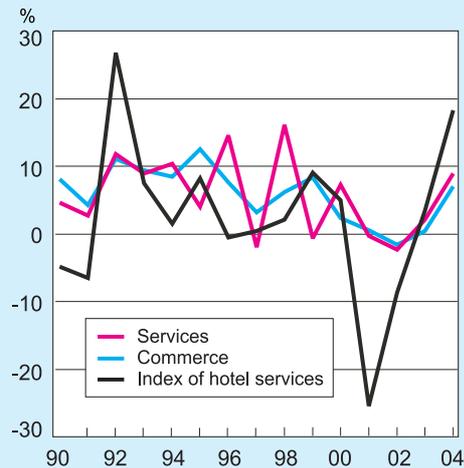


## 5. Commerce and services

Commerce and services activity increased significantly in 2004, pursuant to the recovery that began in the second half of 2003 as the relative easing of security tension and the recovery of global demand allowed domestic demand to improve. Commerce and services product increased by 8.4 percent after a slight upturn in 2003 (Table 1.34 and Figure 1.32). Because gross product of the business sector expanded by 6.2 percent, the share of commerce and services in business-sector gross product climbed to 51.7 percent. Commerce and services exports (exports of services excluding transport services), which accounted for 23 percent of total exports in 2003 (excluding diamonds), increased by 14.2 percent in volume terms after 7 percent growth in 2003. Employment rose by 3 percent, outpacing the business sector at large, but investments continued to decline moderately.

**Figure 1.32**  
Real Increase in Commerce and Services Product, 1990–2004



SOURCE: Appendix Table 1.A.41.

Commerce and services activity increased significantly in 2004, pursuant to the recovery that began in the second half of 2003 as the relative easing of security tension and the recovery of global demand allowed domestic demand to improve.

The product of the services industries (hotels and catering, business and financial services, education and health business services, etc.) increased by 9 percent in 2004 after a slight upturn in 2003. The improvement was powered by stronger global demand for high-tech production, leading to a perceptible increase in exports of computer and R&D services, and by an increase in the activities of business and financial services, which, among other things, cater to ICT companies. The security improvement, the resulting increase in tourism, global growth, and the domestic economic improvement all abetted the expansion of activity in hotel and catering services. Hotel and catering services, which are considered luxuries, are noted for high domestic demand elasticity and are consumed mainly by high-income persons. Thus, the increase in domestic consumption of these services may be due partly to an improvement in the situation of those of high income.<sup>67</sup>

The growth of services product over the years has been powered by rising standards of living and also, in respect to education and health, by the gradual contraction of government involvement and the partial privatization of service delivery. The business sector accounts for 10.7 percent of employment in education services and 40 percent of employment in health and welfare services—an estimate in which most hospitals are included. Activity in education, health, and welfare services delivered by

Service product increased by 9 percent after modest growth in 2003.

<sup>67</sup> The Central Bureau of Statistics' Household Expenditure Survey finds that the share of meals away from home in total household consumption is high in upper deciles and low in lower deciles.

business<sup>68</sup> increased in 2004 due to the upturn in per-capita disposable income<sup>69</sup> and the concomitant demand for these services.

**Table 1.34**  
**Commerce and Services, Main Indicators, 1995–2004**

	(annual change, percent)							
	1995–98	1998	1999	2000	2001	2002	2003	2004
Product	8.2	13.1	1.6	5.8	-0.4	-2.1	1.6	8.4
Product excluding start-ups	7.8	12.5	1.9	2.1	1.0	-0.7	2.4	8.1
<i>Of which:</i> Commerce	5.6	6.2	8.3	2.4	0.6	-1.6	0.4	7.0
Services	9.3	16.1	-0.7	7.3	-0.7	-2.3	2.1	9.0
Labor input	5.2	3.9	5.1	8.8	-0.9	2.4	3.4	1.9
Capital stock <sup>a</sup>	13.7	13.6	10.9	9.3	7.7	5.7	3.8	2.8
Labor productivity	2.9	8.8	-3.1	-2.8	0.5	-4.4	-1.8	6.4
Multi-factor productivity	-0.5	5.0	-5.4	-6.8	-1.3	-4.3	-1.2	5.9
Real wage	1.9	0.8	6.2	9.4	2.2	-6.6	3.6	2.9
Real labor cost <sup>b</sup>	1.7	-0.8	-0.2	5.9	1.7	-4.0	-1.0	0.8
Relative price <sup>c</sup>	0.2	0.1	0.5	2.8	0.4	-0.8	-3.1	2.0
Exports <sup>d</sup>	7.7	15.0	26.7	36.1	-20.8	-11.0	7.2	14.2
Investment	31.5	-4.1	-1.7	-4.1	-10.8	-12.6	-3.6	3.2

<sup>a</sup> At beginning of year.

<sup>b</sup> Deflated by production prices.

<sup>c</sup> Relative to business-sector prices.

<sup>d</sup> Including export of tourist and other services. Deflated by index of services exports. Current prices.

**Table 1.35**  
**Business Services Revenue, 1996–2004**

	(percent)													
	Share in business-sector product						Real rise in revenue							
	1996	2000	2001	2002	2003	2004	1997	1998	1999	2000	2001	2002	2003	2004
Computer services and R&D <sup>a</sup>	17.2	33.4	30.5	26.8	27.5	28.1	12.0	33.4	21.8	57.8	-12.3	-10.1	-4.8	12.8
Employment services	9.2	9.1	9.0	8.2	7.3	6.8	0.9	18.0	12.4	3.7	-5.2	-11.6	-12.6	2.9
Security and cleaning	7.9	7.0	8.2	9.2	9.7	9.5	17.4	5.2	-3.2	4.2	11.7	9.1	3.6	7.7
Other business services <sup>b</sup>	47.7	33.8	35.6	36.3	37.0	36.0	-4.7	18.7	-7.1	-5.6	1.3	-0.6	-0.8	7.6
Real estate and equipment rental	17.9	16.6	16.8	18.2	18.5	19.6	-1.2	25.5	4.4	0.3	-2.4	5.1	-0.7	16.9
Total	100.0	100	100	100	100	100	1.1	21.4	3.1	10.8	-3.7	-2.7	-2.5	10.4

<sup>a</sup> Including software companies and ICT start-ups and biotechnology start-ups.

<sup>b</sup> Including legal, accountancy, market research, engineering, architecture, advertising and public relations, photography, and other services.

SOURCE: Central Bureau of Statistics.

<sup>68</sup> Including independent institutions that operate on a business basis; not including not-for-profit institutions and those owned by central government, municipal government, and the Zionist National Institutions.

<sup>69</sup> The share of the business sector in national health expenditure climbed from 23 percent in 1990 to 28 percent in 2003. Welfare services have been partly privatized by central and municipal authorities. (Joseph Katan, "Partial Privatization of the Personal Social Services—Dilemmas and Main Issues," in Yaakov Kop (ed.), *Resource Allocation for the Social Services 2001*, Center for Social Policy Studies in Israel.

**Table 1.36**  
**Commerce and Services by Type: Product, Employment and Wages, 1995–2004**

	(annual change, percent)																							
	Share in GDP				Output				Labor input <sup>d</sup>				Real wage <sup>a,d</sup>				Relative price <sup>b</sup>							
	1995	1999	2000	2001	2002	2003	2004	1996–2000	2001	2002	2003	2004	2001	2002	2003	2004	2001	2002	2003	2004				
Total	100	100	100	100	100	100	100	6.4	-0.4	-2.1	1.6	8.4	-0.9	2.4	3.4	1.9	2.2	-6.6	3.6	2.9	0.4	-0.8	-3.1	2.0
<i>Of which:</i> Commerce	30.8	30.5	29.5	29.8	30.0	29.6	29.3	5.5	0.6	-1.6	0.4	7.0	-0.8	5.0	-0.3	2.9	1.8	-6.3	4.0	0.0	1.0	1.1	1.0	1.0
Services	69.2	69.5	70.5	70.2	70.0	70.4	70.7	6.8	-0.7	-2.3	2.1	9.0	-0.9	1.1	5.2	1.4	2.4	-6.8	3.5	4.0	0.1	-1.7	-4.8	2.5
<i>Of which:</i>																								
Hotels and catering	5.9	5.0	5.1	4.5	4.7	4.5	4.6	3.5	-11.7	0.8	-2.2	11.1	-5.6	-5.2	-0.5	2.0	-0.5	-6.4	5.2	0.3	-9.3	20.2	-11.0	3.4
Business services	29.8	33.4	35.0	33.8	33.6	32.3	32.9	9.9	-3.7	-2.7	-2.5	10.4	-1.2	1.5	11.4	2.6	3.2	-8.6	3.6	4.3	6.1	-8.3	-4.3	1.2
Insurance and financial institutions <sup>c</sup>	19.2	18.3	18.1	18.5	17.9	20.1	20.1	5.1	1.9	-5.4	14.5	8.4	1.4	4.9	1.6	1.3	1.2	-6.8	1.4	9.8	-8.4	0.3	1.5	0.3
Health	4.5	4.3	3.9	4.3	4.5	4.4	4.2	3.7	8.6	2.9	-0.4	4.1	-0.6	3.1	1.9	-3.7	1.4	-6.3	7.3	2.4	7.3	1.0	-3.3	-2.8
Education	2.8	2.6	2.5	2.5	2.5	2.3	2.3	3.9	0.1	-2.9	-5.2	6.2	2.3	4.0	2.5	3.5	2.9	-1.9	-0.7	2.7	-3.2	-0.3	-5.2	-1.7
Personal and other	7.0	5.9	5.8	6.5	6.9	6.7	6.6	2.7	11.9	2.8	-0.5	6.7	5.5	4.1	-1.1	0.1	1.2	-5.0	-0.7	0.7	2.6	-0.4	-2.4	0.5

<sup>a</sup> Per employee post deflated by the CPI.

<sup>b</sup> Deflated by business-sector-product price.

<sup>c</sup> Including banks.

<sup>d</sup> Including Palestinians and foreign workers (reported and unreported).

SOURCE: Central Bureau of Statistics data.

The increase in service product outpaced the growth of labor input, meaning that labor productivity improved.

Commerce product grew by 7 percent in 2004.

The balance of active businesses in commerce and services continued to improve.

Labor productivity in the services increased as product expanded more rapidly than labor input. The upturn in labor productivity was perceptible in the main service industries and evidently traced, among other factors, to the improvement in demand. Many foreign workers were replaced by Israelis in 2004; foremost among them were about 5,200 workers in hotel and catering services, 15 percent of the total population of foreign workers. Replacement of foreign workers also seems to have occurred in cleaning and welfare services (Table 1.36).

Commerce product increased by 7 percent after three years of standstill due to the recovery of private consumption. Employment in commerce industries expanded even though employment in the retail food trade edged upward modestly for the second consecutive year, possibly as consumers changed to shopping in large cut-rate outlets on the outskirts of cities, where turnover per person employed is high.

Pursuant to the improvement in commerce and services product, the balance of active businesses—the number of businesses opened less those that closed down—continued to improve. Businesses open and close on the basis of long-term considerations. Thus, more businesses opened than closed in 2003 in view of indications of recovery and the balance of active businesses continued to improve in 2004 in response to the improvement in commerce and services product. The number of businesses in most commerce and service industries increased relative to 2003 (Table 1.37).

**Table 1.37**  
**Number of Commerce and Services Businesses, 2003 and 2004<sup>a</sup>**

	(percent change from previous year)		
	2003	2004	2004 No. of businesses
Commerce, vehicle and other repairs	-0.3	2.4	84,727
Hotels and catering services	2.2	4.6	16,907
Real estate, machine, equipment and goods hire	-2.7	1.1	21,325
Computer services and R&D	3.0	8.7	9,919
Manpower agencies, security and cleaning	-0.2	2.0	4,884
Education	0.6	1.7	11,290
Health and welfare services	1.5	2.4	28,304
Personal and other services	-0.2	2.6	28,047
Entertainment, leisure, culture and sports	1.9	3.4	15,353
Banking, insurance and other financial institutions	3.8	1.7	11,018
Other business activities	3.5	5.8	60,933
Total commerce and services	1.0	3.1	292,066

<sup>a</sup> Going business, excluding nonprofit organizations and financial institution, that reported turnover greater than zero in at least one month in the year.

SOURCE: The Central Bureau of Statistics VAT file.

Investment in commerce and services (Table 1.34) increased by 3.2 percent in 2004 due to the improvement in economic activity—representing a turnaround after a downtrend since 1998—in contrast to stagnation in nonresidential investment. The upturn in commerce and services investment was composed of a steep decline in

investment in buildings and an appreciable recovery of investment in equipment. The latter increase may have traced to firms' belief that uncertainty was declining and activity would continue to grow, coupled with an easing of the restriction on credit for the expansion of activity, as shown in the Bank of Israel Companies Survey (Figure 1.34). Decisions in favor of investing in equipment apparently require expectations of a protracted improvement in economic activity. Prices of buildings for commerce and services use rose in 2004, probably due to the decline in building investment.

Investment increased by 3.2 percent.

### *Hotel and catering services*

Hotel and catering services product increased by 11.1 percent, due to the improvement in security and economic conditions, but remained 3.3 percent lower than the 2000 level (Table 1.36). Turnover improved perceptibly in the first half of the year and continued to rise more gently in the second half due to improvements in incoming tourism and domestic demand for hotel and catering services. Industry employment increased by 2.7 percent after declines in 2001 and 2002 and flat performance in 2003. The number of active businesses continued to expand and the pace of the increase quickened. Due to the upturn in activity, the industry's indebtedness to banks increased but did so more slowly than the growth of product, so that the ratio of problem loans to industry product declined.

Hotel and catering product increased by 11.1 percent in 2004.

The improvement in tourism allowed hotel and catering services product to increase much more rapidly than business-sector product. Some 4.9 percentage points—about NIS 410 million—of the total upturn in hotel and catering services product is attributable to the improvement in incoming tourism.<sup>70 71</sup>

Hotel services product increased by 14.3 percent and hotel employment, accounting for about one-fourth of total employment in hotel and catering services, increased perceptibly after three years of noticeable decline. In early 2004, the hotel industry concluded a labor agreement stipulating a gradual return to the wage level that preceded the incoming-tourism crisis in 2001, after an accord concluded in 2002 included wage cuts to help hoteliers to cope with the crisis. The number of hotel rooms hardly changed in 2004. Available rooms increased by 1.4 percent as some rooms that had been closed for security reasons were put to alternative uses or restored to guest use from the second quarter onward (Table 1.38).

Hotel services product grew by 14.3 percent.

<sup>70</sup> The improvement in tourism also abetted a 1.2 percent increase in transport product (as explained in detail in the transport section in the chapter on infrastructure industries) and, to some extent, an increase in commerce product. The multiplier effect that augments these growth rates was not taken into account in this estimate.

<sup>71</sup> Assuming that the entire 11.1 percent increase in hotel and catering services product originates in the security improvement, it is arguable that 4.9 percentage points of the increase should be credited to the upturn in tourism resulting from the security improvement. To make this calculation, we used data on the average per-tourist expenditure for hotel and catering services in 2004 as presented in Ministry of Tourism, Incoming Tourism Survey 2004, and data on hotel and catering services product as a share of turnover as presented in the 2001 Survey of Trade, Services, Transport, and Communications.

**Table 1.38**  
**Hotel Services, 1990–2004**

	(annual rate of change, percent)										
	1990–97	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Tourist entries by plane	8	-4	-3	-1	18	26	7	-46	-27	25	38
Tourist bed-nights	3	12	-6	-9	-5	18	4	-60	-31	22	50
Israeli bed-nights	5	9	11	9	11	6	2	13	5	-1	4
Total bed-nights	4	11	1	-1	3	11	3	-23	-4	4	14
Revenue	2	7	-1	2	6	13	8	-26	-11	2	20
Index of hotel services	3	-0	-0	1	5	13	7	-25	-9	3	19
Employment <sup>a</sup>	4	5	-1	0	1	5	0	-22	-13	-2	10
Labor input <sup>a</sup>	5	-4	0	-1	-1	6	1	-23	-15	-1	9
No. of rooms <sup>a</sup>	2	6	4	5	5	6	8	2	2	-1	0
No. of closed rooms					-17	-4	97	123	31	-14	-15
Multi-factor productivity	-2	8	-2	1	5	7	5	-11	-1	4	14

<sup>a</sup> In tourist hotels.

SOURCE: Table 1.A.43.

Hotel bed-nights increased by 14 percent due to a modest increase in nights by Israelis and a significant upturn in nights by incoming tourists.

Exports of tourism services increased perceptibly in 2004.

Total hotel bed-nights increased by 14 percent in 2004 as Israelis' use of hotels increased slightly and incoming tourists' bed-nights rose significantly. Incoming tourists accounted for 28.4 percent of hotel bed-nights in 2004, a much larger fraction than in 2003 but much less than the 48.4 percent level recorded in 1999. Hotel rates for Israelis increased by 5.6 percent in 2004 after declining in 2001 and 2002 and leveling off in 2003.

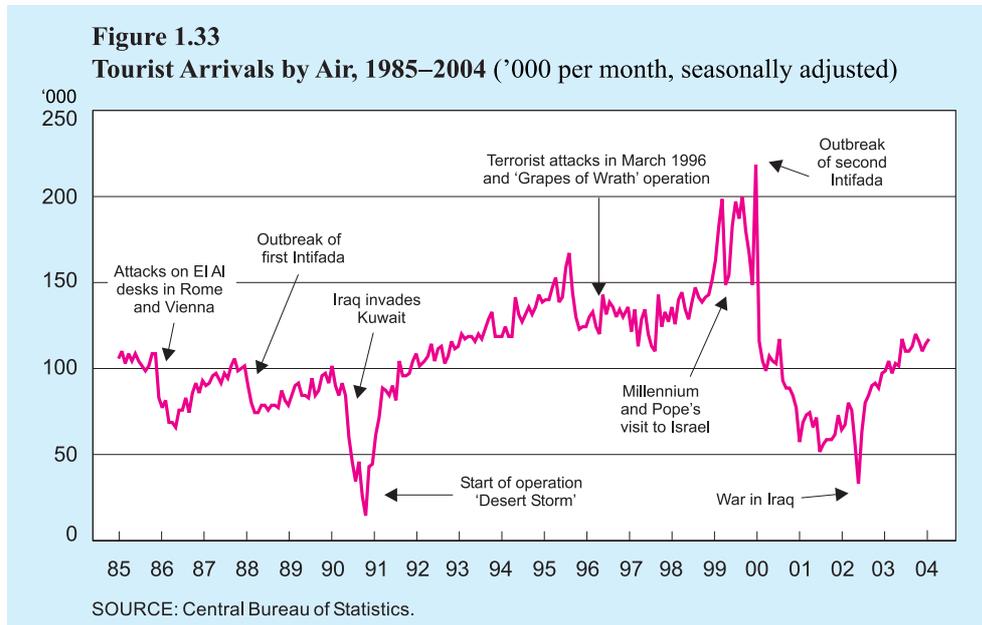
Exports of tourism services (excluding consumption in Israel by foreign workers) increased by 39 percent in 2004, mostly in the second and third quarters, and came to NIS 6.7 billion after a slight upturn in 2003. Global tourism services accounted for 7.3 percent of exports of goods and services in 2002, whereas in Israel in 2004 they were only 3 percent of goods and services exports and 3.6 percent of nondiamond exports. Over the years, global tourism has grown more quickly than global growth and has gathered strength at times of rapid global GDP growth.

Hotel bed-nights increased more rapidly than incoming-tourist arrivals in 2004 (Figure 1.33) due to a change in the composition of the incoming tourism—a decline in the proportion of tourists who came to visit relatives and make little use of hotels, and of those on business visits, which are relatively short, and an increase in the proportion of visitors for leisure, pleasure, sightseeing, or pilgrimage purposes.<sup>72</sup> For this reason, in 2004 the average tourist spent more during the visit and more per day of the visit.

Hotel occupancy improved considerably in all districts, foremost Tel Aviv and Jerusalem. The increase in Tel Aviv traced initially to a sizable upturn in tourist bed-nights and, later on, to the economic improvement, which caused business and Jewish tourism to expand. In the Jerusalem District, where occupancy was very low in 2003,

<sup>72</sup> Ministry of Tourism, Survey of Incoming Tourism, semi-annual report, 2003 and 2004.

the improvement originated in an increase in incoming-tourist bed-nights that offset a decline in bed-nights by Israelis. The improvement at hotels in Eilat and on the Dead Sea, where occupancy in 2003 was relatively high, was less vigorous.



#### *How the Ministry of Tourism is coping with the tourism crisis*

To cope with the crisis that has beset tourism since the beginning of the security unrest, the Ministry of Tourism has been applying an array of tools on both the supply and the demand sides. In 2001 and 2002, and to some extent in 2003, assistance from the ministry focused on the supply side, i.e., on reducing hotels' costs; in 2004, the levels of aid decreased and were focused on stimulating demand. The tools include a marketing fund for hotels and an incentive fund for incoming-tourism organizers that reimburses organizers for their expenses. The size of these funds decreased in 2004, relative to 2003, to NIS 9 million and NIS 10 million, respectively.

The ministry has focused its overseas marketing activities in recent years on several identifiable market segments (Jews and Christian pilgrims) and on promoting Eilat as a tourist destination. The ministry also helps by expanding the resources of tourism organizers in Israel and Israeli-tourism wholesalers abroad and by increasing domestic tourism operators' participation in overseas expositions.

Catering services product increased by 9.1 percent in 2004 due to the upturns in disposable income and tourism. This is consistent with the long-term growth trend, which for years has been driven by rising standards of living.

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

Computer and R&D services product increased by 12.8 percent in 2004.

Product of the computer and R&D services industry increased by 12.8 percent in 2004 after having contracted in 2003. Product excluding start-up companies rose by 9.5 percent and product of start-ups increased by 23.6 percent after steep declines in 2001–2003. Product increases were recorded by start-ups in both ICT and biotechnology. Industry exports (including start-ups) expanded by 14.3 percent, employment increased by 5 percent, and wage per person employed rose, evidently due to an increase in demand for labor and a perceptible upturn in labor productivity.

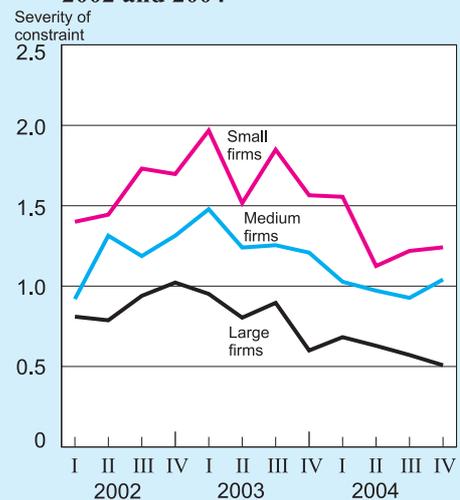
*Banking services*<sup>73</sup>

The banking industry continued to improve in 2004 as the banks' value added and earnings increased.

The banking industry continued to improve in 2004. Value added<sup>74</sup> increased by 13 percent—contributing 1.1 percent to commerce and services product, after a 23 percent increase in 2003—and profitability grew. The combination of moderate increases in lending and use of bank resources allowed the banking activity index<sup>75</sup> to advance by 4.3 percent after declining in 2003. Lending increased in 2004 in real terms after contracting in 2003<sup>76</sup> (Table 1.39).

Bank earnings increased, revenues from lending activity before loan-loss provisions grew and the loan-loss provision contracted, evidently due to the general economic improvement and the rather large provisions that had been made in the past. Thus, earnings from lending activity after loan-loss provisions increased. Due to the upturn in total profitability (from ordinary activities) and wage payments, the banks' standardized value added<sup>77</sup> increased by 13 percent (Table 1.39).

**Figure 1.34**  
**Financing Difficulty Constraint in Manufacturing Firms, 2002 and 2004**



SOURCE: Bank of Israel, Companies Survey, 2004: IV.

<sup>73</sup> The analysis in this section treats the banking industry as part of the services industry and as an input for other industries; it does not examine all implications of the industry's activity. For a detailed analysis of developments in the bank, see the 2004 Banking System Survey.

<sup>74</sup> Calculated from banks' reports up to September 2004; therefore, annual value added will be different. Value added is composed of salaries and related expenses—maintenance and depreciation of buildings and equipment plus pre-tax earnings from ordinary activities.

<sup>75</sup> See Table 1.39 for definitions.

<sup>76</sup> 2004 average on 2003 average.

<sup>77</sup> See Table 1.39 for definitions.

Revenues from operating charges increased by 8.4 percent. The labor input continued to decline, pursuant to a trend that began in 2000 for reasons that evidently include mergers in the industry, wider use of electronic banking, and a slight decrease in the number of branches. Labor cost increased, probably as a reflection of the upturn in banks' earnings.

Developments in the banking industry had different effects on the business sector. Credit started to expand again and mobilization of non-banking sources of finance grew vigorously (during the first nine months of the year). By implication, the supply of banking credit was apparently diverted mainly to small companies, which depend on the banks because they have no access to alternative sources. The Bank of Israel Companies Survey reinforces this estimation by noting that the restriction on sources of finance for the development of activities eased in 2004 for all companies—small, medium, and large (Figure 1.34).

**Table 1.39**  
**Development in Banking Activity, Main Indicators, 1997–2004**

	(annual rate of change, percent)							
	1997	1998	1999	2000	2001	2002	2003	2004
Credit to public <sup>a</sup>	4.5	10.4	12.1	13.4	12.7	5.6	-3.6	3.9
Labor input	0.6	-0.4	-1.8	0.6	0.4	-1.6	-4.0	-0.7
Labor costs	6.0	1.6	4.3	9.0	0.3	0.6	-0.6	3.6
Value added (adjusted)	5.5	15.5	0.5	14.5	-7.8	-13.2	23.0	13.0
Stock-market turnover	25.1	31.1	34.2	32.6	-8.3	36.8	11.0	44.8
Number of debits	1.2	2.2	2.1	0.7	3.5	6.6	-4.6	-1.9
Mortgages	-5.1	-12.1	8.3	-4.7	0.5	-0.7	-20.1	18.3
Number of branches	-3.7	0.5	1.6	-2.3	-1.8	-2.3	-2.7	-1.2
ATMs	7.9	2.6	2.4	0.1	2.4	-1.6	0.2	0.8
Requests for information via internet						46.8	76.7	24.2
Banking transactions via internet						49.2		
Index of banking activity <sup>b</sup>	3.5	6.4	8.6	7.6	6.9	7.2	-4.4	4.3
Labor productivity	2.9	6.8	10.6	7.0	6.5	9.0	-0.4	5.0
Multi-factor productivity	2.8	6.1	9.0	7.8	6.7	9.1	-1.3	4.9

<sup>a</sup> Total commercial banking system based on annual average according to real end-month data.

<sup>b</sup> Weighted average of credit to public, number of debits, labor input, total new loans, and securities turnover.

SOURCE: Table 1.A.44.

## 6. Information communication technology<sup>78</sup>

The information communication technology (ICT) industry is a conglomerate of production and service industries for the electronic absorption, presentation, and transmission of information. It incorporates manufacturing industries—communication equipment; supervisory, measurement, and control apparatus; and electronic components—and service industries: communications and computer and

The ICT industry incorporates manufacturing industries and service industries.

<sup>78</sup> Reference to the ICT aggregate in this section does not replace reference to the components of ICT in the principal industries as customarily defined (services, manufacturing, communications).