

CHAPTER I

MAIN ECONOMIC DEVELOPMENTS

THE YEAR 1964 SHOWED further rapid growth of the national product, together with a noticeable deterioration in the balance of payments position. The rate of monetary expansion slowed down, but the accelerated increase in the money supply during the years 1962-63 left its mark on economic activity in 1964.

Israel's economy exhibits—with slight modifications and relatively mild fluctuations—several trends which have become an almost permanent feature of the local scene. A rapid demographic growth and a relatively high rate of capital formation—due to a large capital import—permit a steady, rapid expansion of the national product. The rise in GNP reached 10-11 percent in 1964, similar to the average rate for the past several years, but somewhat less than in 1962-63 when it was particularly high. However, the most prominent development in 1964 occurred precisely in that area which constitutes the touchstone of Israel's advance toward economic independence—the balance of payments. After dropping in 1963, the import surplus moved up steeply during the year reviewed—from \$ 404 million to \$ 528 million, or by \$ 124 million. This pushed up the ratio between the import surplus and total available resources. Moreover, the decline which occurred in 1964 in the proportion of unilateral receipts to foreign borrowing also suggests some deterioration in the financing of the import surplus.

The large increase in the import surplus was the combined result of a marked slackening in the export growth rate and an appreciable expansion of imports. Export proceeds advanced by \$ 42 million, or 7 percent, during the year reviewed, as compared with an average annual rise of 18.5 percent over the past decade, while the value-added component of exports went up only 3 percent. The slower expansion of overseas sales and the even slower one in the value-added component were mainly due to the precipitate fall in both the quantity and prices of citrus exports. Industrial exports also showed a lower growth rate than in previous years—a development at least partly due to the booming local market and the relative decline in the profitability of export production. Import developments likewise departed from the pattern of earlier years. Outlay on imports was \$ 166 million, or 16.5 percent, higher than in 1963, in contrast to an average annual rise of some 11 percent during the past decade.

The accelerated increase in imports and the slower expansion of exports must be viewed in conjunction with the intensification of economic activity and

mounting domestic demand under conditions of full employment and growing pressure on manpower reserves, and also in conjunction with import and export developments in 1963. During the year imports rose to a relatively modest extent—by less than 6 percent—partly because of the utilization of stocks of imported raw materials accumulated in past years. On the other hand, various indicators suggest the replenishing of stocks of several raw materials, whose

Table I-1
INDICATORS OF ECONOMIC DEVELOPMENT, 1961-64
(percentages)

	Increase or decrease (-) as against previous year			
	1961	1962	1963	1964
Resources and uses				
(at constant prices)				
Total resources	13.6	12.1	8.4	12.8
Gross national product	10.2	12.7	12.1	10.6
Private consumption	10.4	11.5	10.8	11.1
Private consumption per capita	6.8	6.7	6.5	6.8
Public consumption	18.0	10.7	9.1	7.7
Gross investment	17.8	14.1	3.0	20.6
Foreign trade—goods and services				
(in dollars)				
Imports	23	12	6	16
Exports	18	18	21	7
Import surplus	28	5	-11	31
Population and employment				
Average population	3.4	4.5	4.0	4.0
Number of employed	4.8	5.7	5.1	4.6
Prices and national income				
(nominal)				
Wages per normal hour of work	10	12	11	11
GNP prices	9	7	8	5
Consumer price index (annual average)	7	10	7	5
National income	18	19	25	16
National income per capita	14	14	20	12
Finance				
Money supply (annual average)	18	17	31	13
Bank credit to the public (annual average)	24	18	20	20

import in 1964 considerably exceeded the amount required for the expanded current production. Furthermore, the import of ships in 1964 was far above the average for the past several years. The appreciable drop in proceeds from citrus exports during the year must be seen in the light of the sharp rise in such sales in 1963, which was an exceptionally good year for citriculture.

All these factors, however, only partially explain the large increase in the import surplus during 1964. The influence of special factors working in the opposite direction must also be borne in mind—factors such as the bumper grain yields, which permitted a smaller import of wheat and barley, and the big rise in exports of citrus products because of the high percentage of fruit unfit for direct export. There can be no doubt, therefore, that the growth of the import surplus was mainly due to the accentuation of economic activity and domestic demand, which found expression in a marked expansion of imports of consumer goods and of raw materials for current production for the home market, and also in the diversion of certain export items to meet domestic demand.

The much larger import surplus in 1964 was reflected by a slower accumulation of foreign exchange reserves, which reached their lowest level in recent years. Despite the more rapid inflow of capital from abroad in 1964, which reached a peak of over \$ 560 million, the net increment to foreign exchange reserves in the banking system totalled less than \$ 15 million, compared with an annual average of over \$ 80 million from 1959 to 1963 and a record total of \$ 200 million during the two-year period 1962–63. Foreign currency conversion was the major factor in the unprecedented growth of IL 640 million, or 66 percent, in the money supply during these two years. The excess liquidity thus generated inevitably had a bearing on domestic demand, and hence on the balance of payments as well.

The impact of an increase in liquidity and demand on the balance of payments is expressed in four ways:

1. The rise in purchasing power *per se* leads to a larger direct import of finished commodities at a time when administrative restrictions on imports are being reduced.
2. Greater consumption of local manufactures increases imports because of the relatively high import component of such production.
3. Rising domestic purchasing power causes the diversion of export goods to the local market because of the better conditions in this market and the higher prices which the producer can fetch therein.
4. An increase in production costs affects the competitiveness of local goods in foreign markets.

During the year reviewed the rate of monetary expansion tapered off considerably, owing primarily to the balance of payments developments. The jump in the import surplus resulted, as stated, in a slower accumulation of foreign exchange reserves and consequently in the mopping up of excess liquidity. In

order to forestall an unduly large increase in bank credit to the public, the liquidity ratio was retained at its high level of 1963, and during the months January-April, a period of rapid seasonal growth in foreign currency balances, it was temporarily raised still further by the Bank of Israel.

The money supply went up 6 percent during the year, but the average balance was 13 percent higher than in 1963, as compared with 31 percent the year before and 17-18 percent in 1961-62. The slower monetary expansion of 1964 was reflected in the latter part of the year by a certain tightening of the country's liquidity position and a rise in the free-market interest rates, but not to such an extent as to appreciably check the mounting of demand and the concomitant developments. It must be remembered that the decrease in liquidity occurred primarily in the second half of the year, and that the average level for the year was still 13 percent higher than in 1963. This increment to the money supply, together with the delayed effect of the monetary expansion of 1963, made possible the continued rapid growth of local demand.

The expansion of capital imports and the continued rapid rise in wages and other domestic incomes explain the much larger outlay on consumption and investment, which came to 17-18 percent. In addition to its impact on the import surplus, the pressure of demand was mirrored by the fast upward movement of service prices—8 percent as compared with 5 percent in 1963. In respect of industrial goods, the Government continued with its policy of restraining prices through administrative means, and the rise during the year was held down to a modest 2 percent approximately, most of it being recorded in the final months. On the other hand, following the weakening of the real estate and equity markets, which first became apparent toward the end of 1963, the soaring of prices which had characterized these markets for several years was halted and they even began to edge downward, especially in the case of equities. The average level of GNP prices was approximately 5 percent higher in 1964 than in the previous year. Although the rise in 1963 was greater—about 8 percent—it partly reflected increases which had occurred in 1962. In 1964 the pressure of aggregate domestic demand continued to be felt in the labor market, and hourly wages went up still further, together with an increase in production costs per unit of output.

The rapid uptrend in GNP was sustained in 1964, the increase amounting to 10 percent. Product per gainfully employed rose from 5.5 to 6 percent. This rate was somewhat lower than in 1962-63, but roughly the same as for the years 1958-61. In the development of the various sectors of the economy, the 19 percent advance in agricultural product stands out. This was primarily due to the maturing of investments made in earlier years and to favorable weather conditions, which resulted in a much larger yield of deciduous fruit and field crops. The construction sector also showed a bigger growth rate in 1964—10 percent as against 5 percent in 1963. Industry and transportation and communications continued to expand rapidly—by 14 and 13 percent respectively, about

the same as in previous years. On the other hand, the increase in the commerce and business services sector was comparatively small—a mere 5 percent.

The marked growth of product was accompanied by a 4.6 percent rise in the number of gainfully employed—a somewhat lower rate than in any of the three preceding years. The average population of Israel went up by 96,000, or 4.0 percent—about the same as in previous years. At the end of 1964 the population reached 2,523,000. The labor force participation rate advanced somewhat, by 4.5 percent. As already mentioned, the increase in gainful employment slightly exceeded that in the civilian labor force, so that unemployment continued downward, although a little more slowly. The level of unemployment stood at 3.3 percent of the civilian labor force, compared with 3.4 percent in 1963 and 3.8 percent in 1962.

As in the three preceding years, the incremental labor force was absorbed without any difficulty, thanks to the buoyant state of the economy. In most parts of the country, particularly in the central region, a shortage of both skilled and unskilled labor continued to be felt. On the other hand, the bulk of unemployment was to be found in the Northern and Southern Districts, where the daily average of registered unemployed dropped by 2 percent as compared with 23 percent in the rest of the economy.

The greater demand for workers in all parts of the country pushed up the average nominal hourly wage by nearly 11 percent—about the same growth rate as in 1963. The advance in real hourly wages averaged 5.6 percent, which is high compared with previous years. In contrast to 1963, changes in the cost-of-living allowance rate accounted for a third of the nominal wage increment, while the balance derived from an increase in basic wages and the wage drift. Rises were particularly high in the personal and public services sectors and in agriculture.

The 11 percent growth in wages does not reflect the total increase expected in the wake of the new labor agreements concluded in 1964. Some of them will be fully implemented only in 1965, for in many cases they were signed in the middle of 1964 and in not a few instances the higher wage rates, including retroactive increments, have been paid only as from the final months of 1964 or even the beginning of 1965.

The marked expansion of the national product was made possible, as in previous years, by a large growth of the capital stock, which totalled 11 percent, or some 6 percent per gainfully employed. Gross capital formation moved up more rapidly—by 21 percent at constant prices. Some 35 percent of the additional available resources—i.e. the combined increase in the product and the import surplus—went to enlarge the economy's capital stock.

More than half of the rise in gross investment is ascribable to the purchase of ships and the buildup of inventories. The completion of work on the National Water Carrier and at the Dead Sea Works depressed investment in

water projects and mineral extraction. In contrast, capital expenditure in the commerce and personal services sectors went up to the marked extent of nearly 17 percent. The value of new residential construction rose by 12 percent, while industrial investment apparently increased at a slower rate than in 1963.

Private consumption per capita again showed a substantial rise of nearly 7 percent, similar to the rate of the three preceding years. For the first time in several years, consumption increased more rapidly than disposable income, and consequently the rate of saving fell off. The relative share of durables and services in total consumption continued upward. Prices of foodstuffs, particularly from agriculture, declined relatively, and there was an exceptionally high increase in real consumption of these items.

Public consumption went up 7 percent in 1964, a low rate compared with earlier years. On the other hand, public sector investment expanded rapidly. The demand surplus of this sector, which comprises the Government, National Institutions, and local authorities—declined, and a dissaving was turned into a positive saving.

These developments were largely connected with the slower growth of current Government expenditure following the reduction of Government imports and the deferment of the full implementation of the wage increases agreed upon in 1964.

The percentage rise in tax revenue hardly changed as compared with 1963, and exceeded the growth of national income. In continuation of the Government's stabilization policy, indirect taxes on consumer goods again were not raised, and in some cases were even cut, but income from import taxes went up owing to the appreciable expansion of imports. The lower income tax rates decided upon in 1964 went into effect only in 1965, but will be applied retroactively from April 1964.

Government financing of residential construction was stepped up considerably in 1964, but other development budget loans were reduced. Government receipts from domestic borrowing fell off, but those from foreign loans were higher during the year reviewed.

The rate of saving out of national income advanced slightly, from 3.5 percent in 1963 to 4 percent. This was the resultant of a rise in public sector saving and a drop in private saving. The improvement in the public sector was due to the slower growth of current Government outlays, while the percentage increase in tax revenue held steady. On the other hand, the rate of saving out of disposable private income declined from 7.5 percent in 1963 to 6 percent.

The year reviewed, which was marked by further rapid economic growth and the accentuation of capital formation, nevertheless underscored the cardinal problem facing the economy—the growing deficit on goods and service account in the balance of payments. A widening of the deficit *per se* sponges up some of the excess liquidity, but only if no countervailing factors are brought

into play, such as an excessive growth of credit, a deficit in the Government's budget, or any other activity augmenting domestic demand. The disinflationary policy pursued by the Government and the Bank of Israel helped to ease these pressures in 1964. This policy did not involve any great sacrifices, nor did it entail the freezing of the economic growth rate or a reduction in employment.

The slowing down of monetary expansion opens up new horizons and possibilities which were nonexistent during the period of accelerated growth. At the same time, however, an improvement in the balance of payments, under conditions of full employment, makes it imperative to free resources from current consumption for export. This calls for a policy restraining the expansion of disposable income and a greater effort to step up private and public saving and to stimulate exports. Forgoing an exaggerated rise in living standards in the present is the price that must be paid to achieve an even greater rise in the long run.