

Chapter 2

The Current Account and the Capital Account¹

1. MAIN DEVELOPMENTS

The deficit on the balance-of-payments current account was \$ 1.7 billion in 2001, 1.6 percent of GDP, as against \$ 1.4 billion in 2000, 1.3 percent of GDP, and an average deficit of \$ 3.4 billion and 3 percent of GDP in 1996–2000 (Table 1.1 and Figure 2.1). The deficit increase in 2001 is mainly the result of a \$ 0.2 billion decline on the goods account and a \$ 0.2 billion decline in current transfers. A \$ 3.2 billion deficit increase on the services account was totally offset by an improvement on the factor inputs account. As for developments during the year, the tourism slump that began in the last quarter of 2000 continued throughout 2001, whereas most of the decline on services account and the improvement on factor inputs account occurred in the third quarter of the year. Most of the increase in the current-account deficit (\$ 1.2 billion) also occurred in the third quarter; the deficit declined by \$ 0.9 billion in the fourth quarter, mostly on the factor inputs account.

Two main factors affected the current-account deficit this year: (a) the security unrest that began in October 2000, coupled with the domestic economic slowdown, and (b) the high-tech crisis and the global economic downturn, after years of prosperity.

These two factors explain most of the large changes in the items that make up the current account. On the services account, net tourism revenues declined by \$ 1.7 billion and the deficit in other services, which include but are not limited to software, telecom, and R&D, widened by \$ 1.2 billion. In contrast, the factor input revenue deficit contracted by \$ 3.3 billion (Table 1.1 and Figure 2.1).

The direct impact of the security tension on the current account may be estimated at \$ 1.9 billion in 2001 and \$ 2.4 billion since October 2000 (Table 2.1). The impact was most severe in the tourism industry, which has lost \$ 2.1 billion in revenues since October 2000. The global tourism slowdown also had an indirect

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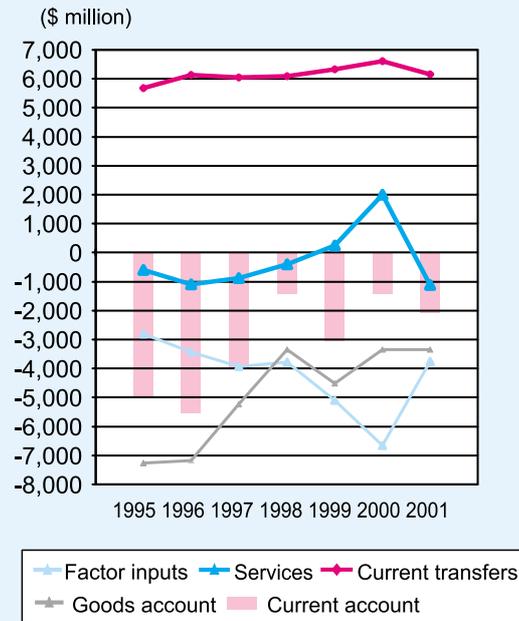
¹ This chapter does not discuss the macroeconomic aspects of the current account; these are discussed at length in the report prepared by the Research Department.

effect on net tourism revenues, especially in the fourth quarter. The trade balance with the Palestinian Authority (PA), which has been positive in recent years, doubled from \$ 0.4 billion to \$ 0.8 billion, mainly due to a decline in wage expenses for workers from the PA areas (partly due to the security unrest and its outcome, the crisis in tourism, and partly due to the decline in domestic demand for labor). Foreign workers were put to greater use as surrogates for workers from the PA areas (Table 2.1). The effect of the September 11 terror attacks in the US was evidenced in the fourth quarter in an additional decline in inbound tourism and, therefore, in tourism industry revenues. However, outbound tourism also decreased.

The global economic slowdown had offsetting effects on several components of the current account: as goods exports declined, so did goods imports.

The global slowdown led to a \$1.2 billion decrease in exports of ITC services.

Figure 2.1
Current Account, 1995-2001



SOURCE: Central Bureau of Statistics.

The global economic slowdown had offsetting effects on several components of the current account. As exports of goods declined, so did imports of goods (Figure 2.2). The slowdown of global trade growth and the crisis in global capital markets also had adverse effects on Israeli trade, which is strongly dependent on these factors because Israel has a small, technological, and open economy. However, due to the parallel decreases in exports and imports, the global slowdown had no significant effect on the goods account of the private sector (Figures 2.1 and 2.2). Net of trade in goods with the Palestinian Authority, which decreased due to the unrest that emanated from the PA areas, the deficit on goods account in the private sector actually decreased by \$ 0.4 billion.

However, the global slowdown had a perceptible adverse effect on exports of information and communications technologies (ICT) services,² especially in the third quarter. Revenues from these exports, recorded in the balance of payments under ‘Other Services,’ declined by \$ 1.2 billion this year. A contributing factor in the decrease was a large upturn in the exports of software and knowledge industries

² Findings based on Central Bureau of Statistics, *Information and Communications Technologies (ICT) Sector 1990–2000*, S.P. 1164, September 2001. These industries are defined differently from those listed in Table 1.2.

Table 2.1
Estimates of the Direct Impact of Security Events on
Main Components of the Current Account, 1999–2001

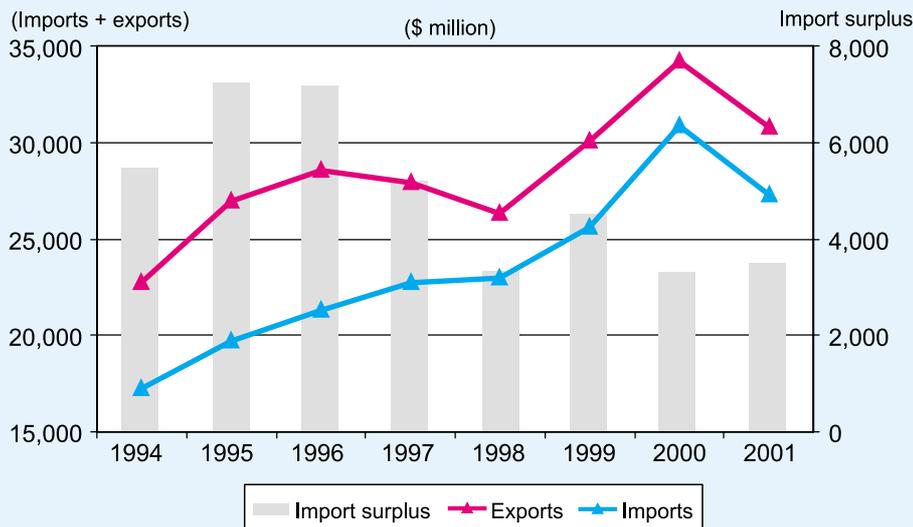
Revenues/expenses in components directly affected by security events	1999	2000	2001	Change in 2001		Change since Oct. 2000
				\$ million	Percent	
Total net revenues	2,131	2,131	222	-1,909	-90	-2,361
Revenues	5,204	5,298	2,852	-2,446	-46	-3,047
Tourism revenues (excl. foreign workers)	3,163	3,423	1,714	-1,709	-50	-2,081
Net trade with Palestinian Authority	1,545	1,378	817	-561	-41	-743
Transport, revenues from fares	496	497	321	176	-35	-223
Expenditures	3,073	3,167	2,630	-537	-17	-686
Wages of Palestinian workers	1,051	966	118	-848	-88	-1,064
Wages of foreign workers	2,022	2,201	2,512	311	14	378

(\$ million)

SOURCE: Based on Central Bureau of Statistics data.

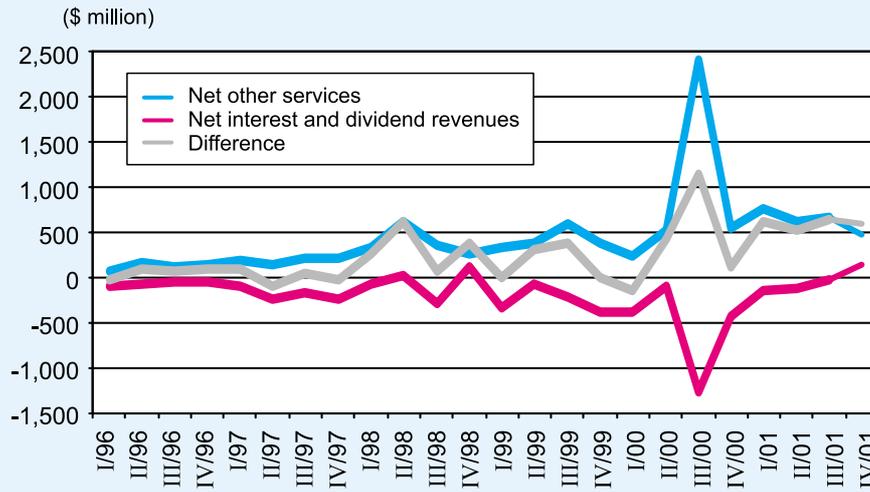
in the previous year, most of which—\$ 1.8 billion—was caused by the sale of one company and the export of its knowledge. The decline in ‘Other Services’ was offset by an improvement in the factor inputs account because shareholders abroad received \$ 1.4 billion in dividends in 2000 on account of this transaction (Figure 2.3).

Figure 2.2
Goods Account—Imports, Exports, and Import Surplus,
Balance of Payments Data, 1994–2001



SOURCE: Central Bureau of Statistics.

Figure 2.3
Private Sector— Other Services and Net Interest and Dividend Revenues and Difference, 1996-2001



SOURCE: Central Bureau of Statistics.

The effect of high-tech companies on the current account is offset among various items.

The effect of high-tech companies³ on the current account was offset among various items. On the basis of several indications, the effect on the goods account was estimated at a \$ 0.3 billion increase in the deficit, whereas in the services account, due to the smallness of the import component in these industries, the deficit widened by about \$ 1 billion. Concurrently, the deficit on factor inputs account declined because the deficit on goods and services account was offset by a decrease in dividend and wage expenditure. (For an expanded discussion, see Box 1.2.)

2. THE GOODS ACCOUNT

a. General remarks

Two components of the balance of payments, private-sector exports and imports of goods, declined at similar rates: 11.2 percent and 10.7 percent, respectively. However, the net deficit on the private sector goods account was largely unchanged from 2000 at \$ 1.4 billion or 1.3 percent of GDP. The trends in total exports and total imports have marched in tandem since 1998 (Figure 2.2), possibly due to the small, open, and technological nature of the Israeli economy, as reflected in recent years.

³ In regard to goods, the Central Bureau of Statistics releases monthly data on the distribution in industrial exports by technological intensity; see Table 2.4. The distribution uses the OECD classification and does not correspond to the definition of firms in 'Information Technology' industries.

In 1999 and 2000, rapid global growth and prosperity coincided with a surge in demand for high-tech products. These developments affected the Israeli economy, which, by meeting some of the demand for these products, recorded increases in both exports and imports. Although all components of exports and imports grew, the main changes during those years were related to high-tech exports and raw-materials imports that served as intermediates for exports and domestic manufacture (Figure 2.6 and Figure 2.7). The events in 2001, in contrast, dampened global and domestic demand. Exports and imports declined concurrently in 2001 even though a small number of high-tech companies operated in ‘niches’ and, for this reason, were less sensitive to export prices, despite the relative stability of private consumption (Figure 2.7).

Gross high-tech exports decreased by \$ 1.1 billion this year, but some of the decline was offset by an estimated \$ 0.8 billion decrease in high-tech imports. Since the downturn in high-tech exports was not greater than the average decline in other industries’ exports, the share of high-tech in exports of goods in 2001 remained at the 2000 level of about 40 percent. Thus, the proportion of high-tech leveled off after increasing steadily from 27 percent in 1996.

The offsetting effect of exports and imports was also evident in high-tech industries, whose weight in total goods exports was unchanged from 2000 at 40%.

Table 2.2
Change in Imports and Exports, by Regions, 2000–2001

Country/region	2000 vs. 1999		2001 vs. 2000 ^a	
	Exports	Imports	Exports	Imports
World at large	12	12	1	1
Industrialized countries	7	10	0	0
Euro zone	4	10	3	2
United States	11	19	1	1
Israel	21	14	–9	–8
Countries comparable to Israel ^b	15	21	2	0

^a First half of each year.

^b Ireland, Portugal, South Korea, Thailand, Indonesia.

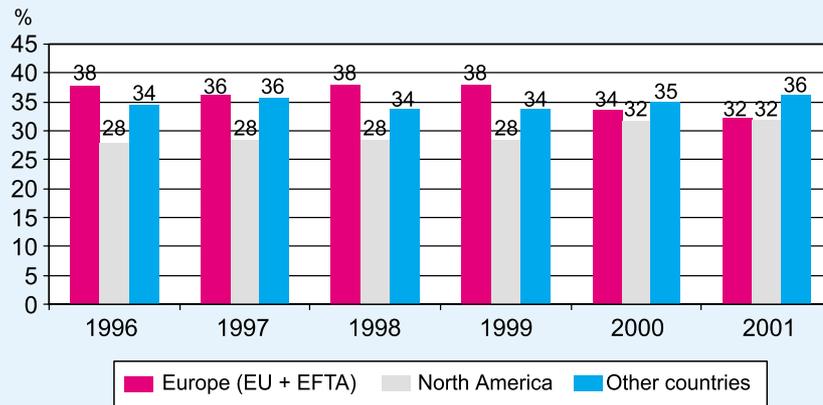
SOURCE: International Financial Statistics.

The terms of trade—which worsened by 0.4 percent in 2001 (after falling by 3.2 percent in 2000) as export prices declined by 2.2 percent and import prices decreased by 1.8 percent—also had a downward effect on exports and imports. Excluding trade in diamonds and fuel, the terms of trade worsened by 0.7 percent.

The annual rate of decrease in civilian imports, according to the foreign-trade data (7.1 percent), was smaller than the rate of decrease in exports of goods (9.5 percent), for reasons including a moderate 3.5 percent upturn in imports of consumer goods (\$ 159 million). Another conspicuous development was the \$ 428 million increase in imports of ships and aircraft (Table 2.5). Defense imports expanded by \$ 0.2 billion, in tandem with the upturn in defense assistance. In view of the security unrest, the export surplus vis-à-vis the Palestinian Authority areas contracted steeply, by 32 percent or \$ 400 million.

The terms of trade worsened by 0.4% in 2001, as export prices declined by 2.2% and import prices decreased by 1.8%.

Figure 2.4
Nondiamond Exports, by Target Country, 1996-2001



SOURCE: Central Bureau of Statistics.

Israel's imports and exports declined more rapidly this year than those of its main trading partners and countries that resemble Israel in various respects.

Israel's imports and exports declined more rapidly this year than the imports and exports of the country's main trading partners (the US and the EU) and countries that resemble Israel in various respects, such as per capita GDP and nonfinancial openness (Table 2.2). The declines in 2001 brought the domestic economy back to the trend in previous years and identify 2000 as an aberrant year in respect to the growth of foreign trade and, especially, of exports.

The trend of concurrent contraction of imports and exports of goods in the private sector began in the first quarter of the year, but in the third quarter the decline in imports surpassed the decline in exports whereas in the fourth quarter exports increased while imports continued to decline.

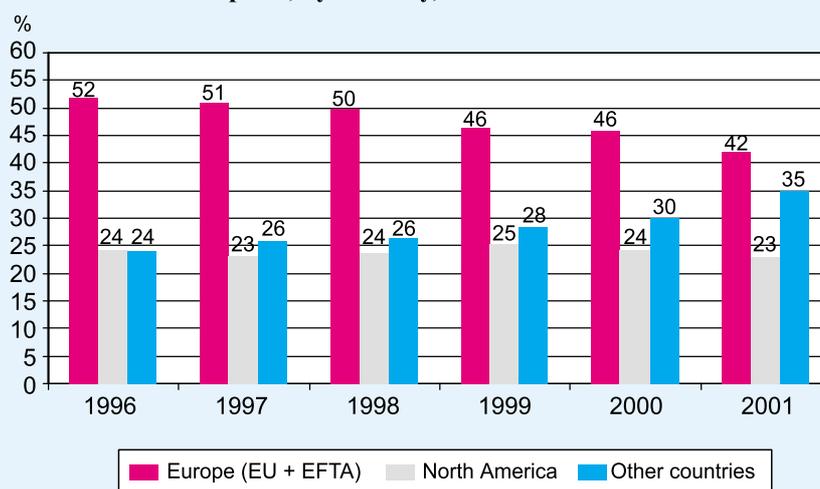
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The geographic redirection of Israel's foreign trade continued in 2001, as imports shifted from the US and, in the main, from Europe to other countries and exports moved from Europe to other countries—even though there was no uniform trend of change in dollar-euro cross-currency exchange rates during the year (Figures 2.4 and 2.5). The intensity of the redirection eased this year, after stronger redirection of exports to the US in 2000 for reasons including the weakening of the euro against the dollar. However, Europe's share in exports of goods has been declining steadily in recent years and even more steeply in imports of goods.

b. Exports and imports

Gross exports of goods, according to the foreign-trade data, were \$ 27 billion in 2001, 6.6 percent (\$ 1.9 billion) less than in 2000 (Table 2.3). Exports of polished diamonds declined by \$ 0.4 billion and other industrial exports contracted by \$ 1.5 billion. Most of the decline in industrial exports occurred in two industries that are identified with high-tech: electronic components and computers (a decrease of \$ 0.6 billion) and communications, control, and medical and scientific equipment (\$ 0.8 billion).

Figure 2.5
Nondiamond Imports, by Country, 1996-2001



SOURCE: Central Bureau of Statistics.

Analysis of the distribution of non-diamond industrial exports among high-tech and mixed-high-tech industries, on the one hand, and traditional and mixed-traditional industries on the other, shows that the decline in high-tech industries was twice that of traditional industries this year—8 percent versus 4 percent. Nevertheless, due to the large scale of high-tech exports, their share in industrial exports hardly declined: 75.5 percent in 2001 as against 76.3 percent in 2000 (and 70.9 percent in 1999) (Table 2.4 and Figure 2.6).

Exports of high-tech and mixed-high-tech industries declined by 8% in 2001; exports of mixed-traditional and traditional industries fell by 4%.

Table 2.3
Industrial Exports of Main Industry Groups (Gross), 1997-2001

(Year-on-year quantity change, percent)

	Annual change, percent					Exports 2001	Distri- bution 2001	Change in price 2001	
	1997	1998	1999	2000	2001				
	(\$ million)								
Total exports	9.8	4.4	8.8	26.6	-6.6	27,046	100.0	-2.5	
Total exports, excl. polished diamonds	10.4	7.9	5.5	27.9	-7.0	19,537	72.2	-2.0	
Textiles, clothing, and leather	-0.2	6.6	6.8	0.7	-8.9	1,042	3.9	-0.6	
Chemicals and oil refining	13.3	3.4	5.3	18.5	1.0	3,737	13.8	-6.3	
Rubber and plastics	7.4	2.2	15.9	4.0	0.9	1,079	4.0	6.4	
Basic metal products	10.2	8.7	-4.8	8.9	-3.7	1,021	3.8	-3.3	
Machinery and equipment	1.8	9.3	-6.2	11.0	0.9	1,134	4.2	-5.3	
Electronic components and computers	12.6	2.4	1.6	146.9	-15.7	3,069	11.3	-0.4	
Equipment: communications, control, medical, scientific	23.5	16.2	14.2	30.8	-12.9	5,246	19.4	-1.8	
Transport vehicles	7.3	26.5	9.8	4.4	3.3	1,046	3.9	0.3	
Polished diamonds	8.2	-4.3	18.2	23.3	-5.4	7,508	27.8	-3.9	

SOURCE: Based on Central Bureau of Statistics data.

Table 2.4
Industrial Exports (Gross) by Levels of Technology, 1997–2001

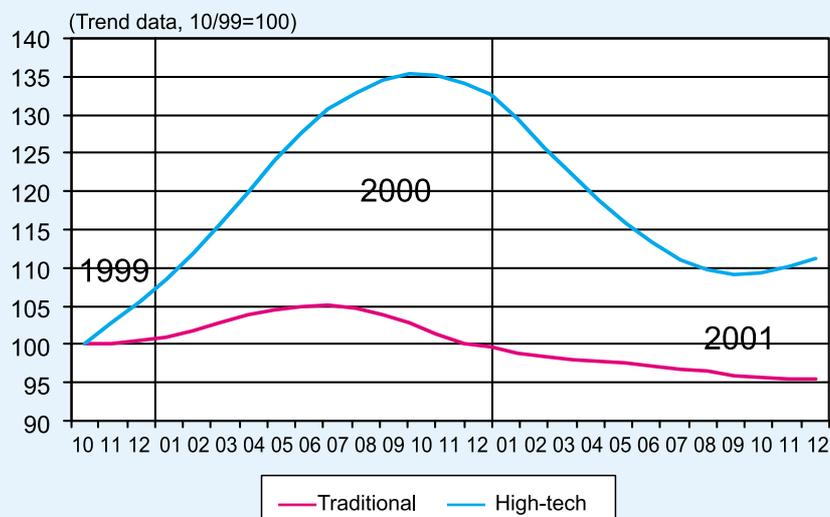
(Year-on-year quantity change, percent)

	Quantity change					Exports 2001	Distri- bution 2001
	1997	1998	1999	2000	2001		
	(\$ million)						
Total exports, excl. polished diamonds	10.4	7.9	5.5	27.9	-7.0	19,537	100.0
High-tech industries	19.4	12.7	10.2	49.1	-10.1	10,062	51.5
Mixed high-tech industries	9.0	7.3	1.2	16.6	-3.1	4,685	24.0
Mixed traditional-tech industries	5.1	2.2	1.9	5.7	-2.7	3,086	15.8
Traditional-tech industries	-4.0	1.9	2.5	2.2	-6.0	1,704	8.7

SOURCE: Based on Central Bureau of Statistics data.

Net imports of goods, according to foreign-trade data, were \$ 33 billion in 2001, 7.1 percent (\$ 2.5 billion) less than in 2000. Diamond imports declined by \$ 1.2 billion and other imports, excluding ships and aircraft, by \$ 1.7 billion (Table 2.5).

Figure 2.6
Industrial Export Index, High-Tech and Traditional Industries, 1999–2001

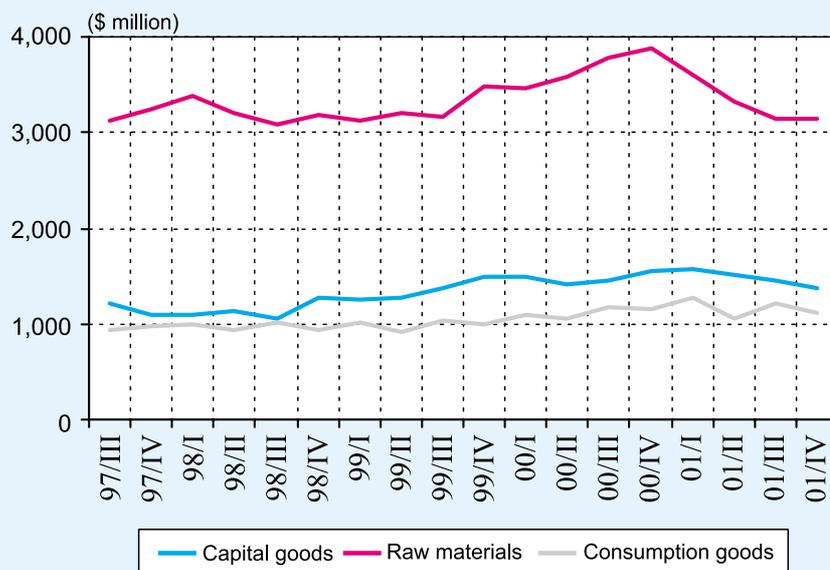


SOURCE: Central Bureau of Statistics, processed by Bank of Israel.

Imports for the machinery and electronics industry declined by 16% in 2001.

The data on import trends by groups of goods, excluding ships, aircraft, diamonds, and fuel, show a slight increase in imports of consumer goods (reflecting the smoothing of consumption that occurs at times of economic slowdown), stability in imports of capital goods, and all of the decline in imports of raw materials (Figure 2.7). Most of the last-mentioned decline took place in imports for the

Figure 2.7
Main Import Components, 1997-2001



SOURCE: Central Bureau of Statistics, processed by Bank of Israel.

Table 2.5
Imports of Goods (Net), by Group, 1997-2001

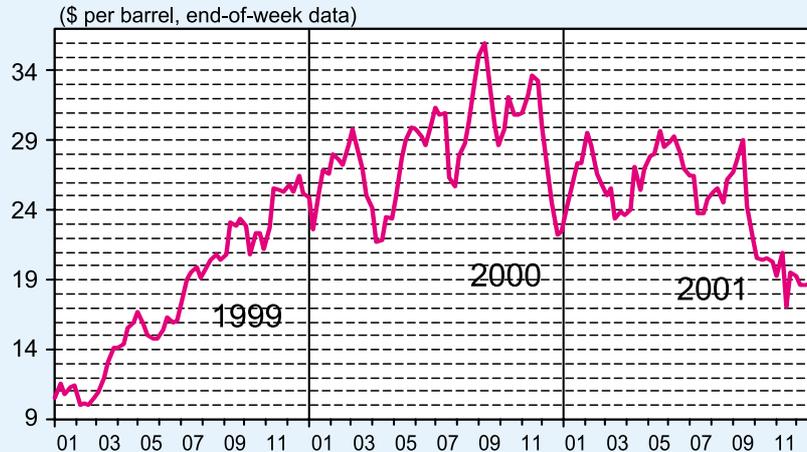
(Year-on-year quantity change, percent)

	Annual change					Imports 2001 (\$ million)	Distri- bution 2001	Change in price 2001
	1997	1998	1999	2000	2001			
Total imports	-3.0	-5.8	13.4	15.0	-7.1	32,712	100.0	-1.8
Total imports, excl. ships, aircraft, and diamonds	-3.8	-2.0	5.9	17.1	-6.1	26,880	82.2	-2.2
Total imports, excl. ships, aircraft, diamonds, and energy imports	-4.7	-0.1	4.9	12.5	-5.3	23,786	72.7	-1.2
Consumer goods	-1.7	0.0	2.0	13.8	3.5	4,657	14.2	-1.5
Raw materials	-3.7	-0.2	1.0	13.3	-10.4	13,170	40.3	-2.2
<i>of which</i> Imports for machinery and electronics industries	-9.6	7.2	5.0	22.9	-15.5	5,455	16.7	-0.1
Capital goods	-9.5	-0.2	18.5	9.6	0.5	5,940	18.2	-1.2
Energy inputs	5.5	-20.3	17.2	65.8	-11.5	3,095	9.5	-10.8
Rough and polished diamonds	-0.8	-19.7	42.1	16.5	-18.8	5,164	15.8	0.0
Ships and aircraft	22.4	-75.0	771.6	-67.3	178.8	668	2.0	
Other	-28.9	355.6	35.0	38.6	-17.0	19	0.1	

SOURCE: Based on Central Bureau of Statistics data.

machinery and electronics industry (16 percent, \$ 1 billion), which reflect high-tech industries to some extent. This corresponds to data on the decline in 2001 in the exports of high-tech industries, which use imported intermediates rather heavily, and also to the downward-pointing statistics on exports of traditional industries, which were also affected by the domestic and global economic downturn.

Figure 2.8
Brent Fuel Prices, 1999-2001



SOURCE: Bloomberg, processed by Bank of Israel.

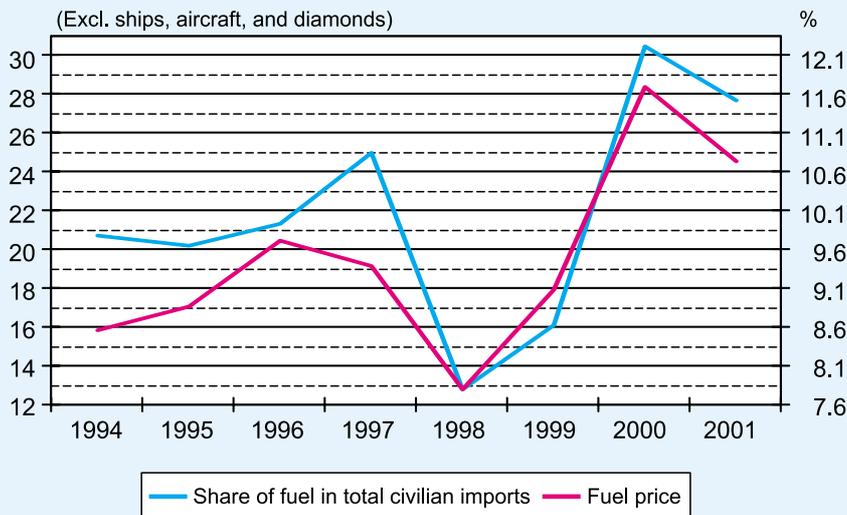
Fuel imports were \$ 3.1 billion in 2001, down \$ 0.4 billion (11.5 percent) from 2000. Oil prices (Brent) decreased by 13.4 percent in 2001—from \$ 28.4 per barrel on average in 2000 to \$ 24.6 in 2001 (Figure 2.8). Thus, the quantity of oil imported increased by only 2.2 percent, a rate consistent with the domestic economic slowdown. Since some petroleum distillates are heavily taxed at rates that are not functions of the price of crude oil, changes in crude-oil prices are not fully passed on to consumers and consumer demand for fuel is not elastic to changes in global prices of crude oil. Consequently, there is a strong positive correlation between the global fuel price and the share of fuel imports in Israel's total civilian imports (Figure 2.9).

3. THE SERVICES ACCOUNT

The deficit on the services account increased by \$ 3.2 billion in 2001. Most of the deficit growth is traceable to two components of this account: tourism at \$ 1.7 billion and other services at \$ 1.2 billion. Since October 2000, when the security unrest began, inbound tourism and, perforce, tourism revenues have been plummeting (Figure 2.10). In the first nine months of 2001, inbound tourism

The deficit on the services account increased by \$ 3.2 billion in 2001.

Figure 2.9
Global Fuel Prices and Share of Fuel in Total Civilian Imports,
1994-2001



SOURCE: Bloomberg and Central Bureau of Statistics, processed by Bank of Israel.

declined by 52 percent relative to the equivalent period in the previous year. An additional decline ensued due to the September 2001 events in the US, and in the fourth quarter inbound arrivals were only 33 percent of their IV-1999 level. Tourism revenues, which as stated declined by \$ 1.7 billion (50 percent) in 2001, include revenues from the basic living expenses of foreign workers, which at \$ 400 million in 2001 constituted 21 percent of revenues on this line of the account. Foreign-worker revenues have been stable in recent years and have no effect of consequence on the tourism component.

The decrease in tourism was reflected mainly in organized inbound groups, and the characteristics of inbound tourists were different this year than in previous years. Pilgrimage tourism declined and the proportion of business and private-visit tourists increased. Group tourism is noted, among other things, for the pattern of its stays in Israel, i.e., bed-nights in hotels. Indeed, hotel bed-nights by inbound tourists declined by 60 percent in 2001. The average tourist spent about five days longer in Israel in the first half of the year than in the equivalent period in the previous year (Ministry of Tourism data) but average revenue per tourist slipped by 11 percent and average revenue per tourist-day fell by about one-third.

The uptrend in outbound tourism—an average annual growth rate of 9 percent in 1996–2000—stopped in 2001. After a 3 percent increase in the first nine months of the year, departures in the fourth quarter decreased by 12 percent. This is almost certainly a response to the September 2001 events in the US, which affected tourism in all locations.

Inbound tourism declined by 52% and tourism revenues by \$1.7 billion.

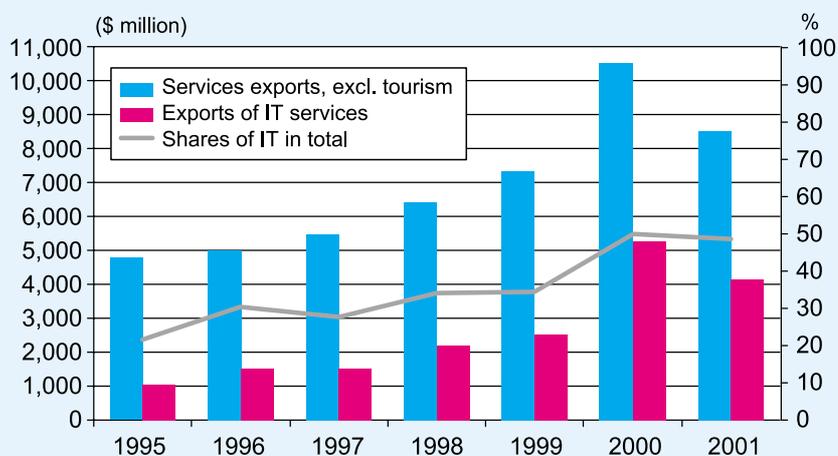
The uptrend in outbound tourism halted; in 2001:IV, departures declined by 12%.

Table 2.6
Service Exports of Information Technology Industries, 1995–2001

Year	Exports of services excl. tourism	Exports of information technology services	Annual change in information-technology exports	Share of information-technology industries in exports of services
	(\$ millions)		(percent)	
1995	4,795	1,028		21.4
1996	5,019	1,522	48.1	30.3
1997	5,475	1,514	-0.5	27.7
1998	6,413	2,178	43.9	34.0
1999	7,348	2,532	16.3	34.5
2000	10,523	5,246	107.2	49.9
2001	9,122	4,147	-20.9	45.5

SOURCE: Based on Central Bureau of Statistics data.

Figure 2.11
Exports of Services (excl. Tourism) and Exports of Information Technology Services, 1995–2001



SOURCE: Central Bureau of Statistics.

Direct investment expenditure declined by \$ 2.6 billion. The decrease occurred in both components of this expenditure: external dividend payments (\$ 1.5 billion) and undistributed earnings (\$ 1.1 billion). Dividend payments by the private sector to direct investors abroad increased significantly in 1999 and 2000. In the third quarter of 2000, a large dividend payment was recorded on account of the sale of one Israeli software company to a nonresident and the transfer of its knowledge abroad; this explains the steep decline in this component in 2001.

Direct investment expenditure declined by \$2.6 billion in 2001 after substantial increases in previous years.

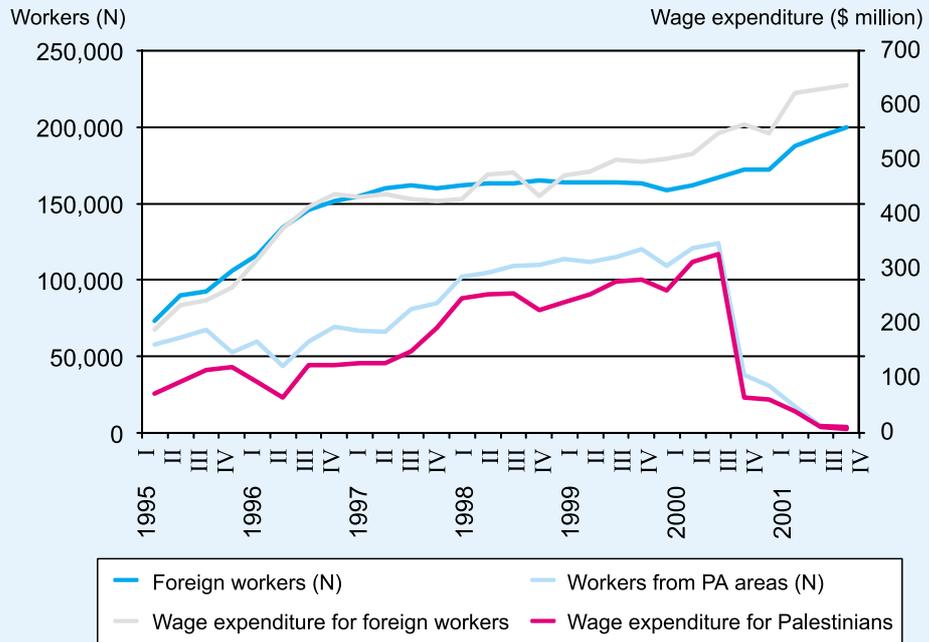
Net interest payments fell by \$ 0.2 billion, as most of a decrease in general-government expenditure was offset by a decline in revenues of the private sector. In the estimation of the Bank of Israel, the global downturn in interest rates on government debt contributed only \$ 90 million to the decrease, since 82 percent of outstanding government debt is in fixed-interest instruments, which are not affected by decreases in interest rates.

From 1995 to the third quarter of 2000, the number of workers from the Palestinian Authority areas doubled on annual average—from 60,000 to 124,000—and the wage expenses for them climbed from \$ 400 million to about \$ 1 billion in each of the years 1998–2000. The security unrest that began in October 2000, coupled with the tourism crisis occasioned by these events and the general economic slowdown, led to an almost total cessation of the use of workers from the PA areas, their numbers plummeting to 4,000 in the last quarter of 2001 (Figure 2.12). The wage expenses for these workers decreased by \$ 0.8 billion in 2001. This decline was partly offset by a \$ 0.3 billion increase in wage outlays for foreign workers.

The number of foreign workers whose wage expenses are included in the balance-of-payments data has been mounting steadily; it doubled from 90,000 in 1995 to 188,000 in 2001, when another 23,000 workers came aboard (annual

Employment of workers from the Palestinian Authority areas came to a nearly total halt; wage expenditure for them was only \$0.1 billion.

Figure 2.12
Foreign Workers, Workers from Palestinian Authority Areas,
and Wage Expenditure, 1995-2001



SOURCE: Central Bureau of Statistics.

average figures) (Figure 2.12).⁴ Wage expenses for these workers increased from \$ 0.9 billion in 1995 to \$ 2.5 billion in 2001. Net of taxes and basic living expenses, foreign workers had an estimated remainder of \$ 1.8 billion that they could send to their families abroad. Reports from banks and moneychangers about overseas transfers of foreign workers' wages fall short of this estimate, apparently because foreign workers remove some of their earnings in ways that circumvent banks and moneychangers.

The number of foreign workers whose wage expenses are included in the balance-of-payments data has doubled since 1995.

5. CURRENT AND CAPITAL TRANSFERS

After years of stability, net current transfers declined by \$ 0.2 billion in 2001, with about half of the decline in transfers of the private sector; capital transfers of this sector also declined, by about \$ 50 million. Transfers from abroad to institutions in Israel—private and governmental—decreased by \$ 0.3 billion (22 percent) but remained slightly higher than the 1999 level. The downturn in transfers to institutions may have been related to falling share prices in the US and the global economic slump. In contrast, US government transfers increased by \$ 0.2 billion (see Box 2.1).

Current transfers to institutions decreased by 22% but surpassed the 1999 level.

Box 2.1: US Government Grants to the Government of Israel

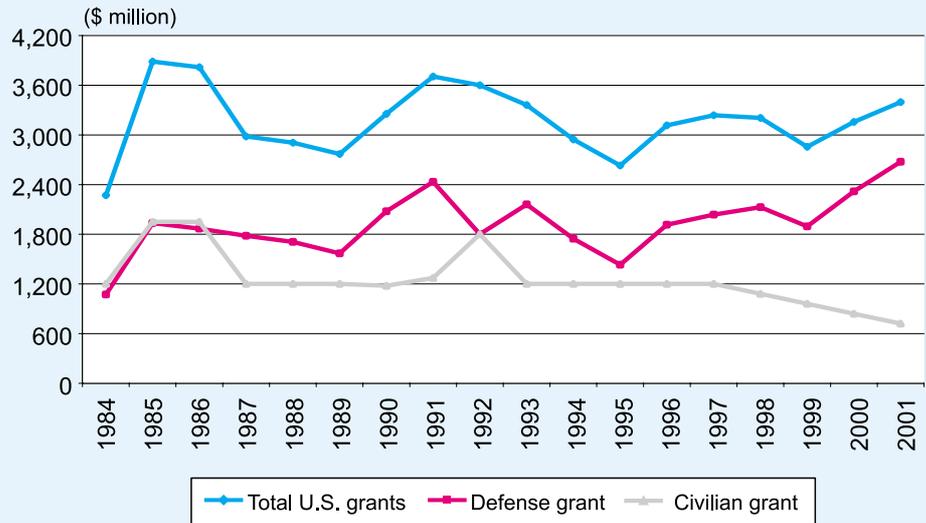
US government grants to Israel (Figure 1) first attained significant levels in 1973, after the Yom Kippur War. Defense assistance was set at \$ 1.8 billion and civilian aid at \$ 1.2 billion. Israel receives the civilian grant in a lump sum; the defense grant is placed in an interest-bearing deposit with a US bank and is received in the course of the year. The accrued interest, estimated today at \$ 100 million per year, is added to the grant. Any portion of the defense grant that is not used in a given year is carried over to subsequent years. Therefore, the defense grant as approved by the US government is different from that actually received (Figure 2). About 75 percent of the grant is earmarked for defense imports from the US; Israel is allowed to use the rest for domestic defense projects.

In addition to the current defense grant, Israel has received three defense-related grants:

- a. US military surplus: since the 1991 Gulf War, the Israel Defense Forces have been receiving weapons and armaments from US army surplus, the value of which is recorded in the balance of payments as a grant.

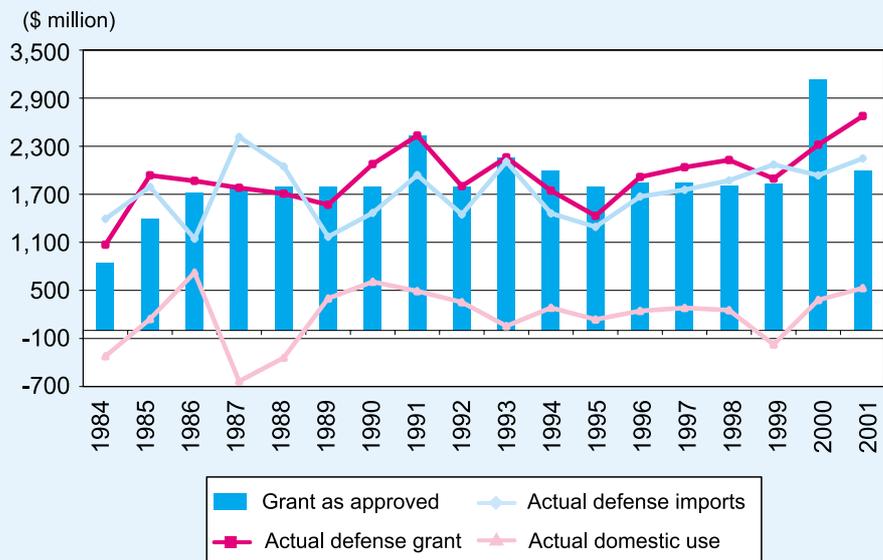
⁴ The Central Bureau of Statistics estimated the number of foreign workers at the end of 2000 at 240,000. See press release, October 30, 2001. The differences between this figure and the number included in the balance of payments have implications for the level of current transfers.

Figure 1
U.S. Government Grants, 1984-2001



SOURCE: Central Bureau of Statistics.

Figure 2
Defense Grant—as Approved, as Used, and Uses in Israel and Abroad, 1984-2001



SOURCE: Ministry of Finance and Central Bureau of Statistics.

b. In 1996 and 1997, Israel received \$ 50 million each year in anti-terror assistance.

c. Assistance for redeployment under the terms of the Wye Accord—\$ 1.2 billion in assistance was approved, for use in four years starting in 2000. In 2001, Israel received \$ 300 million under this arrangement and converted half of it into domestic currency. In 2000 Israel received a similar sum .

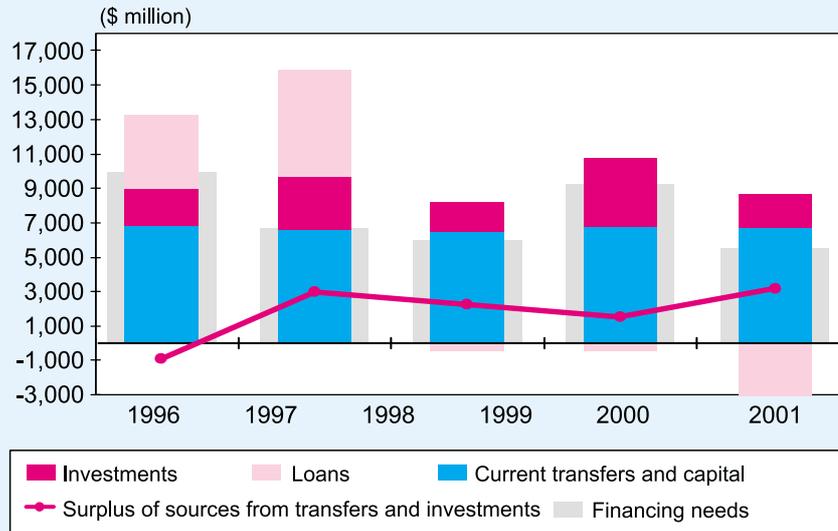
As stated, the regular civilian grant was \$ 1.2 billion per year. However, larger grants were approved in certain years—in 1985 and 1986, to help Israel carry out its Economic Stabilization Program, and in 1992, in compensation for damage occasioned by the Gulf War. The civilian grant is used mainly to pay back loans from the US government in past years, whereas the defense grant is tendered on a current basis for the given year against invoices for imports or domestic expenditure. As the payback sums of US government loans decreased, the two countries agreed that starting in 1998 the civilian grant would decrease each year by \$ 120 million and the defense grant would increase by \$ 60 million. Thus, by 2007 the defense grant to the Government of Israel will be \$ 2.4 billion and the civilian grant will have been phased out. The civilian grant was delayed this year; only \$ 150 million arrived during the year and the remaining \$ 570 million came in February 2002. Since the US administration had committed itself to completing the grants, the Central Bureau of Statistics recorded the civilian grants as if they had arrived in full in 2001 and recorded the undertaking to make up the grant as an increase in government assets abroad.

6. FINANCING THE DEFICIT ON THE GOODS, SERVICES, AND FACTOR INPUTS ACCOUNT

The deficit on the goods, services, and factor inputs account (hereinafter: the deficit) was \$ 8.1 billion in 2001, almost unchanged from 2000 (\$ 8.0 billion), whereas the sources of financing in the form of transfers, loans, and investments was \$ 5.5 billion, only about half the 2000 level. The economy's financing needs are not identical to the size of the deficit because statistical discrepancies, reflecting errors in measurement of the goods, services, and factor inputs account and in capital flows, are subtracted from it. Statistical discrepancies were \$ 2.5 billion this year as against \$ 1.6 billion in 2000. The statistical discrepancies lowered the financing needs in 2001 to \$ 5.6 billion. Thus, current transfers alone, at \$ 6.4 billion, surpassed the financing needs (Figure 2.13) after covering only 69 percent a year ago.

Available sources were \$2.6 billion smaller than the deficit on the goods, services, and factor inputs account.

Figure 2.13
Sources of Financing of the Deficit on Goods, Services, and Factor Inputs Account, 1996-2001



SOURCE: Central Bureau of Statistics, processed by Bank of Israel.

When statistical discrepancies are positive, as in 2001, the deficit may have been smaller than measured or the economy may have had an unrecorded capital flow. The magnitude of statistical discrepancies this year and the change in their sign make it difficult to perform a year-on-year comparison and to analyze the economy's financing needs. Since the discrepancies in 2001 may therefore have originated in the quality of the data, among other factors, the analysis of developments in the current account, the capital account, and the financial account is deficient.

Among the economy's financing sources, current transfers stand out for many years of stability. On average for the past four years, current transfers have been equal to 77 percent of the deficit on goods, services, and factor inputs account. In contrast, net investment declined by about one-half. Nonresident investments decreased by \$ 5.2 billion and were only partly offset by a \$ 2.9 billion decrease in resident external investments.

Total non-debt sources (transfers and investments) were \$ 8.8 billion—\$ 2.6 billion lower than the 2000 level. However, the economy's financing needs were \$ 4.0 billion smaller than in 2000. Thus, notwithstanding the severe decline in investment, a surplus of non-debt sources remained to finance the deficit. This surplus allowed the economy to reduce its net external debt by \$ 3.3 billion, after a decrease of \$ 1.2 billion in 2000. Most of the drawdown traces to an increase in assets abroad.

