

6. Commerce and services

The decline in the activity of the commerce and services industry was checked in 2003, against the backdrop of the relative security calm, moderate recovery of global demand, and rapid and successful conclusion of the Second Gulf War. The product of the industry dipped by 0.7 percent and exports rose by 10 percent—a turnaround after the marked decline of 2001–2002.

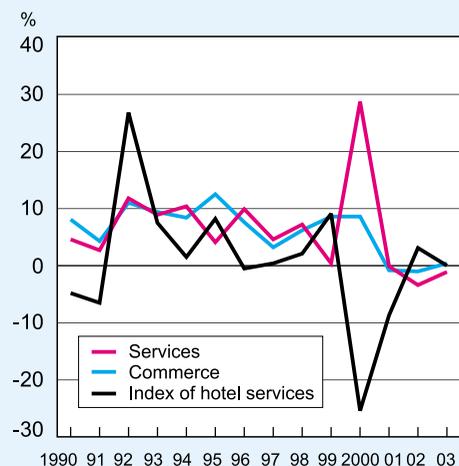
The decline in the activity of the commerce and services industry slowed in 2003, in the context of the relative easing of the security situation, moderate recovery of global demand, and quick and successful conclusion of the second war in Iraq. The product of the industry fell by 0.7 percent, compared with its marked contraction in 2002. Since business-sector product expanded by 1.8 percent, the share in it of commerce and services product fell to 51.4 percent. The industry's exports, which account for about a third of total nondiamond exports, rose in volume terms by 10 percent—a turnaround after a marked decline in both 2001 and 2002. The number of persons employed in the industry rose by 2 percent, compared with a 1 percent increase in the business sector, but investment in it continued to decline (Table 1.37 and Figure 1.34). The product of the industry fell in 2003: I because of the Gulf War, and recovered gradually subsequently.

The product of the services industry (catering and hotels, business and financial services, education, health, etc.) dipped by 1.1 percent in 2003. The conclusion of the Gulf War and the improvement in the security situation contributed to the expansion of activity in the catering and hotel industry during the year. By contrast, demand for computerization and R&D services did not rise appreciably, also because of the slow growth rate of the global ICT industry.

The expansion of the product of the services industry over time is due to the rise in the standard of living, and in education and health it is also because of the reduction of government involvement and transition to the provision of these services by the business sector. The activity of the education, health, and welfare business services contracted in 2003, in spite of the reduction of government intervention in their provision, apparently because of the decline in per capita disposable income,⁴⁷ and with it in the demand for these services. Because of the lower government involvement in economic activity, the purchase of services from the business sector declined in 2003.

⁴⁷ The share of the business sector in national expenditure on health rose from 23 percent in 1990 to 28 percent in 2002. Welfare services were partially privatized by the government and the local authorities (J. Katan (2002), "The Partial Privatization of Personal Welfare Services: Dilemmas and Main Problems," in J. Kop (ed.) *The Allocation of Resources to Social Services, 2001*, The Center for the Study of Social Policy in Israel (Hebrew).

Figure 1.34
Real Increase in the Index of
Commerce and Services,
1990–2003



SOURCE: Appendix Table 1.A.41.

Table 1.37
Commerce and Services, Main Indicators, 1995–2003

	(annual change, percent)						
	1995–98	1998	1999	2000	2001	2002	2003
Product	7.2	10.1	2.2	22.3	-0.3	-2.7	-0.7
Product excluding start-ups	6.8	9.5	2.5	18.8	1.0	-1.5	-0.2
<i>of which</i> Commerce	5.6	6.2	8.6	8.6	-0.8	-1.0	0.4
Services	7.8	11.9	-0.1	28.6	-0.1	-3.4	-1.1
Labor input	5.3	4.2	7.0	10.6	-1.3	1.5	1.6
Capital stock ^a	19.6	11.8	10.1	8.5	6.1	3.4	2.2
Labor productivity	1.8	5.7	-4.1	10.5	1.0	-4.1	-2.3
Multi-factor productivity	-3.7	2.5	-5.6	9.0	-0.5	-3.7	-2.0
Real wage	2.1	0.9	6.2	9.5	2.5	-6.7	-2.8
Real labor cost ^b	1.9	-0.5	0.0	10.8	2.5	-4.9	-3.5
Relative price ^c	0.2	-0.1	0.3	-1.6	0.5	-0.3	0.7
Exports ^d	9.3	17.2	24.3	37.0	-19.5	-11.3	10.0
Investment	4.5	-12.5	-1.6	-4.2	-12.1	-8.8	-6.3

^a At beginning of year.

^b Deflated by output prices.

^c Relative to business-sector prices.

^d Business services exports deflated by services exports index.

For source and definitions see Appendix Table I.A.40.

Table 1.38
Business Services Revenue, 1996–2003

	(percent)											
	Share in GDP					Real rise in revenue						
	1996	2000	2001	2002	2003	1997	1998	1999	2000	2001	2002	2003
Computer services and R&D ^a	17.2	31.2	29.9	26.8	27.8	12.0	33.4	21.8	59.3	-5.2	-8.6	-4.0
Employment services	9.2	9.2	8.9	8.0	7.2	0.9	18.0	12.4	13.6	-5.2	-11.6	-12.6
Security and cleaning	7.9	7.0	7.9	8.8	9.2	17.4	5.2	-3.2	12.0	11.7	9.1	1.3
Other business services ^b	47.7	36.0	36.9	37.5	38.1	-4.7	18.7	-7.1	8.9	1.3	-0.8	-1.5
Real estate and equipment rental	17.9	16.6	16.4	17.6	17.7	-1.2	25.5	4.4	8.5	-2.2	4.9	-2.8
Total	100	100	100	99	100	1.1	21.4	3.1	19.9	-1.2	-2.4	-3.1

^a Including software companies and start-ups.

^b Including legal, accountancy, market research, engineering, architecture, advertising and public relations, photography, and other services.

SOURCE: Central Bureau of Statistics.

The number of persons employed in the services industry rose—despite the decline in their product—because of the contraction of labor productivity, primarily in the financial, business, health, welfare, and education services. Many foreign workers were replaced by Israelis in 2003—largely in the catering and hotel services, and apparently also in cleaning and welfare services.

The product of commerce rose by 0.4 percent in 2003 due to the recovery of private consumption.

The product of the commerce industry rose by 0.4 percent in 2003, apparently because of the recovery of private consumption, after its decline in the two preceding years. The number of persons employed in the industry remained virtually unchanged, with a decline in their number in retail food commerce, possibly due to the shift to cheaper purchases in larger stores on the outskirts of towns, where revenue per employee is high, and to an increase in efficiency in retail outlets.

During an economic slump workers move from unionized industries to the commerce and services industry, which are less unionized. The increase in the supply of positions in the commerce and services industries⁴⁸ is due to consumption, which moderates the contraction of activity in commerce,⁴⁹ and commerce was in fact less affected than other industries by the shocks and recession of the last three years. Note, however, that the persistence of the slump obliged firms to undergo extensive reorganization.

Table 1.39
Number of Businesses, 1999–2003^a

	(percent change from previous year)					No. of businesses
	1999–2000	2001	2002	2003	2003	
Commerce, vehicle and other repairs	-0.3	-0.3	-4.0	0.3		74,392
Hotels and catering services	-0.1	1.4	-6.8	2.8		12,607
Real estate, machine, equipment and goods hire	0.9	0.1	-5.4	-1.4		16,882
Computer services and R&D	5.7	9.7	2.1	6.7		7,324
Manpower agencies, security and cleaning	-1.8	0.8	-4.7	1.9		3,831
Education	4.0	1.4	-1.9	-0.2		8,105
Health and welfare services	4.5	4.2	3.8	2.7		25,000
Personal and other services	3.7	2.8	0.4	1.3		19,517
Entertainment, leisure, culture and sports	3.0	3.1	0.0	2.1		11,642

^a Going business excluding non-profit organizations and financial institutions.

SOURCE: The Central Bureau of Statistics VAT file.

The balance of active businesses—the number of new firms less the number of those that closed—turned positive in 2003.

The balance of active businesses—the number of new firms *less* the number of those that closed their doors—turned positive in 2003. The considerations for closing a business are long term: in 2002, with the internalization of the slowdown, many businesses closed, but in 2003, against the backdrop of signs of an imminent recovery, the number of new businesses soared. The number of businesses in most commerce and services industries was up from 2002 (Table 1.39), despite the continued decline in their product (Table 1.40). Although the balance of businesses improved, the real estate business, whose balance was negative, was the exception.

⁴⁸ W.C. Goodman (2001), “Employment in Services Industries Affected by Recessions and Expansions,” *Monthly Labor Review*, October, 124 (10), 3–11.

⁴⁹ See preceding note.

Table 1.40
Commerce and Services by Type: Product, Employment and Wages, 1995–2003

(annual change, percent)

	Total	Commerce	Services	Services					
				Hotels and catering	Business services	Insurance and financial institutions ^a	Health	Education	Personal and other
Share in GDP									
1995	100	30.8	69.2	5.9	29.8	19.2	4.5	2.8	7.0
1999	100	31.3	68.7	5.1	34.2	16.3	4.4	2.6	6.1
2000	100	27.8	72.2	4.4	33.5	22.7	3.9	2.3	5.3
2001	100	27.7	72.3	4.2	33.2	22.7	4.3	2.4	5.6
2002	100	28.2	71.8	4.4	33.3	21.4	4.5	2.3	5.9
2003	100	28.5	71.5	4.4	32.5	22.2	4.5	2.2	5.8
Output									
1996–2000	9.1	6.8	10.0	3.0	11.6	12.7	6.2	5.0	3.3
2001	–0.3	–0.8	–0.1	–4.4	–1.2	–0.5	8.5	0.4	5.3
2002	–2.7	–1.0	–3.4	0.6	–2.4	–8.0	2.9	–3.4	1.7
2003	–0.7	0.4	–1.1	–0.5	–3.1	2.8	–1.5	–7.8	–1.9
Labor input^b									
2001	–1.3	0.2	–2.0	–9.8	–1.2	1.5	2.1	2.3	8.5
2002	1.5	4.6	–0.2	–9.4	1.5	4.7	4.3	4.0	3.8
2003	1.6	–0.5	2.8	–0.7	5.1	1.1	4.9	0.2	0.5
Real wage^{b, c}									
2001	2.5	1.8	2.8	–0.5	3.2	1.2	1.4	2.9	1.2
2002	–6.7	–6.3	–6.9	–6.4	–8.6	–6.8	–6.3	–1.9	–5.0
2003	–2.8	–2.6	–2.8	0.8	–3.5	–3.5	–2.6	–5.4	–4.9
Relative price^d									
2001	0.5	1.0	0.3	–6.8	2.0	0.2	0.8	1.8	2.0
2002	–0.3	1.0	–0.9	8.6	–5.4	2.1	0.6	–1.2	0.1
2003	0.7	1.0	0.5	–0.1	–2.7	–1.5	–1.2	–0.8	2.7

^a Including banks.^b Including Palestinians and foreign workers (reported and unreported).^c Per employee post deflated by the CPI.^d Deflated by business-sector-product price.

SOURCE: Central Bureau of Statistics data.

As regards investment in the commerce and services industry (Table 1.37), the moderate level of economic activity in 2003 caused investment to contract by 6.3 percent—a trend that has been in evidence since 2001—exceeding the decline in the business sector as a whole. Investment in the commerce and services industry may be more sensitive to uncertainty than other industries because it is comprised of small businesses. The contraction of investment stemmed mainly from the steep drop in investment in structures and very moderate rise in investment in equipment. The moderate rise in investment in equipment may be due to firms' assessments that uncertainty is diminishing, and that activity will expand, while the response of investment in structures to these changes is naturally slower.

The contractionary trend of investment in the industry evident since 2001 continued.

Hotels and catering services

The product of the catering and hotel industry dipped by 0.5 percent in 2003. Revenues were particularly hard hit in 2003:I due to the war in Iraq.

The product of the hotel industry rose by 3.3 percent, as did the number of tourist entries.

In spite of the improvement in the security situation, the product of the hotels and catering services industry dipped by 0.5 percent in 2003. Revenues were particularly hard-hit in 2003:I, due to the Gulf War, which caused both incoming tourism and domestic demand to drop, with a gradual recovery in the rest of the year. The industry's labor input, which continued to contract in 2003, was down by 0.7 percent. Notwithstanding, 3,358 new businesses opened, while 3,017 closed down. The industry's debts to the banks fell by a real 7.5 percent, although the extent of problem loans rose.

The product of the hotel services industry rose by about 3.3 percent, as did hotel revenues. The product of this industry was most hard-hit in 2003:I, because of the Gulf War. The decline in the number of employees in hotels, who constitute 25 percent of all hotel and catering services employment, more or less came to an end in 2003. A labor agreement for the hotel industry signed early in 2002 included wage reductions in an effort to help hotels cope with the crisis in incoming tourism. Wages were frozen in 2003, and negotiations will be held in 2004 regarding a return to the wage path prevailing prior to the agreement. The number of hotel rooms dipped slightly, but there was a concurrent contraction in the number of closed rooms that were converted for other uses, so that the number of available rooms rose marginally (Table 1.41).

Table 1.41
Hotel Services, 1990–2003

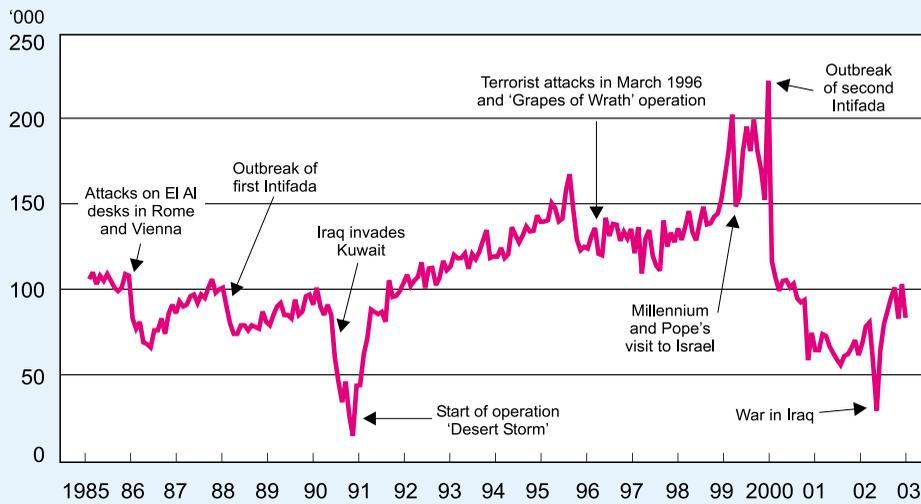
	(annual rate of change, percent)									
	1990–97	1995	1996	1997	1998	1999	2000	2001	2002	2003
Tourist entries by plane	6	12	-4	-3	-1	18	7	-46	-27	25
Tourist bed-nights	3	12	-6	-9	-5	18	4	-60	-31	22
Israeli bed-nights	5	9	11	9	11	6	2	13	5	-2
Total bed-nights	4	11	1	-1	3	11	3	-23	-4	3
Revenue	2	7	-1	-1	2	8	5	-26	-10	3.1
Index of hotel services	3	-1	-1	-1	2	9	5	-25	-9	3.1
Employment ^a	4	5	-1	0	1	5	0	-22	-13	-3
Labor input ^a	5	-4	0	-1	-1	6	1	-23	-14	-2
No. of rooms ^a	2	6	4	5	5	6	8	2	2	-1
No. of closed rooms					-17	-4	97	123	31	-16
Multi-factor productivity	-2	8	-2	-1	1	3	2	-11	-1	5

^a In tourist hotels.

SOURCE: Table 1.A.43.

The total number of hotel bed-nights rose by 3 percent in 2003 (Figure 1.35), because of the fall in bed-nights of Israelis and sharp rise in those of tourists. The continued decline in prices, which dipped by 3.3 percent, did little to help rally domestic demand

Figure 1.35
Tourist Arrivals by Air, 1985–2003 ('000 per month, seasonally adjusted)



SOURCE: Central Bureau of Statistics.

because of the low elasticity of demand⁵⁰ for bed-nights to prices. Some domestic demand for hotel services may also have been transferred abroad.⁵¹

Revenue from incoming tourism (excluding consumption in Israel by nonresidents) rose by 7 percent in dollar terms in 2003, a trend shift from the steep decline evident in the last two years. Both tourist entries into Israel by air and tourist bed-nights increased. In 2003:I there was a slump in incoming tourism, because of the Gulf War, followed by a steady improvement in the rest of the year. Tourist entries rose faster than tourist bed-nights. This trend began in the crisis year of 2001, as a result of the change in the composition of incoming tourism, with a relative increase in the number of tourists who come to Israel to visit relatives and tend to stay less at hotels. It was also due to a drop in the number of persons coming on business trips, which tend to be short, alongside a marked reduction in tourist groups, evident in 2003, too.⁵² As a result of these developments, average expenditure per tourist day also continued to decline.

⁵⁰ The elasticity of the demand for bed-nights to income is about 1.3; A. Fleischer and S. Buccolo (2002), "War, Terror, and the Tourism Market in Israel," *Applied Economics*, 34, no.11.

⁵¹ There was no increase in the number of Israelis who exited Israel in 2003, but in the absence of figures on the distribution of persons leaving Israel by purpose, it is not known whether the number of persons leaving for vacation purposes, which is a substitute for hotel services in Israel, rose. However, the number exiting to the Sinai rose markedly in 2003, and this may account for the fact that the decline in bed-nights of Israelis was steeper in Eilat than in the rest of the country.

⁵² Ministry of Tourism, *Survey of Incoming Tourism*, semi-annual report, 2003.

Hotels were affected differently according to geographical location, in connection with the location of the security incidents and the nature of tourism. In Jerusalem and Tiberias, which rely primarily on Jewish and Christian pilgrimage tourism, the number of tourist bed-nights rose from its low level in 2002, as did the number of bed-nights of Israelis. In Eilat and the Dead Sea region, however, where most tourists are Israelis, the number of bed-nights dipped slightly, apparently because of the alternative offered by the Sinai and abroad. In the hotel industry there has been a notable increase in recent years in the number of rooms owned by hotel chains, at the expense of those owned by hotels which do not belong to chains. This helps hotels to cope with the current crisis, as membership of a chain means that a fall in revenues in one part of the country can be compensated by a rise elsewhere.

How the Ministry of Tourism copes with the crisis

The Ministry of Tourism has deployed a variety of measures—on both the supply and the demand sides—to contend with the crisis in the industry since the start of the security unrest. The Ministry's aid in 2003 was much less than in 2002, and included the following actions:

1. A loan fund partly guaranteed by the State. Its activity continued in 2003, and amounted to NIS 400 million. The loan framework was set for each hotel in accordance with its grade and the level of security incidents in its region. Only fifty percent of the loans were extended in 2003 because despite the State guarantee the banks refused to extend loans to hotels as a result of the greater severity of the regulations issued by the Supervisor of Banks. At the end of 2003 the Ministry of Industry and Trade established a fund for small businesses, including tourism businesses (loans with 70 percent State guarantee). The subject is being examined vis-à-vis the banks and the Accountant-General.
2. A marketing fund for hotels and an incentive fund for organizers of incoming tourism provide aid by repaying costs; the extent of these funds was lower in 2003 than in 2002, standing at NIS 28 million and NIS 10 million respectively.
3. An incentive fund to encourage domestic tourism to areas affected by the security situation, e.g., Jerusalem, Tel Aviv, Tiberias, and Nazareth. The fund, which was active between December 2002 and end-March 2003, loaned at a cost of NIS 2 million.

The program for reducing the municipal rates paid by hotels in areas hit by terrorism was stopped in 2003.

In the last few years the marketing activities abroad by the Ministry of Tourism have focused on identifiable market segments (Jews, Christian pilgrims) and on marketing Eilat as a tourism target. In addition, the Ministry helps to increase the resources available to tourism organizers in Israel and to Israeli tourism wholesalers abroad, as well as to increase participation by domestic tourism bodies in fairs abroad.

The aid program in 2003 has continued the trend evident in 2002, albeit to a lesser extent, and is connected with the shock caused by the Intifada. Focused aid should be short-term in order to prevent delays in the necessary process of adjusting the extent of activity, including the number of employees, to demand.

The Ministry of Tourism is contending with the crisis that has hit the industry since the beginning of the Intifada by means of a plethora of measures—a loan fund, an incentive fund for organizers of incoming tourism, and a fund to encourage internal tourism.

The product of the catering services industry fell by 4 percent in 2003—in contrast with the long-term growth trend which for many years has been led by the rise in the standard of living—as a result of the fall in disposable income and the adverse effects of the Gulf War. The decline was concentrated at the beginning of the year, and there was some recovery later in the year.

Computer and R&D services, including ICT firms and start-ups, and biotechnology start-ups

The product of the computer and R&D services industry fell by about 4 percent in 2003, a more moderate rate than in 2001–2002. Product excluding start-ups rose by 2.7 percent, compared with strong growth in 1997–2002, while the product of start-ups plummeted by 25 percent in 2003, continuing its steep decline in 2001–2002; the steep drop in the product of ICT start-ups is particularly prominent. The product of biotechnology start-ups (NIS 830 million) hardly fell at all, however. Exports of the industry (including start-ups) rose by about 4.9 percent; employment was up by 2.3 percent compared with its steep decline in 2002, and labor cost continued to fall because of the decline in labor productivity (Table 1.44).

The product of the computer and R&D services industry contracted by 4 percent in 2003, a more moderate rate than in 2001–2002, and its exports rose by 4.9 percent.

*Bank services*⁵³

The situation of the banking improved in 2003: value added⁵⁴ rose by about 11 percent, after declining in the two preceding years, and banks' profits grew. However, the combination of the contraction of credit extended and stability in the extent of activity led to a 4.8 percent fall in the index of banking activity,⁵⁵ continuing the trend of more moderate expansion evident in 2002. Credit extended by the banks contracted in real terms in 2003, after expanding in previous years (Table 1.42). A breakdown of credit by indexation segment shows that the decline was due in part to the marked local-currency appreciation. Concurrently, the extent of capital raised from nonbank sources rose (in the first nine months of the year).

The situation of the banking industry improved in 2003: value added rose by 11 percent, after declining in the two preceding years, and banks' profits grew.

Banks' profits soared in 2003. Net interest income before loan-loss provision rose sharply, and loan-loss provision remained unchanged, so that net interest income grew. The rise in ordinary profit and wages enhanced the adjusted value added⁵⁶ of the banks by 11 percent (Table 1.42).

The banks' income from operating charges rose by about 2.9 percent, even though the index of real bank charges went up by only 0.5 percent⁵⁷ and the extent of debit

⁵³ The analysis in this section treats the banking industry as part of the services industry, and does not examine all the implications of the industry's activity. For a more detailed analysis of the development of the banks, see the *Annual Report* of the Supervisor of Banks, to be published later this year.

⁵⁴ Salaries and associated costs *plus* maintenance and amortization of structures and equipment *plus* ordinary before-tax income.

⁵⁵ See definition in Table 1.42.

⁵⁶ See definition in Table 1.42.

⁵⁷ The index of average real bank charges of the five major banks was 0.5 percent higher in the first half of 2003 than in the second half of 2002.

Table 1.42
Development of Banking Activity, Main Indicators, 1997–2003

	(annual rate of change, percent)						
	1997	1998	1999	2000	2001	2002	2003
Credit to public ^a	4.5	10.4	12.1	13.4	12.7	5.6	–3.6
Labor input	0.6	–0.4	–1.8	0.6	0.4	–1.6	–3.3
Labor costs	6.0	1.6	4.3	9.0	0.3	0.6	2.9
Value added (adjusted)	5.5	15.5	0.5	14.5	–7.8	–13.2	10.9
Stock-market turnover	25.1	31.1	34.2	32.6	–8.3	36.8	3.1
Number of debits	1.2	2.2	2.1	0.7	3.5	6.6	–4.6
Mortgages	–5.1	–12.1	8.3	–4.7	0.5	–0.7	–20.1
Number of branches	–3.7	0.5	1.6	–2.3	–1.8	–2.3	–2.7
ATMs	7.9	2.6	2.4	0.1	2.4	–1.6	0.3
Requests for information via internet						46.8	76.7
Banking transactions via internet						49.2	
Index of banking activity ^b	3.5	6.4	8.6	7.6	6.9	7.2	–4.8
Labor productivity	2.9	6.8	10.6	7.0	6.5	9.0	–1.5
Multi-factor productivity	2.8	6.1	9.0	7.8	6.7	9.1	–2.2

^a Total commercial banking system based on annual average according to real end-month data.

^b Weighted average of credit to public, number of debits, labor input, total new loans, and securities turnover.

SOURCE: Table 1.A.44.

declined. The index of bank services fell by 2.2 percent.⁵⁸ Labor input declined in 2003, apparently because of the reduction in the number of branches and expansion and greater use of electronic devices. Note, however, that labor cost rose due to retirement and dismissal costs in the industry. At the beginning of 2003 ten percent of the work force of Bank Hapoalim was cut, and a voluntary retirement plan was introduced in Bank Leumi.

As regards the implications for the business sector of the developments in banking, the decline in supply of sources of finance could affect economic activity. The banks had to restrict credit because they had not adhered to capital adequacy⁵⁹ in the boom period of the early 1990s.⁶⁰ According to the credit channel approach, when the supply of bank credit contracts, it is mainly small firms, which depend on the banks because they do not have access to alternative sources of finance, that are affected. The ability of large companies to raise capital on the stock markets in Israel and abroad was not affected, however, so that in 2003—especially 2003:IV—these firms raised capital from nonbank sources. The assessment that the small firms suffered more from the contraction of credit is borne out by the Bank of Israel's Companies Survey, according to which the major constraint preventing the expansion of activity throughout the business sector was financing difficulties, and this was greater among small firms than among large ones (Figure 1.36). Part of the constraint, which eased in 2003:IV as the economy stabilized, is undoubtedly due to the banks' credit-rationing policy.

⁵⁸ Source: Central Bureau of Statistics. It is almost certain that the increase in the charges not included in the index was greater than that in the index.

⁵⁹ The difference between the actual risk-weighted capital ratio and the ratio required by the Supervisor of Banks.

⁶⁰ According to Y. Fishman and D. Ruthenberg of the Bank of Israel's Banking Supervision Department.

The banks had to restrict credit because they had not adhered to capital adequacy during the boom. The decline in the supply of sources of finance may have affected economic activity and impacted on small businesses, which depend on banks as they do not have access to alternative sources of finance.