

## CHAPTER I

### MAIN ECONOMIC DEVELOPMENTS IN 1961

IN 1961 the real increase in the national product amounted to approximately 9 per cent. This rate was somewhat higher than in 1960, when it came to 7–8 per cent, and was about the same as the average rate of growth in recent years. Employment rose by 4.7 per cent, so that the additional output per person employed amounted to around 4 per cent. The increase in product last year was accompanied by two unfavorable developments which stemmed from the marked expansion of demand for consumption and investment: the accelerated rise of prices and a substantial increase in the import surplus. The level of domestic prices went up nearly 8 per cent, following a period of relative stability in 1959 and 1960, when the average annual increase did not exceed 2–3 per cent. The import surplus rose by 21 per cent, reaching the \$400 million mark, after relative stability in the years 1957 to 1959 and a rise of 6 per cent in 1960.

The faster growth of the national product as compared with 1960 was connected with an appreciable gain of 13 per cent in the agricultural product and of 9 per cent in that of the building sector,<sup>1</sup> as against a slight decline in these two branches in 1960. In contrast, no marked changes were registered in the other branches. The rapid growth of the agricultural product was largely due to the favorable weather conditions which prevailed in 1961 following a period of severe drought, especially in 1960. The expansion of building operations was linked with the increase in public housing construction in the wake of the accelerated immigration, as well as in all other types of building.

As in the past several years, industrial output again rose faster than national product; it went up by 15 per cent, thus increasing the relative share of this sector in GNP and reflecting the rapid industrialization of the economy. The output of the transport sector rose by 7 per cent in 1961, and that of commerce and services by 9 to 10 per cent.

The growth of national product was partly made possible by the 4.7 per cent rise in employment, which was somewhat higher than the rate in the previous year (3.5 per cent). The increase in the number of gainfully employed was due to the larger immigration and the natural increase of the population on the one hand, and the continued reduction of unemployment on the other. In 1961 immigration took an upward turn, surpassing the figures of the preceding three

<sup>1</sup> Including earthworks.

years by a considerable margin. On the other hand, there was a slight drop in the natural increase. The total growth of the population amounted to 3.3 per cent as against 3 per cent in each of the two preceding years.

In spite of this substantial expansion of population and manpower, unemployment continued to decline in 1961, amounting to 4.3 per cent of the total labor force. There was also a reduction in the "depth" of unemployment and in the extent of relief work, those remaining without jobs being mainly handicapped persons. In short, the year reviewed was one of really full employment, and in most parts of the country the shortage of skilled workers was more acute than in 1960, and even a shortage of unskilled workers began to be felt.

Besides the expansion of manpower, a further factor contributing to the higher product in 1961 was the marked increase in the capital stock. Gross investment advanced by 18 per cent, following a relatively low volume in 1960. Most of the increment took place in industry, transportation, and residential construction. Total capital stock rose by 10 per cent, and that per person employed by 4–5 per cent. The additional product per gainfully employed came to approximately 4 per cent, half of which was due to an increase in the capital stock per worker, and half to an improvement in productivity.

Real private consumption rose by 10 per cent in 1961 as against 8 per cent in 1960. Per capita, the increase was 6.5 per cent as compared with 5 per cent; in other words, the overall growth was due both to the expansion of the population and to an increase in consumption per person. A conspicuous factor in this increase was the shifting trend toward commodities typical of a high standard of living. In foods there was a switch from bread and grains to meat, beverages, expensive cigarettes, etc. Concurrently, the proportion of food within total private consumption dropped to 34 per cent, while purchases of durable goods and automobiles rose appreciably. In 1961 nearly 80 per cent of all families owned at least one radio, 65 per cent a gas appliance, and 55 per cent an electric refrigerator.

The growth of private consumption was more or less equal to that of private disposable income, and consequently there was only a slight increase in the level of private saving. On the other hand, there was a substantial rise in Government saving owing to an increase in tax revenue, particularly from indirect levies. As a result, the percentage of national saving from GNP went up in 1961, after having contracted somewhat the previous year. This additional saving, however, failed to match the large gain in domestic investment, which was made possible by a considerable increase in capital imports. Some 83 per cent of net domestic investment was still financed by foreign capital.

The slower growth of exports and the marked expansion of imports produced an increase of some 21 per cent in the import surplus. The rise in exports at a lower rate than in the previous year—16 per cent as against 24 per cent—was due to several reasons: boom conditions and mounting prices in the domestic market, as well as inadequate progress in increasing the country's competitive-

ness abroad at the existing export premium rates, in spite of the indirect subsidies which were granted, including the right to charge a higher price in the home market as compensation for the lower earnings from export.

The development of export has significant implications for the Israel economy. For with the anticipated decline in the volume of unrequited receipts from abroad, it will have to finance a larger share of import. The import component of local production is high, primarily in respect of raw materials, and if it should become necessary to curtail such import because of the inability to finance it through unrequited receipts or export, this would very likely severely disrupt the economy.

Exports of industrial commodities rose by 16 per cent, which was a smaller increase than in any of the two preceding years. Exports of diamonds and services continued to climb, but the level of agricultural export remained unchanged owing to the lower citrus yield. The greater weight of industrial and diamond exports and the lower weight of agricultural exports reduced the average percentage of added value earned on export.

The high level of demand in the home market and the rise in local prices increased the disparity between the unrealistic exchange rate for the Israel pound (before devaluation) and its real value. Consequently, the value of commodity and service imports went up by 18 per cent, after a 2 per cent drop in import prices. An especially large rise of 36 per cent occurred in the import of equipment, particularly aircraft and ships. There was also a substantial growth of 17 per cent in imports of raw materials, and of 18 per cent in respect of finished consumer goods.

Despite the widening of the gap between imports and exports by \$ 69 million, the economy continued to accumulate foreign currency balances as a result of the large increase in capital imports, which encompassed both unilateral remittances (primarily personal restitution payments and Reparations from Germany) and long- and medium-term loans. The country's foreign currency balances, net of short-term liabilities, grew by \$74 million.

The rise in the domestic price level came to nearly 8 per cent, which was the highest rate in the past five years. The acceleration had begun in the second half of 1960 and was primarily due to the expanding demand.

Prices continued to mount in spite of an increase in the import surplus and the large growth of domestic product. The rise was most pronounced in those goods and services for which there are no import substitutes, such as buildings, vegetables, and personal services. In the second half of 1961 the upward trend was slowed down, despite the fact that it was only then that the major wage increments and the payment of the additional cost-of-living allowance went into effect. It appears that these wage increases were absorbed, at least in part, at the expense of profits, which had been rising in recent years.

The marked increase in excess demand was caused primarily by the larger investment of business enterprises, which in turn was made possible by the mone-

TABLE I-1  
*Indicators of Economic Development, 1957-61*

	Per cent increase or decrease (-)			
	From 1957 to 1958	From 1958 to 1959	From 1959 to 1960	From 1960 to 1961
<i>Resources and their uses</i> (at constant prices)				
Total resources	8	11	9	12
Gross national product	7	12	7	9
Private consumption	10	9	8	10
Private consumption per capita	6	6	5	6.5
Public consumption	4	8	12	8
Gross investment	7	8	1	18
<i>Foreign trade—goods and services (at current prices)</i>				
Imports	3	6	14	18
Exports	8	22	24	16
Import surplus	—	-5	6	21
<i>Population and employment</i>				
Average population	4	3	3	3.3
Number of employed	3	4	3.5	4.7
<i>Prices and national income (nominal)</i>				
Average daily wages	5	5	4.5	10
National product	7	3	3	8
Consumer price index	3	2	2	7
National income	14	13	11	19
National income per capita	10	10	8	15
<i>Finance</i>				
Money supply (annual average)	15	13	14	18
Bank credit to the public (annual average)	19	23	27	32

tary growth which had already started in 1960. The greater expenditure of households on consumer goods and housing approximated the growth in their contribution to production. The steep rise in Government tax revenue only partly offset the increased demand.

In 1961, as in the preceding years, the monetary expansion and the increase in the liquidity of the economy were connected with the accumulation and conversion of foreign exchange reserves. This large-scale conversion directly enlarged the money supply, while indirectly, by increasing the liquid assets of the banking system, it permitted a considerable expansion of credit.

The rate of monetary growth was not uniform throughout the year. It was actually concentrated in the first half, when foreign currency balances in the banking system rose by IL.120 million, bank credit by more than IL.100 million, and the money supply by IL.120 million. This process was arrested in the second half of the year, when the money supply contracted by IL.30 million and the volume of credit went up by only IL.35 million. The curbing of the monetary growth was partly due to the steps taken by the Bank of Israel to restrain credit expansion, namely, the raising of the liquidity ratio, the abolition of "mixed liquidity", and the imposition of the requirement to maintain liquid assets also on time deposits for over 18 months. Moreover, there was a marked slowing down in the conversion of foreign currency in the second half of 1961. This was partly of a seasonal nature, but in part was also due to the growing anticipation of devaluation, which was expressed in a lower rate of conversion of foreign currency transfers and in a large increase in PAZAK and TAMAM deposits by recipients of personal restitution payments.

The restriction of credit, the anticipation of devaluation, and the reduction of the Government's indebtedness to the Bank of Israel, all these checked the rise in the economy's liquidity and the enlargement of the money supply in the second half of the year. The increase in the average amount of the money supply during the whole of the year amounted to IL.148 million, or 18 per cent, while the volume of credit rose by 32 per cent; thus, both considerably exceeded the real growth of the product, which amounted to 9 per cent.

TABLE I-2

*Changes in Money Supply, Product, Prices, and Import Surplus, 1958-61*

<i>Year</i>	<i>Per cent increase or decrease (-) as against previous year</i>				
	<i>Money supply</i>	<i>Credit</i>	<i>Gross national product</i>	<i>Local prices</i>	<i>Import surplus</i>
1958	15	19	7	7	—
1959	13	23	12	3	-5
1960	14	27	7	3	6
1961	18	32	9	8	21

The expansion of credit in 1961 was much greater than in previous years and contributed in large measure to both the growth of the money supply and the pressure on the exchange rate, the real level of which was further eroded by the monetary expansion. The unrealistic rate of exchange and the system of multiple exchange rates distorted the price structure, increasing the disparity between domestic prices and the international price level.

In this connection, it may be of interest to compare several major indicators during two periods: first, the years 1958 and 1959, when monetary expansion was comparatively moderate; and second, the years 1960 and 1961, when the growth assumed very rapid proportions.

Table I-2 shows that in 1960 and 1961 the monetary expansion was larger than in the two preceding years, as regards both the money supply and the volume of credit. Contrary to the prevailing opinion in Israel, the accelerated monetary expansion did not bring about a faster increase in output; rather, it accentuated the rising price trend and appreciably widened the gap between imports and exports. This is clearly borne out by a comparison of the years 1959 and 1961. The excess liquidity of the economy produced unfortunate results from the viewpoint of both the balance of trade and the mounting of prices. Moreover, by impairing the internal equilibrium, it contributed to the reduction of the real value of the currency.

A comparison with the years preceding the monetary reform of 1952 shows many similarities between the two periods, even though the factors of monetary growth were completely different. Whereas prior to 1952 the monetary expansion was caused by deficit Government financing in the wake of mass immigration, in 1960 and 1961 the main factors were the expansion of credit to the public and the conversion of foreign currency. But in both periods the monetary expansion sent prices upward and undermined the rate of exchange. The monetary growth outstripped the gain in production, and under conditions of full employment of the production factors, it was unable to effect an increase in output. Rising production could not keep pace with demand, and this excess demand pushed prices up, increased the trade deficit, and weakened the country's competitiveness. The exchange rate became unrealistic, and the distortions in the economy made this country's integration into the world market more remote, besides destroying the basis for all normal economic evaluation criteria.

These problems have assumed importance particularly since the economy has reached saturation point in several products as far as the internal market is concerned, and is striving to achieve a greater degree of integration into the world market. Although the year 1961 was marked by full employment and a satisfactory growth in product, at the same time prices rose at the highest rate in the past five years and the trade deficit reached unprecedented proportions. Furthermore, the price structure became more distorted, with all the accompanying detrimental effects thereof. These developments were connected, among other things, with the excessively rapid increase in liquidity and domestic demand, as well as with the existence of a system of relative prices which encouraged imports and discouraged exports.

All these trends reached such a point in 1961 as to make a new departure in economic policy imperative—one that would permit more rapid progress toward economic independence and the elimination of the distortions that have crept into the structure of prices and production.