

CHAPTER III

THE BALANCE OF PAYMENTS

MAIN DEVELOPMENTS¹

COMMODITY EXPORTS expanded rapidly in 1966, while imports remained stable; as a result, the trade deficit fell conspicuously. The deficit on services account² also declined slightly. All told, the import surplus was cut by \$ 83 million, or 16 percent, to stand at \$ 452 million. This followed a smaller decrease of \$ 34 million in 1965, when the trade deficit contracted sharply but that on services account increased. During the last two years the import surplus shrank by \$ 117 million, and was 21 percent smaller in 1966 than in 1964.

Capital imports fell sharply in 1966, being \$ 96 million (or 16 percent) less than in 1965 and \$ 133 million (21 percent) less than in 1964. Most of the decline occurred in capital imports for the public sector, and affected all types of unilateral transfers and long-term loans to the Government.

Unilateral transfers by private individuals showed a smaller decrease. There was also a certain drop in investments from abroad, but the net balance remained virtually unchanged owing to a decline in Israeli investments in other countries.

Short-term liabilities increased much more slowly in 1966, a development largely reflecting the rise of interest rates in foreign money and capital markets.

Imports expanded by \$ 25 million, or 2 percent, compared with 5 percent in 1965. In both years the growth of imports (totalling altogether \$ 82 million) was entirely accounted for by services, commodity imports decreasing somewhat. The service items showing the biggest increases in 1966 were interest payments, expenditure of Israeli tourists abroad, and foreign currency outlay of Israeli

¹ In the balance of payments tables commodity imports and exports are shown at f.o.b. values, while payments to foreign companies for the transportation and insuring of imported goods are included with service imports. However, the breakdown of commodity imports and exports is based on c.i.f. import data and on foreign trade definitions; in other tables imports and exports are therefore shown according to foreign trade definitions, with imports and exports of services adjusted accordingly.

² The balance of payments here cited is a provisional estimate which on the debit side includes \$ 85 million in errors and omissions. The foreign trade data are relatively complete, and hence it may be assumed that corrections will be made in the other current-account items or in the capital movement items. Consequently, the analysis of developments in these sections of the balance of payments and in the current deficit must be accepted with some reservation. On the other hand, the trade balance can be discussed with a much greater degree of reliability.

shipping and aviation companies. The most striking rises in 1965 and 1966 taken together were in Government imports, and besides the items already mentioned, in insurance services.

Exports increased in 1966 by \$ 109 million, or 15 percent, after a similar gain in 1965. Over both years, the growth came to nearly \$ 200 million, with two-thirds of the increment being in commodities. As regards services, the increase was largely confined to two items: interest income, which reflected the rise in interest rates abroad, and the bigger income from maritime shipping to and from Israel as a result of the upward revision of freight tariffs and the larger share of Israeli ships in cargo conveyance on these routes.

Table III-1
THE BALANCE OF PAYMENTS, BY MAJOR ITEM, 1965-66
(\$ million)

| | 1965 | | | 1966 | | |
|---------------------------------------|----------------|----------------|---------------|----------------|----------------|---------------|
| | Credit | Debit | Net | Credit | Debit | Net |
| A. Current account^a | | | | | | |
| Commodities | 404.0 | 731.3 | -327.3 | 474.5 | 732.1 | -257.6 |
| Government services | 20.2 | 132.2 | -112.0 | 25.0 | 135.5 | -110.5 |
| Other services | 286.5 | 382.2 | -95.7 | 300.1 | 404.0 | -83.9 |
| Total | 710.7 | 1,245.7 | -535.0 | 819.6 | 1,271.6 | -452.0 |
| B. Unilateral transfers | | | | | | |
| To the private sector | 262.6 | 6.3 | 259.3 | 250.2 | 5.5 | 244.7 |
| To the public sector | 95.9 | 4.3 | 91.6 | 65.4 | 3.8 | 61.6 |
| Total | 358.5 | 10.6 | 347.9 | 315.6 | 9.3 | 306.3 |
| C. Capital movements | | | | | | |
| Long- and medium-term | 407.5 | 166.2 | 241.3 | 416.1 | 228.9 | 187.2 |
| To the private sector | 91.9 | 9.2 | 82.7 | 82.5 | 8.3 | 74.2 |
| To the public sector | 315.6 | 157.0 | 158.6 | 333.6 | 220.6 | 113.0 |
| Short-term | 85.8 | 108.9 | -23.1 | 60.9 | 17.1 | 43.2 |
| Gold and foreign exchange reserves | — | 105.8 | -105.8 | 28.8 | 10.0 | 18.8 |
| Other short-term accounts | 85.8 | 3.1 | 82.7 | 31.5 | 7.1 | 24.4 |
| Total | 493.3 | 275.1 | 218.2 | 476.4 | 246.0 | 230.4 |
| Grand total | 1,562.5 | 1,531.4 | 31.1 | 1,611.6 | 1,526.9 | 84.7 |
| D. Net errors and omissions | — | 3.1 | -31.1 | — | 84.7 | -84.7 |

^a Commodity imports and exports valued f.o.b.

SOURCE: Central Bureau of Statistics.

Commodity exports expanded in 1966 by \$ 70 million, or 17 percent, while commodity imports virtually held steady. The trade deficit was thus reduced by \$ 72 million,¹ or 19 percent. These developments represent a continuation of the trend that started in 1965, when exports also rose rapidly—by 16 percent—and imports declined somewhat. As a result, commodity exports in 1966 were \$ 125 million, or 36 percent, higher than in 1964. Imports were a little lower than in 1964, while the trade deficit shrank from \$ 454 million to \$ 318.5 million, or by 30 percent, returning to its average level during the 1962–63 period.

Changes in Israel's terms of trade² in 1966 were favorable to her. The improvement amounted to 5 percent, with export prices advancing by 7 percent, and import prices by 2 percent. The diamond industry was responsible for most of the increase, in respect of both export and import prices. The change in the terms of trade yielded the economy \$ 8 million net (a gain of \$ 24 million on exports and a loss of \$ 16 million on imports).

The paring of the trade deficit to the 1962–63 level—this stands out all the more if related to the national product, which in 1966 was 20 percent larger than in 1963—reflects first and foremost the change in the rate of economic activity: a transition from conditions of demand pressure to economic restraint, and from an annual increase of 10 percent in the product to no growth at all and mounting unemployment.

In 1965–66 commodity imports were more or less stationary, after having expanded by 24 percent in 1964. However, they underwent a marked change in composition. On the one hand, imports of materials for export production were larger. This is particularly true of uncut diamonds (up \$ 30 million), and reflects the growth of polished diamond exports and changes in raw diamond stocks. Imports of consumer goods were also somewhat bigger, though this was mostly accounted for by frozen meat and occurred despite a drop in durable goods, which gathered momentum toward year's end.

On the other hand, there was a decline in two other groups: imports of investment goods contracted sharply, and inputs destined for the domestic market (including inventory accumulation), to a slight degree. Investment, which is governed by business considerations, is the sphere most susceptible to changes in the trend of economic activity. The marked decline in capital formation was thus partly due to the transition from a situation of strong demand pressure and rapid expansion of output to one of sagging demand, a stable or slightly falling trend in output, and the accumulation of stocks of finished products which inevitably accompanies such a change. But the smaller volume of investment was also due to factors unrelated to the recession: the completion

¹ With commodity imports valued on a c.i.f. basis and according to balance of payments definitions.

² The index of commodity export prices divided by the index of commodity import prices.

of large development projects which was not accompanied by the launching of new projects on a comparable scale, and to some extent, perhaps declining industrial profitability, which began to affect the growth of capital formation as far back as 1964. The decrease in imports of investment goods occurred in equipment and machinery for industry and agriculture, whereas those for the commerce and service sectors more or less held steady.

Table III-2
SUMMARY BALANCE OF PAYMENTS, 1963-66*
(\$ million)

| | 1963 | 1964 | 1965 | 1966 |
|---|----------|----------|----------|----------|
| Imports of goods and services | -1,011.5 | -1,188.5 | -1,245.7 | -1,271.6 |
| Exports of goods and services | 576.8 | 619.2 | 710.7 | 819.6 |
| Import surplus | -434.7 | -569.3 | -535.0 | -452.0 |
| Unilateral transfers and long- and medium-term capital movements | 531.0 | 626.4 | 589.2 | 493.5 |
| Unilateral transfers | 346.6 | 351.3 | 347.9 | 306.3 |
| Long- and medium-term capital movements | 184.4 | 275.1 | 241.3 | 187.2 |
| Short-term capital movements | 28.2 | -26.4 | 82.7 | 24.4 |
| Accumulation of gold and foreign exchange reserves | -109.1 | -21.3 | -105.8 | 18.8 |
| Errors and omissions | -15.4 | -9.4 | -31.1 | -84.7 |

* Commodity imports and exports are valued f.o.b. All items are shown net; a negative sign denotes a debit balance, and no sign a credit balance.

SOURCE: Central Bureau of Statistics.

Imports of current inputs for the home market¹ fell off slightly.² This was apparently due primarily to the reduction of stocks of imported inputs and not to smaller requirements for current production, for the ratio between imports and total domestic uses was lower in 1966 than in any other year. However, it should be emphasized that the main effect of the recession on the balance of payments was the arresting of the upward trend in imports of current inputs as a result of the nonincrease in total domestic uses. Had domestic uses

¹ Imports for inventory accumulation are included here; the volume of imported inputs for the domestic market, including inventory accumulation, is obtained by deducting inputs for export production from total imported inputs.

² Wheat and fodder imports rose by over \$ 20 million, as local output declined as a result of drought. The decrease in imports of other imported inputs was therefore greater.

expanded at the 1965 rate of 6 percent, this would have entailed the import of \$ 20 million to \$ 40 million worth of additional inputs.

A high level of economic activity in 1966 would undoubtedly have had another effect on imports: in this case the fall in imports of investment goods (excluding ships and aircraft) presumably would not have reached such sizable proportions (\$ 25 million, or about 19 percent, at constant prices). The structural revamping of the economy, the object of the moderation policy, may in itself cause a temporary decline in investment, but in the long run such a reorganization, if effective, is likely to be reflected by a greater expansion of investment than under normal conditions.

The increase in commodity exports was slightly larger in 1966 than in 1965 and considerably greater than in 1964. Industrial exports expanded much more rapidly in 1966 than in either of the two previous years, but more slowly than the annual average for the two years following the devaluation of 1962 or for earlier years (see Table III-9). It should be recalled that wages have gone up steeply since the devaluation, outstripping the rise in productivity, and that this trend started from a point of relatively low profitability on export. The accelerated growth of export in 1966 despite this handicap was made possible by several factors. The most important was the greater demand for some of Israel's export products in foreign markets, which was accompanied by a rise in the prices fetched. The higher prices alone contributed much to the export increment during the last two years—30 percent in 1965 and 35 percent in 1966—and even more to incremental value added—40 percent in 1966 (see Table III-11 and III-12). In physical terms, export growth was slightly slower in 1966 than in 1965, reflecting fluctuations in citrus shipments. Overseas sales of industrial products other than diamonds were quantitatively larger than during the two preceding years.

Export subsidies, which were much higher in 1966 than in either 1964 or 1965, were raised for most items toward the end of the year reviewed, and consequently this was not a significant factor in the expansion of exports in the course of the year. An exception is the higher subsidies paid to the textile and clothing industries, which took effect at the beginning of 1966 and undoubtedly accounted for the stepped-up sale of these products abroad.

A more complex matter is the influence of the third factor: the change in the level of economic activity, reflecting the transition from a state of excess demand to economic restraint. A decline in the level of aggregate domestic demand is liable to affect export in two ways: directly, by inducing producers to divert a larger proportion of their output to the overseas market, and indirectly as a result of the easing of pressure to raise wages and the elimination of labor shortages.

Most of the incremental industrial export in 1966 was accounted for by products marketed almost exclusively abroad and by a number of special items.

Table III-3

IMPORTS, EXPORTS, AND THE IMPORT SURPLUS,^a 1962-66

(\$ million)

| | 1962 | 1963 | 1964 | 1965 | 1966 | Percent increase or decrease (-) as against previous year | | | | | | | | | | | |
|-----------------------|-------|---------|---------|---------|---------|---|------|------|------|-------|------|------|------|-------|------|------|------|
| | | | | | | Quantity | | | | Price | | | | Value | | | |
| | | | | | | 1963 | 1964 | 1965 | 1966 | 1963 | 1964 | 1965 | 1966 | 1963 | 1964 | 1965 | 1966 |
| Imports | | | | | | | | | | | | | | | | | |
| Commodities | 613.8 | 647.5 | 803.4 | 794.4 | 793.0 | 5 | 22 | -2 | -2 | 1 | 2 | 1 | 2 | 6 | 24 | -1 | — |
| Services | 368.8 | 393.9 | 421.6 | 489.5 | 518.5 | 7 | 6 | 12 | 4 | — | 1 | 4 | 2 | 7 | 7 | 16 | 6 |
| Total | 982.7 | 1,041.4 | 1,225.0 | 1,283.9 | 1,311.5 | 5 | 16 | 3 | — | 1 | 2 | 2 | 2 | 6 | 18 | 5 | 2 |
| Exports | | | | | | | | | | | | | | | | | |
| Commodities | 271.4 | 337.1 | 349.4 | 404.0 | 474.5 | 19 | 4 | 11 | 10 | 4 | — | 4 | 7 | 24 | 4 | 16 | 17 |
| Services | 231.8 | 269.6 | 306.3 | 344.9 | 385.0 | 16 | 11 | 7 | 9 | — | 2 | 6 | 3 | 16 | 14 | 13 | 12 |
| Total | 503.2 | 606.7 | 655.7 | 748.9 | 859.5 | 18 | 7 | 9 | 10 | 2 | 1 | 5 | 5 | 21 | 8 | 14 | 15 |
| Import surplus | 479.5 | 434.7 | 569.3 | 535.0 | 452.0 | -8 | 28 | -5 | -14 | -2 | 2 | -2 | -2 | -9 | 31 | -6 | -16 |

^a Commodity imports valued c.i.f. and commodity exports f.o.b.

SOURCE: Central Bureau of Statistics.

Their contribution to the growth of export exceeded their weight in total export. On the other hand, the contribution of commodities produced chiefly for the domestic market and for which export is marginal, was less than average. Among the latter group, there was a noteworthy increase in sales of textiles and clothing, which were more heavily subsidized in 1966 (see Table III-9).

As regards items produced wholly or largely for sale abroad, the main influence is that exerted indirectly through the factors of production. This was still of limited proportions in 1966, as wage increases were no smaller than in previous years, but in view of the changed situation in the labor market there was no longer any difficulty in obtaining required labor. Changes in demand conditions mainly affect items intended principally for the domestic market. Though exports of this group of goods taken together did not expand more rapidly in 1966, the amount of time elapsing since the turning-point may have been too short to show results. On the other hand, continuation of the excess demand which prevailed in 1964 presumably would have slowed the expansion of exports and even caused them to contract.

2. IMPORTS

(a) *Commodity imports*

Commodity imports remained more or less stable over the last three years. In 1966 the net figure came to \$ 793 million, about the same as in 1965 and \$ 10 million less than in 1964. Import prices edged up somewhat—by 2 percent in 1966 and 1 percent in 1965—so that in real terms imports contracted by 2 percent in 1966, following a similar decrease in 1965 (see Table III-4).

The picture does not change materially even if we deduct imports of ships and aircraft, which display a highly irregular trend. Exclusive of this item, there was a real increase of 16 percent in 1964, of 2 percent in 1965, and no increase at all in 1966.

Import growth actually began to slow down at the beginning of 1965, before the recession started. To some extent, this can apparently be attributed to the big expansion of imports in 1964 for the purpose of building up stocks—partly because of the rapid growth in the consumption of imported manufactures and trade therein.

But the decisive factor keeping down imports was the moderation of economic activity, which began in 1965 and continued in 1966, becoming very pronounced toward the end of the year. This must be regarded, for the time being, as the main contribution of the recession to the improvement of the balance of payments.

The impact of the recession was felt in varying degrees in different areas. Its most acute repercussions were in imports of investment goods, while imports of finished consumer goods and current inputs for production were affected to a

Table
COMMODITY IMPORTS, BY
(\$

| | 1962 | 1963 | 1964 | 1965 | 1966 |
|--|-------|-------|-------|-------|-------|
| Consumer goods | | | | | |
| Food | 18.1 | 25.2 | 36.5 | 35.2 | 42.7 |
| Other current consumption items | 13.1 | 15.0 | 18.5 | 21.4 | 22.9 |
| Durable goods | 13.2 | 17.7 | 27.5 | 26.0 | 22.5 |
| Total consumer goods | 44.4 | 57.9 | 82.5 | 82.7 | 88.1 |
| Production inputs | | | | | |
| For agriculture | 29.2 | 32.3 | 29.7 | 34.1 | 48.1 |
| For industry | 251.1 | 251.7 | 308.7 | 312.1 | 304.4 |
| For construction | 17.5 | 12.5 | 16.8 | 17.4 | 10.0 |
| Spare parts | 36.8 | 32.8 | 38.5 | 43.2 | 44.7 |
| Fuel | 40.1 | 44.5 | 46.6 | 53.2 | 58.3 |
| Subtotal | 374.7 | 373.8 | 440.3 | 460.1 | 465.7 |
| Raw diamonds, net | 67.2 | 93.2 | 102.3 | 95.5 | 124.9 |
| Total production inputs | 441.9 | 467.0 | 542.6 | 555.6 | 590.6 |
| Investment goods | | | | | |
| For agriculture | 8.0 | 6.4 | 8.5 | 5.2 | 5.6 |
| For industry and construction | 72.7 | 75.7 | 74.1 | 88.7 | 64.8 |
| For transportation and communications | 26.9 | 27.4 | 38.0 | 33.5 | 29.5 |
| Other investment goods | 13.7 | 14.3 | 16.9 | 19.4 | 21.6 |
| Total, exclusive of ships and aircraft | 121.3 | 123.7 | 137.5 | 146.8 | 121.5 |
| Ships and aircraft | 21.7 | 16.4 | 59.9 | 31.9 | 17.6 |
| Total investment goods | 143.0 | 140.1 | 197.4 | 178.7 | 139.1 |
| Total imports | 629.3 | 665.0 | 822.5 | 817.0 | 817.8 |
| Less: Imports returned and adjustments | 15.5 | 17.5 | 19.1 | 22.6 | 24.8 |
| Net commodity imports c.i.f., according to balance of payments | 613.8 | 647.5 | 803.4 | 794.4 | 793.0 |

III-4

ECONOMIC DESTINATION, 1962-66

(million)

| Percent increase or decrease (-) as against preceding year | | | | | | | | | | | |
|--|------|------|------|-------|------|------|------|-------|------|------|------|
| Quantity | | | | Price | | | | Value | | | |
| 1963 | 1964 | 1965 | 1966 | 1963 | 1964 | 1965 | 1966 | 1963 | 1964 | 1965 | 1966 |
| 4 | 35 | 5 | 21 | 34 | 7 | -5 | — | 39 | 45 | — | 21 |
| -13 | 15 | 21 | 7 | 32 | 7 | -4 | — | 14 | 23 | 16 | 7 |
| 31 | 54 | -3 | -14 | 2 | 1 | -2 | 1 | 34 | 55 | -1 | -13 |
| 11 | 37 | 6 | 6 | 17 | 4 | -2 | 1 | 30 | 42 | 3 | 7 |
| 8 | -8 | 12 | 40 | 2 | — | 3 | 1 | 11 | -8 | 15 | 41 |
| — | 21 | — | -3 | — | 2 | 2 | 1 | — | 23 | 1 | -2 |
| -29 | 32 | -1 | -44 | — | 2 | 2 | 1 | -29 | 34 | 1 | -43 |
| | | | | | | | | -11 | 17 | 13 | 3 |
| 11 | 10 | 17 | 12 | — | -5 | -2 | -2 | 11 | 5 | 14 | 10 |
| -1 | 19 | 2 | — | 1 | -1 | 2 | 1 | -1 | 18 | 5 | 1 |
| 39 | 2 | -9 | 23 | — | 8 | 3 | 6 | 39 | 10 | -7 | 31 |
| 6 | 15 | 1 | 4 | 1 | 1 | 2 | 2 | 6 | 16 | 3 | 6 |
| -20 | 31 | 12 | 6 | — | 1 | 3 | 2 | -20 | 33 | 15 | 8 |
| 4 | -3 | 12 | -27 | — | 1 | 3 | 2 | 4 | -2 | 15 | -26 |
| 2 | 37 | -14 | -14 | — | 1 | 3 | 2 | 2 | 39 | -12 | -12 |
| 15 | 16 | 12 | 9 | — | 1 | 3 | 2 | 15 | 18 | 15 | 11 |
| 2 | 10 | 4 | -19 | — | 1 | 3 | 2 | 2 | 11 | 7 | -17 |
| -24 | 265 | -47 | -45 | — | — | — | — | -24 | 265 | -47 | -45 |
| 2 | 39 | -11 | -24 | — | 1 | 2 | 2 | 2 | 41 | -9 | -22 |
| 5 | 22 | -2 | -2 | 1 | 2 | 1 | 2 | 6 | 24 | -1 | — |
| 5 | 22 | -2 | -2 | 1 | 2 | 1 | 2 | 6 | 24 | -1 | — |

more moderate degree, declining only slightly or else expanding more slowly (see Table III-4).

The smaller import of investment goods was due partly to factors unconnected with the recession. In recent years a number of big development projects were completed, while new ones were initiated on a much smaller scale. It should be borne in mind that in such projects the distribution of the actual investment over time is naturally somewhat irregular.¹ Another factor that should be noted is the slower expansion of industrial investment, which began in 1964 and apparently was connected with the decline in profits due to the big wage hikes granted at a time when output prices remained stationary. This situation was aggravated with the deceleration of economic growth during 1965, and by the end of 1966, when the decline in imported investment goods had become quite precipitate, the full effects of the recession were presumably being felt.

Imports of investment goods other than ships and aircraft contracted by 17 percent in 1966, after having gone up by 7 percent in 1965 and 11 percent in 1964. In real terms, the decrease in 1966 totalled 19 percent. Nearly every branch showed a substantially lower figure. Imports of industrial machinery and equipment shrank by 18 percent, i.e. at about the average rate. There were sharper decreases in transport equipment and construction and quarrying equipment, which reflected the slump in construction activity and its repercussions on the road haulage branch.

Items departing from the general trend were equipment for the commerce and service sectors and scientific and other apparatus. These imports expanded, but to a smaller extent than in previous years. Another exceptional item was equipment for electric power generation, which remained stable after doubling in 1965 as compared with the three preceding years. The increase here was due to the erection of a new power station. Investments of the kind—in public utilities and carried out by the public sector—are not susceptible in the short run to changes in economic activity, as are other investments. The latter, which are governed by business considerations, are very sensitive to economic trends. They contain an element of risk, and hence depend largely on future expectations. In an economy undergoing rapid expansion, there is usually a considerable surplus of production capacity, and the interruption of the growth causes a steep decline in investments motivated by the expectation of a further expansion of demand.

Investments for replacing obsolescent equipment are also not governed by technical factors alone. Here considerable flexibility is possible, and a change in economic trends and outlook creates a tendency to postpone the replacement of obsolescent equipment. Financing is likewise an important factor in such

¹ The big projects are executed by the public sector, and hence the decline may have partly stemmed from the fact that projects implemented during the last two years were decided upon when the economy was still marked by excess demand pressure, which led to a tendency to limit such investments as much as possible.

Table III-5
COMMODITY IMPORTS,* BY ECONOMIC DESTINATION, QUARTERLY, 1963-66
(\$ million, at current prices)

| Year and quarter | Total imports excl. ships, aircraft, and raw diamonds | Total imports excl. ships and aircraft | Consumer goods | | Raw diamonds, net | Production inputs excl. raw diamonds | | Investment goods excl. ships and aircraft | | |
|------------------|---|--|----------------|-------------------|-------------------|--------------------------------------|-----------------------|---|--|------|
| | | | Total | Of which durables | | Total | Of which for industry | Total | Of which for industry and construction | |
| 1963 | I | 123.8 | 11.8 | 3.7 | 93.2 | 82.4 | 53.5 | 29.6 | 18.3 | |
| | II | 144.4 | 14.4 | 4.1 | | 97.0 | 65.8 | 33.0 | 21.1 | |
| | III | 137.8 | 12.3 | 4.7 | | 93.3 | 62.5 | 32.2 | 18.8 | |
| | IV | 143.7 | 19.6 | 5.2 | | 101.1 | 69.8 | 29.0 | 16.9 | |
| 1964 | I | 165.2 | 188.3 | 24.5 | 6.3 | 23.1 | 107.6 | 75.6 | 33.1 | 17.3 |
| | II | 167.4 | 198.1 | 19.1 | 6.9 | 30.7 | 110.6 | 76.1 | 37.7 | 18.9 |
| | III | 156.3 | 184.6 | 17.3 | 7.4 | 28.3 | 103.9 | 71.7 | 35.1 | 19.3 |
| | IV | 171.1 | 191.3 | 21.8 | 6.7 | 20.2 | 118.2 | 85.4 | 31.1 | 17.6 |
| 1965 | I | 162.4 | 183.2 | 19.8 | 6.0 | 20.8 | 110.8 | 76.6 | 31.8 | 18.6 |
| | II | 179.6 | 200.1 | 19.8 | 6.6 | 20.5 | 119.9 | 80.3 | 39.9 | 25.5 |
| | III | 167.0 | 192.4 | 18.6 | 6.3 | 25.4 | 110.9 | 74.0 | 37.5 | 23.7 |
| | IV | 180.4 | 209.2 | 24.6 | 6.9 | 28.8 | 118.9 | 82.0 | 36.9 | 21.0 |
| 1966 | I | 180.2 | 205.7 | 26.0 | 7.2 | 25.5 | 118.8 | 80.9 | 35.4 | 18.6 |
| | II | 169.4 | 204.3 | 18.4 | 5.1 | 34.9 | 119.0 | 76.3 | 32.0 | 16.8 |
| | III | 170.8 | 198.6 | 43.9 | 5.4 | 27.8 | 118.7 | 74.9 | 28.2 | 16.8 |
| | IV | 154.6 | 191.6 | 19.6 | 4.8 | 37.0 | 109.0 | 72.9 | 26.0 | 12.6 |

* Gross imports, exclusive of raw diamonds, which are cited net in this table.

circumstances. A period of changing trends is often accompanied by the accumulation of stocks and financing difficulties, and the resulting involuntary investment in finished-goods inventories is made *inter alia* at the expense of investment in capital assets.

Added to these factors in 1966 was a special one connected with the nature of the turning-point. The recession being a precondition for the reorganization of the economy, by its very nature it involves changes in the relative profitability of various branches and products. Future prospects are the decisive consideration in investment decisions, and until crystallization of the shifts in the relative profitability of the various branches due to economic-policy decisions, there is an intermediate stage during which potential investors tend to defer their plans.

Investment goods were more affected by the recession than other imports, but its effect fully manifested itself after a longer time-lag. This, of course, is explained by the fact that investments require longer planning, and it is not always possible to revise the plan once implementation has started, even when circumstances alter. Imports of investment goods for industry and construction declined by 26 percent in 1966 as compared with 1965, while during the second half of 1966 the decrease as against the corresponding six months of 1965 reached 36 percent.

Imports of goods for final consumption expanded by 7 percent in 1966. In physical terms, the growth rate was similar to that of 1965 and much slower than in previous years. As regards the underlying factors, the picture is complex, for besides the impact of the recession, there was the influence of long-run trends in consumption habits, as well as changes in fiscal and import policy.

Imports of durable goods expanded rapidly until 1964. Most of the rise was in passenger cars (which accounted for about half the total increment during the 1962-64 period). After the raising of taxes on cars at the end of 1964, imports of this item fell sharply. The decline was particularly steep in the period immediately following the tax increase, the volume dipping to about half its previous level. Toward the end of 1965 and the beginning of 1966, imports picked up somewhat, but they were still far below the pre-increase figure. In the second half of 1966 there was another sharp drop. This was clearly due to the recession, but may partly have been connected also with the raising of taxes on fuel and of license fees at the beginning of 1966.

Two other import items which expanded appreciably in recent years were furniture (due to the import liberalization policy) and television sets. Together with automobiles, purchases of television sets rose rapidly during these years. In 1965, when car imports fell off, furniture and television sets accounted for a large part of the increment.

In some respects, consumer durables resemble investment goods. One similarity is the great sensitivity of both to the economic situation and the expectations

generated thereby. Consequently, a recession affects imports of durable consumer goods more than it does other consumer items. In the second half of 1966 such imports were 40 percent smaller than in the corresponding period of 1965, while the decrease over the year as a whole as compared with 1965 was only 13 percent.

Food imports were appreciably larger in 1966, in contrast to all other items. However, the increase was entirely in frozen meat. Over the past four years imports of this product have grown fourfold, a development attributable to the Government's policy on domestic beef production. Imported meat is cheaper, and the quantity imported in the past apparently did not satisfy the demand. If imports of frozen meat and sugar (the stocks and prices of which fluctuate sharply) are deducted, food imports were 17 percent below the 1965 level.

FOOD IMPORTS, 1963-66

(\$ million)

| | 1963 | 1964 | 1965 | 1966 |
|--------------------------------|-------------|-------------|-------------|-------------|
| Frozen meat | 6.5 | 12.5 | 18.6 | 27.4 |
| Sugar (for direct consumption) | 8.2 | 13.4 | 2.7 | 3.8 |
| Other foodstuffs | 10.5 | 10.6 | 13.9 | 11.5 |
| Total | 25.2 | 36.5 | 35.2 | 42.7 |

Imports of current production inputs expanded slowly in the past two years—by 6 percent in 1966 and 3 percent in 1965—after a rapid rise of 16 percent in 1964. Input prices edged up only slightly, so that the trend in the real volume of these imports was similar to that in its value—a rise of 4 percent in 1966, 1 percent in 1965, and 15 percent in 1964.

The main determinant of such import is, of course, the level of economic activity. Another is the change in the stocks of these goods, which can considerably affect the rates of expansion from year to year. However, no reliable data on this point are available, and conclusions concerning stocks are therefore based on general data and various indicators.

As to the level of economic activity, it is necessary to distinguish between exports and other uses, owing to their widely disparate trends. Whereas exports expanded during the last two years by over 10 percent per annum in real terms, the growth of domestic uses slowed down markedly, and in 1966 there was even an absolute decline.

Imports of uncut diamonds account for a large share of current inputs—over 20 percent in 1966. This item has been expanding rapidly in recent years, in line with the upward trend in sales of polished diamonds. However, it displays sharp fluctuations from year to year owing to changes in stocks. The import

Table III-6
 COMMODITY IMPORTS,* 1962-66
 (\$ million)

| | 1962 | 1963 | 1964 | 1965 | 1966 | Increase or decrease (-) as against preceding year | | | | | | | |
|--------------------------|------|------|------|------|------|--|------|-------|------|---------|------|------|------|
| | | | | | | \$ million | | | | Percent | | | |
| | | | | | | 1963 | 1964 | 1965 | 1966 | 1963 | 1964 | 1965 | 1966 |
| Meat and fish | 10.0 | 9.8 | 15.5 | 21.9 | 30.5 | -0.2 | 5.7 | 6.4 | 8.6 | -2 | 58 | 41 | 39 |
| Milk and milk products | 1.4 | 2.0 | 3.1 | 5.7 | 2.1 | 0.6 | 1.1 | 2.6 | -3.6 | 43 | 55 | 84 | -63 |
| Cereals and rice | 44.9 | 41.0 | 44.7 | 43.7 | 64.0 | -3.9 | 3.7 | -1.0 | 20.3 | -9 | 9 | -2 | 46 |
| Sugar and honey | 4.0 | 13.3 | 19.4 | 6.0 | 5.5 | 9.3 | 6.1 | -13.4 | -0.5 | 233 | 46 | -69 | -8 |
| Coffee, tea, cocoa | 5.2 | 6.1 | 8.7 | 7.0 | 8.1 | 0.9 | 2.6 | -1.7 | 1.1 | 17 | 43 | -20 | 16 |
| Unprocessed tobacco | 1.5 | 2.2 | 3.7 | 4.1 | 3.5 | 0.7 | 1.5 | 0.4 | -0.6 | 47 | 68 | 11 | -15 |
| Other food and beverages | 7.8 | 17.3 | 9.6 | 9.2 | 11.7 | 9.5 | -7.7 | -0.4 | 2.5 | 122 | -45 | -4 | 27 |
| Oilseeds | 23.4 | 21.7 | 28.7 | 29.7 | 33.7 | -1.7 | 7.0 | 1.0 | 4.0 | -7 | 32 | 3 | 13 |
| Wood | 26.7 | 23.3 | 29.7 | 30.8 | 23.6 | -3.4 | 6.4 | 1.1 | -7.2 | -13 | 27 | 4 | -23 |
| Cotton | 4.4 | 4.8 | 9.8 | 8.4 | 6.1 | 0.4 | 5.0 | -1.4 | -2.3 | 9 | 104 | -14 | -27 |
| Yarns | 10.3 | 10.4 | 13.8 | 15.0 | 14.1 | 0.1 | 3.4 | 1.2 | -0.9 | 1 | 33 | 9 | -6 |
| Other textiles | 8.2 | 5.6 | 7.3 | 7.0 | 6.4 | -2.6 | 1.7 | -0.3 | -0.6 | -32 | 30 | -4 | -9 |
| Edible oils and fat | 8.3 | 8.9 | 4.9 | 8.9 | 6.9 | 0.6 | -4.0 | 4.0 | -2.0 | 7 | -45 | 82 | -22 |
| Chemicals | 34.6 | 36.2 | 42.6 | 45.4 | 48.1 | 1.6 | 6.4 | 2.8 | 2.7 | 5.6 | 18 | 7 | 6 |

| | | | | | | | | | | | | | |
|--|--------------|--------------|--------------|--------------|--------------|-------------|--------------|-------------|-------------|----------|-----------|-----------|----------|
| Iron and steel | 44.6 | 42.7 | 54.1 | 54.9 | 41.7 | -1.9 | 11.4 | 0.8 | -13.2 | -4 | 27 | 1 | -24 |
| Nonferrous metals | 13.7 | 12.3 | 16.3 | 17.7 | 21.7 | -1.4 | 4.0 | 1.4 | 4.0 | -10 | 33 | 9 | 23 |
| Raw diamonds, net | 67.2 | 93.2 | 102.3 | 95.5 | 124.9 | 26.0 | 9.1 | -6.8 | 29.4 | 39 | 10 | -7 | 31 |
| Fuel | 40.1 | 44.5 | 46.6 | 53.2 | 58.3 | 4.4 | 2.1 | 6.6 | 5.1 | 11 | 5 | 14 | 10 |
| Other raw materials | 60.0 | 65.3 | 74.9 | 81.0 | 80.3 | 5.3 | 9.6 | 6.1 | -0.7 | 9 | 15 | 8 | -1 |
| Machinery | 83.0 | 79.1 | 81.9 | 95.2 | 78.6 | -3.9 | 2.8 | 13.3 | -16.6 | -5 | 4 | 16 | -17 |
| Generators and electrical equipment | 25.1 | 25.7 | 24.4 | 31.2 | 27.3 | 0.6 | -1.3 | 6.8 | -3.9 | 2 | -5 | 28 | -12 |
| Communication equipment | 9.4 | 7.6 | 17.2 | 16.6 | 14.5 | -1.8 | 9.6 | -0.6 | -2.1 | -19 | 126 | -3 | -13 |
| Automotive vehicles | 32.4 | 39.2 | 52.2 | 48.0 | 33.7 | 6.8 | 13.0 | -4.2 | -14.3 | 21 | 33 | -8 | -30 |
| Ships and aircraft | 29.5 | 21.3 | 67.2 | 36.4 | 25.3 | -8.2 | 45.9 | -30.8 | -11.1 | -28 | 215 | -46 | -30 |
| Electrical household appliances | 1.7 | 3.0 | 4.2 | 4.8 | 3.7 | 1.3 | 1.2 | 0.6 | -1.1 | 76 | 40 | 14 | -23 |
| Furniture | 0.4 | 0.7 | 1.9 | 2.9 | 2.4 | 0.3 | 1.2 | 1.0 | -0.5 | 75 | 171 | 53 | -17 |
| Miscellaneous | 31.5 | 27.8 | 37.8 | 36.8 | 41.1 | -3.7 | 10.0 | -1.0 | 4.3 | -12 | 36 | -3 | 12 |
| Total | 629.3 | 665.0 | 822.5 | 877.0 | 817.8 | 33.7 | 155.9 | -9.0 | -1.4 | 5 | 24 | -1 | — |
| Less: Imports returned and adjustments | 15.5 | 17.5 | 19.1 | 22.6 | 24.8 | | | | | | | | |
| Total commodity imports, net | 613.8 | 647.5 | 803.4 | 794.4 | 793.0 | 33.7 | 155.4 | -4.0 | -1.4 | 6 | 24 | -1 | — |

* Gross imports, except for raw diamonds which are here cited net.

SOURCE: Central Bureau of Statistics.

component of Israel's other export items is likewise above the average for domestic uses, so that changes in the volume of exports exert a relatively big influence on imported inputs.

If inputs for export production are separated from other domestic uses (including inventory accumulation¹), it turns out that the latter contracted by 2 percent in 1966, after levelling off in 1965 and expanding by 21 percent in 1964.

A comparison of data on imported inputs for domestic uses with data on GNP destined for domestic uses shows that during the past two years the ratio between the two decreased. This decline (to the extent that it was not due to a change in the composition of output² or to import substitution) indicates that stocks of imported inputs contracted. In 1966 the ratio between imports and GNP in respect of domestic uses was somewhat lower than in 1963, and substantially lower than in 1964 (when the import of inputs expanded considerably).

The sharp rise in imported inputs in 1964—which totalled 19 percent (at constant prices) for current inputs other than raw diamonds—was at least partly due to the accumulation of stocks. In 1963 imports were apparently smaller than required for current production (having decreased in real terms by 1 percent as compared with 1962), and stocks fell below their normal level. Thus imports in 1964 were partly intended for replenishing stocks, or perhaps even for building them up above their average volume. It is against this background that developments in 1965 and 1966 must be viewed. The fact that imports did not expand—and relative to GNP even declined—at least partly reflects a disinvestment in stocks of imported inputs. In 1966 the ratio between imported inputs and GNP was lower than in any of the four preceding years, and appreciably lower than the average for this period.

This decline in input stocks, and the resulting stability in the total volume of imports, must be attributed to the recession, which led to the weakening of demand and the accumulation of stocks of finished products. But the main effect of the recession, as far as input imports are concerned, is to be seen in the nongrowth of the product itself. The expansion of domestic uses to the same extent as in 1965—by 6 percent (which was much less than in any previous period)—would have entailed the import of an additional \$ 20 million to \$ 40 million worth of inputs.

(b) *Services*

Imports of services expanded by 6 percent in 1966, as compared with 16 percent in 1965 and 7 percent in each of the two preceding years. In 1965 and 1966 commodity imports did not increase, and services were solely responsible for

¹ Exclusive of raw diamonds.

² The most striking change in the sectorial composition of output was the relative decrease in the weight of the construction sector, where the import component is far below the average.

the growth in total imports. During these two years imports of services went up by nearly \$ 100 million—\$ 68 million in 1965 and \$ 29 million in 1966.

Unlike commodity imports, imports of services are not affected by inventory fluctuations, and in general their connection with current production is much more tenuous. The item figuring most prominently in the 1966 import increment (accounting for about half the total increase and showing a much faster growth rate than in previous years) was capital servicing. The increase here was almost wholly due to larger interest payments abroad.

Table III-7
IMPORTS OF SERVICES,* 1962-66
(\$ million)

| | 1962 | 1963 | 1964 | 1965 | 1966 | Increase or decrease (-) as against preceding year | | | |
|--------------------|--------------|--------------|--------------|--------------|--------------|---|-------------|-------------|------------|
| | | | | | | IL million | | Percent | |
| | | | | | | 1965 | 1966 | 1965 | 1966 |
| Transportation | 68.7 | 70.6 | 83.1 | 93.5 | 102.5 | 10.4 | 9.0 | 12.5 | 9.6 |
| Passenger | 8.0 | 10.2 | 12.1 | 12.5 | 14.9 | 0.4 | 2.4 | 3.3 | 19.2 |
| Other | 60.7 | 60.4 | 71.0 | 81.0 | 87.6 | 10.0 | 6.6 | 14.1 | 8.1 |
| Foreign travel | 26.0 | 38.0 | 37.3 | 43.7 | 48.8 | 6.4 | 5.1 | 17.2 | 11.7 |
| Insurance | 27.8 | 31.1 | 41.0 | 49.5 | 53.0 | 8.5 | 3.5 | 20.7 | 7.1 |
| Capital servicing | 76.6 | 80.8 | 93.8 | 106.0 | 118.6 | 12.2 | 12.6 | 13.0 | 11.9 |
| Government, n.e.s. | 113.8 | 105.7 | 98.6 | 132.2 | 135.5 | 33.6 | 3.3 | 34.1 | 2.5 |
| Miscellaneous | 55.9 | 67.7 | 67.6 | 64.6 | 60.1 | -3.2 | -4.5 | -4.7 | -7.0 |
| Total | 368.8 | 393.9 | 421.6 | 489.5 | 518.5 | 67.9 | 29.0 | 16.1 | 6.0 |

* Calculated according to the c.i.f. value of commodity imports.

SOURCE: Central Bureau of Statistics.

Two other items which contributed significantly to the increment were "other transportation expenditure" and "expenditure of Israeli tourists abroad". The growth in the former was due to the larger overseas outlay of Israeli shipping and aviation companies. The increase in the amount spent in 1966 by tourists came to 12 percent, following a rise of 17 percent the year before. This growth far exceeds that in income from foreign tourism in Israel. Moreover, in the last two years the increase in Israeli tourist expenditure abroad was three times greater than that in the country's income from foreign tourism—\$ 12.5 million as against \$ 4 million. This considerably reduced the surplus in the country's tourism account.

Outlay on insurance services increased to a much lesser extent than in 1965, a development apparently reflecting the economic slowdown. In previous years this item generally expanded more rapidly than the national product.

Government imports were only slightly larger in 1966, but this followed a very

big growth the year before. Taking the last two years together, this item showed the biggest increase in service imports.

The rise in passenger transport outlay occurred together with a decline in income from passenger transport, this reflecting the diminishing share of Israeli companies in the conveyance of passengers to and from Israel.

The only item which declined during the last two years was miscellaneous services, mainly owing to the smaller expenditure of the Jewish Agency abroad as the volume of immigration shrank.

Table III-8
IMPORTS AND EXPORTS OF TRANSPORTATION SERVICES, 1963-66
(\$ million)

| | 1963 | 1964 | 1965 | 1966 |
|---|-------|-------|-------|-------|
| Imports | | | | |
| Passenger transport | | | | |
| Sea | 2.5 | 2.7 | 2.4 | 2.3 |
| Air | 7.7 | 9.4 | 10.1 | 12.6 |
| Total | 10.2 | 12.1 | 12.5 | 14.9 |
| Other transportation expenditure | 60.4 | 71.0 | 81.0 | 87.6 |
| Total, according to the c.i.f. value of commodity imports | 70.6 | 83.1 | 93.5 | 102.5 |
| Transport of commodity imports by foreign companies | 16.8 | 21.7 | 21.9 | 18.0 |
| Total, according to the f.o.b. value of commodity imports | 87.4 | 104.8 | 115.4 | 120.5 |
| Exports | | | | |
| Passenger transport | | | | |
| Sea | 9.1 | 11.1 | 12.7 | 11.1 |
| Air | 24.3 | 25.8 | 29.8 | 30.0 |
| Total | 33.4 | 36.9 | 42.5 | 41.1 |
| Cargo transport | | | | |
| Exports | 8.8 | 8.8 | 15.4 | 13.7 |
| Other commodities | 27.7 | 29.6 | 34.9 | 42.1 |
| Other income from transportation | 16.3 | 16.2 | 18.7 | 21.6 |
| Total, according to the f.o.b. value of commodity imports | 86.2 | 91.5 | 111.5 | 118.5 |
| Transport of commodity imports by Israeli companies | 28.6 | 35.0 | 36.5 | 38.2 |
| Total, according to the c.i.f. value of commodity imports | 114.8 | 126.5 | 148.0 | 156.7 |

SOURCE: Central Bureau of Statistics.

3. EXPORTS

(a) *Commodity exports*

Commodity exports expanded by \$ 70 million, or 17.5 percent, in 1966 to reach \$ 475 million. This growth rate is somewhat higher than that in 1965 and far above the 1964 rate. Exports of locally produced commodities¹ advanced 16.9 percent in 1966, as against 15.4 percent in 1965 and 3.5 percent in 1964.

A considerable proportion of the export increment during the last two years stemmed from the higher prices fetched abroad: this accounted for 30 percent of the growth in 1965 and 35 percent in 1966. The biggest price rise—13.3 percent—was in diamonds, and it accounted for some 75 percent of the incremental value added due to higher prices (see Table III-12). The remainder was derived mainly from citrus exports, prices of which were up 3.3 percent. This reflects a substantial rise in the first quarter of 1966—when the bulk of the shipments take place—as compared with the corresponding period of 1965, and the sagging of prices in the second quarter. Agricultural exports other than citrus also benefited from price increases averaging some 4 percent as compared with 1965. Prices of quarry and mine products averaged about 3 percent higher in 1966, reflecting on the one hand the rise of copper prices in the world market, and on the other the fall in potash prices due to much larger supply. Prices of other industrial exports remained unchanged on the average.

The physical increase in locally produced exports came to 11 percent in both 1965 and 1966, as against 3 percent in 1964 (see Table III-11). The rapid growth of citrus sales in 1965 brought up the growth rate for total exports that year. As to industrial exports other than diamonds, the quantitative increase was greater in 1966 than in 1965.

However, not every dollar's worth of export yields the same net foreign currency income. From the aspect of value added, there are marked disparities between the commodities, and a change in the composition of export may sometimes involve a change in the average value added. The contribution of export to aggregate income and the real resources diverted to export must be measured according to the value added.

At current prices, value added increased by 19 percent in 1966, after a similar gain in 1965 and a decline of 3 percent in 1964. But here too higher export prices figured conspicuously, over 40 percent of the 1966 incremental value added (\$ 16 million out of \$ 39 million) stemming from the higher prices obtained (see Table III-12).

The quantitative increase in value added was much more modest, totalling 11 percent as compared with 13 percent in 1965 and 1 percent in 1964. In industrial exports other than diamonds, the increase was slightly larger than in 1965—

¹ I.e. exports exclusive of sales of old ships and aircraft, as well as works of art, collectors' pieces, antiques, personal effects, etc.

Table III-9

NET COMMODITY EXPORTS, BY MAIN CATEGORY, 1963-66

(\$ million)

| | 1963 | 1964 | 1965 | 1966 | Percent increase or decrease (-) as against preceding year | | | Weight in total exports in 1965 | Weight in export increment | |
|-----------------------------|-------------|-------------|-------------|-------------|--|-------------|------------|---------------------------------|----------------------------|-------------|
| | | | | | 1964 | 1965 | 1966 | | 1965 | 1966 |
| Agricultural exports | | | | | | | | | | |
| Citrus | 74.8 | 52.9 | 71.3 | 74.9 | -29.3 | 34.8 | 5.0 | 17.8 | 34.4 | 5.3 |
| Poultry products and cotton | 7.3 | 8.5 | 7.6 | 8.9 | 16.4 | -10.6 | 17.1 | 1.9 | -1.7 | 1.9 |
| Other agricultural products | 7.0 | 5.5 | 7.4 | 10.5 | -21.4 | 34.5 | 41.9 | 1.8 | 3.6 | 4.6 |
| Total | 89.1 | 66.9 | 86.3 | 94.3 | -24.9 | 28.9 | 9.3 | 21.5 | 36.3 | 11.8 |
| Industrial exports | | | | | | | | | | |
| Diamonds | 104.0 | 118.2 | 131.8 | 165.1 | 13.7 | 11.5 | 25.3 | 32.9 | 25.4 | 49.2 |
| Minerals and scrap | 12.3 | 19.8 | 27.1 | 34.0 | 61.0 | 36.9 | 25.5 | 6.8 | 13.6 | 10.2 |
| Copper-cement | 4.3 | 9.3 | 7.6 | 12.2 | | | | | | |
| Potash | 5.4 | 7.7 | 13.2 | 12.7 | | | | | | |
| Phosphates | 1.2 | 1.1 | 2.9 | 4.4 | | | | | | |
| Scrap | 1.0 | 1.2 | 3.0 | 4.3 | | | | | | |

| | | | | | | | | | | |
|--|--------------|--------------|--------------|--------------|-------------|-------------|-------------|--------------|--------------|--------------|
| Fuel | 7.6 | 9.4 | 10.0 | 15.5 | 23.7 | 6.4 | 55.0 | 2.5 | 1.1 | 8.1 |
| Other metal products | 16.5 | 7.9 | 9.9 | 10.8 | -52.1 | 25.3 | 9.1 | 2.5 | 3.7 | 1.3 |
| Citrus products | 12.8 | 18.1 | 19.1 | 19.9 | 41.4 | 5.5 | 4.2 | 4.8 | 1.9 | 1.2 |
| Textiles and clothing | 31.5 | 39.7 | 40.3 | 45.5 | 26.0 | 1.5 | 12.9 | 10.0 | 1.1 | 7.7 |
| Other industrial products | 62.2 | 67.7 | 76.7 | 83.8 | 8.8 | 13.4 | 9.3 | 19.1 | 16.8 | 10.5 |
| Total industrial exports | 246.9 | 280.8 | 314.9 | 374.6 | 13.7 | 11.2 | 19.3 | 78.5 | 63.7 | 88.3 |
| Total commodity exports from domestic output | 336.0 | 347.7 | 401.2 | 468.9 | 3.5 | 15.4 | 16.9 | 100.0 | 100.0 | 100.0 |
| Sales of ships and aircraft | 0.4 | 2.1 | 2.7 | 5.1 | | | | | | |
| Works of art, antiques, collectors' pieces, personal effects, etc. | 3.5 | 4.6 | 4.6 | 4.3 | | | | | | |
| Total commodity exports | 339.9 | 354.4 | 408.5 | 478.3 | 4.3 | 15.3 | 17.1 | | | |
| Less: Adjustments ^a | 2.8 | 5.0 | 4.5 | 3.8 | | | | | | |
| Net commodity exports, according to balance of payments | 337.1 | 349.4 | 404.0 | 474.5 | 3.6 | 15.6 | 17.5 | | | |

^a Total commodity exports in the above line differ from the balance of payments figure for two reasons: (a) they include some export by the ship and aircraft repair branch, which in the balance of payments appears under exports of services; (b) they are based on foreign trade definitions (relating to the movement of goods from country to country), and not on balance of payments definitions (relating to changes in the ownership of the goods). For balance of payments presentation, the export figures have therefore been adjusted for these two sources of discrepancy.

SOURCE: Central Bureau of Statistics.

12 as against 11 percent. But here too this was accounted for by a comparatively small number of items marketed almost exclusively abroad, whose contribution was relatively greater than their weight within total export. The textile and garment industries, which were more heavily subsidized in 1966, contributed much more to incremental value added than in the previous year.

The growth of export in 1966, and its acceleration as compared with 1964 and 1965, occurred despite the mounting of production costs, which has characterized recent years and which started at a point where the profitability of export was already low. Among the factors influencing export growth were the greater demand for various Israeli products abroad, the enlarging of export subsidies, and the smaller sale of exportable goods in the domestic market. These factors affected the different groups of export products in varying degrees.

The effect of increased demand abroad was felt chiefly in a number of distinct export items; these showed a much higher sales volume in 1966, together with a big rise in price.

Export subsidization was on a considerably larger scale than in previous years.¹ In 1966 the total amount granted was appreciably expanded and new types of subsidies were introduced, the most important of which was direct incentives applicable to all exports. However, these incentives, instituted in April 1966, were at first very small—ranging from 0.5 to 3.5 percent of the value of the exports (i.e. about 10 to 15 agorot per dollar of value added). Toward the end of the year, in November, they were more than doubled, to 30 to 40 agorot per dollar of value added. In view of their low rates and the dates of their introduction, these incentives apparently did not greatly influence the development of export during 1966. On the other hand, the much larger export premiums granted textiles and clothing at the beginning of 1966 undoubtedly had a strong effect. Overseas sales of these items expanded much more rapidly than in 1965, though here too the contraction of the domestic market was an important factor.

In 1966 the typical export branches, such as diamonds and minerals, registered big gains. Approximately two-thirds of the incremental industrial exports and their incremental value added (\$ 20 million out of \$ 31 million) were contributed by these two branches. The diamond industry accounted for most of the profit accruing to the economy from higher prices abroad, but even in quantitative terms the export of these branches moved up at an above-average rate. Also contributing substantially to the incremental industrial export were scrap and refined petroleum products. Below-average rises were recorded in citrus products (another traditional export branch) and other metal products (the export of which is of a special character).

In these branches, which market the bulk of their output overseas, changes in

¹ See section 4 below on export incentives.

Table III-10
EXPORTS* AND VALUE ADDED, 1963-66
(\$ million)

| | Exports | | | | Value added | | | | Weight in exports, 1965 | Weight in incremental exports, 1966 | Weight in value added, 1965 | Weight in incremental value added, 1966 |
|-----------------------------|---------|-------|-------|-------|-------------|-------|-------|-------|-------------------------|-------------------------------------|-----------------------------|---|
| | 1963 | 1964 | 1965 | 1966 | 1963 | 1964 | 1965 | 1966 | | | | |
| Citrus | 74.8 | 52.9 | 71.3 | 74.9 | 63.0 | 42.4 | 58.0 | 62.1 | 17.8 | 5.3 | 27.6 | 10.5 |
| Other agricultural products | 14.2 | 14.0 | 14.9 | 19.5 | 11.8 | 11.0 | 12.1 | 16.5 | 3.7 | 6.6 | 5.8 | 11.2 |
| Diamonds | 104.0 | 118.2 | 131.8 | 165.1 | 17.8 | 22.4 | 26.0 | 40.8 | 32.9 | 49.2 | 12.4 | 37.7 |
| Minerals | 11.4 | 18.7 | 24.2 | 28.9 | 9.4 | 15.9 | 20.5 | 25.8 | 6.0 | 8.4 | 9.8 | 13.5 |
| Citrus products | 12.8 | 18.1 | 19.0 | 19.9 | 8.7 | 12.3 | 12.6 | 13.3 | 4.7 | 1.3 | 6.0 | 1.8 |
| Textiles and clothing | 31.5 | 39.7 | 40.3 | 45.5 | 18.0 | 23.4 | 23.0 | 25.3 | 10.0 | 7.7 | 11.0 | 5.9 |
| Other industrial goods | 87.3 | 86.1 | 99.7 | 114.1 | 52.1 | 48.4 | 57.6 | 65.2 | 24.9 | 21.3 | 27.5 | 19.4 |
| Total | 336.0 | 347.7 | 401.2 | 468.9 | 180.8 | 175.8 | 209.8 | 249.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Total excl. diamonds | 143.0 | 162.6 | 183.2 | 209.4 | 88.2 | 100.0 | 113.7 | 129.6 | | | | |

* Exports in this table include only products from domestic output (cf. Table III-9).

Table III-11

GROWTH OF EXPORTS^a AND VALUE ADDED, 1964-66
(percentages)

| | Quantitative increase in exports | | | Quantitative increase in value added | | | Increase in exports at current prices | | | Increase in value added at current prices | | |
|-----------------------------|----------------------------------|-------------|-------------|--------------------------------------|-------------|-------------|---------------------------------------|-------------|-------------|---|-------------|-------------|
| | 1964 | 1965 | 1966 | 1964 | 1965 | 1966 | 1964 | 1965 | 1966 | 1964 | 1965 | 1966 |
| Citrus | -10.4 | 22.9 | 1.7 | -10.5 | 22.4 | 3.1 | -29.3 | 34.8 | 5.0 | -32.7 | 36.8 | 7.1 |
| Other agricultural products | 9.9 | 4.3 | 30.9 | 6.8 | 7.4 | 36.4 | -1.4 | 6.4 | 30.9 | -6.8 | 10.0 | 36.4 |
| Diamonds | 3.1 | 7.4 | 10.5 | 3.4 | 7.1 | 10.8 | 13.7 | 11.5 | 25.3 | 25.8 | 16.1 | 56.9 |
| Minerals | 43.0 | 20.3 | 18.2 | 43.6 | 18.9 | 19.5 | 64.0 | 29.4 | 23.6 | 69.1 | 28.9 | 25.9 |
| Citrus products | 42.2 | 8.3 | 1.0 | 41.4 | 8.1 | 0.8 | 41.4 | 5.0 | 4.7 | 41.4 | 2.4 | 5.6 |
| Textiles | 22.2 | 3.0 | 11.9 | 22.8 | 2.1 | 8.7 | 26.0 | 1.5 | 12.9 | 30.0 | -1.7 | 10.0 |
| Other industrial goods | -2.4 | 11.3 | 14.3 | -9.2 | 12.0 | 13.5 | -1.4 | 15.8 | 14.4 | -7.0 | 19.0 | 13.2 |
| Total | 3.6 | 10.7 | 10.8 | 1.0 | 12.6 | 11.3 | 3.5 | 15.4 | 16.9 | -2.8 | 19.3 | 18.7 |
| Total excl. diamonds | 10.6 | 10.0 | 12.9 | 7.9 | 11.1 | 12.2 | 13.7 | 12.7 | 14.3 | 13.4 | 13.7 | 14.0 |

^a See note to Table III-10.

the level of aggregate domestic demand are likely to be felt mainly through their effect on the productive factors—increased demand pressure being reflected by a rise in wages and by labor shortages. The moderation of economic activity can benefit such branches by easing the pressure for higher wages and by making labor more readily available. Wages continued upward in the early months of 1966 at a rate no slower than in previous years, but on the other hand there was a larger supply of labor. The big export gains posted by these branches were also due to the much stronger demand in the world market, which was reflected by substantial price increases. This applies to diamonds, and among the minerals, to copper-cement and copper scrap (which accounts for most of Israel's scrap sales). On the other hand, excess supply and falling prices marked the potash and citrus products markets, and exports of these items increased very little or even declined. It should be noted that in those products where fixed investment is of greater importance, such as minerals, wage conditions do not greatly affect the short-term profitability of export once the investment has been made.

Other exports are by industries marketing most of their output in the domestic market, and for which exports are of secondary importance. Here, the competition between the domestic and the overseas market is more obvious, while the effects of demand conditions are felt both in the demand for their products and in the supply of productive factors.

In previous years, which were characterized by mounting demand pressure, the weight of export in the output of these branches declined. The contraction of demand is thus likely to bring up the share of exports. The data for 1966 as a whole do not show any significant acceleration in the growth of such sales, but the interval elapsing since conditions changed may have been too short to show results. The development of exports during the course of the year tends to strengthen the assumption that toward the end of 1966 the recession and higher subsidies began to exert a positive influence on their growth.

In examining the impact of the recession on exports, it is important to distinguish between its short-term and long-term consequences. Profitability considerations differ in each case. For existing enterprises, in the short run only variable costs constitute an actual expenditure, and hence the price at which export is profitable is lower. In order to utilize surplus production capacity for exports, it is enough for the return thereon to cover the variable costs; however, there are undoubtedly branches where variable costs exceed the return from exports, so that a decline in domestic demand is in itself insufficient to render these exports profitable. In the former case, increasing the proportion of total output marketed abroad results in a smaller profit than that earned before the recession, owing to the big differential between the local market price and that fetched abroad. Such a decrease in profits may have no effect in the short run, but in the long run—when the question of renewing equipment arises—it may

Table III-12

INCREASE IN VALUE ADDED FROM EXPORT,^a BY QUANTITY AND PRICE COMPONENTS, 1964-66
(\$ million)

| | 1964 | | | | 1965 | | | | 1966 | | | |
|------------------------|------------------|-----------------------|-------------------------|-----------------------------|------------------|-----------------------|-------------------------|-----------------------------|------------------|-----------------------|-------------------------|-----------------------------|
| | Export increment | Value added increment | Of which: | | Export increment | Value added increment | Of which: | | Export increment | Value added increment | Of which: | |
| | | | Due to change in prices | Due to change in quantities | | | Due to change in prices | Due to change in quantities | | | Due to change in prices | Due to change in quantities |
| Citrus | 21.9 | -20.6 | -14.0 | -6.6 | 18.4 | 15.6 | 6.1 | 9.5 | 3.6 | 4.1 | 2.3 | 1.8 |
| Other agric. products | -0.2 | -0.8 | -1.6 | 0.8 | 0.9 | 1.1 | 0.3 | 0.8 | 4.5 | 4.4 | 0.0 | 4.4 |
| Diamonds | 14.2 | 4.6 | 4.0 | 0.6 | 13.6 | 3.6 | 2.0 | 1.6 | 33.3 | 14.8 | 12.0 | 2.8 |
| Minerals | 7.3 | 6.5 | 2.4 | 4.1 | 5.5 | 4.6 | 1.6 | 3.0 | 5.7 | 5.3 | 1.3 | 4.0 |
| Citrus products | 5.3 | 3.6 | 0.0 | 3.6 | 0.9 | 0.3 | -0.8 | 1.1 | 0.9 | 0.7 | 0.6 | 0.1 |
| Textiles | 8.2 | 5.4 | 1.3 | 4.1 | 0.6 | -0.4 | -0.9 | 0.5 | 5.2 | 2.3 | 0.3 | 2.0 |
| Other industrial goods | -1.2 | -3.7 | 1.1 | -4.8 | 13.6 | 9.2 | 3.7 | 5.5 | 14.4 | 7.6 | -0.2 | 7.8 |
| Total | 11.7 | -5.0 | -6.8 | 1.8 | 53.5 | 34.0 | 12.0 | 22.0 | 67.7 | 39.2 | 16.3 | 22.9 |

^a See note to Table III-10.

lead to the reduction of the size of the plant. Hence the importance of trimming production costs per unit of output and of increasing competitiveness. The expansion of overseas sales by the development of new export branches, which would absorb the factors of production released by those experiencing a decline in profitability, likewise depends on the existence of an adequate profit level.

The need to develop new export branches profitable to the economy stands out sharply when viewed in the light of the high tariff walls protecting branches serving the domestic market. These branches, the economic profitability of maintaining which is altogether doubtful, produce import substitutes at a very high real cost, and insofar as they sell part of their output abroad, such export is unprofitable and limited in size owing to the big gap between domestic and export prices. On the other hand, the inadequate level of profits on overseas sales hinders the development of new export branches capable of producing at a lower real cost to the economy.

This situation reflects a more general problem: the efficiency of the economy—or, in other words, the existence of distortions in the allocation of resources, reflected by the diversion of productive factors to uses which from the viewpoint of the economy as a whole are less profitable, but which are rendered profitable to the producer through high protective duties. The degree of discrimination between these two destinations ought to be diminished by increasing the competitiveness of Israel's exports on the one hand, and reducing the excessive protection of inefficient producers on the other.

(b) *Services*

Exports of services expanded by 12 percent in 1966, about the same rate as in 1965 but slightly below that in preceding years. The deceleration was due chiefly to two items reflecting the economic slowdown—cargo transport and insurance; in several other items, on the other hand, expansion was more rapid.

Income from cargo haulage to and from Israel was up 8 percent, as compared with 18 percent in 1965. The growth rate in 1966 was also far below the average for recent years. This must be ascribed to the slower expansion of the carrying capacity of the merchant fleet and to the relatively small increase in cargo volume conveyed between Israel and foreign ports. On the other hand, freight charges on these routes were revised upward, and Israel's share of total freight volume on these routes increased.

Income from passenger conveyance fell off, together with a sharp rise in the amount paid by Israeli tourists to foreign carriers. This reflects the decline in the weight of Israeli companies in the transport of passengers to and from Israel.

Income from tourism rose more rapidly in 1966, but the growth rate—7 percent—was still much lower than the annual average for the period before 1963,

Table III-13
EXPORTS OF SERVICES,^a 1962-66
(\$ million)

| | 1962 | 1963 | 1964 | 1965 | 1966 | Increase or decrease (-) as against previous year | | | |
|--------------------|--------------|--------------|--------------|--------------|--------------|--|-------------|-------------|-------------|
| | | | | | | \$ million | | Percent | |
| | | | | | | 1965 | 1966 | 1965 | 1966 |
| Transportation | 116.4 | 114.8 | 126.5 | 148.0 | 156.7 | 21.5 | 8.7 | 17.0 | 5.9 |
| Passenger | 33.5 | 33.4 | 36.9 | 42.5 | 41.1 | 5.6 | -1.4 | 15.2 | -3.3 |
| Cargo | 59.0 | 65.1 | 73.4 | 86.8 | 94.0 | 13.4 | 7.2 | 18.3 | 8.3 |
| Other income | 21.9 | 16.3 | 16.2 | 18.7 | 21.6 | 2.5 | 2.9 | 15.4 | 15.5 |
| Tourism | 38.4 | 53.4 | 54.8 | 55.0 | 59.1 | 0.2 | 4.1 | 0.4 | 7.5 |
| Insurance | 26.9 | 30.6 | 42.8 | 47.7 | 51.3 | 4.9 | 3.6 | 11.4 | 7.5 |
| Capital servicing | 21.3 | 26.9 | 28.7 | 36.9 | 48.2 | 8.2 | 11.3 | 28.6 | 30.6 |
| Government, n.e.s. | 10.4 | 15.2 | 21.1 | 20.2 | 25.0 | -0.9 | 4.8 | -4.3 | 23.8 |
| Other services | 18.4 | 29.3 | 32.4 | 37.1 | 44.7 | 4.7 | 7.6 | 14.5 | 20.5 |
| Total | 231.8 | 269.6 | 306.3 | 344.9 | 385.0 | 38.6 | 40.1 | 12.6 | 11.6 |

^a Calculated according to the c.i.f. value of commodity imports.
SOURCE: Central Bureau of Statistics.

and lower than the rate of increase in world tourism. The incremental income from tourism was also much smaller in absolute terms than the incremental expenditure of Israeli tourists abroad.

Income from insurance services consists mainly of payments by foreign insurers of claims and of commissions to their agents in Israel, as well as commissions received by Israeli insurance companies for reinsurance abroad. The growth rates of the last two items declined in 1966, following the slower expansion of insurance business.

Capital servicing rose appreciably, reflecting in the main the higher interest rates in the world money and capital markets, which increased the State's foreign currency income from interest, as well as the return on foreign security investments by Israeli residents, which have expanded considerably in recent years. Another item showing a faster growth rate was "other services", which consists chiefly of the current outlays in Israel of foreign companies operating in the country. Here too expansion has been rapid in recent years.

4. EXPORT INCENTIVES

Export subsidies were considerably larger in 1966, while their composition and character underwent a drastic change. Both the increase in the volume of subsidies, and even more so the changes in their composition, reflect the policy of encouraging export.

Up to 1965 only a very small number of branches were subsidized—the textile and garment industries, as well as several agricultural products the export of which was intended primarily to dispose of surplus supplies. Another incentive, of relatively great importance, was the provision of cheap credit to all exporters through special funds. These measures accounted for some 80 percent of all export subsidies in 1965. The remainder was given in the form of tax refunds (other than imposts on imports of direct inputs, for which a special system of rebates was in force), and Government participation in various expenditures connected with export.

In 1966 most of the existing subsidies were enlarged and Government participation in export outlays considerably expanded, both by an increase in the amount provided and by the addition of new outlays to the list. The most striking change, however, was the institution of a general system of incentives covering all export items. This is not properly reflected by comparisons between total annual subsidy figures, as the general incentives were introduced in April 1966 and their rates doubled in November 1966.

(a) *General incentives*

Direct incentives are given in the form of tax refunds on indirect inputs for export production;¹ however, in contrast to the rebating of taxes on direct imported inputs, these refunds are not calculated specifically for each item, but are applied to groups of commodities classified by their value-added component. All export products have been divided into four groups, and a uniform subsidy rate fixed for each group. The rate rises the higher the percentage of value added, reaching 8.5 percent of the f.o.b. value of exports in the group with a value added of over 66 percent.² The subsidy generally ensures an additional 30 to 40 agorot per dollar of added value in all groups, the benefit being greatest at the lower limit (i.e. on items with the lowest percentage of value added in the group concerned), and declining the closer the item is to the upper limit.

In this connection, it should be noted that indirect taxes in Israel are exceedingly high. Domestic marketing is not affected by them, as it is protected by high customs duties. But the competitiveness of exports suffers as compared with

¹ Inputs for export production not imported by the plant itself.

² As from November 1966, subsidy rates are as follows: on less than 25 percent value added—1 percent of the f.o.b. value of exports; on 25–45 percent—3.5 percent; on 46–65 percent—6 percent; on 66 percent or more—8.5 percent.

Table III-14
EXPORT SUBSIDIES,^a 1964-66
(IL million)

| | 1966 | 1965 | 1964 |
|---|-------------------|-------|-------|
| Refund of taxes and imposts | 4.8 | 4.4 | 1.6 |
| Direct incentives | 9.0 | — | — |
| Refund of and participation in export outlays | 20.4 | 11.5 | 11.0 |
| Subsidies to export companies | 1.2 | 0.9 | 1.2 |
| Subsidies on textiles and participation in funds | | | |
| Subsidies | 14.9 ^b | 1.4 | 1.2 |
| Participation in Wool and Cotton Funds | (4.6) | (4.0) | (0.9) |
| Subsidies on agricultural exports under the export encouragement policy | 3.2 | 0.9 | 0.1 |
| Total | 53.5 | 19.1 | 15.1 |
| Subsidies through branch funds ^a | 13.8 | 9.6 | |
| Wool and synthetic yarn products | 8.1 | 4.0 | |
| Plywood | 5.5 | 5.5 | |
| Leather | 0.2 | 0.1 | |
| Budgetary subsidies ^b | 19.3 | 15.6 | |
| Of which: Eggs | 6.0 | 5.0 | |
| Total | 86.6 | 44.3 | |

^a Exclusive of the Cotton Fund.

^b These subsidies, which are actually granted on domestic production, apply to cotton, ground-nuts, fresh vegetables, dried vegetables, edible oil, and olive oil.

SOURCE: Ministry of Finance and the branch funds.

countries where levies are low or where the system of taxation makes it possible to completely exempt exports from indirect taxes (e.g. in the case of the tax on value added).

Apart from the direct incentives, which are of general application, there are several indirect aid measures connected with current production—the reduction of costs, refunding of outlays, and rebating of taxes—which apply either to all exports or at least to all industrial exports. The most important of these measures is the provision of cheap credit, mainly through two funds: the Industrial Working Capital Fund and the Industrial Export Fund, which are financed partly by the Bank of Israel and the Government and partly in the form of controlled bank credit. Loans from these funds are given at 6 percent interest per annum. In 1966 the volume of credit was considerably enlarged, the outstanding balance rising by 37 percent, which far exceeded the growth of overseas sales. This increase stemmed partly from the inclusion of exporters who previously did not resort to the funds and of producers whose output is

Table III-15

BUDGETARY INDUSTRIAL EXPORT SUBSIDIES, BY ITEM, 1964-66
(IL thousand)

| | 1964 | 1965 | 1966 |
|---|---------------|---------------|---------------|
| A. Refund of taxes and imposts | | | |
| Refund of customs duty on accessories, spare parts, and auxiliary materials | 166 | 362 | 1,147 |
| Refund of war risk insurance (Arnona) | 1,166 | 2,603 | 2,749 |
| Refund of taxes on imports for export production (property tax on stocks) | 150 | 1,203 | 762 |
| Refund of travel tax to approved exporters | 116 | 250 | 100 |
| Total | 1,598 | 4,418 | 4,758 |
| B. Direct incentives | | | |
| Refund of taxes on imported materials not included in special arrangements | — | — | 8,962 |
| C. Refund of and participation in outlays | | | |
| Refund of wharfage fees on imports for export production | 920 | 1,499 | 2,937 |
| Refund of wharfage fees on exports | 185 | 540 | 2,400 |
| Participation in goods transport via Eilat | 1,548 | 2,103 | 1,837 |
| Foreign trade risk insurance | 69 | 799 | 734 |
| Guaranteeing of shipping routes | 4,739 | 1,904 | 1,535 |
| Participation in costs of advertising, market research, and maintenance of sales offices abroad | 1,383 | 2,031 | 3,173 |
| Development and research | 229 | 1,307 | 6,907 |
| Transshipment of goods | 124 | 473 | 793 |
| Miscellaneous | 1,756 | 887 | 45 |
| Total | 10,953 | 11,532 | 20,361 |
| D. Subsidies to export companies | | | |
| Grant based on turnover of export companies | 408 | 695 | 711 |
| For covering losses of export companies | 808 | 247 | 460 |
| Total | 1,216 | 942 | 1,171 |
| E. Subsidies on textile products | | | |
| Participation in the Wool and Synthetic Products Fund | 425 | — | 400 |
| Grant for exports of garments from imported cloth | 1,324 | 1,417 | 2,268 |
| Subsidy on yarn exports | — | — | 1,793 |
| Subsidy on cloth and garment exports | — | — | 9,933 |
| Refunds because of higher raw cotton costs | — | — | 934 |
| Participation in Cotton Fund | 500 | 3,967 | 4,189 |
| Total | 2,159 | 5,384 | 19,517 |
| Grand total | 16,776 | 22,276 | 54,769 |

SOURCE: The Accountant General.

exported indirectly. In 1966 the outstanding balance of credit from the two funds averaged more than IL 330 million, broken down as follows: diamond exports—IL 140 million; other industrial items—IL 180 million; and agricultural products—IL 10 million. Besides these funds, exporters are permitted to obtain foreign currency credit from Patach deposits and from overseas sources (either suppliers or lines of credit open to Israeli banks operating abroad). This credit too is granted at a comparatively low interest rate. The total volume of cheap credit provided to exporters in 1966 is estimated at IL 400 million to IL 450 million. If the interest on this credit is compared with the normal interest rate payable in Israel—11 percent per annum—the resulting reduction in production costs comes to nearly IL 20 million.¹

Other measures of this type are the refund of wharfage fees on exports and imports for export production, the reduction of insurance costs, and the refund of various taxes—the war risk insurance (Arnona) fees, the property tax on stocks, and customs duties on accessories, spare parts, and auxiliary materials partly serving exports.² This form of aid totalled IL 10 million in 1966. In some cases the arrangements had been expanded in 1965, but no changes were introduced in 1966.

There were substantial increases in other indirect subsidies. These are of two types: (1) special activities more remotely connected with current exports and partly possessing the character of long-term investment (e.g. advertising costs, the maintenance of offices abroad, development of new products, costs connected with the penetration of new markets, etc.); and (2) outlays in specific spheres (e.g. participation in the cost of transporting goods to Eilat, the covering of losses incurred on shipping routes, transshipment of goods, etc.).

Government participation in costs connected with exporting, other than ordinary current costs, totalled IL 15 million in 1966. Most of the 1966 increase occurred in the “special expenditure” item and stemmed from the marked expansion of activities eligible for such participation and the granting of full refunds in order to compensate for the high indirect tax rates. On the other hand, Government participation in specific outlays was reduced in 1966.³

The relative weights of the above types of subsidies have changed in accordance

¹ The interest rate in the world money market rose in 1966, and this was presumably reflected in the volume of supplier credit and that from credit lines of Israeli banks operating abroad. This apparently offset somewhat the big increase in the amount of financing through the export funds.

² This refund of customs duty is essentially the same as the refund of customs duty on direct inputs for export production; however, in practice the matter is more complicated, and the item may be regarded as a borderline case justifying its inclusion among the subsidies here listed.

³ An item of considerable weight is the covering of losses incurred on certain shipping routes. This subsidy has been fixed in advance for a limited period. In 1965 and 1966 losses on these routes were smaller owing to the higher percentage of cargo capacity exploited.

REFUND OF TAXES AND OUTLAYS, 1964-66

(IL million)

| | 1964 | 1965 | 1966 |
|---------------------------------|------|------|------|
| Tax and current outlays | 2.9 | 7.0 | 10.1 |
| Special outlays ^a | 1.6 | 3.3 | 10.2 |
| Expenditure in specific spheres | 7.6 | 5.6 | 4.3 |
| Total | 12.1 | 15.9 | 25.2 |

^a This item includes a certain sum spent on activities which come under the category of general services for exporters, rather than participation in actual outlays by exporters. This sum is estimated at IL 1.0 million in 1966 and IL 0.7 million in 1965.

with the shifting emphasis in export policy. At first only a limited number of outlays connected with export were subsidized, but with the growing realization of the need to expand these supports, their application has been extended to types of expenditure of a more general nature. Nevertheless, the amount of support that can be provided through such subsidies is necessarily limited. In some cases there exists a certain degree of rigidity from the time aspect; for instance, the development of new products requires preliminary planning and a lengthy period of implementation. The marked expansion of such subsidies at the beginning of 1966 actually foreshadowed the switch to the system of direct incentives, which since the end of 1966 has been the main instrument of financial aid to export designed to offset the effects of the existing system of indirect taxes and customs duties, which discriminates against exporters as compared with those in other countries.

(b) *Subsidies on textiles and other supports through branch funds*

The textile and garment industries have been accorded a special place in the export encouragement policy. In 1966 the special subsidies granted them¹ amounted to about one-third of all subsidies on commodity exports and over 40 percent of those on industrial exports, whereas these two industries accounted for only 12 percent of industrial exports and only 15 percent of total value added therefrom. Subsidies to the cotton branch at the end of 1966 ranged for the most part between IL 3 and IL 5 per dollar of gross value added;² those to the wool and synthetic yarn branches and on clothing made from imported materials reached an average of IL 1.5 per dollar of added value; while the subsidy on woollen yarn was lower—IL 1.1 per dollar.

In these branches special subsidy arrangements were in force even before the

¹ Exclusive of the share of these industries in other subsidies.

² Value added, as defined here and elsewhere in connection with the branch funds, is the gross value added of the entire branch—i.e. the f.o.b. value of the exports, less direct current imported inputs, but not the imported capital input (interest and depreciation), nor indirect imported inputs.

1962 devaluation. They were based mainly on funds serving the individual branches concerned—the Cotton Fund and the Wool Fund—which were financed from imposts on their raw material imports. In addition, garments manufactured from imported materials intended mainly for export were directly subsidized. For some of the products, these funds equalized the producer prices of exports with those obtainable in the domestic market (e.g. cotton yarn, and to a lesser extent knitwear), whereas in the case of other products, the differential between the local market price and the export price was only narrowed.

In the middle of 1966 the Cotton Fund was abolished, and direct subsidies substituted for the arrangements previously in force in this branch. This change can largely be ascribed to the growing deficit incurred by the Cotton Fund. The big investments made in the early sixties resulted in an appreciable expansion of production capacity, while on the other hand domestic demand slackened in the last two years. These conditions were also reflected by the relatively slow rise of prices in the domestic market.¹ These were also years of substantial wage increases, and presumably this combination of factors had a detrimental effect on profitability. In view of the growth of production capacity, sagging domestic demand, and apparently the reduced profitability of local marketing, export subsidies on textiles and clothing were raised at the beginning of 1966. As regards the integrated enterprises (which account for the bulk of overseas textile sales and a substantial part of those of clothing made from local materials), the supports were revised, subject to certain conditions,² from IL 1.75 to IL 2.30 per dollar's worth of export. The gross value added of clothing exports averages about 50 percent, so that the subsidy, including direct incentives totalling 6 percent, now reaches approximately IL 5 per dollar of value added.

With the abolition of the Cotton Fund, export subsidies on cotton yarn produced by mills in the central part of the country were reduced to an average of slightly over IL 3 per value-added dollar. The trimming of the subsidy, which occurred simultaneously with the raising of spinning costs for yarn marketed locally, was intended to curtail exports of yarn, which has a relatively low value added and is considered unprofitable to the economy, and stimulate exports of textiles and clothing.³

In the wool branch, the fund arrangement remained in force. Up to the end of 1965 there was a duty of 80 agorot on every dollar's worth of raw wool imported and a premium of 80 agorot on every dollar's worth of export; hence this was also the subsidy rate on value added. At the beginning of 1966

¹ Textile prices rose by only 2.8 percent between 1963 and 1965, while garment prices declined by 0.4 percent over the same period.

² The diversion of at least 25 percent of total output to the overseas market and the attainment of a certain minimum volume.

³ Because of the employment situation, subsidy rates for spinning mills in development areas were left virtually unchanged. These subsidies generally range between IL 2.5 and IL 6 per dollar of gross value added.

the subsidy on wool yarn exports was raised to IL 1.1 per dollar of value added. Fabrics and other products made from local yarns were granted an extra premium of IL 0.30 per dollar's worth of export; since value added averaged 50 percent, the subsidy rate came to IL 1.70 per value-added dollar. Knitwear and woollen garments also benefit from direct export incentives, ranging from 3.5 to 6 percent of the f.o.b. dollar value of such exports.

Some garments are manufactured primarily for export—e.g. leather coats and items made from imported cloth—and these are subsidized directly. At the beginning of 1966 the subsidy rate was raised from IL 0.35 to IL 0.45 per dollar's worth of export, and since value added averages only 35 percent, the subsidy per value-added dollar comes to IL 1.3—to which must be added the direct grant.

This subsidy of IL 1.3 is far lower than that on garments made from locally manufactured cloth, which averages IL 4.6 per dollar (exclusive of direct incentives). Nevertheless, items made from imported materials account for over 70 percent of all overseas garment sales. There are two reasons for this: First, the greater competitiveness of the items made from imported materials reflects the relatively lower efficiency of Israel's textile industry. The garments manufactured from local materials carry the burden of this inefficiency, since the manufacturer has to pay a higher price for inferior cloth, and this undoubtedly brings down the price of the finished product. Secondly, there is apparently an indirect profit on production from imported materials; this arises from the fact that the required import component is estimated liberally and part of the imported materials, which are exempt from customs duty, find their way to the domestic market where they fetch high prices.

The plywood industry is also subsidized through an equalization fund. The income is derived from an import duty on unprocessed wood, and is used to equalize the return on exports with that on plywood sales in the local market. In 1966 the subsidy rate reached IL 115¹ per cubic meter, following a slight rise over the previous year's figure. This is equivalent to IL 0.70 per dollar's worth of export, or about IL 1.0 per dollar of value added.

(c) *Subsidies on agricultural exports*

These subsidies are generally of two main types: those granted under the export encouragement policy, and those on various agricultural products under arrangements tantamount to the withdrawal of surpluses and which are really intended to support domestic production. These arrangements, especially as regards eggs, cotton, and groundnuts, have been in existence for many years and are financed through the budget; on the other hand, the first category is relatively new, being introduced on a limited scale in 1964 and considerably extended toward the end of 1966. Subsidies of the second type have been on a

¹ Excluding the rebate of import duty on unprocessed wood.

much larger scale than genuine export subsidies. Still more striking is the vast differential between the rates for the two groups: in 1966 subsidies on eggs, cotton, and groundnuts, the main items in the second category, totalled approximately IL 11 million on exports of \$ 10 million, whereas subsidies intended to promote exports amounted to only IL 3 million on sales of \$ 9.5 million.

The latter type of subsidy is granted mainly on items produced primarily or largely for export: flowers, avocados, and winter vegetables raised in hothouses. In 1966 these subsidies were of two principal kinds: grants and loans to finance the installation of the special equipment required for raising winter vegetables on the one hand, and minimum price guarantees on the other. A large percentage of the subsidies paid in 1966 were thus of a nonrecurrent character, actually representing Government participation in fixed equipment investment. The second type—guaranteed minimum prices—is of particular importance for small farmers, for whom the export markets are unknown territory, while the production costs involved are relatively high. In most cases, export prices exceeded the guaranteed minimum in 1966, so that no subsidy had to be given.

Direct export incentives for agricultural products were not introduced in 1966, coming into effect only in April 1967. Citriculture, which accounts for the overwhelming share of agricultural exports, received virtually no support in 1966, except for the refunding of certain outlays.

Summary

The system of subsidies, as it existed at the end of 1966, possessed certain very significant features as regards its efficiency in promoting exports and determining their contribution to economic progress.

First of all, the raising of subsidies—and especially the introduction of direct incentives in 1966—unquestionably increased the profitability of export in relation to domestic marketing. The period following the devaluation of 1962 was characterized by demand pressure and rising producer prices in the domestic market, together with a decline in the relative profitability of export. The revision of subsidy rates, which added between 40 and 50 agorot per dollar of value added in the case of most items, is tending to rectify the situation. However, it must be stressed that even at its starting point—the devaluation—the relative profitability of many export products was much lower than that of goods sold in the sheltered domestic market. For this reason, domestic marketing is not detrimentally affected by the indirect taxes imposed on inputs, which have undermined the competitiveness of exports.

However, apart from the comparison with products marketed locally, it is no less important to compare the increased return on exports with the rise in production costs. In this respect, the detrimental influence of developments in recent years has been greater, and the countervailing effect of the larger subsidies more limited. The rise in wages and other costs during these years apparently depressed industrial profits in general, and even more so the profi-

tability of export. The granting of higher subsidies, aimed at counteracting the influence of these developments, has increased the profitability of export relative to domestic marketing, but it has been insufficient to completely restore the absolute level of profitability.

In 1966 subsidy rates were revised in a much more uniform manner than in the past, with the majority of items benefiting from more or less equal increases. Nevertheless, one distinguishing characteristic of the existing system is still the striking lack of uniformity in the distribution of subsidies, a large part of the total amount going to a relatively small percentage of products which enjoy intensive support, while the remainder is spread thinly over a large number of other items. This is reflected by the fact that, whereas some items are subsidized to the extent of IL 5 to IL 6 per dollar of gross value added, most other items receive only a tenth of this amount. Such a wide disparity creates artificial differences in profitability, which distort the picture from the aspect of national economic priorities. Thus a situation has arisen where one branch exports at a real cost of IL 8 to IL 9 per value-added dollar, while other branches cannot export if their costs reach IL 4 per dollar. This means that the system of subsidies renders profitable exports which cost the economy much more, and results in a much lower factor contribution to the country's foreign currency earnings, than would possible alternative uses rendered unprofitable by the nonuniform application of subsidies.

It should be noted that the lack of uniformity in subsidy rates is largely a legacy of the past, and that in 1966 the incremental subsidies were allocated much more equally.¹ However, they were still far from uniform, as the majority of products already highly subsidized enjoyed larger increments than those granted on a uniform basis.

Another characteristic of the system is the large share of subsidies granted in the form of participation in or refund of costs. Such support increases the return on exports, but it does this by subsidizing specific factors of production, and there is no necessary connection between the amount of support a certain item should receive from the economic viewpoint and the extent to which it utilizes the productive factor so cheapened.

Yet the method is not objectionable in all cases. There is presumably room for such measures when applied not to current outlays but to activities connected with export promotion, which in a sense constitute long-term investment. Sometimes a relatively long period is required until such expenditure results in a larger export, and enlarging the return on export is liable to be less efficient in these cases.

¹ This is not fully reflected by the amounts actually expended in 1966, as the uniform increases came into effect mainly toward the end of the year. On the other hand, incentives for a number of priority branches were further raised at the beginning of 1967 by 6.5 percent per dollar's worth of export f.o.b. This selective increase constitutes a deviation from the principle of uniform subsidies.

5. CAPITAL IMPORTS

Capital imports, including transfers and long- and medium-term loans, added up to \$ 493 million in 1966. This is substantially smaller than the annual level during 1962-64 and about \$ 100 million below the 1965 figure.

The decrease occurred in transfers to both the public and the private sector, but was most striking in the case of the former. In recent years there has been a declining trend in the weight of transfers to the public sector, especially unilateral transfers, owing to the termination of the Reparations Agreement and the discontinuance of direct U.S. Government grants.

The country's foreign exchange reserves underwent a marked change in 1966. Beginning in 1958, the reserves grew from year to year, but in 1966 they fell off by about \$ 20 million since the contraction of capital imports was greater than the decrease in the deficit on current account.

(a) *Unilateral transfers*

The outstanding change in unilateral transfers in 1966 was the complete cessation of receipts on account of German reparations, which for many years after 1952 were one of the main component items. As Israel owes some liabilities to Jewish organizations abroad on account of reparations received in previous years, the item showed a \$ 2 million debit in 1966.

Transfers on account of personal restitution payments from Germany (plus a small sum from Austria) aggregated \$ 110 million—approximately the same as in 1965 but lower than the record level of 1964. It should be noted that the proportion of nonrecurrent payments on account of restitution is declining, while that of pensions is moving up.

Private transfers, which advanced steadily to a high of \$ 98 million in 1965, declined during the year reviewed by some \$ 10 million. Part of the decrease can be attributed to the contraction of immigration in 1966, reflected by the smaller amount transferred by newcomers, especially in kind.

There was also some decline in institutional transfers. Such transfers, in particular those to the National Institutions—were very large in 1965, so that their volume in the year reviewed was still greater than in the years 1962 to 1964.

All told, the volume of unilateral transfers reached \$ 306 million in 1966, compared with approximately \$ 350 million in both 1964 and 1965.

(b) *Long- and medium-term capital movements*

The State's long- and medium-term foreign debt expanded by some \$ 113 million in 1966, after rising by nearly \$ 158 million in 1965 and \$ 131 million in 1964.

Foreign currency indebtedness reached \$ 1,320 million at the end of 1966,

Table III-16
THE BALANCE OF PAYMENTS, 1965-66
(\$ million)

| | 1965 | | | 1966 | | |
|--|----------------|----------------|--------------|----------------|----------------|--------------|
| | Credit | Debit | Net | Credit | Debit | Net |
| A. Current deficit | 710.7 | 1,245.7 | -535.0 | 819.6 | 1,271.6 | -452.0 |
| B. Unilateral transfers | | | | | | |
| Private transfers | | | | | | |
| In cash | 94.5 | 1.8 | 92.7 | 86.8 | 1.3 | 85.5 |
| In kind | 9.4 | 4.1 | 5.3 | 7.0 | 4.2 | 2.8 |
| German restitution | 112.7 | — | 112.7 | 110.4 | — | 110.4 |
| German reparations | 19.8 | 3.1 | 16.7 | — | 2.0 | -2.0 |
| U.S. Govt. grant-in-aid | 4.7 | — | 4.7 | 3.0 | — | 3.0 |
| U.N. technical assistance | 0.4 | 0.2 | 0.2 | 0.4 | 0.2 | 0.2 |
| Institutional transfers | | | | | | |
| In cash | 113.4 | 1.4 | 112.0 | 104.8 | 1.6 | 103.4 |
| In kind | 3.6 | — | 3.6 | 3.2 | — | 3.2 |
| Total | 358.5 | 10.6 | 347.9 | 315.6 | 9.3 | 306.3 |
| C. Long- and medium-term capital movements | | | | | | |
| Independence and Development Loans | 100.4 | 67.1 | 33.3 | 124.3 | 113.0 | 11.3 |
| World Bank loans | 23.4 | 0.4 | 23.0 | 48.2 | 31.0 | 17.2 |
| Export-Import Bank loans | 8.0 | 23.5 | -15.5 | 8.3 | 9.1 | -0.8 |
| U.S. Govt. D.L.F. and A.I.D. loans | 47.4 | 3.4 | 44.0 | 13.6 | 4.7 | 8.9 |
| U.S. Govt. loans in connection with food surpluses | 27.0 | 3.8 | 23.2 | 29.2 | 5.7 | 23.5 |
| Other long- and medium-term loans | 109.4 | 58.8 | 50.6 | 110.0 | 57.1 | 52.9 |
| Investments from abroad, net | 91.9 | 9.2 | 82.7 | 82.5 | 8.3 | 74.2 |
| Total | 407.5 | 166.2 | 241.3 | 416.1 | 228.9 | 187.2 |
| D. Short-term capital movements | | | | | | |
| Short-term loans | 68.6 | — | 68.6 | 15.4 | — | 15.4 |
| Deposits with International Monetary Fund | — | — | — | — | 10.0 | -10.0 |
| Clearing accounts | — | 3.1 | -3.1 | — | 1.5 | -1.5 |
| Foreign deposits | 9.7 | — | 9.7 | 16.1 | — | 16.1 |
| U.S. Govt. deposits | 7.5 | — | 7.5 | — | 5.6 | -5.6 |
| Foreign exchange reserves | — | 105.7 | -105.7 | 18.8 | — | 18.8 |
| Monetary gold | — | 0.1 | -0.1 | 10.0 | — | 10.0 |
| Total | 85.8 | 108.9 | -23.1 | 60.3 | 17.1 | 43.2 |
| Total (C) + (D) | 493.3 | 275.1 | 218.2 | 476.4 | 246.0 | 230.4 |
| Grand total | 1,562.5 | 1,531.4 | 31.1 | 1,611.6 | 1,526.9 | 84.7 |
| Net errors and omissions | — | 31.1 | -31.1 | — | 84.7 | -84.7 |

SOURCE: Central Bureau of Statistics.

as against \$ 1,225 million the year before. Short-term liabilities accounted for only a small proportion of these figures—about \$ 110 million at the end of 1966 and approximately \$ 125 million at the end of 1965. In contrast to the decline in short-term debts, medium- and long-term indebtedness increased from \$ 1,100 million at the end of 1965 to \$ 1,210 million.

Table III-17
CAPITAL IMPORTS, 1964-66
(\$ million)

| | 1964 | 1965 | 1966 | Increase or decrease (-) from 1965 to 1966 |
|---|------|------|------|---|
| Unilateral transfers | | | | |
| (1) Transfers to the private sector | 270 | 257 | 243 | -14 |
| Private transfers | 96 | 98 | 88 | -10 |
| Personal restitution from Germany | 134 | 113 | 110 | -3 |
| Transfers to nonprofit institutions | 40 | 46 | 45 | -1 |
| (2) Transfers to the public sector | 81 | 91 | 63 | -28 |
| German reparations, net | 17 | 17 | -2 | -19 |
| U.S. Government grant-in-aid | 8 | 5 | 3 | -2 |
| Transfers to National Institutions | 56 | 69 | 62 | -7 |
| Total unilateral transfers | 351 | 348 | 306 | -42 |
| Capital movements | | | | |
| (1) To the private sector | 143 | 83 | 74 | -9 |
| Foreign investments in Israel, net | 143 | 83 | 74 | -9 |
| (2) To the public sector | 131 | 159 | 113 | -46 |
| Independence and Development Loans, net | 24 | 33 | 11 | -22 |
| World Bank loans | 13 | 23 | 17 | -6 |
| U.S. Government loans (incl. Export-Import Bank) | 41 | 52 | 32 | -20 |
| Other long- and medium-term loans, net | 53 | 51 | 53 | 2 |
| Total long- and medium-term capital movements | 274 | 242 | 187 | -55 |
| Total capital imports | 625 | 590 | 493 | -97 |

SOURCE: Central Bureau of Statistics.

Receipts from U.S. Government D.L.F. and A.I.D.¹ loans were smaller than in 1965. The total volume of U.S. Government loans was especially large in 1965, so that the decrease in 1966 was very sharp. However, the \$ 35 million approximately received from the D.L.F. and A.I.D. and in the form of food surpluses was small even compared with the years before 1965. A possible explanation for part of the decline is the fact that aid provided within a single U.S. Government budgetary year may fall into two calendar years, depending on the dates of payment. The amount received under the food surplus arrangement, which bears interest at 4½ percent per annum and is repayable in Israeli pounds, was similar to that of 1965. U.S. Government aid is extended entirely in the form of loans, and the \$ 3 million listed as a direct grant in 1966 represents the sum drawn on under former agreements.

Total liabilities on account of the Independence and Development Loans reached \$ 543 million at the end of 1966, as against \$ 532 million at the end of 1965. Sales of Development Bonds increased in 1966, totalling—together with cumulated interest on savings bonds—nearly \$ 124 million, as compared with approximately \$ 100 million in 1965. The 1966 figure includes the exchange of some \$ 22 million worth of bonds from previous issues for those of new issues.

Redemption of the Independence Loan was completed in 1966. These bonds were sold as from 1951, and the final repayment in 1966 came to \$ 33 million. Redemption on account of the Development Loan in 1966 reached some \$ 28 million, so that the total amount repaid was approximately \$ 61 million.

Since redemptions plus conversions into Israeli pounds totalled \$ 113 million, net receipts on account of the Development Loan amounted to only \$ 11 million—a much smaller sum than in previous years.

The premature redemption of bonds in Israeli currency totalled some \$ 18 million—slightly more than in 1965. Approximately \$ 5 million worth were converted by tourists and immigrants, about \$ 9 million worth were converted for investment purposes, while the remaining \$ 4 million were converted by the Jewish Agency and other institutions. This breakdown resembles that of 1965, when the total amount converted was \$ 17 million.

Total long- and medium-term foreign indebtedness, exclusive of the Independence and Development Loans and U.S. Government and World Bank loans, increased by some \$ 53 million, compared with \$ 51 million in 1965.

Net investments from abroad declined by only some 10 percent in 1966, following a steep drop the year before. Total foreign investments in Israel contracted by approximately \$ 10 million, but there was also a slight decrease in Israeli investments in other countries.

¹ Development Loan Fund and Agency for International Development. These loans are granted for 20 years, bear 3½ percent interest, and are repayable in dollars.

Table III-18
FOREIGN INVESTMENTS IN ISRAEL, 1964-66
(\$ million)

| | 1964 | 1965 | 1966 | Increase or decrease (-) from 1965 to 1966 |
|--|--------------|--------------|--------------|--|
| Capital transfers in cash | 86.7 | 54.8 | 46.8 | -8.0 |
| Investment in Israeli securities | 52.4 | 37.7 | 38.8 | 1.1 |
| Capital transfers in the form of Independence and Development Bonds | 10.6 | 9.4 | 9.7 | 0.3 |
| Capital transfers in kind | 10.6 | 8.3 | 5.3 | -3.0 |
| Reinvestment of profits and Israeli currency investments | 13.5 | 9.6 | 8.9 | -0.7 |
| Total | 173.8 | 119.8 | 109.5 | -10.3 |
| Less: | | | | |
| Liquidation of foreign investments in Israel | 17.1 | 27.9 | 27.0 | -0.9 |
| Israeli investments abroad, net | 10.8 | 3.7 | 3.5 | -0.2 |
| Investments in foreign securities | 3.0 | 5.5 | 4.8 | -0.7 |
| Total | 30.9 | 37.1 | 35.3 | -1.8 |
| Total foreign investment in Israel, net | 142.9 | 82.7 | 74.2 | -8.5 |

SOURCE: Central Bureau of Statistics.

Capital transfers in cash were down by some \$ 8 million, following a decrease of \$ 32 million in 1965, while investment in shares remained at approximately the same level as the year before. Total investments from abroad (less foreign investments liquidated in Israel) contracted from \$ 157 million in 1964 to \$ 92 million in 1965 and \$ 82 million in 1966.

(c) *Foreign exchange reserves*

Israel's foreign exchange reserves totalled approximately \$ 730 million at the end of 1966, about \$ 19 million less than at the end of the previous year. This represents a marked change in trend, as the figure had advanced, often substantially, in every year since 1958.

Total short-term capital movements are regarded as balancing the difference (deficit or surplus) between the current account on the one hand and long- and medium-term capital movements on the other. The marked expansion of foreign

Table III-19
ISRAEL'S FOREIGN EXCHANGE RESERVES, 1961-66
(\$ million)

| End of year | Deposits abroad (incl. gold and I.M.F.) | Increase or decrease (-) as against previous year | Less: Deposits of foreign banks and nonresidents in Israel's banking system | Foreign currency deposits, net | Increase or decrease (-) as against previous year |
|-------------|---|---|---|--------------------------------|---|
| 1961 | 376 | — | 80 | 296 | — |
| 1962 | 506 | 130 | 100 | 406 | 110 |
| 1963 | 615 | 109 | 121 | 494 | .88 |
| 1964 | 643 | .28 | 128 | 515 | .21 |
| 1965 | 749 | 106 | 138 | 611 | 96 |
| 1966 | 730 | -19 | 154 | 576 | -35 |

exchange reserves in 1965 stemmed partly from the relatively large increase in short-term liabilities, whereas in 1966 such liabilities grew to a much more moderate extent. Total short-term capital movements in 1966 decreased by \$ 43 million, as compared with a rise of approximately \$ 23 million in the preceding year.

A further factor which cannot be ignored when analyzing the balance of payments for 1966 is the \$ 85 million in errors and omissions.