for expanding GNP by about 10 percent per annum. In 1965 the growth of demand slowed down and in the following year virtually tapered off. In 1967, especially the second half, demand resumed its upward movement, and product also rose somewhat.

Since 1965 it is demand that has limited product growth, and as far as supply factors are concerned, it could have grown faster; this is in contrast to the years 1960-64, when demand expanded faster than product, whose growth

contracted from the first quarter of 1966 until the second quarter of 1967, and expanded in the third quarter of 1967.

<sup>1</sup> The import surplus declined in only one of these years—1963—owing to the devaluation of 1962.

**Diagram II-2**  
**ANNUAL REAL GROWTH OF GNP, 1962-67**



\* On the basis of investment, public consumption, and export.

was limited from the supply side.<sup>1</sup> Although the population and the capital stock expanded more slowly in the last two years and the labor force participation rate fell in 1967, there were enough unutilized factors of production to permit GNP to increase by an additional 4 to 5 percent yearly, i.e. by a total of more than IL 1,000 million in 1965-67 (see Diagram II-3). However, it does not seem likely that without a marked rise in the relative profitability of export such an increment could have led to the reduction of the import surplus or the accumulation of foreign currency balances to the extent that actually occurred.

The braking of the GNP growth rate in 1965 can be ascribed not only to the slower expansion of investment but also to the overheating of the economy and speculative demand in preceding years. Excessive economic activity resulted in a surplus stock of housing and other investment assets, which became still more difficult to liquidate when demand weakened.

<sup>1</sup> This general conclusion is based on a given composition of demand and productive factors during the period referred to. It does not necessarily apply to each sector; in agriculture, for instance, the growth of productive capacity outstripped that of demand during this period.

Mounting pressure on the labor market, wages, prices, and the balance of payments induced the Government to adopt a policy of economic restraint at the end of 1964. In 1965 this policy was not yet reflected in the public sector demand surplus, which rose above the 1964 level.<sup>1</sup>

Nevertheless, the growth of aggregate demand slowed down in 1965, because investment, for reasons stated above, declined and private transfers from abroad fell, thereby affecting consumption. The public's outlook then began to change, a development reinforced by the Government's declared policy of economic retrenchment. The 1966 budget was designed to impose restraint, and the investment of public sector companies was cut back. However, when by the second half of the year it had become clear that the retrenchment was greater than planned, the Government reversed its policy, with a consequent expansion of its direct demand surplus in the domestic market. Despite its smaller net credit outflow, the Government apparently did not exert a contractionary influence on aggregate demand in 1966.<sup>2</sup> The reflationary-policy measures began to leave their mark on public consumption in the last quarter of 1966 and the first quarter of 1967,<sup>3</sup> reaching a peak in the third quarter of the year. The decisive factor in this upswing was unquestionably the heavier defense spending during the second quarter of 1967 and the immediate postwar period.

In the latter part of 1966 and early 1967 it was decided to accelerate the execution of various development projects, and the effects of this decision (designed to relieve unemployment) were undoubtedly felt in the third and fourth quarters of 1967. The projects included such infrastructural investments as the extension of the country's road network and the erection of public buildings; in addition, grants and credits were provided to investors in order to stimulate capital spending. We therefore see that the public sector was the crucial factor in increasing aggregate demand in 1967 and in the resumption of economic growth in the second half of the year. Some of the expansion of public sector operations was planned in advance, in the form of civilian development projects. But for the most part it was due to the unforeseen and rapid increase in military expenditure.

In the last quarter of 1967, when some of the more urgent projects had been completed and signs of rapid economic recovery appeared, the Government cut down on its spending. Since tax revenue also began to soar, the Government's

<sup>1</sup> In 1965 the public sector demand surplus rose whatever the definition: current domestic demand, demand including capital-account purchases and imports, and—the widest definition—including also net credit to the public.

<sup>2</sup> For a detailed analysis of economic trends in 1966, see Bank of Israel Annual Report for 1966, Chapters II and VII.

<sup>3</sup> This trend is not visible in Table VII-9, according to which most of the Government's expansionary influence was felt in the second and third quarters of 1967. The divergence is probably due primarily to the fact that the rise in public consumption was offset during part of the period by the contraction of net credit to the public.

contribution to the overall demand surplus apparently declined considerably toward the end of the year.

The development of the national product was determined chiefly by the scope of public sector activities, especially in the second half of 1967, when the impact of the rapid monetary expansion discernible since the beginning of the year also made itself felt on demand. Another contributory factor was the expansion of exports, although it was not as strong as in 1966. Private transfers from abroad on account of personal restitution etc. also increased. All these were reflected by a rise in private incomes and the rapid growth of private consumption.

Investment, however, continued downward during the year. Although it was stepped up appreciably in the third quarter of 1967, partly because of the rise in publicly financed development work, the growth rate was not sustained in the last quarter, and over the year as a whole it was not sufficient to offset the effect of reduced investment on aggregate demand.

That the public sector was mainly responsible for the revival of economic activity is also clear from the fact that it outstripped other sectors in the rate of expansion. In the first half of 1967 public consumption was 30 percent above the 1966 average, and it remained at roughly this level during the second half of 1967, displaying a slight downward tendency.

In the first half of the year private consumption was about 5 percent lower than in the second half of 1966, and increased only in the third quarter; in the second half of the year it was approximately 13 percent above the first half and about 8 percent above the second half of 1966.

Investment too was lower in the first half of 1967 than in the previous six months and in the first half of 1966 (by 28 and 40 percent respectively), turning upward only in the third quarter of the year reviewed, when it regained its level of the final quarter of 1966. In the second half of 1967 the figure stood 20 percent above that of the first half.

Not all of the increase in aggregate demand in the second and third quarters of 1967 contributed to the growth of GNP, part (particularly some of the defense requirements) being supplied from imports. But most of the incremental public consumption during this period was supplied by the domestic market, this being reflected by a growth of product.

The sectorial product figures also show that the increase in GNP ascribable to the public sector apparently began at the end of 1966 or early 1967. If we exclude agriculture (whose relatively big expansion was largely due to favorable climatic conditions), the next sector to show signs of recovery was industry. Here the declining trend was arrested at the beginning of the year reviewed (although the average level for the first quarter was 4-5 percent lower than in the last quarter of 1966). The reversal of trend, however, was apparently delayed by the war. A rapid upswing set in in the third quarter, and carried over through the

final quarter and, according to preliminary data, also into the early months of 1968.

Activity in construction, the first sector to show signs of a slump in 1965, began to pick up in the third quarter of 1967, although at a relatively slow rate, and at the end of the year the level was still below that at the beginning. Transportation also began to revive in the third quarter.<sup>1</sup>

#### 4. STRUCTURAL CHANGES IN THE ECONOMY

##### (a) *Composition of available resources*

One of the central problems of Israel's economy is to reduce its huge import surplus, and here the trend has changed since 1965, the surplus narrowing after having grown during the early 1960's (except in 1963). In 1960-64 the annual import surplus shot up from \$ 335 million to \$ 570 million, i.e. by 70 percent. This increase—at an average annual rate of 18 percent (despite the 1963 decline)—was faster than the growth of domestic product, bringing up the share of the import surplus in real resources at the disposal of the economy from 11 percent in 1960 to 14 percent in 1964 (see Table II-3 and Diagram II-3). This means that capital import requirements<sup>2</sup> grew not only absolutely but also in relation to product.

The moderation of economic activity from 1965 and the slower growth of aggregate demand were reflected by a change in the opposite direction. In 1967 the import surplus was cut to \$ 437 million, and its weight declined to 10 percent of available resources despite the slower GNP growth rate; this is a little below the average for 1965-67, and appreciably less than the 13 percent average for 1960-64.<sup>3</sup> These trends were also reflected by the expansion of the State's foreign liabilities.<sup>4</sup>

The \$ 133 million decline in the import surplus between 1964 and 1967 was achieved thanks to the checking of the growth of imports and the continued expansion of exports. The advancing trend in exports accelerated in 1965, but in the next two years the growth rate tapered off.

<sup>1</sup> Table A-II-3 in the appendix (in Hebrew only) shows an increase in the second quarter of 1967, but this is misleading, chiefly because the road haulage branch, whose output was shrinking at the time, is excluded.

<sup>2</sup> The import surplus in 1961-64 added up to \$ 1,933 million, while unilateral transfers from abroad aggregated \$ 1,378 million; the remaining \$ 555 million was covered by investments from abroad and an increase in foreign indebtedness.

<sup>3</sup> In 1965-67 the cumulative import surplus dropped to \$ 1,415 million and unilateral transfers from abroad totalled \$ 1,170 million; the balance covered by foreign investments and additional foreign liabilities was only \$ 245 million.

<sup>4</sup> A detailed analysis of balance of payments developments will be found in Chapter III, "The Balance of Payments".

Diagram II-3

COMPOSITION OF RESOURCES AT THE DISPOSAL OF THE ECONOMY, 1960-67

(at constant prices)

Percent

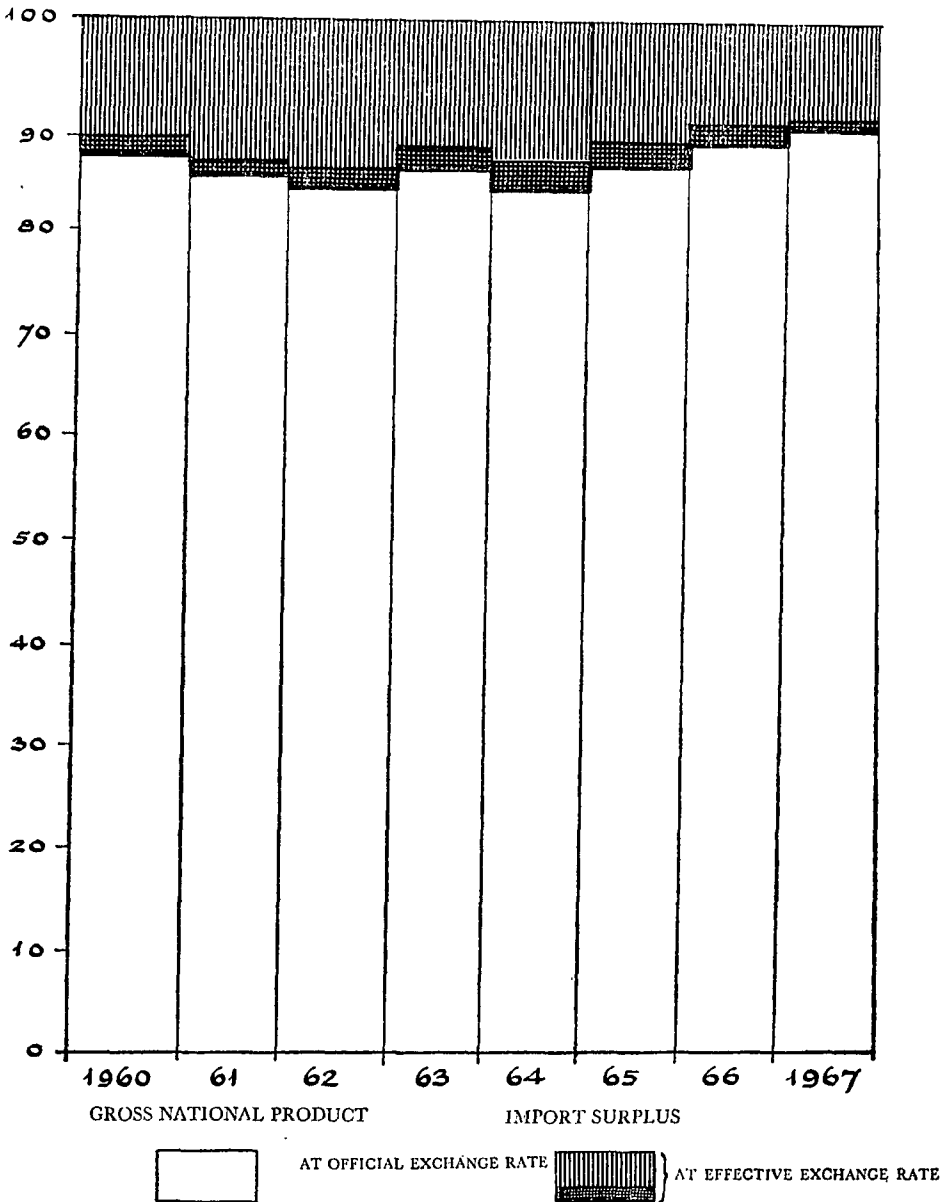


Table II-3

**COMPOSITION OF RESOURCES AT THE DISPOSAL OF THE ECONOMY, 1960-67**  
(percentages)

		Import surplus	Net factor payments to rest of world	Gross national product at market prices	Total
1960	At official exchange rate <sup>a</sup>	11.3		88.7	100.0
	" effective " "	13.5	0.6	85.9	100.0
1961	" official " "	14.0		86.0	100.0
	" effective " "	15.8	1.2	83.0	100.0
1962	" official " "	14.2		85.8	100.0
	" effective " "	16.1	1.0	82.9	100.0
1963	" official " "	12.3		87.7	100.0
	" effective " "	14.5	0.4	85.1	100.0
1964	" official " "	13.7		86.3	100.0
	" effective " "	16.1	0.4	83.5	100.0
1965	" official " "	11.7		88.3	100.0
	" effective " "	14.0	0.4	85.6	100.0
1966	" official " "	10.0		90.0	100.0
	" effective " "	11.7	0.6	87.7	100.0
1967	" official " "	9.5		90.5	100.0
	" effective " "	10.3	0.9	88.8	100.0
1960-64	" official " "	13.1		86.9	100.0
	" effective " "	15.0	0.7	84.3	100.0
1965-67	" official " "	10.4		89.6	100.0
	" effective " "	12.0	0.6	87.4	100.0

<sup>a</sup> Including net factor payments to the rest of the world.

(b) *Composition of domestic resource use*

Total real domestic resource use (private and public consumption and investment) hardly rose in 1966-67. In 1966, in fact, it contracted by 0.9 percent, compared with an average annual growth of 10 percent in 1960-65 (see Table II-1).

The composition of domestic demand underwent a marked change in the last three years. Whereas in 1960-65 all demand components moved up by an average of some 10 percent per annum, in 1966-67 private consumption grew by only 2.4 percent, and investment (which in 1960-65 expanded at an annual rate of 11 percent) shrank by an average of 22 percent per annum. The growth of public consumption, on the other hand, accelerated from 10 to 18 percent, with the rise being faster in 1967, mainly because of the larger defense spending in the wake of the war.

These changes are reflected in the weights shown in Table II-4 (see also Diagram VI-4). The share of investment in total domestic demand fell from

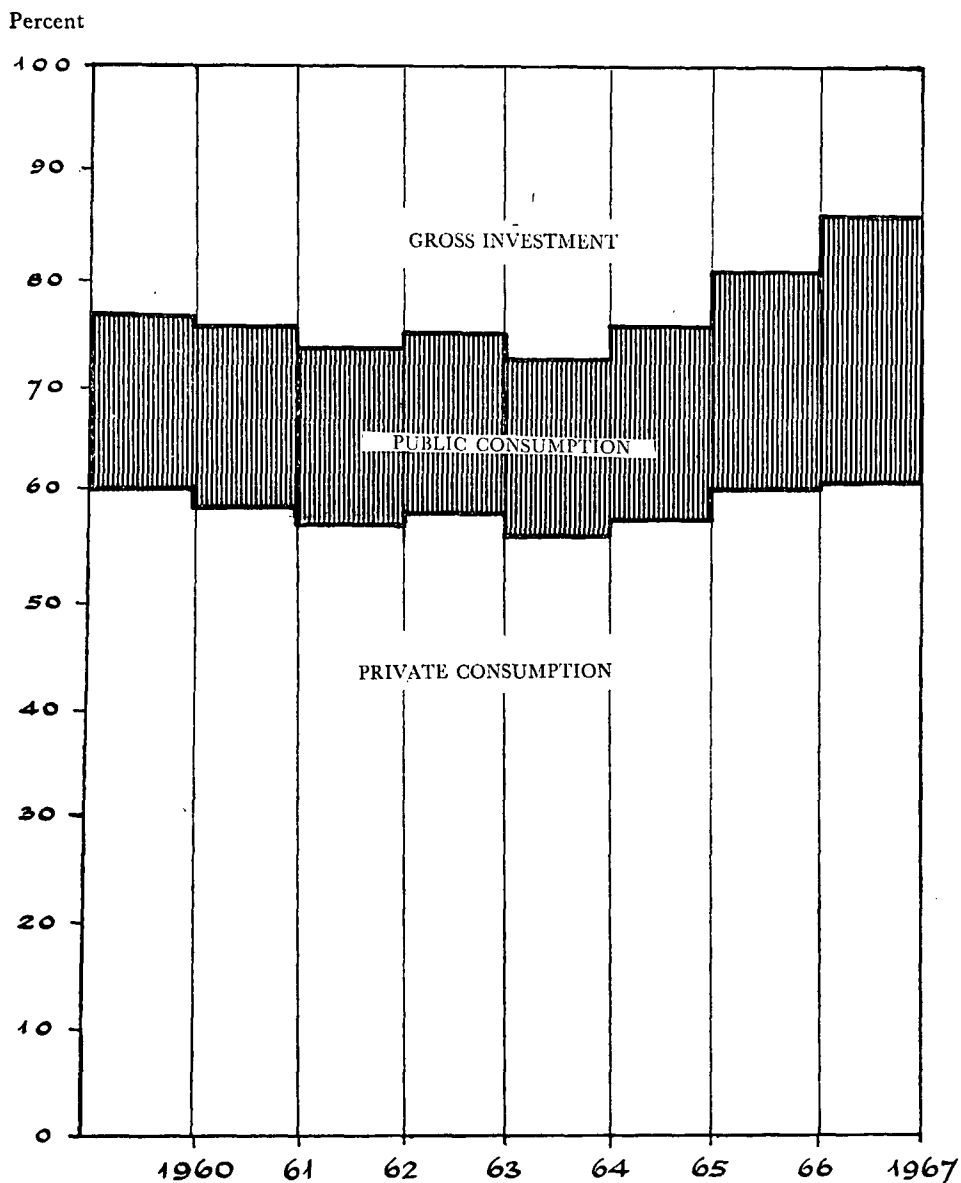
Table II-4

(percentages, at current prices)

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**Diagram II-4**  
**DOMESTIC USE OF RESOURCES, 1960-67**  
 (at current prices)



27 percent in 1964 to 14 percent in 1967 (the average weight in 1965–67 was 19 percent, compared with 25 percent in 1960–64). The weight of private consumption went up from 56 percent in 1964 (58 percent average in 1960–64) to 61 percent in 1967 (60 percent in 1965–67). The biggest increase was in public consumption—from 17 percent in 1964 (17 percent in 1960–64) to 25 percent in 1967 (21 percent in 1965–67).

These structural changes in demand and resource use can be viewed as the outcome of two trends: On the one hand, since the main impact of the recession was a sharp curtailment of investment (this was both cause and effect), the relative share of consumption necessarily went up, even though the growth rate was smaller than in previous years. On the other hand, the much heavier defense spending raised the weight of public consumption at the expense of private consumption and investment. The increase in public consumption affected the level of investment not only relatively but also absolutely; if defense requirements had not risen so steeply, the Government would have been able—and felt obliged—to devote a larger share of resources to investment and development.

### (c) *Sectorial composition of the national product*

The economic developments of recent years are also reflected in the sectorial composition of GNP (see Table II-5). The outstanding changes in 1965–67 were the decline of over 2 percent in the share of construction, and the rise in the weight of the public sector by a similar rate. Industry was down 1.7 percent, while agriculture advanced to almost the same extent. The weights of other sectors remained fairly constant over this period.<sup>1</sup> These trends are also reflected in the structure of employment (see Table IX-5).

The smaller contribution of construction to GNP must be seen in the light of its very high share in 1963–65 and the existence of an excess supply of buildings in 1965–67. But the factors of production released by this sector, particularly labor (as well as the new factors added to the economy during the period) were not absorbed by other sectors. The demand for manufactures declined, so that industrial employment fell and the export growth rate did not rise. As a result, unemployment mounted rapidly, reaching a peak in the middle of 1967. Only the public sector increased its share of product, mainly because of the larger defense requirements.

The turning point in economic activity in the second half of 1967 was also reflected by changes in its sectorial composition: at the end of 1967 the shares of industry and transportation were above the end-1966 level, while the weight of the public sector also continued upward; agriculture experienced a decline, and construction continued to fall off.

<sup>1</sup> Excluding imputed income from home ownership, which cannot be considered an active economic sector and the value of which rises with the stock of dwellings.

Table II-5

**SECTORIAL ORIGIN OF GROSS NATIONAL PRODUCT, AT CONSTANT  
MARKET PRICES, 1965-67**

(percentages)

	1965	1966	1967
Agriculture	6.4	6.4	7.7
Industry	26.6	26.5	24.9
Construction	9.3	7.4	5.9
Transportation and communications	9.8	9.7	9.7
Public sector and nonprofit institutions	16.7	17.8	19.7
Housing	10.4	11.1	11.6
Finance, commerce, and personal services	20.8	21.1	20.5
Total	100.0	100.0	100.0

(d) *Productivity*

In 1960-64 GNP grew at a vigorous rate. The strongly rising demand pressed on available resources, and besides pushing up prices and worsening the balance of payments, it reduced unemployment to its lowest level (3-3.5 percent of the labor force); this, together with the rapid expansion of the stock of capital assets, raised productivity considerably. This was made possible by the more efficient exploitation of existing equipment and structures, which in turn can be attributed to the pumping of more capital into the economy, the introduction of technological innovations, and the more efficient utilization of the existing work force. Even in 1965, when the first signs appeared of a weakening of demand, productivity still increased fairly rapidly (see Table II-6). In 1960-65 product per factor unit advanced by an average of 3.5 percent per annum. In industry the gain came to more than 4 percent during this period.

In 1966, when product levelled off and even contracted during part of the year, productivity decreased by nearly 2 percent. This must be largely ascribed to the growth of hidden unemployment because of the desire to put off dismissals in the hope that demand and production would revive. The lower rate of capital utilization following production cutbacks in numerous branches also brought down productivity. But at a time when demand and sales were declining, dismissals could be postponed only temporarily. As the recession wore on and hopes of a rapid recovery evaporated, an increasing number of workers were laid off, and in 1967 the average number of gainfully employed fell 5 percent below the 1966 level.

The underutilization of capital and employed labor in 1966 made it possible to increase GNP in 1967 somewhat faster than in 1966, despite the lower level of employment. In addition, weather conditions in 1967 were favorable for agri-

**Table II-6**  
**CHANGES IN REAL PRODUCT, FACTORS OF PRODUCTION,**  
**AND PRODUCTIVITY, 1961-67**

(percentages)

	Increase or decrease (-) as against preceding year							Average annual change	
	1961	1962	1963	1964	1965	1966	1967	1961-65	1966-67
Real product	10.3	11.2	11.5	10.2	8.2	1.0	2.5	10.3	1.7
Labor input									
Gainfully employed	6.4	5.7	5.1	5.6	2.9	0.6	-4.9	5.1	-2.2
Man-days					2.1	1.1 <sup>a</sup>	-8.2 <sup>a</sup>		-3.7
Product/labor ratio									
Per gainfully employed	3.7	5.2	6.1	4.4	5.2	0.4	7.8	4.9	4.0
Per man-day					6.0	-0.1	11.7		5.6
Stock of fixed reproducible assets <sup>b</sup>									
Total	11.0	12.0	10.0	11.0	10.0	7.0	5.0	10.8	6.0
Per gainfully employed	4.3	6.0	4.7	5.1	4.6	6.4	10.4	4.9	8.4
Product per factor unit (factor productivity) <sup>c</sup>									
Measured by no. of gainfully employed	2.7	3.5	4.9	3.0	3.3	-1.3	5.6	3.5	2.1
Measured by no. of man-days					3.9	-1.7	8.5		3.3

<sup>a</sup> Based on the revised number of gainfully employed in 1966, according to the number of man-hours per gainfully employed shown in the 1966 manpower surveys.

<sup>b</sup> The change in stock at the beginning of the year; including housing (the real product includes the imputed value of housing).

<sup>c</sup> Calculated according to the preceding year's weights of the return on capital and labor. The return on labor includes the imputed earnings of nonemployees, taken as the average wage of employees (see Table II-10).

culture. There was thus an unprecedented rise in productivity—by 5.6 percent per unit of capital and labor when labor is measured by the number of gainfully employed, and by 8.5 percent when labor is measured by the number of man-days.<sup>1</sup> Over the two years 1966-67 productivity averaged 2.1 percent higher; in other words, the ground lost in 1966 was evidently recovered in the following year.

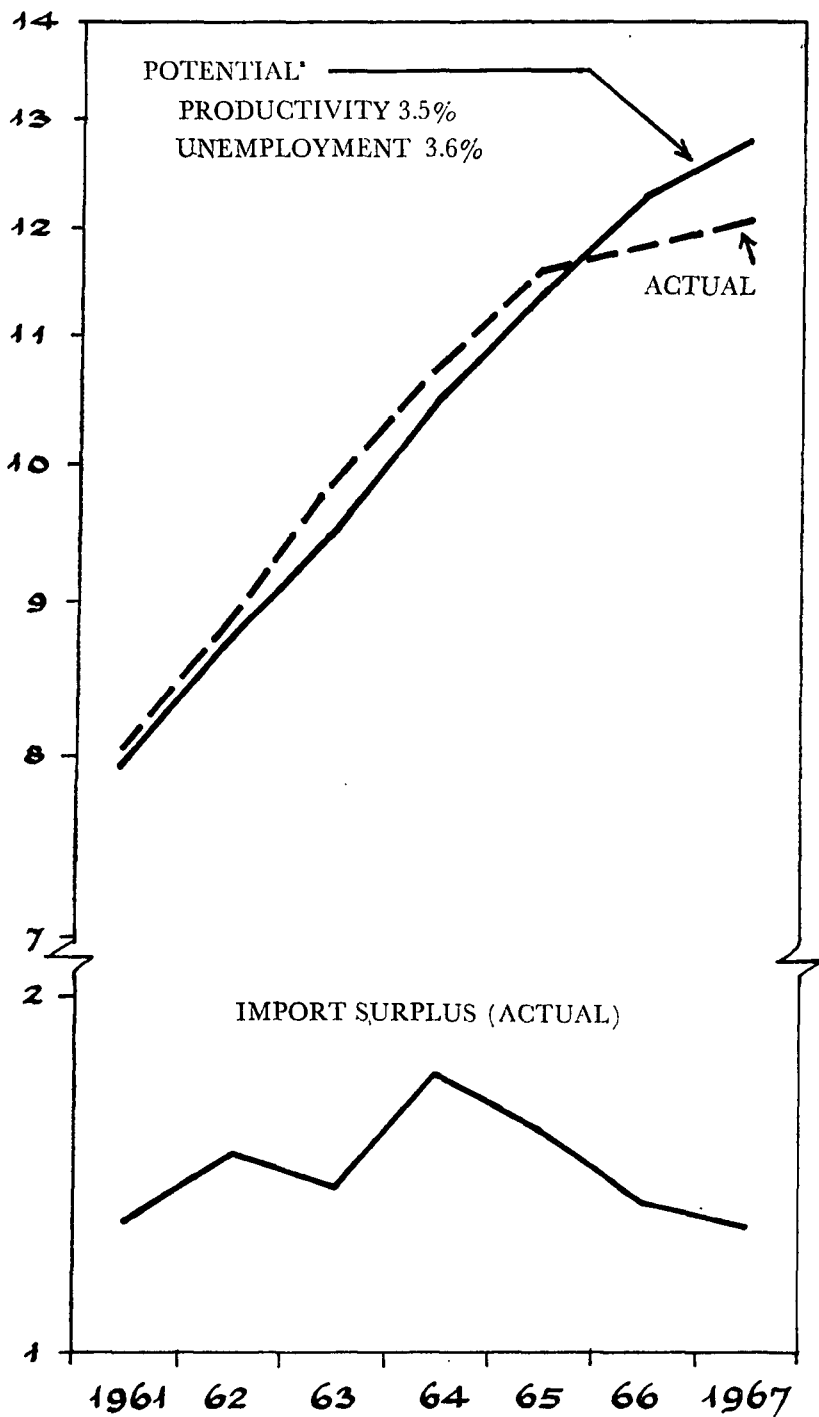
Agriculture recorded an impressive gain in 1967, after two years of decline due largely to adverse weather conditions. The services also showed a substantial advance, while industrial productivity rose little, if at all.<sup>2</sup> This primarily

<sup>1</sup> See Chapters IX and X for employment data. The number of employees shown by the manpower surveys for 1967 appears to be understated, so that the percentage increase in productivity is biased upward.

<sup>2</sup> See Table XII-1. The number of industrial workers, on which the calculation in Chapter XII is based, was computed from the census of industry and crafts, which indicated a decline of 5.5 percent, whereas the manpower surveys show a decline of 10.5 percent.

Diagram II-5  
ANNUAL ACTUAL AND POTENTIAL GNP, 1961-67

(IL '000 million, at 1967 prices)



\* Average growth during the period 1960-65.

reflects a decrease in the second half of 1966, since there was a rapid improvement in the second half of 1967.

(e) *Prices*

One of the major attainments of the economic slowdown was the checking of the price rise. Inflationary pressures had driven up the price level very sharply and almost uninterruptedly ever since the establishment of the State in 1948. In 1960–65 GNP prices climbed at an average annual rate of 8 percent. At the beginning of 1966, before the full impact of the recession was felt, prices continued upward, owing to tax increases and mounting costs (especially wages); but the higher costs apparently were not fully reflected by prices. From the second half of 1966 until the end of 1967 the price level remained firm. Consumption prices, which had risen by 7 percent in 1966 (at the beginning of the year, as stated), advanced only 1 percent in the year reviewed.

Even if this price stability was virtually unprecedented, the weakening of demand—which marked at least part of this period—could have been expected to dampen prices. While the prices of some goods and services did fall, the decline was not very widespread nor did it bring down the general price level. In Israel, as in most other countries, prices and wages display a downward rigidity, and the economy tends to adjust itself to shrinking demand (particularly when it is thought to be temporary and mild) by building up stocks, reducing output, and laying off workers, rather than by cutting prices.

Prices did show a tendency to fall in financial transactions. The increased liquidity of the economy and the subsiding of demand were felt in the money markets as well, being reflected by a decrease in nominal interest rates in the bill brokerage trade and elsewhere.

The price of the other major factor of production—labor—also displayed a certain elasticity. Annual average wages per employee did not increase at all, so that in real terms there was a decline of 1 percent (see Table X-1). The restraining influence of unemployment was in evidence at the end of 1966 and the beginning of 1967, when agreements previously signed were not fully implemented, and the cost-of-living allowance was not revised despite the rise in the consumer price index. Real wages per employee dropped somewhat in almost all major sectors (see Table X-4). However, this was apparently due to the fact that (in contrast to the previous year) no retroactive adjustments were paid and workers put in fewer hours, since hourly wages averaged 5 percent higher (see Table X-6). Here too we see that the ebbing of demand was primarily reflected by a drop in employment and a rise in unemployment, rather than by a fall in the wage level.

(f) *Incomes*

In 1965 the growth of real product slowed down, but as prices mounted at a relatively rapid rate, the nominal GNP growth rate did not drop and

**Table II-7**  
**NATIONAL PRODUCT AND INCOME, 1960-67**  
 (IL million)

	1960	1961	1962	1963	1964	1965	1966	1967
1. Gross national product at market prices	4,527	5,438	6,522	7,847	9,142	10,825	11,773	12,141
2. Indirect taxes on domestic output	493	634	721	850	980	1,071	1,256	1,280
3. Subsidies on domestic output	88	73	98	133	153	176	203	194
4. Net taxes on domestic output (2-3)	405	561	623	717	827	895	1,053	1,086
5. Taxes on imports	263	339	336	354	425	489	484	410
6. Export subsidies	105	148	44	31	34	43	95	173
7. Import taxes net of export subsidies (5-6)	158	191	292	323	391	446	389	237
8. Total indirect taxes, net (4+7)	563	752	915	1,040	1,218	1,341	1,442	1,323
9. Depreciation	364	438	631	765	878	1,022	1,144	1,240
10. National income—estimated from the expenditure (resource use) side (1-8-9)	3,600	4,248	4,976	6,042	7,046	8,462	9,187	9,578
11. National income—estimated directly from the income side <sup>a</sup>	3,425	4,039	4,793	5,959	6,957	8,281	9,141	9,454
12. Errors and omissions (10-11)	175	209	183	83	89	181	46	124

<sup>a</sup> The income-side aggregate is estimated as value added originating in each sector and consists of compensation of employees plus estimated profits and imputed rent. The difference between this and the expenditure-side estimate is discussed briefly in note <sup>1</sup> on p. 14.  
 SOURCE: Central Bureau of Statistics.

national income soared 20 percent (see Tables II-7 and II-8), or by more than the average annual growth in 1960-65.

In 1965-67 national income advanced 6 to 7 percent per annum. In 1967 nominal GNP rose more slowly than the year before; in real terms, however, the growth rate accelerated because prices went up more slowly in 1967. Net indirect tax revenue was down 8.3 percent, and national income increased by 4.3 percent,<sup>1</sup> compared with an average of 19 percent in 1960-65.

In 1965 income tax collections slowed down because of the revision of tax rates in accordance with the recommendations of the Zadok Committee. Disposable private income from domestic sources thus increased at the same rate as national income—by 20 percent, one of the highest rates in recent years (see Table II-9). In 1966 income tax revenue again went up more slowly, reflecting the sluggish growth of national income; but since tax rates were revised upward, revenue still grew much faster than incomes. Disposable income thus rose slightly less than national income, the increase amounting to 7 percent. In 1967 the growth rate of direct tax receipts declined steeply, while that of transfer payments to households was somewhat higher; as a result, net direct tax revenue (i.e. net of transfers) declined by 18 percent and disposable income from domestic sources rose by some 6 percent, or a little faster than national income. The tax system thus helped to increase disposable income in 1967 by reducing net tax collections (direct and indirect taxes, less subsidies and transfers) by some 12 percent. This was not due to the lowering of tax rates (on the contrary, the introduction of a defense levy raised the average rate of tax), but to the slower expansion of the tax base. Another contributory factor was the change in income distribution.<sup>2</sup>

Changes in income distribution in the year reviewed deviated from the pattern of 1966. Employee compensation, which stood at 59.6 percent of national income in 1963-65, rose to 65.3 percent in 1966 (see Table II-10) and non-wage income fell 7 percent. Returns to capital (after deducting the imputed labor of self-employed, taken as the average wage of employees) fell from 12.7 to 7.4 percent of the net capital stock. In 1966, moreover, nonwage income per self-employed declined by 4.6 percent, while income per employee rose by 19 percent. In 1967 the share of employee compensation in national income fell to 62.4 percent; income per employee barely rose, while that per self-employed jumped 34 percent. The return on capital went up appreciably and, as a percentage of net capital stock, regained its 1965 level. These sharp

<sup>1</sup> In view of the aforementioned upward bias in the national product growth rate, the increase in national income may not have exceeded 3-4 percent.

<sup>2</sup> In 1966 and the beginning of 1967 nonwage incomes declined, and the tax authorities adopted a more liberal attitude toward the collection of advances from self-employed, whose marginal tax rates are above average. Together with the offsetting of losses incurred in 1966, this probably explains much of the slowdown in income tax collections in 1967.



**Table II-8**  
**CHANGES IN NOMINAL GROSS NATIONAL PRODUCT AND NATIONAL INCOME, 1961-67**  
 (percentages)

	Increase or decrease (-) as against preceding year							Annual average	
	1961	1962	1963	1964	1965	1966	1967	1961-65	1966-67
Gross national product at market prices	20.1	19.9	20.3	16.5	18.4	8.8	3.1	19.0	5.9
Net taxes									
On domestic output	38.5	11.1	15.1	15.3	8.2	17.7	3.1	17.2	10.2
Total indirect taxes	33.6	21.7	13.7	17.1	10.1	7.5	-8.3	19.0	-0.7
Depreciation	20.3	44.1	21.2	14.8	16.4	11.9	8.4	22.9	10.1
National income	18.0	17.1	21.4	16.6	20.1	8.6	4.3	18.6	6.4

changes in the magnitude and distribution of income increased profits, stimulated investment, and generated expectations that the economic recovery would continue.

(g) *Consumption and saving*

The above changes in income left their mark on the public's consumption and saving behavior. Although real private income per capita rose by 2.3 percent, per capita consumption failed to increase (see Table IV-1). Thus the rate of private saving out of disposable income from domestic sources moved up from 5.7 percent in 1966 to 9.1 percent (see Table XIX-3). These changes should be viewed together with the opposite development in 1966, when real per capita income declined and the rate of private saving dropped from 9.2 to 5.7 percent. In other words, the rates of private consumption and saving returned to their 1965 level.

**Table**  
**PRIVATE**  
(IL million)

	1960	1961	1962	1963	1964	1965	1966	1967
1. National income	3,600	4,248	4,976	6,042	7,046	8,462	9,187	9,578
2. Public sector income from property	92	101	129	145	184	204	281	282
3. Private income from economic activity (1-2)	3,508	4,147	4,847	5,897	6,862	8,258	8,906	9,296
4. Total compulsory payments	419	502	636	803	966	1,227	1,480	1,520
a. Income tax	316	376	490	641	815	993	1,146	1,172
b. National Insurance contributions	103	126	146	162	181	234	334	348
5. Transfer payments, net	238	263	325	402	476	597	766	935
6. Total compulsory payments less transfer payments (4-5)	181	239	311	401	520	630	714	585
7. Disposable private income from domestic sources (3-6)	3,327	3,908	4,536	5,496	6,342	7,628	8,192	8,711
8. Private transfers from abroad	332	374	758	788	836	733	684	672
9. Total disposable private income (7+8)	3,659	4,282	5,294	6,284	7,178	8,361	8,876	9,383

NOTE: After the Hebrew edition of the Annual Report went to press, the data on private transfers from abroad were revised upward for both 1966 and 1967, increasing disposable private income from all sources by the same amount: in 1966 the change came to IL 9 mil-

## II-9

### INCOME, 1960-67

at current prices)

Percent increase or decrease (-) as against previous year							Average 1961-65 (%)	Average 1961-67 (%)
1961	1962	1963	1964	1965	1966	1967		
18.0	17.1	21.4	16.6	20.1	8.6	4.2	18.6	6.4
9.8	27.7	12.4	26.9	10.9	37.7	0.4	17.4	17.6
18.2	16.9	21.7	16.4	20.3	7.8	4.4	18.7	6.1
19.8	26.7	26.3	20.3	27.0	20.6	2.7	24.0	11.3
19.0	30.3	30.8	27.1	21.8	15.4	2.3	25.7	8.7
22.3	15.9	11.0	11.7	29.3	42.7	4.2	17.8	21.9
12.9	23.6	23.7	18.4	25.4	28.3	22.1	20.7	25.2
28.5	30.1	28.9	29.7	21.2	13.3	-18.1	27.6	-3.7
17.6	16.1	21.2	15.4	20.3	7.4	6.3	18.1	6.8
12.7	102.7	4.0	6.1	-12.3	-6.7	-1.8	17.2	-4.3
17.2	23.6	18.7	14.2	16.5	6.1	5.7	18.0	5.9

lion and in 1967 to IL 44 million. This adds 3.3 percent to the rate of change in private transfers in 1967, and 6.1 percent to disposable private income from all sources.

**Table II-10**  
**NATIONAL INCOME AND FACTOR RETURNS, 1963-67**

	1963		1964		1965		1966		1967	
	IL m.	%	IL m.	%	IL m.	%	IL m.	%	IL m.	%
(1) National income	6,042	100.0	7,046	100.0	8,462	100.0	9,187	100.0	9,578	100.0
(2) Total wage bill <sup>a</sup>	3,600	59.6	4,200	59.6	5,040	59.6	5,998	65.3	5,980	62.4
(3) Nonwage incomes (1-2)	2,442	40.4	2,846	40.4	3,422	40.4	3,189	34.7	3,598	37.6
(4) Return on capital <sup>b</sup>	943	10.4	1,205	11.5	1,557	12.7	1,022	7.4	1,777	12.3
(5) Wages per employee <sup>c</sup> (IL)	5,849	13.7	6,426	9.9	7,854	22.2	9,343	19.0	9,410	0.7
(6) Income per nonemployee <sup>d</sup>	12,620	26.2 <sup>e</sup>	14,195	12.5	14,408	1.5	13,752	-4.6	18,432	34.0

NOTE: The percentages in lines (1) to (3) are weights; in line (4)—the return relative to the net stock of fixed assets (including dwellings) at current prices (as estimated by A. L. Gaathon); in lines (5) and (6)—annual change.

<sup>a</sup> The datum is a gross estimate, and differs from that cited in Chapter X, "Wages", as it comprises all wage outlays of employers, including fringe benefits, as well as the imputed wages of members of cooperatives and service workers in kibbutzim, and the pay of the defense establishment (see Report of the Committee to Examine the Distribution of National Income, Jerusalem, 1966, Appendix Table 18—in Hebrew). The annual increase is based on National Insurance data.

<sup>b</sup> On the assumption that average earnings of nonemployees are equal to those of wage earners.

<sup>c</sup> Based on the number of employees according to National Insurance data (which differ from manpower survey figures—see Chapter X, "Wages"). In 1963 and 1964 these data, which represent the number of jobs held by employees, were respectively 8 and 6.5 percent higher than those of the manpower surveys. In 1965-66 the difference was reduced to about 1 percent, but in 1967 it rose again to 8.4 percent.

<sup>d</sup> The estimates here are very rough and should be regarded solely as indicators of annual changes. The main statistical deficiencies are as follows:

1. The number of nonemployees is obtained residually by deducting the number of employees according to National Insurance data from the total number of employed. The figure is overstated, since it includes those employed by the defense establishment. On the other hand, it should be noted that for various reasons, some of which have been mentioned above, the National Insurance data on employees are also overstated. Hence the direction of the net bias cannot be clearly determined.

2. Nonwage incomes also include returns to capital of employees. In 1964 the net worth (mainly housing) of employees amounted on an average to about 80 percent of that of nonemployees, and this is reflected in the distribution of returns to capital as between employees and nonemployees (although not to the same extent). The data on nonwage incomes, especially the absolute sums, should therefore be accepted with reservation.

<sup>e</sup> Based on the number of nonemployees according to manpower survey data, after adjusting for new definitions.