CHAPTER III

THE BALANCE OF PAYMENTS

1. Main Developments[1]

Exports of goods and services far outstripped the growth of imports in the year reviewed—17 percent as against 5—and as a result, the deficit on current account was slashed by $ 160 million (12 percent) to $ 1,100 million. But this only partly reflected a basic improvement in the balance of payments situation; for the most part it was the outcome of a combination of special factors and random short-term influences.

In exports there were several adverse developments. The uptrend in industrial sales sagged owing to the diminished competitiveness of Israel's products abroad. Toward the end of 1972 and the beginning of 1973 the growth rate picked up, but it is too early to say whether this marked the resumption of the vigorous expansion that prevailed until mid-1971.

In line with the trend evident since the end of 1970, the capital account improved considerably in the year surveyed, when there was a notable rise in unilateral transfers and an even greater rise in their weight relative to the deficit on current account. This, along with a much larger inflow of investment capital from abroad during this period, reduced the economy's dependence on foreign credit for financing its current deficit, until in 1972 it disappeared altogether, as transfers were sufficient to cover the entire deficit. Nevertheless, foreign borrowing was on only a slightly smaller scale than in the previous two years, and the economy's foreign indebtedness shot up by $ 650 million. There was a similar increase in foreign exchange reserves, which doubled in volume.

A number of factors contributed to the above developments, such as the economic boom, the quiet security situation, and the large immigration from the affluent countries. But short-term influences also carried considerable weight. During this period there was a drastic change in the financial picture due to the evaporation of devaluation expectations and the widening of the differential between interest rates and financial yields in Israel and those obtaining abroad. Another contributory factor was an administrative one—the lifting of foreign currency control on certain capital transactions.

[1] Unless otherwise stated, the import-export data in this chapter do not include trade with the administered areas. See Bank of Israel, *Annual Report 1971,* p. 29, note 1.

Table III–1

CURRENT ACCOUNT, 1966–72[a]

	Imports					Exports			Deficit					Current account with administered areas	Overall current account
				Total								Total			
	Goods	Defense imports	Services	Incl. defense imports	Excl. defense imports	Goods	Services	Total	Trade balance	Defense imports	Services	Incl. defense imports	Excl. defense imports		
A. $ million															
At current prices															
1966	795	116	406	1,317	1,201	475	397	873	–321	–116	–9	–445	–328		
1967	729	283	444	1,456	1,173	518	412	930	–211	–283	–32	–527	–243	–4	–532
1968	1,057	249	506	1,812	1,563	598	534	1,132	–459	–249	28	–680	–431	32	–648
1969	1,259	334	595	2,188	1,854	679	587	1,265	–580	–334	–8	–922	–589	54	–869
1970	1,372	624	653	2,649	2,025	717	644	1,361	–655	–624	–9	–1,288	–664	55	–1,234
1971	1,759	555	768	3,082	2,527	900	914	1,814	–859	–555	146	–1,268	–713	40	–1,228
1972	1,895	492	835	3,222	2,730	1,082	1,037	2,119	–813	–492	202	–1,103	–611	27	–1,076
At 1971 prices															
1966	846	130	475	1,451	1,321	490	445	935	–356	–130	–30	–516	–386		
1967	776	318	525	1,619	1,301	545	454	999	–231	–318	–71	–620	–302		
1968	1,137	283	591	2,011	1,728	636	619	1,255	–501	–283	28	–756	–473		
1969	1,298	359	662	2,319	1,960	686	663	1,349	–612	–359	1	–970	–611		
1970	1,400	643	700	2,743	2,100	732	690	1,422	–668	–643	–10	–1,321	–678		
1971	1,759	555	768	3,082	2,527	900	914	1,814	–859	–555	146	–1,268	–713		
1972	1,787	474	808	3,069	2,595	987	1,013	2,000	–800	–474	205	–1,069	–595		

B. Percent annual change												
Prices												
1967	—	—	–2	–1	—	–2	2	—				
1968	–1	–1	2	—	—	–2	–4	–3				
1969	4	6	5	5	5	6	3	5				
1970	1	4	4	3	2	–1	6	3				
1971	2	3	7	4	3	2	8	4				
1972	6	5	4	5	5	9	2	6				
Quantity												
1967	–8	145	11	12	–2	11	2	7	–35	145	20	–22
1968	47	–11	13	24	33	17	36	26	117	–11	22	57
1969	14	27	12	15	13	8	7	7	22	27	28	29
1970	8	79	6	18	7	7	4	5	9	79	36	11
1971	26	–14	10	12	20	23	32	25	29	–14	–5	5
1972	2	–15	5	—	3	10	11	10	–7	–15	–16	–17
Value												
1967	–8	144	9	11	–2	9	4	7	–34	144	18	–26
1968	45	–12	15	24	33	15	30	22	118	–12	29	77
1969	19	34	18	21	19	14	10	12	26	34	36	37
1970	9	87	10	21	9	6	10	8	13	87	40	13
1971	28	–11	18	16	25	26	24	33	30	–11	–2	6
1972	8	–11	9	5	8	20	13	17	–5	–11	–12	–14

[a] Imports c.i.f., exports f.o.b.

Source: Central Bureau of Statistics.

Export and import commodity prices have been moving up at a similar rate in recent years, so that the terms of trade have remained unchanged. However, it should be noted that the export price index for diamonds is statistically problematical.[2] If diamonds are deducted from both imports and exports, the upward trend has been stronger in import than in export prices, which implies a worsening of the terms of trade. This is estimated at 2 percent for the past two years, compared with 5–6 percent in 1967–69.

(a) *Imports*

Imports went up sluggishly in 1972, mainly because of a $ 190 million decline in two items—defense goods and ships and aircraft. The first does not reflect internal economic developments at all, while the second is only very loosely connected with regular economic activity and is highly erratic.

Random factors worked in the opposite direction in the case of motor vehicles (the reference is to the anticipated hiking of the import tax at the beginning of 1973) and electric power equipment (with the much heavier investment in this branch). Imports of uncut diamonds expanded noticeably, in line with the uptrend in exports. However, the influence of external and special factors was much weaker in the upward than in the downward direction.

The two principal categories of imports (net of exogenous influences) exhibited differing trends in 1972. Current inputs (excluding rough diamonds) remained stable in quantitative terms in spite of the expansion of production, while investment goods for industry were up 14 percent in quantitative terms. This divergence reflects a differential response to short–term factors, whose main effect was the reduction of the economy's stock of imported goods.

The increased import of capital goods for industry was a shade faster than in the two preceding years, but close to the long–run average. The growth here occurred despite a steep jump in the relative price of imported equipment in the past two years, but this rise only slightly more than compensated for the relative price decline in the previous five years.

The stability in current inputs despite the 10 percent expansion of the economy's output can apparently be attributed first and foremost to the drawing–down of stocks. It may also reflect a greater degree of import substitution in the face of the steep foreign price rises over the past two years.[3] Insofar as this did in fact take place, it was only of secondary importance, and would only partly explain the standstill in imports of intermediates. It is not plausible that structural changes of this sort, which tend to diminish the economy's need for imported intermediates, should be very drastic; moreover, past experience shows that input coefficients remain stable in the long run. On the other hand, the period discussed

[2] It shows much higher rates of increase than the import price index for rough diamonds.

[3] Input-output analysis shows that stability in imports of current inputs cannot be attributed to changes in the economy's output mix.

Table III–2

CURRENT DEFICIT, TRANSFERS, AND THE CAPITAL ACCOUNT (SUMMARY[a]), 1967–72

(IL million)

	1967	1968	1969	1970	1971	1972	Total 1963–66	Total 1967–69	Total 1970–72
1. Current account and long-term capital movements									
Balance on current account, excl. administered areas	–527	–680	–922	–1,282	–1,267	–1,103	–1,986	–2,129	–3,652
Balance on current account with administered areas	–4	32	54	49	40	27	—	82	116
Unilateral transfers	521	435	459	649	765	1,055	1,300	1,415	2,469
Investments from abroad	24	13	18	22	75	141	494	55	238
Long-term loans	295	168	168	559	642	583	474	631	1,784
Surplus of transfers and long-term capital over current account deficit	**310**	**–32**	**–224**	**–3**	**255**	**703**	**282**	**54**	**955**
2. Change in foreign exchange reserves due to economic transactions	–230	52	218	–105	–362	–823	–224	40	–1,290
3. Nonresidents' deposits and loans by foreign banks to Israeli banks	5	35	115	121	208	173	40	155	502
4. Israeli investments abroad	–17	–18	–18	–24	–11	–11	–70	–53	–46
5. Other short-term capital	–53	–10	–55	29	–89	–60	–51	–118	–120
6. Errors and omissions	–15	–28	–36	–18	0	18	23	–79	0

NOTE: A minus sign (–) denotes debits, and a positive sign credits.
[a] See Table III–24 for further details.
SOURCE: Central Bureau of Statistics.

saw a marked change in the worthwhileness of maintaining inventories: expectations of a devaluation in the near future disappeared, and the holding stocks became much dearer because of a rise in the real rate of interest due to an anticipated deceleration of the price rise after the impact of the devaluation had run its course, and because of the increased return on financial assets.

After being built up in 1969–70, inventories were apparently at a high level in 1971, but, as already noted, in the year reviewed they were run down. If inventories had been maintained at the previous year's level, there probably would have been an increase of $ 60–80 million in imports of current production inputs. The running-down of stocks has only a transient effect on such imports—it causes a temporary deviation from the quantities actually required for current use. Even if production remains unchanged, imports will have to be stepped up in the future. The level will, of course, go up even more should it again become worthwhile to hold stocks.

The rapid uptrend in imports in the first three months of 1973 strengthens the assumption regarding the importance of inventory fluctuations in explaining the movement of imports. The renewed rise apparently does not reflect a change in the worthwhileness of holding stocks or a return to their previously higher level, but merely indicates that the downward adjustment of inventories has been completed. It is also possible, however, that there has been a resumption of the build-up of stocks in the face of an anticipated advance in foreign prices.

The disparate response of current inputs and capital goods to changes in the short–term influences stem from their inherent differences. Investment plans are *ipso facto* far less sensitive to such influences than a variable like the level of inventories.

(b) *Exports*

Much of the export growth was due to the notable gain in diamonds, a distinctly export–oriented product whose sales primarily reflect changes in foreign demand.

In the broad group of manufactures sold both locally and abroad and where exports are more sensitive to developments in the domestic market, growth slackened in 1972. This occurred despite the much more buoyant demand in foreign markets in comparison with the previous two years, when several of Israel's principal customers experienced a slump. The slowdown in exports is partly explained by the stiffening competition from the home market, but a more telling factor was the petering–out of the uptrend in the export profitability of this group of products, and possibly even a downturn during part of the period. In some industrial branches special factors were behind this development.

The broad group of industrial exports that are sensitive to domestic conditions advanced during the past four years by more than 20 percent p.a. in quantitative terms. This can be credited to the greatly increased profitability of such exports due to the relatively faster rise in the effective rate of exchange compared with

Table III–3

TRADE ACCOUNT, QUARTERLY DATA, 1969–72

($ million)

	Imports[a, b]		Exports[a]		Trade deficit[a]		Ships and aircraft	
	Un-adjusted	Seasonally adjusted	Un-adjusted	Seasonally adjusted	Un-adjusted	Seasonally adjusted	Exports	Imports
1969								
I	275.1	279.6	197.2	155.0	77.9	124.6	14.0	0.1
II	330.2	335.4	166.5	168.0	163.7	167.4	8.2	1.5
III	296.2	308.8	137.7	177.4	158.5	131.4	—	1.0
IV	368.9	345.7	175.9	187.0	193.0	158.7	9.8	3.2
Total	**1,270.4**	**1,269.5**	**677.3**	**687.4**	**593.1**	**582.1**	**32.0**	**5.8**
1970								
I	343.3	347.8	204.6	169.7	138.7	178.1	35.3	—
II	360.5	351.7	173.8	176.7	186.7	175.0	—	—
III	313.4	331.8	157.7	191.5	155.7	140.3	10.1	1.4
IV	350.7	335.0	196.2	195.1	154.5	139.9	13.1	0.6
Total	**1,367.9**	**1,366.3**	**732.3**	**733.0**	**635.6**	**633.3**	**58.5**	**2.0**
1971								
I	373.2	376.3	243.3	202.8	129.9	173.5	106.5	—
II	406.0	388.0	223.4	223.2	182.6	164.8	23.3	—
III	381.6	420.9	183.8	231.8	197.8	189.1	19.3	—
IV	438.5	415.1	259.7	255.5	178.8	159.6	37.5	4.5
Total	**1,599.3**	**1,600.3**	**910.2**	**913.3**	**689.1**	**687.0**	**186.6**	**4.5**
1972								
I	452.4	461.6	287.2	239.4	165.2	222.2	13.8	—
II	476.4	459.3	259.7	261.7	216.7	197.6	13.8	8.3
III	411.5	458.6	228.8	290.4	182.7	168.2	16.1	0.5
IV	543.5	502.9	313.1	303.9	230.4	199.0	20.1	4.4
Total	**1,883.8**	**1,882.4**	**1,088.8**	**1,095.4**	**795.0**	**787.0**	**63.8**	**13.2**

[a] Excluding ships and aircraft.
[b] The import data here do not fully correspond with those in Table III–4 because of the revision in the latter table of the annual figures and the lack of a quarterly breakdown thereof.
SOURCE: Central Bureau of Statistics.

costs and domestic prices. The prices received by the exporter outpaced the increase in costs until 1969, reflecting the absence of demand pressure in the domestic market and the underutilization of the factors of production. In the next two years profitability continued upward, but much more slowly, and for part of the period there may have even been a downturn in some industries as the slack in factor utilization was taken up. As a result, the expansion of industrial exports began to lose vigor in the middle of 1971; this trend carried over through most of 1972, but at the end of the year and the beginning of 1973 there were signs of a pick-up. There were two underlying factors: a more buoyant demand in foreign markets with the recovery of several major industrial countries from the slump of the previous two years, and an increase in export returns due to the upward revaluation of several European currencies against the dollar (and Israeli pound) in 1971 and the inflation prevailing in the export markets. In 1972 the industrial export price index was 5 percent higher in dollar terms than in the previous year, and in the last quarter of 1972 it stood 10 percent above the average for 1971.

It is too early, as previously stated, to say whether there has been a renewal of the notable headway made by industrial exports during the four years up to mid-1971. But it seems that the upturn in export profitability in the wake of the currency revaluations, increased incentives, and the inflation abroad represents more a rectification of the negative trend in export prices relative to domestic prices and costs than a resumption of the strong advance in export profitability.

(c) *Capital account*

The main feature of the capital account was the sustained growth of unilateral transfers. While the annual average increase failed to match the strong surge of the previous year, the very fact that funds continued to flow into the economy on the same large scale as in the last quarter of 1971 is remarkable. Foreign investments were also up sharply, doubling in volume. In both these items the level more or less held steady in the course of 1972.

The rise here may be partly attributed to such long-term factors as the booming domestic economy and the high level of profits, which enhanced Israel's attraction to investors; the calmer security situation; and the large immigration from affluent countries. But these probably do not fully explain the steep jump in certain items (e.g. immigrant transfers and investments soared from $ 77 million in 1970 to $ 308 million in 1972). Presumably the long-run factors have a lagged effect, but it is important to note that the steep rise in these items coincided with a drastic change in the influence of short-term factors: the waning of expectations of an imminent devaluation and the widening of the interest rate and yield differentials in comparison with other countries. What enabled these factors to exert their influence in an unrestricted fashion was the liberalization of foreign currency control, notably the guaranteed reconversion of certain types of transfers.

Receipts from transfers and investments more than covered the deficit on current account. Nevertheless, foreign borrowing was only slightly lower than in the two preceding years. The receipt of foreign credit is fully controlled by the Government, and the fact that it remained at a high level despite its negative monetary effect and some easing of the country's balance of payments position suggests that the policy of foreign credit restraint was not fully effective, even though in the course of 1972 there was a definite decline in the number of foreign loan permits granted. It seems that in the face of the prevailing interest rate differential between Israel and foreign money markets, there was increased pressure from various quarters to receive loans from abroad.

The sharp rise in capital imports relative to the current deficit is mirrored by the swelling of foreign exchange reserves. Gross reserves expanded by $ 850 million, and net reserves (i.e. after deduction of liquid foreign liabilities) by $ 690 million. It should be noted, however, that this definition of net reserves lost much of its significance with the relaxation of foreign currency control. The concept reflects the economy's liquid foreign assets net of outstanding liquid liabilities. But the granting of the right of reconversion greatly increased the potential liquid claims, which are not reflected in the measurement of net reserves.

Another outstanding feature of the capital account was the soaring of the country's external debt by $ 650 million to $ 4,100 million. The past few years have seen a big jump in the debt, and at the end of 1972 it was 3.4 times greater than at the end of 1966. This, however, has not been fully reflected in the debt servicing burden, since a large part of the incremental liabilities have maturities exceeding the average for the liabilities outstanding at the end of 1966, and repayments have consequently gone up more slowly than the debt.

Regarding the economy's foremost problem of the balance of payments, if the sharp and unexpected surge of defense imports after 1967 is ignored, there has probably been some improvement since the eve of the 1966–67 recession. In quantitative terms, the deficit was 35 percent higher in 1972 than in 1965, while the product expanded by 70 percent during this period. It should be remembered, however, that in 1972 there were a number of deviations from the long–run trend due to the operation of short–term and special factors. If defense imports are included in the calculation, there has of course been a marked deterioration in Israel's balance of payments position in comparison with the pre–1967 period.

As for the sources of financing the deficit, the notable growth of unilateral transfers and investments unquestionably constitutes a great improvement, helping to counterbalance the rise in the deficit. However, it is difficult to determine to what extent these are stable sources and to what degree they are affected by short–run factors.

Table III–4
COMMODITY IMPORTS,[a] BY ECONOMIC DESTINATION, 1969–72
($ million)

	1969	1970	1971	1972	Percent annual increase or decrease (–)											
					Quantity				Price				Value			
					1969	1970	1971	1972	1969	1970	1971	1972	1969	1970	1971	1972
Consumer goods																
Food	43.6	50.6	62.5	80.7	13	11	18	4	3	5	5	24	16	17	24	29
Other nondurables	36.2	42.0	56.7	62.0	—	15	26	2	3	1	7	7	3	16	35	9
Durables	61.6	50.0	58.7	82.0	55	–21	15	31	3	3	2	7	60	–19	17	40
Total	**141.4**	**142.6**	**177.9**	**224.7**	**23**	**–2**	**20**	**12**	**3**	**3**	**4**	**13**	**27**	**1**	**25**	**26**
Intermediate inputs																
To agriculture	50.5	66.9	78.7	72.0	1	25	10	–9	–2	6	7	—	–1	32	18	–9
To industry (excl. diamonds)	476.1	547.8	595.0	612.0	11	13	8	–1	5	2	1	4	17	15	9	5
To construction	18.9	21.5	33.9	47.1	16	12	56	34	5	2	1	4	22	14	58	39
Spare parts, tools, etc. for current use	77.0	91.7	89.2	107.2	31	17	–4	15	5	2	1	4	38	19	–3	20
Fuel	69.9	70.0	89.4	97.3	9	2	5	–2	2	–2	22	11	11	—	28	9
Subtotal	**692.4**	**797.9**	**886.2**	**935.6**	**13**	**13**	**8**	**3**	**4**	**2**	**3**	**4**	**17**	**15**	**11**	**7**
Rough diamonds (net)	192.8	154.4	224.1	316.1	10	–12	48	27	8	–9	–2	11	19	–20	45	41
Total	**885.2**	**952.3**	**1,110.3**	**1,251.7**	**11**	**8**	**15**	**7**	**5**	**—**	**2**	**6**	**17**	**8**	**17**	**13**
Capital goods																
For agriculture	8.2	6.9	9.2	11.1	22	–18	27	16	5	3	5	4	28	–16	33	21
For industry and construction	160.7	181.9	201.2	251.3	40	10	6	20	5	3	5	4	47	13	11	25

For inland transport	47.1	57.9	76.7	111.0	42	19	26	39	5	3	5	4	49	23	32	45
Other	40.1	41.9	43.0	47.9	44	1	–2	7	5	3	5	4	51	8	3	11
Subtotal	**256.1**	**288.6**	**330.1**	**421.3**	**40**	**10**	**9**	**23**	**5**	**3**	**5**	**4**	**47**	**13**	**14**	**28**
Ships and aircraft	32.0	58.4	186.6	63.6	–53	77	205	–67	5	3	5	4	–44	83	220	–66
Total gross imports	**1,314.7**	**1,441.9**	**1,804.9**	**1,961.3**	**14**	**9**	**23**	**3**	**5**	**1**	**2**	**6**	**20**	**10**	**25**	**9**
Total imports, excl. ships and aircraft and diamonds	**1,089.9**	**1,222.7**	**1,382.1**	**1,581.6**												
Imports returned (excl. diamonds)	10.5	8.1	5.5	5.2												
Total net imports	**1,304.2**	**1,433.8**	**1,799.4**	**1,956.1**												
Less: Balance of payments adjustments	45.5	60.3	40.8	61.1												
Total net imports, excl. the administered areas (according to the balance of payments)	**1,258.7**	**1,373.5**	**1,758.6**	**1,895.0**												
Commodity imports from the administered areas	13.3	18.5	28.3	36.6												
Total net imports, incl. the administered areas (according to the balance of payments)	**1,272.0**	**1,392.0**	**1,786.9**	**1,931.6**												

[a] Imports c.i.f.

SOURCE: Central Bureau of Statistics.

2. Commodity Imports

The growth of commodity imports slowed noticeably in 1972, from 25 percent in 1971 to 9 percent in current prices, and from 23 to 3 percent in real terms. One reason for the more sluggish rise was the tumbling of ship and aircraft imports by 67 percent—from $ 187 million in 1971 to $ 64 million. This item is subject to sharp fluctuations and is only slightly connected with developments in the economy. Another contributory item, which is also not directly affected by the general trends in the economy, is rough diamonds; here imports were up 27 percent in quantitative terms in 1972, after advancing 48 percent the year before (41 as against 54 percent in value terms). Less these two items, commodity imports rose 14 percent in current prices, compared with 13 percent in 1971; in real terms the increases were 9 and 11 percent respectively.

Trends in the principal commodity groups were mixed. The increase in consumer goods slowed from 20 percent in 1971 to 12 percent in real terms, while the rise in imported current inputs, excluding diamonds, sagged from 8 to 3 percent. In contrast, imports of investment goods other than ships and aircraft were up 23 percent in real terms, after advancing 9 percent in 1971 (in value terms, 28 and 14 percent respectively).

These rates of change in the broad commodity import groups do not, of course, reflect the precise trends within each subgroup. While the growth of imports for current consumption sagged, the uptrend in consumer durables accelerated sharply, reaching 31 percent in quantitative terms, as contrasted with a rise of 15 percent in 1971 and a decline of 21 percent in 1970. The deceleration in current consumption imports was due mainly to the steep 16 percent rise in c.i.f. import prices (24 percent for foodstuffs alone). Imports of consumer durables were largely influenced by the indirect taxation policy. Much of the appreciable 1972 increase occurred in the fourth quarter, owing to expectations of stiff tax hikes and a rise in foreign car prices. This sparked a wave of advance purchases, which helped to bring up total car imports by 70 percent for the year. The share of domestic industry in total sales slumped in 1972, owing *inter alia* to the relatively greater increase in the prices of locally assembled vehicles compared with those purchased abroad and to the crisis that befell one of the Israeli plants.

The much heavier 1972 import of capital goods other than ships and aircraft is explained by a combination of factors. One is the acquisition of plant and equipment for the Eshkol III electric power station at Ashdod. This doubled the share of imported plant and equipment for the electricity and water branch in total capital goods imports for industry and construction—from 6 percent in 1971 to 13 percent—and accounted for 30 percent of the total increase in this item. Excluding electricity and water, imports of capital goods were up 16 percent (this is a rough estimate, which is probably downward biased).

The second factor in the expansion of capital goods imports was the 50 percent jump in commercial vehicles. This, too, can be attributed to the anti-

Table III-5

USES OF DOMESTIC OUTPUT AND THEIR IMPORT COMPONENT, 1968–72

	Exports			Domestic uses			Total uses	
	Incl. diamonds	Excl. diamonds	Total	Private consumption	Public consumption	Investment	Incl. diamonds	Excl. diamonds
	Uses of domestic output (IL million, at 1965 producer prices)							
1968	3,287	2,764	9,377	5,837	1,450	2,090	12,664	12,141
1969	3,553	3,008	10,672	6,276	1,694	2,702	14,225	13,680
1970	3,922	3,408	11,652	6,635	1,964	3,053	15,574	15,060
1971	4,803	5,173	12,867	6,992	2,320	3,555	17,669	17,039
1972	5,423	4,619	14,027	7,634	2,170	4,223	19,459	18,646
	Required imports of current inputs ($ million, at 1971 prices)							
1968	310	166	490	301	93	96	800	656
1969	329	179	558	325	106	127	887	737
1970	343	201	604	345	115	144	947	805
1971	407	233	682	365	151	166	1,089	915
1972	475	251	741	401	142	198	1,216	992
	Percent increase in uses of domestic output (at constant prices)							
1969	8.1	8.8	13.8	7.5	16.8	29.3	12.3	12.7
1970	10.4	13.3	9.2	5.7	15.9	13.0	9.5	10.1
1971	22.5	22.4	10.4	5.4	18.1	16.4	13.5	13.1
1972	13.1	10.7	9.0	9.2	–6.5	18.8	10.1	9.4
	Percent increase in required imports of current inputs (at constant prices)							
1969	6.1	7.8	13.9	8.0	14.0	32.3	10.9	12.3
1970	4.3	12.3	8.2	6.2	8.5	13.4	6.8	9.2
1971	18.7	15.9	12.9	5.8	31.3	15.3	15.0	13.7
1972	16.7	7.7	8.7	9.9	–6.0	19.3	11.7	8.4

cipated raising of taxes and foreign prices, which induced many to buy earlier than planned.

Another contributory factor was the import of equipment to replace items that had to be scrapped.

Imports of current production inputs rose less in 1972 than in the previous year—3 percent in quantitative terms, as against 8 percent. Inputs for agriculture were down 9 percent, reflecting a drop in feed purchases because of the raising of foreign prices and a change in the "food basket" of the various types of livestock. The dearer cost of such staples as wheat and soybeans partly accounted for the decline in inputs for the food industry. Purchases of other intermediates for

Table III-6

REQUIRED AND ACTUAL IMPORTS OF CURRENT COMMODITY INPUTS, 1968–72

	Required imports								Total actual imports, excl. diamonds	Difference between required and actual imports
	Exports		Domestic destinations				Total required imports			
	Incl. diamonds	Excl. diamonds	Total	Investment	Private consumption	Public consumption	Incl. diamonds	Excl. diamonds		
1. At current prices ($ million)										
1968	303	149	436	85	269	82	739	585	593	8
1969	340	167	521	121	301	99	861	688	692	4
1970	338	193	581	143	328	110	919	774	798	24
1971	407	233	682	166	365	151	1,089	915	886	–29
1972	511	263	777	205	423	149	1,288	1,040	936	–104
2. At 1968 prices ($ million)										
1968	310	166	490	96	301	93	800	656	651	–5
1969	329	179	558	127	325	106	887	737	727	–10
1970	343	201	604	144	345	115	947	805	822	17
1971	704	233	682	166	365	151	1,089	915	886	–29
1972	475	251	741	198	401	142	1,216	992	900	–92

				3. Percent annual quantitative change				
1969	6.1	7.8	13.9	32.3	8.0	14.0	10.9	12.3
1970	4.3	12.3	8.2	13.4	6.2	8.5	6.8	9.2
1971	18.7	15.9	12.9	15.3	5.8	31.3	15.0	13.7
1972	16.7	7.7	8.7	19.3	9.9	–6.0	11.7	8 4
				4. Quantity index: 1968=100				
1969	106.1	107.8	113.9	132.3	108.0	114.0	110.9	112.3
1970	110.6	121.1	123.3	150.0	114.6	123.7	118.4	122.7
1971	131.3	140.4	139.2	172.9	121.3	162.4	136.1	139.5
1972	153.2	151.2	151.2	206.3	133.2	152.7	152.0	151.2
				5. Percent of total imports, excl. diamonds (at 1971 prices)				
1968		25.3	74.7	14.6	45.9	14.2		100
1969		24.3	75.7	17.2	44.1	14.4		100
1970		25.0	75.0	17.9	42.9	14.3		100
1971		25.5	74.5	18.1	39.9	16.5		100
1972		25.3	74.7	20.0	40.4	14.3		100
				6. Percent of incremental imports				
1969		16.0	84.0	38.3	29.6	16.0		100
1970		32.4	67.6	25.0	29.4	13.2		100
1971		29.1	70.9	20.0	18.2	32.7		100
1972		23.4	76.6	41.6	46.8	–11.7		100

industry, excluding diamonds, were up 5 percent in current prices—this, too, a more sluggish rate than in 1971.

According to estimates based on constant input coefficients, in 1972 actual imports apparently fell short of current requirements (see Table III–6). The main reason for deviations here is inventory fluctuations, due both to expectations concerning future import prices and to changes in the cost of maintaining stocks. An examination of the movement of intermediate imports in the course of the year reveals that, after they had risen steadily in the first part of 1971 and peaked in August (a development which should be viewed against the background of the uncertainty that prevailed in the European markets and the anticipated alteration of various exchanges rates, including the devaluation of the Israeli pound), the curve fell at the end of 1971 after speculative stocks had been drawn down in the wake of the devaluation of the IL in August 1971. During 1972 the level drifted slowly upward. One of the distinguishing features of the year was the absence of devaluation expectations. On the one hand, Israel's foreign currency reserves were greatly augmented, thus helping to alleviate the balance of payments problem; on the other hand, the devaluation of the dollar in 1971 brought relative calm to the European markets and eliminated expectations of a further revaluation during 1972 of European currencies in relation to the dollar, and hence also in relation to the Israeli pound. To these factors must be added the high cost of holding stocks—a fact explained both by the rise in the real rate of interest in the face of an anticipated deceleration of the price advance once the effects of the devaluation had run their course, and by the high rates of return obtainable in such markets as real estate and securities thanks to the prevailing boom, which also helped to increase the alternative cost of maintaining stocks.

In the first months of 1973 imports of inputs picked up, apparently signifying the termination of the process of adjusting stocks and perhaps also the resumption of stockpiling in the face of an expected further round of import price increases.

From the aforegoing it is clear that some slackening of the uptrend in intermediate imports was to be expected in 1972. Unlike capital goods, intermediates are procured for current use, and purchases can be adjusted fairly quickly. By contrast, imports of capital goods are generally connected with long-term planning and are one-time purchases involving large sums. Years of preparation sometimes precede the acquisition of the goods; hence such imports are less sensitive to speculative expectations than current production inputs, and take much longer to respond to such expectations.

The demand for imported inputs has been characterized by an advancing trend in the import component of production. This stands out most in exports, which in 1972 expanded by 13 percent whereas imported inputs rose 17 percent. This development was influenced by the strong gain posted in diamonds, where the import component is very high. Excluding diamonds, the change was in the opposite direction—i.e. the import component declined. In public consumption

Table III–7

COMMODITY IMPORTS, BY FINAL DESTINATION,[a] 1968–72

($ million, at 1971 prices)

	1968	1969	1970	1971	1972	Percent of total imports, excl. diamonds					Percent of increment, excl. diamonds				Percent annual quantitative increase			
						1968	1969	1970	1971	1972	1969	1970	1971	1972	1969	1970	1971	1972
Private consumption	423	476	493	543	601	40.6	39.7	37.5	33.7	36.2	34.0	14.4	17.0	116.0	12.5	3.6	10.1	10.7
Investment, excl. ships and aircraft	292	403	446	496	605	28.0	33.6	33.9	30.8	36.4	71.2	36.4	17.0	218.0	38.0	10.7	11.2	22.0
Ships and aircraft	68	34	61	187	61	6.6	2.8	4.6	11.6	3.7	–21.8	22.9	42.9	–252.0	–50.0	79.4	206.6	–67.4
Total private domestic uses	**783**	**913**	**1,000**	**1,226**	**1,267**	**75.2**	**76.2**	**76.0**	**76.1**	**76.3**	**83.4**	**73.7**	**76.9**	**82.0**	**16.6**	**9.5**	**22.6**	**3.3**
Public consumption	93	106	115	151	142	8.9	8.9	8.7	9.4	8.6	8.3	7.6	12.2	–18.0	14.0	8.5	31.3	–6.0
Total domestic uses	**876**	**1,019**	**1,115**	**1,377**	**1,409**	**84.1**	**85.1**	**84.7**	**85.5**	**84.9**	**91.7**	**81.4**	**89.1**	**64.0**	**16.3**	**9.4**	**23.5**	**2.3**
Exports, excl. diamonds	166	179	201	233	251	15.9	14.9	15.3	14.5	15.1	8.3	18.6	10.9	36.0	7.8	12.3	15.9	7.7
Total uses, excl. diamond exports	**1,042**	**1,198**	**1,316**	**1,610**	**1,660**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**15.0**	**9.8**	**22.3**	**3.1**
Diamonds	144	150	142	174	224										4.2	–5.3	22.5	28.7
Total imports	**1,186**	**1,348**	**1,458**	**1,784**	**1,884**										**13.7**	**8.2**	**22.4**	**5.6**

[a] Direct imports of finished goods, plus imports of intermediates apportioned among the various end-uses in accordance with constant input-output coefficients. The differences between the figures yielded by this computation and the actual imports of intermediates (see Table III–3) stem from changes in stocks of imported goods or in the input coefficients.

Table III–8

IMPORTS, BY ECONOMIC DESTINATION, QUARTERLY DATA, 1969–72[a]

($ million)

	Total[b]		Consumer durables		Intermediates[c]		Capital goods[b]	
	Unadjusted	Seasonally adjusted	Unadjusted	Seasonally adjusted	Unadjusted	Seasonally adjusted	Unadjusted	Seasonally adjusted
1969 I	275.1	279.6	13.9	14.0	115.6	114.5	49.9	53.1
II	330.2	335.4	15.8	15.5	131.9	134.3	68.9	64.0
III	296.2	308.8	12.6	14.5	128.4	138.6	57.4	60.9
IV	368.9	345.7	18.9	17.2	163.2	150.4	74.4	71.2
Total	**1,270.4**	**1,269.5**	**61.2**	**61.2**	**539.1**	**537.8**	**250.6**	**249.2**
1970 I	343.3	347.8	13.9	13.7	155.4	154.8	73.1	77.2
II	360.5	351.7	11.7	11.4	164.1	166.6	81.8	75.5
III	313.4	331.8	11.8	13.5	142.5	150.3	66.4	70.7
IV	350.7	335.0	12.4	11.4	159.6	149.8	69.7	67.9
Total	**1,367.9**	**1,366.3**	**49.8**	**50.0**	**621.6**	**621.5**	**291.0**	**291.3**
1971 I	373.2	376.3	14.2	12.9	175.8	173.6	77.9	81.5
II	406.0	388.0	14.0	14.3	171.2	168.1	90.3	81.8
III	381.6	420.9	12.1	14.7	166.9	182.1	67.7	73.4
IV	438.5	415.1	18.4	16.3	180.0	169.8	94.5	91.3
Total	**1,599.3**	**1,600.3**	**58.7**	**58.2**	**693.9**	**693.6**	**330.4**	**328.0**
1972 I	452.4	461.6	17.7	17.1	183.6	183.3	102.7	110.1
II	476.4	459.3	19.4	19.5	172.2	171.2	109.2	99.5
III	411.5	458.6	17.4	20.8	163.8	179.7	91.8	101.8
IV	543.5	502.9	27.2	24.0	202.6	187.1	117.4	112.4
Total	**1,883.8**	**1,882.4**	**81.7**	**81.4**	**722.2**	**721.3**	**421.1**	**423.8**

[a] The data in this table differ from those in Table III–4 because of the revision in the latter of the annual figures and the lack of a quarterly breakdown thereof.
[b] Excluding ships and aircraft.
[c] Excluding diamonds, fuel, and spare parts.
SOURCE: Central Bureau of Statistics.

from domestic output there was a rise in the average import component because of a fall in the share of construction, which has a below-average import component.

There were pronounced changes in the destination of the incremental imported inputs. The weight of investment, excluding ships and aircraft, and of private consumption in the total increment, excluding diamonds, jumped from 20 and 18 percent respectively in 1971 to 42 percent and 47 percent in 1972, while that of public consumption fell from 33 percent in 1971 to –12 percent. These changes brought up the share of domestic uses from 71 to 77 percent and depressed that of nondiamond exports from 29 to 23 percent (see Table III–6).

These changes stand out even more if direct imports (i.e. of final goods) are included in the final uses. The weight of private consumption in incremental nondiamond imports jumped from 17 percent in 1971 to 116 percent, while that of investment, excluding ships and aircraft, soared from 17 to 218 percent; however, if ships and aicraft are included, the weight of investment fell. After accounting for 12 percent of the increase in 1971, public consumption made a negative contribution of –18 percent in the year reviewed. The share of exports moved up from 11 to 36 percent.

3. Commodity Exports

The expansion of exports of locally produced goods slowed from 25 percent in 1971 to 20 percent. In quantitative terms, the deceleration was even more pronounced—from 21 to 10 percent.

Diamonds figured prominently in this year's gain, rising 47 percent as against 32 percent in the previous year. This brought up their weight in incremental exports of domestically produced goods from 36 percent in 1971 to 70 percent; their weight in total exports of such goods reached 46 percent, after drifting downward for several years.

Overseas citrus sales were off 4 percent, owing mainly to demand conditions abroad rather than to domestic economic developments.

In the broad group of manufactures that are not preponderantly export-oriented the uptrend slowed considerably in 1972. Excluding diamonds and minerals, the quantitative rise was the lowest in several years—6 percent, compared with 12, 14, and 21 percent in 1969, 1970, and 1971 respectively. This development can be attributed to the pressure of domestic demand, the zero growth of export profitability, and special factors of work in several branches.

(a) *Export-orientated and other special commodities*

Approximately half of Israel's commodity exports consist of items produced overwhelmingly for the overseas market (citrus, diamonds, mine and quarry products, and citrus products) and which are therefore relatively little affected by domestic demand conditions. These products are distinguished from other exports in several additional respects: some are subject to demand limitations due to their relatively low income elasticity of demand, while the absence of a domestic market results in a low short-run elasticity of supply.

Citrus exports fell off in 1972 in physical terms, as part of the exportable crop was diverted to the local market in order to prop up foreign prices and thereby avert a decline in proceeds. Despite this, export earnings dipped 4 percent, after a 32 percent gain in 1971. While Israel commands a formidable share of its overseas outlets for this item, the prices fetched are also influenced by fluctuations in competing supplies. The distribution of sales over the year is another significant factor.

Table III-9

NET COMMODITY EXPORTS, 1966–72

($ million, at current prices)

	1966	1967	1968	1969	1970	1971	1972	Percent annual increase or decrease (–)				Percent of total increment		
								1969	1970	1971	1972	1970	1971	1972
Agricultural exports														
Citrus	74.7	85.3	88.4	91.3	86.1	113.9	108.9	3.3	–5.7	32.3	–4.4	–12.4	15.6	–2.8
Other	19.7	22.2	24.5	27.6	43.5	41.0	51.4	12.7	57.6	–5.7	25.4	38.0	–1.4	5.8
Total	**94.4**	**107.5**	**112.9**	**118.9**	**129.6**	**154.9**	**160.3**	**5.3**	**9.0**	**19.5**	**3.5**	**25.6**	**14.2**	**3.0**
Industrial exports														
Diamonds (net)	164.7	157.9	194.8	215.9	201.0	265.3	389.0	10.8	–6.9	32.0	46.6	–35.6	36.0	69.0
Minerals and scrap	36.4	30.8	33.7	38.5	41.8	42.9	43.3	14.2	8.6	2.6	0.9	7.9	0.6	0.2
Copper-cement	12.2	10.4	11.6	15.0	14.6	11.3	11.1							
Phosphates	4.4	4.6	6.0	7.5	4.9	3.4	4.3							
Potash	12.9	13.6	13.9	13.2	21.1	26.7	26.1							
Scrap	4.5	2.0	1.3	2.5	2.5	1.0	1.1							
Textiles and clothing	45.5	51.9	63.7	80.6	96.4	119.7	123.3	26.5	19.6	24.2	3.0	37.8	13.0	2.0
Citrus products	19.0	25.1	26.4	32.6	35.0	43.6	55.4	23.5	7.4	24.6	27.1	5.7	4.8	6.6
Other chemicals	15.8	16.3	18.0	15.6	14.0	7.7	2.5	–13.3	–10.3	–45.0	–67.5	–3.8	–3.5	–2.9
Other metal products	10.8	8.0	26.4	24.1	18.2	31.1	31.8	–8.7	–24.5	70.9	2.3	–14.1	7.2	0.4
Aircraft and parts	1.8	5.8	8.6	7.0	5.9	6.8	10.6	–18.6	–15.7	15.3	23.3	–2.6	0.5	2.1
Edible oils and oilcake	7.1	2.3	5.5	7.5	9.3	13.4	14.5	36.4	24.0	44.1	8.2	4.3	2.3	0.6
Other industrial products	71.5	86.6	103.5	130.1	161.4	205.9	240.0	25.7	24.1	27.6	16.6	74.9	24.9	19.0
Total industrial exports	**372.6**	**384.7**	**440.6**	**551.9**	**583.0**	**736.4**	**910.4**	**14.8**	**5.6**	**26.3**	**23.6**	**74.4**	**85.8**	**97.0**
Total industrial exports, excl. diamonds and minerals	**171.5**	**196.0**	**252.1**	**297.5**	**340.2**	**428.2**	**479.2**							

Total exports from domestic output	**467.0**	**492.2**	**593.5**	**670.8**	**712.6**	**891.3**	**1,070.7**	**13.0**	**6.2**	**25.1**	**20.1**	**100.0**	**100.0**	**100.0**
Sale of old ships and aircraft	5.1	18.8	3.4	5.9	2.0	4.5	13.1							
Equipment shipped by Israeli firms operating abroad	0.3	1.0	0.1											
Works of art, collections, antiques, personal effects, etc.	4.6	5.4	5.6	4.9	7.8	8.5	6.2							
Fuel and stores supplied to foreign ships and aircraft				7.4	8.1	11.2	11.9							
Total commodity exports (foreign trade definition)	**477.0**	**517.4**	**602.6**	**689.0**	**730.5**	**915.5**	**1,101.9**	**14.3**	**6.0**	**25.3**	**20.4**			
Adjustments and returned exports	–2.4	–0.7	–4.7	–10.2	–13.8	–15.6	–19.9							
Total commodity exports, excl. administered areas (balance of payments definition)	**474.6**	**518.1**	**597.9**	**678.8**	**716.7**	**899.9**	**1,082.0**							
Exports to administered areas	—	15.4	51.1	67.4	85.2	93.8	120.1							
Total net commodity exports, incl. administered areas (balance of payments definition)	**474.6**	**533.1**	**649.0**	**746.2**	**801.9**	**993.7**	**1,202.1**							

SOURCE: Central Bureau of Statistics.

Table III–10

GROWTH OF COMMODITY EXPORTS, BY MAJOR GROUP, 1967–72

($ million, at current prices)

	Total commodity exports			Percent of 1967 exports	Percent increase 1967–71	Percent of 1967–71 increment	Percent increase 1972	Percent of 1972 increment
	1967	1971	1972					
Citrus	85.3	113.9	108.9	17.3	33.5	7.2	–4.4	–2.8
Other agricultural exports	22.2	41.0	51.4	4.5	84.7	4.7	25.4	5.8
Minerals	30.8	42.9	43.3	6.3	39.3	3.0	0.9	0.2
Diamonds	157.9	265.3	389.0	32.1	68.0	26.9	46.6	69.0
Textiles and clothing	51.9	119.7	123.3	10.5	130.6	17.0	3.0	2.0
"Special" items[a]	57.5	102.6	111.1	11.7	78.4	11.3	8.3	4.7
Other industrial products[a]	88.6	205.9	243.7	17.6	37.8	29.9	18.4	21.1
Total	**492.2**	**891.3**	**1,070.7**	**100.0**	**81.1**	**100.0**	**20.1**	**100.0**

[a] See Table III–9. "Special items" are all those listed in Table III–9 that are not detailed here.
SOURCE: Central Bureau of Statistics.

The uptrend in citrus products was a little faster in 1972—27 percent as against 25 percent the year before. This industry absorbs surplus fresh fruit that is not exported or sold for direct domestic consumption. The prices paid by the canneries are below those for the other two destinations; in fact, sales to industry are intended to prevent the softening of prices in the other two markets.

The acceleration in citrus products is explained by sales out of storage, since production did not expand and most of the surplus exportable fruit was sold for direct domestic consumption because of the high prices obtainable.

Table III–11

CITRUS EXPORTS, 1967–72

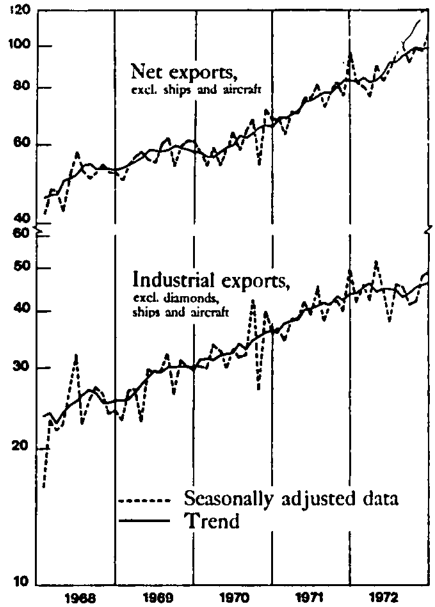
	1967	1968	1969	1970	1971	1972
$ million	85.3	88.4	91.3	86.1	113.8	109.8
Percent annual change						
Value	14.2	3.6	3.3	–5.7	32.2	–4.3
Price	–5	–6	6	–6	7	—
Quantity	20.2	10.2	–2.5	0.3	23.6	–4.3

Diamond exports were up by a record 47 percent in 1972, after advancing 32 percent the year before. This brought up the share of this item in locally produced commodity exports to 36 percent, ending a downturn of several years' duration. Fluctuations in this industry's output, nearly all of which is marketed abroad, is, in the short run, primarily a function of changes in foreign demand, particularly in the American market. The boom of the past two years was largely connected with the improved financial position of the high-income groups in the United States, after a laggard economy in 1970. It should be noted that, with the mounting importance of the affluent Japanese market for her diamond exports, Israel has become somewhat less dependent on the U.S. In diamonds there is no possibility of substitution between the foreign and domestic markets, and the only connection between this industry and the domestic market is the need to compete with other branches for labor. However, since the weight of fixed capital in this industry is low, a rise in labor costs can adversely affect exports even in the short run.

Figure III-1

NET EXPORTS AND INDUSTRIAL EXPORTS, 1968–72

($ million; monthly data)



Source: Central Bureau of Statistics.

One of the characteristics of the world diamond industry is that the various producing countries specialize in different types of stones, with each country enjoying a near-monopolistic position in the world markets in its specialty. The impressive export advance scored by Israel in 1972 was partly due to the success of the local industry in penetrating the market for new types of stones, which are larger (over half a carat) than those previously polished in Israel. This opened up many new marketing outlets.

In minerals, the world price of copper continued to retreat, depressing Israel's export earnings (the supply of minerals, as already noted, is inelastic in the short run). The quantitative decrease in potash, which accounts for more than half of Israel's total mineral sales abroad, was due to technical hitches at the local plant which precluded the stepping-up of exports.

Overseas sales of noncitrus farm products, some of which are grown primarily for the foreign market (winter vegetables, flowers, and certain fruits), were up 25 percent, after receding 6 percent in 1971. Favorable climatic conditions resulted in bumper yields of fruit (mainly avocado), flowers, and cotton and a larger export; on the other hand, climatic conditions had a detrimental effect on vegetables. Sales of flowers, whose cultivation is labor-intensive, slowed because of the lack of manpower.

(b) *Other industrial exports*

In the broad group of manufactures which are not intended predominantly for the overseas market and which encompass the bulk of Israeli industry, export growth slackened in 1972. Excluding diamonds and minerals, the level of industrial exports moved up 6 percent in real terms in 1972, after gains of 21 percent in 1971 and 14 percent in 1970. In this context it should be noted that the development of some of the items is largely governed by special factors.

Since the commodities in this group are sold both locally and abroad, direct substitution between the two markets is often possible. Exports here are more sensitive to changes in relative prices, the pressure of domestic demand, and changes in production costs. A heavier domestic demand brings up the share of the home market in output and depresses that of exports. This favoring of the domestic market is also seen in the fact that when a rise in production costs is accompanied by a cutback in production, exports are the first to suffer.

"Other industrial exports" consist of two large groups: textiles and clothing, where the effective rate of exchange is affected by special branchwide arrangements, and all the remaining items.

In textiles and clothing the nominal export growth rate tumbled from 24 percent in 1971 to 3 percent, while other industrial commodities posted a 17 percent advance, compared with 28 percent in 1971.

The most striking development in 1972 was the decline in the share of these two groups in incremental exports (which is the obverse of the increased share of diamonds, discussed above): whereas in 1967–71 they accounted for 47 percent of the incremental exports, in 1972 the figure dipped to only 23 percent.

In several industries the slackening of export growth may be attributed to special factors. In textiles it was due to the decline in knitted fabrics and panty hose, which had to face stiff competition in foreign markets; Japanese competition in world markets explains the more sluggish rise in electronic products; the completion of several large export orders was the main cause in the printing industry; the severing of diplomatic relations with Uganda depressed the uptrend in metal products. The deceleration in these industries was accompanied by a decline in the export share of output (see Table III–12).

Two factors were mainly responsible for the impressive headway made in exports up to 1971: the cumulative rise in industrial export profitability due to a deliberate policy of fostering overseas sales, and the fact that export prices moved up faster than those in the domestic market because of the relatively weak demand pressure in the latter.

Table III–12

GROWTH OF INDUSTRIAL EXPORTS AND THEIR SHARE IN OUTPUT, 1968–72

	Exports (IL million, at 1969 producer prices)					Percent annual quantitative change				Exports as a percent of output (at 1969 prices)				
	1968	1969	1970	1971	1972	1969	1970	1971	1972	1968	1969	1970	1971	1972
Food	120.4	156.8	176.3	209.7	235.8	30.2	12.4	18.9	12.4	6.5	7.8	8.3	9.0	9.5
Textiles and clothing	243.2	294.1	352.2	418.8	411.9	20.9	19.8	18.9	–1.6	17.8	19.5	20.8	20.6	17.7
Wood and wood products	22.9	27.1	25.2	27.1	30.7	18.3	–7.0	7.5	13.3	6.3	6.9	6.1	6.2	6.2
Paper and allied products	47.0	6.6	9.6	7.6	7.9	–86.0	45.5	–20.8	3.9	22.1	3.0	4.0	2.9	2.8
Printing and publishing	12.8	15.6	17.9	30.0	29.5	21.9	14.7	67.6	–1.7	5.4	5.7	5.6	11.4	10.4
Leather and leather products	6.4	10.9	11.4	15.2	18.1	70.3	4.6	33.3	–2.3	5.6	8.8	8.8	11.2	13.2
Rubber and plastic products	41.8	52.8	77.0	91.2	94.1	26.3	45.8	18.4	3.2	12.6	13.2	16.8	16.9	14.7
Chemicals	141.7	159.9	173.4	184.6	173.9	12.8	8.4	6.5	–5.8	19.2	19.5	18.2	17.2	14.2
Nonmetallic mineral products	9.2	7.6	8.3	10.1	5.8	–7.4	9.2	21.7	–42.6	2.8	2.1	2.0	2.2	1.1
Basic metals	16.1	15.1	22.5	23.8	22.3	6.2	49.0	5.8	–6.3	6.3	4.8	7.3	7.7	6.7
Metal products	110.8	104.7	110.2	147.8	155.6	–5.5	5.3	34.1	5.3	14.9	11.8	11.6	13.1	12.9
Machinery	14.9	19.9	20.9	17.2	20.3	33.6	5.0	–7.7	18.0	5.0	5.4	4.8	3.8	4.1
Electrical and electronic equipment	18.9	39.8	48.2	76.5	97.3	110.6	21.1	58.7	27.2	4.6	6.4	7.3	10.5	12.1
Transport equipment	39.9	35.5	27.8	30.4	37.4	11.0	–21.7	9.4	23.0	11.5	8.0	4.9	4.5	5.4
Miscellaneous	24.8	28.8	33.5	52.4	78.7	16.1	16.3	56.4	50.2	25.9	23.9	26.3	31.4	42.5
Total, excl. diamonds and minerals	870.8	975.2	1,114.4	1,342.4	1,419.3	12.0	14.3	20.5	5.7	11.3	11.0	11.4	12.2	11.7

The effective exchange rate for exports went up 70 percent from 1966 until the end of 1971. This was due both to the altering of the official rate of exchange and to the raising of direct export incentives. The effective rate for imports also moved up 70 percent during this period, but until the devaluation of August 1971 it trailed behind the export rate (see Table III–15). The price of value added,[4] which includes the effects of the change in industrial export and imported input prices, advanced about 75 percent during these years (Table III–16).

The changes in input prices between 1966 and 1971 were milder. The relatively slow rise in costs reflected the existence of unemployed factors of production at the beginning of the recovery from the recession. Inputs purchased in the domestic market became 29 percent dearer, wages per unit of output went up 12 percent, and the price of investment goods per unit of output rose 18 percent (see Table III–17). Profits per unit of capital obviously depend on the composition of inputs. Alternative calculations based on varying input and value-added proportions for commodities in the highest incentive group show that until 1970 the return per unit of capital on export production rose significantly.

It should be noted that the period under discussion saw an upsurge in the profitability of industrial production as a whole, so that from the aspect of export growth the fact that export prices went up faster than domestic prices was important—whereas product prices in the home market rose 29 percent during this period, the prices received by the exporter shot up 67 percent.

A combination of factors was responsible for the retardation of the advance of industrial exports from the end of 1971. After increasing mildly until 1970, domestic demand pressure began to build up strongly in 1971 and 1972 under conditions of full factor employment. In several industries this brought up the share of the domestic market in output at the expense of exports; this applies in particular to minerals, plywood, other chemicals, nonferrous metal products, and knit goods (see Table III–12).

The change in the relative price of exports was another cause of their deceleration in 1972. Until this year the prices received by exporters had outpaced the rise in the price of industrial output sold in the domestic market—from 1966 to 1971 the former moved up 67 percent, and the latter by only 29 percent. In 1972 both advanced 12 percent (see Tables III–17 and III–18), thereby arresting the uptrend in the relative price of exports. It is important to note in this context that, because of the preference shown for the home market, a sharp increase in costs may adversely affect exports even if their relative price continues to rise.

Another factor depressing export profitability was the differential rate of

[4] The concept "change in the price of value added" as used here refers to the change in value added, measured in Israeli pounds, due to changes in prices and effective exchange rates, assuming a constant physical relationship between inputs and outputs.

Table III–13

QUARTERLY EXPORT DATA, 1969–72

($ million)

		Net exports, excl. ships and aircraft		Industrial exports, excl. diamonds, ships, and aircraft		Industrial exports, excl. products sold mainly abroad and special items[a]	
		Unadjusted	Seasonally adjusted	Unadjusted	Seasonally adjusted	Unadjusted	Seasonally adjusted
1969	I	197.2	155.0	73.4	77.8	60.3	64.5
	II	166.5	168.0	89.1	83.1	70.1	67.8
	III	137.7	177.4	86.1	89.3	64.7	65.1
	IV	175.9	187.0	103.2	92.9	80.1	76.5
	Total	**677.3**	**687.4**	**351.7**	**343.1**	**275.2**	**273.9**
1970	I	204.6	169.7	87.7	95.2	70.9	76.1
	II	173.8	176.7	100.4	97.0	83.0	79.7
	III	157.7	191.5	100.1	107.3	81.3	83.0
	IV	196.2	195.1	116.3	103.8	92.5	86.5
	Total	**732.7**	**733.0**	**404.5**	**403.3**	**327.7**	**325.3**
1971	I	243.3	202.8	101.4	110.6	82.4	89.7
	II	223.4	223.2	126.1	121.5	103.4	98.2
	III	183.8	231.8	119.8	126.8	94.8	96.8
	IV	259.7	255.5	147.3	129.9	113.7	105.0
	Total	**910.2**	**913.3**	**494.6**	**488.8**	**394.3**	**389.7**
1972	I	287.2	239.4	117.2	130.0	93.3	102.4
	II	259.7	261.7	143.5	140.4	117.8	113.3
	III	228.8	290.4	126.0	134.2	102.6	105.1
	IV	313.1	303.9	158.8	139.9	132.8	125.6
	Total	**1,088.8**	**1,095.4**	**545.5**	**544.5**	**446.5**	**446.4**

[a] Industrial exports, excluding minerals, diamonds, other metal products, other products not from domestic output, fuel and stores supplied to foreign ships and aircraft, used and locally produced ships and aircraft.

SOURCE: Central Bureau of Statistics.

Table III–14

EXPORTS AND VALUE ADDED, 1968–72

($ million)

	Exports					Value added					Weight in 1972 in:			
	1968	1969	1970	1971	1972	1968	1969	1970	1971	1972	Total exports	Incremental exports	Value added	Incremental value added
Citrus	88.4	91.3	86.1	113.9	108.9	76.1	78.7	73.0	96.5	90.4	10.2	–2.8	15.0	–6.9
Other agricultural produce	24.5	27.6	43.5	41.0	51.4	20.8	23.6	37.3	35.6	44.8	4.8	5.8	7.4	10.5
Diamonds	194.8	215.9	201.0	265.3	389.0	40.4	43.3	56.4	91.5	141.1	36.3	69.0	23.4	56.4
Textiles and clothing	63.7	80.6	96.4	119.7	123.3	34.5	44.3	54.0	72.5	73.3	11.5	2.0	12.1	0.9
Minerals	33.7	38.5	41.8	42.9	43.3	27.5	31.4	34.0	35.3	35.4	4.0	0.2	5.9	0.1
Other industrial products	188.7	216.9	243.8	308.5	354.8	111.5	129.9	143.8	184.5	219.2	33.1	25.8	36.3	39.4
Total commodity exports	**593.5**	**670.8**	**712.6**	**891.3**	**1,070.7**	**310.4**	**352.3**	**398.5**	**516.2**	**604.2**	**100.0**	**100.0**	**100.0**	**100.0**
Total commodity exports, excl. diamonds	**286.1**	**336.0**	**382.0**	**471.1**	**521.4**	**174.4**	**205.6**	**231.8**	**292.4**	**327.9**	**48.7**	**28.0**	**54.3**	**40.3**

Table III–15

CHANGES IN THE EFFECTIVE EXCHANGE RATE FOR EXPORTS, 1966–72[a]

Value-added group		1966		1967		1970		1971		1972
		April	Nov.	March	Nov.[b]	Feb.	Aug.	Jan.	Aug.[c]	Aug.
A. IL/$ above beginning-of-period official rate[d]										
1. (up to 25 percent)		1.0	1.8		50	60	120	122	205	215
2. (26–45 percent)	(26–35)	3.5	10.5		60	70	130	133	205	215
	(36–45)							140	206	216
3. (46–65 percent)	(46–55)	7.5	18.0	34.5[e]	70	85	140	145	207	217
	(56–65)							150	208	218
4. (66 percent +)		10.5	25.5	45.0[e]	85	105	155	162	209	219
B. Percent above beginning-of-period official rate[d]										
1.		0.3	0.6		16.7	17.1	40.0	40.7	68.3	71.7
2.		1.2	3.5		20.0	23.2	43.3	44.3	68.3	71.7
								46.7	68.7	72.0
3.		2.5	6.0	11.0[d]	23.3	28.3	46.7	48.3	69.0	72.3
								50.0	69.3	72.7
4.		3.5	8.5	15.0[d]	28.3	35.0	51.7	54.0	69.7	73.0
C. Exchange rate for import component (percent above beginning-of-period official rate[d])										
		—	—	—	16.7	16.7	40.0[f]	40.0	68.0	68.0

[a] The computation includes only changes in the official rate and direct incentive payments.
[b] IL 0.5 (16.7 percentage points) was due to the devaluation.
[c] IL 0.7 (23.3 percentage points) was due to the devaluation.
[d] IL 3/$ 1.
[e] In March 1967 certain products in groups 3 and 4 began to get preferential treatment, the incentives on them gradually increasing beyond the level for the rest of the products in these groups. These additional incentives were abolished in November 1967.
[f] On the reservations concerning this datum see Bank of Israel, *Annual Report 1971,* Table III–12, note 1.

change in costs and export returns. Until 1970 export earnings went up faster than costs, but in 1971 costs rose steeply, some of them even more rapidly than export returns (see Tables III–17 and III–18), and this trend carried over through 1972.

A comparison of the movement of input prices in 1971–72 with the years 1965–70 shows that purchased intermediates became 22 percent dearer in the

Table III–16

EFFECTIVE EXCHANGE RATE FOR THE VALUE-ADDED DOLLAR IN INDUSTRIAL EXPORTS,[a] 1965–72

Value-added group and percent value added	1965	Nov. 1966	Nov. 1967	Feb. 1970	Aug. 1970	Jan. 1971	Aug. 1971	Aug. 1972
Index (1965=100)								
(a) 2 35 percent	100	110.0	126.0	135.4	149.4	152.3	169.0	178.5
(b) 3 55 percent	100	110.9	128.7	137.8	152.2	155.1	169.8	175.9
(c) 4 70 percent	100	112.1	133.3	142.9	156.7	160.0	170.4	175.1
(d) 4 55 percent	100	115.5	137.8	150.0	161.3	165.5	171.0	177.1
(e) 4 35 percent	100	124.3	149.7	168.9	173.4	180.0	172.8	182.3
Percent increase over preceding period								
(a)		10.0	14.5	7.5	10.3	1.9	11.0	5.6
(b)		10.9	16.1	7.1	10.4	1.9	9.5	3.6
(c)		12.1	18.9	7.2	9.7	2.1	6.5	2.8
(d)		15.5	19.3	8.9	7.5	2.6	3.3	3.6
(e)		24.3	20.1	12.8	2.7	3.8	–4.0	5.5

[a] The figures take into account the changes in the official exchange rate and export incentives as well as the August 1970 defense levy on imports. Duties on imports-for-exports are not taken into account, but since their weight is small, this does not affect the period trend.

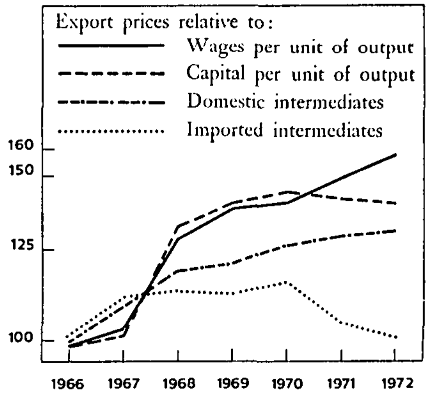
last two years, compared with an 18 percent rise in the five preceding years. The price of capital goods per unit of output went up by 22[5] and 3 percent respectively, and wages by 13 as against 6 percent (the 1972 figure for wages apparently has a downward bias, as the renegotiation of many of the wage agreements for 1972–73 was being dragged out, and these will include retroactive pay increments, which the producer is already taking into account). The prices of imported inputs also rose quite sharply in the two last years—by 45 percent, as contrasted with 29 percent in 1965–70 (see Table III–17).

[5] The prices here do not include the subsidized credit element, capital gains arising from devaluation, or a decrease in the real value of credit repayments in cases where the credit is not value-linked.

The influence of the input price rise on the unit return to capital depends on the weights of the component inputs; because of the variability in the input mix, there may be different profitability trends in the various branches. This provides a partial explanation of the dissimilar response of the various branches to the increased price of inputs, and it finds expression in the differential rates of export growth. Beginning in 1971, the unit return to capital tapered off and in some cases even turned downward. However, data for the end of 1972 suggest that, with the accelerated rise in export prices in dollar terms, there may have been a reversal of trend.

Figure III–2

PRICES TO THE EXPORTER RELATIVE TO INPUT PRICES, 1966–72



Export profitability was also favorably influenced by the narrowing in August 1970 of the gap between the effective exchange rates for imported inputs and exports. This gap resulted in a larger return per value-added dollar the smaller the percentage of value added, and complete elimination of the differential may even depress the effective export rate for some commodity groups. It should be stressed that the existence of such a gap leads to a distorted factor allocation.

The rapid mounting of costs obviously affected the profitability of industry as a whole; however, as already noted, the slowing of profitability growth in a given branch because of this factor may affect exports more than domestic marketing.

The deceleration of nondiamond industrial exports, which began in the final part of 1971, continued in the year reviewed. But toward the end of 1972 the level started to perk up again, and this trend carried over into the first months of 1973. It is still too early to say whether this signified the resumption of the vigorous rise that prevailed up to mid-1971. One of the contributing factors was the more rapid expansion of Israel's export markets in 1972, after a sluggish growth in 1971 (see Table III–19).

Another reason was the advance of export prices, due to the upward revaluation of several European currencies at the end of 1971 and the inflation prevailing in Israel's principal export markets. The raising of incentive rates in the middle of 1972 also had some effect. The exchange rate changes at the beginning of 1973 undoubtedly drove export prices up still more, but this is not yet reflected in the export figures for the first four months of the year. Nondiamond industrial export prices moved up 5 percent in 1972, after inching up

Table III–17

INDICATORS OF INDUSTRIAL EXPORT PROFITABILITY, 1966–72[a]

	1966	1967	1968	1969	1970	1971	1972	End-1972 as against average 1972
Prices received by the exporter								
Percent annual change	3.8	11.1	11.6	3.7	11.6	12.0	12.8	6.4
Index (1965=100)	103.8	115.3	128.7	133.4	148.9	166.7	188.0	200.1
Prices paid by the importer for imported intermediates[b]								
Percent annual change	2.0	1.7	9.9	4.2	8.9	23.7	16.6	4.5
Index (1965=100)	102.0	103.7	114.0	118.8	129.4	160.0	186.6	195.0
Price of export value added[c]								
70 percent value added								
Percent annual change	4.6	15.0	12.2	3.5	12.6	7.8	11.2	7.3
Index (1965=100)	104.6	120.3	135.0	139.7	157.3	169.6	188.6	202.3
50 percent value added								
Percent annual change	5.6	20.2	13.0	3.2	13.8	3.0	9.2	8.4
Index (1965=100)	105.6	126.9	143.4	148.0	168.4	173.4	189.4	205.3
Domestic market prices								
Percent annual change	4.8	1.2	2.4	1.8	6.8	9.2	11.6	5.0
Index (1965=100)	104.8	106.0	108.5	110.5	118.0	128.9	143.9	151.1
Wages per unit of output								
Percent annual change	5.1	6.7	–10.4	–3.6	9.9	5.0	7.2	–1.5
Index (1965=100)	105.1	112.1	100.5	96.8	106.4	111.7	119.7	117.9
Price of capital per unit of output[d]								
Percent annual change	5.3	7.6	–14.0	–2.2	8.3	14.1	14.1	
Index (1965=100)	105.3	113.3	97.4	95.3	103.2	117.7	134.3	

[a] Excluding diamonds, textiles, and minerals.
[b] Imports-for-exports.
[c] Based on the incentives for the value-added group getting the highest incentive rate, using two alternative assumptions regarding the proportion of value added.
[d] The product of the increase in the price of capital goods and the decline in the volume of capital per unit of output in fixed physical terms.

Table III–18

PRICES TO THE EXPORTER RELATIVE TO INPUT PRICES, 1966–72

(annual averages; 1965=100)

Export prices relative to:	1966	1967	1968	1969	1970	1971	1972 Average	1972 End of year
Imported intermediates	101.8	111.2	112.9	112.3	115.1	104.2	100.8	102.6
Domestic intermediates	99.0	108.8	118.6	120.7	126.2	129.3	130.6	132.4
Wages per unit of output	98.8	102.9	128.1	137.8	139.9	149.2	157.1	169.7
Capital per unit of output	98.6	101.8	132.1	140.0	144.3	141.6	140.0	

by a mere one percent in each of the previous two years. The rise was concentrated in the last quarter of the year, when prices stood 10 percent above the annual level for 1971.

The value-added component of Israel's commodity exports amounted in 1972 to $ 604 million, or 56 percent of the total value of exports; this compares with 58 percent the year before. However, it should be pointed out that the weight of diamonds in these data is large, and the estimate of their value added is sta-

Table III–19

GROWTH OF ISRAEL'S EXPORT MARKETS,[a] 1965–72

(percentages)

	Developed countries	Others	Total
1965	8.2	23.7	10.5
1966	7.7	7.5	7.7
1967	5.3	4.6	5.2
1968	13.8	12.2	13.6
1969	10.7	10.4	10.7
1970	7.9	10.3	8.3
1971	6.3	9.9	6.8
1972	9.4		

[a] The measure of market expansion is the volume of total imports of the countries of destination, weighted by each country's share in Israel's 1970 exports (excluding diamonds, ships and aircraft, and military equipment). In 1970, 71.5 percent of Israel's exports went to developed countries. The group of "other" countries, consisting of the remaining large export markets, accounted for 12.7 percent of Israel's total exports.

tistically problematical.[6] Not counting diamonds, the value added of industrial exports rose 12 percent, compared with an 11 percent gain in exports; this brought up the proportion of value added in such exports to 63 percent.[7] In total commodity exports other than diamonds, value added increased by 9 percent—similar to the advance in such sales—and reached $ 460 million, or 68 percent of the total figure.

4. Exports and Imports of Services

In Israel's services account, excluding defense imports and transactions with the administered areas, the surplus rose from $ 140 million in 1971 to over $ 200 million in the year reviewed. In previous years this account was roughly in balance with slight fluctuations in either direction (see Table III–20). The growth of the surplus stemmed from a 14 percent gain in exports and a smaller (9 percent) increase in imports. These rates were much lower than in 1971, but the decline was greater in exports (see Tables III–21 and III–22)

The slowdown was most pronounced in income from tourism, which advanced by $ 33 million, or 18.8 percent, as against $ 75 million (73 percent) in 1971. The curve did not go up evenly during the year—the first half saw a continuation of the rapid rise of 1971, and the level stood 50 percent higher than in the comparable period in 1971. But following the attacks on Israeli air transport, the uptrend was arrested in the second half of the year, and revenue was about the same as in the second half of the previous year in nominal terms and fell off in real terms.

Another item that rose more sluggishly in 1972 is income from transport services, but since the growth of transport outlays also slowed, the net inflow rose from $ 120 million to $ 160 million, or by 17 percent, compared with 26 percent in 1971. About one-third of the 1972 gain stemmed from the revision of international prices, the remaining two-thirds representing the real increase. In 1971 the ratio was more heavily tilted in favor of the latter The difference was due chiefly to the slower growth of the merchant marine in 1972, after a very sizable expansion the year before, which was connected with the start of operation of the Eilat-Ashkelon oil pipeline.

As in 1971, the foreign currency outlays of Israeli shipping companies and airlines trailed behind the rise in their foreign currency receipts.

6 This estimate appears to be deficient on two counts. In the first place, there is reason to doubt the reliability of the price index for diamond exports. It far outstripped the rise in prices of imported rough stones, which seems rather improbable. Secondly, the output mix of this industry apparently underwent a change, and the value added estimate, which is based on constant physical coefficients, is therefore not up to date. As a result, the import in 1971–72 of uncut stones required for current production as calculated according to the constant coefficients was much lower than the actual import.

7 Value added here is gross value added, i.e. output net of current imported inputs only, but not imported primary factor inputs (depreciation and return to capital).

Table III-20

IMPORTS AND EXPORTS OF SERVICES,[a] 1966–72

($ million)

	1966	1967	1968	1969	1970	1971	1972
A. Excl. administered areas and defense							
Transportation							
Credit	158	161	200	214	257	324	379
Debit	103	100	129	137	174	205	223
Net	55	61	71	77	83	119	156
Travel							
Credit	59	52	96	86	103	178	212
Debit	49	44	52	66	54	60	70
Net	10	8	44	20	49	118	142
Cargo insurance							
Net	4	4	7	8	10	11	12
Other insurance							
Net	–5	–11	–11	—	–12	–11	–9
Capital services							
Credit	48	55	65	73	65	120	128
Debit	107	123	136	151	183	207	218
Net	–59	–68	–71	–78	–118	–87	–90
Other services							
Credit	49	52	69	81	81	117	136
Debit	44	68	69	79	74	98	116
Net	5	–16	—	2	7	19	20
Government, n.e.s.							
Credit	25	31	33	33	28	34	27
Debit	43	41	46	71	54	60	55
Net	–18	–10	–13	–38	–26	–26	–28
Net total, excl. defense imports	**–8**	**–32**	**27**	**–9**	**–7**	**143**	**203**
B. Defense imports	**–116**	**–283**	**–249**	**–334**	**–624**	**–555**	**–492**
Net total, incl. defense imports	**–124**	**–315**	**–222**	**–343**	**–631**	**–412**	**–289**
C. Net transactions with the administered areas		–17	–6	–1	–10	–25	–56
Total balance on services account	**–124**	**–332**	**–228**	**–344**	**–641**	**–437**	**–345**

[a] On the basis of c.i.f. recording of commodity imports.
SOURCE: Central Bureau of Statistics.

In the third principal item in the services account—capital services—the uptrend faltered noticeably in both imports and exports. As regards the outflow, the low 5.5 percent rise is explained by two factors. One of the two components of this item—profit and dividend withdrawals by foreign investors—fell off in absolute terms. This was due to the same factors that greatly stimulated the

Table III–21

EXPORTS OF SERVICES,[a] 1966–72

($ million)

	1966	1967	1968	1969	1970	1971	1972	Annual increase or decrease (–)					
								$ million			Percent		
								1970	1971	1972	1970	1971	1972
Transportation	157.7	160.8	200.2	214.4	257.2	328.0	379.3	42.8	67.0	55.1	20.0	26.0	17.0
Passenger	41.3	43.4	54.3	50.7	54.1	68.6	88.9	3.4	14.5	20.3	6.7	26.8	29.6
Freight	93.6	92.9	115.0	128.2	157.6	186.4	221.9	29.4	28.8	35.5	22.9	18.3	19.0
Other income	22.8	24.5	30.9	35.5	45.5	73.0	68.5	10.0	23.7	–0.7	28.2	52.1	–1.0
Travel	59.1	52.2	96.0	85.8	103.0	178.3	211.8	17.2	75.3	33.5	20.0	73.1	18.8
Insurance	58.1	60.9	71.2	98.8	111.3	137.2	155.5	12.5	25.9	18.3	12.7	23.3	13.3
Capital services	48.2	54.5	65.4	72.9	64.8	119.8	127.6	–8.1	55.0	7.8	–11.1	84.9	6.5
Government, n.e.s.	25.0	30.7	32.6	33.2	28.0	33.7	27.0	–5.2	5.7	–6.7	–15.7	20.4	–19.9
Other services	49.4	52.4	68.9	81.3	81.2	117.0	136.3	5.4	30.3	19.3	–0.1	44.1	16.5
Total	**397.5**	**411.5**	**534.3**	**586.4**	**645.5**	**914.0**	**1,037.5**	**64.6**	**259.2**	**127.3**	**10.1**	**41.0**	**14.0**
Exports to the adiministered areas		4.6	15.3	16.4	23.6	35.1	44.6	–0.3	19.0	9.5	43.9	48.7	27.1
Grand total	**397.5**	**416.1**	**549.6**	**602.8**	**669.1**	**949.1**	**1,082.1**	**64.3**	**278.2**	**136.8**	**11.0**	**41.3**	**14.5**

[a] On the basis of c.i.f. recording of commodity imports.
SOURCE: Central Bureau of Statistics.

Table III–22

IMPORTS OF SERVICES,[a] 1966–72

($ million)

	1966	1967	1968	1969	1970	1971	1972	Annual increase or decrease (–)					
								$ million			Percent		
								1970	1971	1972	1970	1971	1972
Transportation	102.8	99.8	128.7	137.1	174.5	205.3	222.5	37.4	30.8	17.2	27.3	17.7	8.4
Passenger	14.9	13.8	15.7	17.5	17.7	20.2	17.0	0.2	2.5	–3.2	1.1	14.1	–15.8
Other	87.9	86.0	113.0	119.6	156.8	185.1	205.5	37.2	28.3	20.4	31.1	18.0	11.0
Travel	48.8	44.0	51.7	65.9	53.8	60.1	70.4	–12.1	6.3	10.3	–18.4	11.7	17.1
Insurance	60.2	67.8	75.3	91.5	114.5	137.6	153.6	23.0	23.1	16.0	25.1	20.2	11.6
Capital services	106.9	123.3	135.9	150.8	183.1	206.9	218.3	32.3	23.8	11.4	21.4	13.0	5.5
Government, n.e.s.[b]	42.7	41.3	45.8	71.0	53.8	60.3	54.7	–17.2	6.5	–5.6	–24.2	12.1	–9.3
Miscellaneous	44.3	68.4	68.8	78.6	74.1	97.7	115.7	0.5	18.6	18.0	–5.9	32.0	18.4
Total, excl. defense imports	**405.7**	**444.6**	506.2	594.9	653.7	767.9	835.2	63.9	109.1	67.3	9.9	17.5	8.8
Defense imports	116.0	283.0	249.2	333.7	624.4	554.6	492.1	290.7	–69.8	–62.5	87.1	–11.2	–11.3
Service imports from the administered areas		21.7	20.7	17.0	33.7	60.4	100.9	10.5	32.9	40.6	98.2	79.2	67.1
Grand total	**521.7**	**749.3**	**776.1**	**945.6**	**1,311.8**	**1,382.9**	**1,428.2**	**365.1**	**72.2**	**45.3**	**38.7**	5.4	3.3

[a] On the basis of c.i.f. recording of commodity imports.
[b] Excluding defense imports.
SOURCE: Central Bureau of Statistics.

inflow of capital into the economy during the year: rising rates of return on financial assets and the ebbing of devaluation expectations. The second component item—interest payments—was up 11 percent in 1972, a low rate relative to the increase in both Israel's foreign currency and other liabilities abroad (mainly nonresidents' foreign currency deposits in Israeli banks). This reflects the lagged effect of the drop in interest rates in the world's capital and money markets from their 1969–70 level.

The slower increase in income from capital services followed a notable gain in 1971. Part of the difference in growth rate between the two years was apparently due to measurement problems, which introduced an upward bias in the 1971 figures.[8] Another cause was the retreating of interest rates in the world's money markets. This trend began in 1970 but made its impact fully felt on interest income in 1971, with the receipt of new foreign investments and foreign currency deposits at the lower rate of interest. In this connection it should also be noted that in the Bank of Israel's accounts interest received on foreign currency reserves is recorded on a cash basis; this understated the bank's earnings in 1972, since not all the income from investments, in particular those implemented in the second half of the year, was received by year's end.

The insurance item is large on both the credit and debit sides, but the net balance is small, since the payment and receipt flows are closely linked—premium payments (on both direct writings and reinsurance policies) are offset by claims payments by foreign insurance companies to Israelis and commissions paid to local agents of foreign companies.

In the very heterogenous "other services" item, the more sluggish growth of receipts in 1972 was partly due to the smaller percentage rise in agents' fees (foreign exporters' commissions to their agents in Israel) with the deceleration of imports. On the payments side there was a slower growth in advertising outlays abroad and in various royalty and rent payments, items which had risen rapidly in previous years.

In transactions with the administered areas there was a further appreciable increase on the debit side, reflecting the sharply higher income of the areas' residents from employment in Israel. This widened the deficit on services account with the areas from $ 10 million in 1971 to $ 60 million.

5. The Capital Account

The sharp upswing in capital imports, evident since 1970, carried over through the year reviewed, when the level moved up from $ 1,482 million to $ 1,780 million, or by about 20 percent—the same rate as in 1971. The sources of growth changed noticeably this year. Most of the increment was accounted for by unilateral transfers, which almost covered the entire deficit on current

[8] See Bank of Israel, *Annual Report, 1971,* Chapter III.

account, whereas in the three preceding years there had been an average shortfall of $ 480 million. Accordingly, in 1972 the economy's foreign currency liabilities went up to almost the same extent as its foreign currency reserves.

Unilateral transfers topped the $ 1,000 million mark, after a gain of $ 289 million. Foreign investments were, at $ 141 million, double the 1971 figure. Long-term loans, which in the previous two years had provided most of the upward thrust in capital imports, fell in 1972 by 9 percent to $ 583 million.

Table III–23

CAPITAL IMPORTS, BY ORIGIN AND RECIPIENT, 1967–72

($ million)

	1967	1968	1969	1970	1971	1972
To the private sector						
Unilateral transfers	254	331	346	443	612	773
Personal restitution	123	143	138	204	231	292
Other private transfers, net	84	143	152	172	306	392
Nonprofit institutions	47	54	56	67	75	89
Net investments from abroad	22	13	18	22	75	141
Long-term loans	5	27	31	45	166	173
Total private sector	**281**	**371**	**395**	**510**	**853**	**1,087**
To the public sector						
Unilateral transfers	267	104	112	206	151	281
National Institutions	278	111	118	223	156	221
Intergovernmental transfers	–11	–7	–6	–17	–5	60
Long-term loans	291	151	137	515	477	410
Independence and Development Loans, net	172	78	63	136	180	184
U.S. Government loans	28	36	51	339	247	191
Other loans	91	37	23	40	50	35
Total public sector	**558**	**255**	**249**	**721**	**628**	**691**
Total capital imports	**839**	**626**	**644**	**1,231**	**1,481**	**1,778**
Less: Israeli investments abroad	17	18	18	24	11	11
Total, excl. Israeli investments abroad	**822**	**608**	**626**	**1,207**	**1,470**	**1,789**

SOURCE: Central Bureau of Statistics.

As in 1970–71, the private capital inflow expanded enormously, while the public sector showed a relatively mild increase. The strongly advancing trend in the private sector during the past three years is explained *inter alia* by a fundamental institutional change in the economy and by the upheavals in the world's financial and currency markets. These developments greatly stimulated the flow of capital to Israel, but part of the incremental capital import in 1972

Table III-24

DEFICIT, TRANSFERS, AND THE CAPITAL ACCOUNT, 1968–72

($ million)

	1968	1969	1970	1971	1972
A. Current account and long-term capital movements					
Balance on current account					
Excluding administered areas	–679.7	–922.3	–1,282.2	–1,267.2	–1,103.4
Administered areas	32.2	53.5	48.6	40.2	27.5
Unilateral transfers	434.7	459.2	649.4	765.3	1,054.5
Balance on current account plus transfers	–212.8	–409.6	–584.2	–461.8	–21.4
Long-term capital movements					
Investment from abroad, net	13.2	17.7	21.8	74.7	141.4
Independence and Development Loans, net	78.0	63.3	135.6	179.5	184.3
U.S. Government loans	25.1	53.9	343.5	262.1	205.4
Other loans	65.0	50.7	80.2	200.2	193.6
Total long-term capital movements	181.3	185.6	581.1	716.5	724.7
Total capital imports	616.0	644.8	1,230.5	1,481.8	1,779.2
Total (A)—Surplus of capital imports over deficit on current account	–31.5	–224.0	–3.1	254.8	703.3
B. Israeli investments abroad, net	–17.5	–18.0	–23.6	–11.2	–11.2
C. Nonfinancial sectors					
Short-term credit from rest of the world	16.5	–24.9	23.2	9.0	–14.0

Short-term credit to rest of the world	–41.6	–31.9	–59.3	–63.0	–41.3
Trade credit	–17.7	–29.2	–0.4	–22.0	–30.0
Other short-term assets	–23.9	–2.7	–58.9	–41.0	–11.3
Total	**–15.1**	**–56.8**	**–36.1**	**–54.0**	**–55.3**
D. Financial sectors					
Foreign deposits	34.6	115.3	120.5	207.7	172.9
With commercial banks	46.0	66.1	117.8	237.4	213.1
With Bank of Israel	–11.4	49.2	2.7	–29.7	–40.2
Loans to foreigners	5.6	1.5	64.6	–35.4	–4.9
Commercial banks	5.4	2.9	63.3	–30.0	37.3
Bank of Israel (incl. clearing accounts)	0.2	–1.4	1.3	–5.4	–42.2
Foreign currency balances					
Change in reserves[a]	52.0	187.1	–119.6	–429.2	–855.8
Central monetary institutions	93.8	292.5	–21.1	–284.9	–518.7
Other monetary institutions	–41.8	–105.4	–98.5	–144.3	–337.1
Less: Adjustments					
Foreign currency valuation adjustments		–30.7		–53.3	–19.1
Special Drawing Rights			–15.1	–13.9	–13.8
Total change in reserves due to economic transactions	**52.0**	**217.8**	**–104.5**	**–362.0**	**–822.9**
E. Errors and omissions	–28.1	–35.8	–17.8	0.1	18.1

NOTE: A minus sign denotes debits, and a positive sign credits.

[a] A minus sign denotes an increase in reserves.

must undoubtedly be attributed to the lagged effect of the special steps taken by the Government in 1970 to stem the previous year's heavy drain on foreign currency reserves. The public sector's capital imports, which are less sensitive to economic changes at home and abroad, are mostly a reflection of the opportunities open to the Government to raise capital from its traditional sources. The year reviewed saw a fall in the public sector's share of capital transfers; this was directly due to the cutback in defense imports, whose financing is connected with the receipt of foreign loans.

Israel's foreign currency reserves expanded strongly in 1972. Those at the Bank of Israel went up by about $ 500 million to stand at approximately $ 1,200 million. Foreign currency indebtedness continued to grow, though more slowly than in 1971, and reached $ 4,000 million—$ 650 million more than in the previous year.

(a) *The background to the capital market developments*

Since the second half of 1970 there has been a strong upswing in capital transfers to the economy, especially the private sector. This is partly attributable to long-term economic and other factors, such as the vigorous level of business activity, high profits, the improved security situation (which allayed the apprehension of foreign investors), tax concessions to various investors, and increased immigration from the affluent countries after 1967. In addition, the liberalization of foreign currency control in the second half of 1968 guaranteed the right to repatriate most types of foreign investments and to reconvert immigrant transfers. This removed a number of barriers which had isolated the Israeli economy from the international money market. Another factor was the abolition of the Interest Law,[9] which eliminated the ceiling on interest rates and permitted foreign investors to take advantage of the big nominal interest rate differential between Israel and other countries. These institutional changes enabled the market forces to operate more freely, thereby permitting the developments in the international financial and currency markets to give a strong fillip to the flow of capital to Israel.

The major factors at work during this period were the waning of devaluation expectations, which until 1970 had been a strong deterrent to the transfer of capital to Israel;[10] the increase in financial yields and the buoyant state of the stock market in 1972; the rapid mounting of prices; the tightening of monetary restraints and the drop in interest rates abroad,[11] which increased the profitability of foreign borrowing; the boom in the property market, which attracted

[9] The Interest Law was rescinded in March 1970.

[10] This was connected with the "package deal" of April 1970, the import surtax levied in August 1970, the unexpected devaluation in August 1971, and the approaching 1973 elections.

[11] Interest rates abroad were below their peak level of 1969.

much of the incremental funds from abroad; and the weakening of speculation against the dollar following the international monetary arrangement of December 1971, which reduced the risk of an automatic devaluation of the Israeli pound because of the revaluation of other currencies in relation to the dollar.

The influence of these factors on capital imports in general, and those to the private sector in particular, presumably would have been smaller than they actually were had it not been for the relaxation of foreign currency control.

In September 1971 and April 1972 restrictions were placed on the reconversion of funds originating in property transactions.[12] While these changes undoubtedly had a dampening effect on the inflow of private capital, in actual fact capital imports not only failed to contract but on the contrary expanded. Thus it must be assumed that the other stimulative factors continued to operate very strongly. It should be noted, however, that in most capital account items the upward trend lost vigor in the course of the year, although the already high level continued to climb.

(b) *Unilateral transfers*

Unilateral transfers rose 38 percent to reach $ 1,055 million, with each item advancing appreciably. They covered 98 percent of the deficit on current account—something which happened previously only in the exceptional year 1967.

Public sector transfers soared 86 percent, after a 27 percent decline the year before, and totalled $ 281 million. There was an impressive rise in two component items: after falling sharply in 1971, National Institution transfers were up 42 percent to $ 221 million. This was apparently due to the improved economic situation in the United States, which made it possible to raise more funds there. Intergovernmental transfers reached $ 60 million, the first significant increase in this item since the termination of reparations payments. Most of the sum in the year reviewed originated in a U.S. Government grant for immigrant absorption and for the creation of a binational fund to finance research projects, which was connected with the liquidation of part of the economy's local currency liabilities.

Private sector transfers were up 26 percent; while this was a smaller rise than in 1971, it may be regarded as a continuation of the strongly advancing trend of the two preceding years—an outcome *inter alia* of the changed situation in the currency and financial markets. In several items the curve began to flatten somewhat, but this was probably to be expected after the record levels reached in recent years.

[12] In September 1971 the right of reconversion was limited to the original investment plus an annual return of 7 percent for a period of five years, after which the balance could be reconverted immediately. In April 1972 additional restrictions went into force on land investments: repatriation was barred for five years, after which the investment could be withdrawn in five equal annual installments.

Table III–25

UNILATERAL TRANSFERS, 1964–72

($ million)

	1964	1965	1966	1967	1968	1969	1970	1971	1972
Personal restitution from Germany and Austria	134.2	112.7	110.4	123.2	143.3	137.9	203.6	230.7	292.3
Lump-sum	96.9	65.5	57.8	64.5	86.9	68.1	119.9	135.3	169.3
Pensions	37.3	47.2	52.6	58.7	56.4	69.8	83.7	95.4	123.0
Personal transfers in cash	90.4	94.5	81.9	87.5	130.8	156.3	175.2	303.4	386.0
Immigrants					30.5	39.6	55.1	112.8	166.7
Others					100.3	119.1	120.1	190.6	219.3
Personal transfers in kind	9.8	9.4	6.9	3.4	9.8	5.1	4.6	13.3	13.1
Total personal transfers from abroad	**234.4**	**216.6**	**199.2**	**214.1**	**283.9**	**299.3**	**383.4**	**547.4**	**691.4**
Personal transfers abroad	4.3	5.9	5.5	6.8	6.6	9.2	7.5	11.1	7.2
Total net personal transfers	**230.1**	**210.7**	**193.7**	**207.3**	**277.3**	**290.1**	**375.9**	**536.3**	**684.2**
Institutional transfers									
In cash	76.8	92.7	93.7	321.8	162.6	172.4	287.4	230.7	305.5
In kind	2.7	3.6	3.3	2.7	1.8	2.2	2.8	3.6	4.7
Total institutional transfers	79.5	96.3	97.0	324.5	164.4	174.6	290.2	234.3	310.2
Net transfers to the Government	25.3	20.2	1.2	–10.8	7.0	–5.5	–16.7	–5.3	60.0
Total unilateral transfers	**334.9**	**327.2**	**291.9**	**521.0**	**434.7**	**459.2**	**649.4**	**765.3**	**1,054.5**

SOURCE: Central Bureau of Statistics.

Personal restitution payments were, at $ 292 million, up 26 percent, compared with 13 percent in the previous year. The increase stemmed from the revaluation of the mark against the dollar, the widening of the scope of the German restitution laws, and the adjustment of pension payments to the rise in the cost of living in that country. In this context it should be noted that the volume of personal restitution, particularly lump-sum payments, exceeded the amount paid by the German government, and it can be assumed that this was due to the transfer of sums paid in earlier years.

Transfers of nonprofit institutions rose from $ 75 million in 1971 to $ 89 million. This continued the strong uptrend evident since 1970, which followed a more modest growth in the preceding period. The rapid expansion of such transfers coincided with a number of special short-run developments, which suggests a possible causal relationship.

Transfers by Israelis from abroad[13] reached $ 220 million, up $ 30 milion. The official definition of this item does not seem to fully reflect its composition, and the growth of the past few years remains unexplained. There is reason to believe that this item includes transfers that are neither gifts nor legacies but money brought back to Israel.

Immigrant transfers were, at $ 167 million, up 48 percent—double the previous year's figure. These growth rates exceed those for the flow of immigration from the affluent countries, which actually fell off during the year reviewed. There is, of course, a time-lag between immigration and the conversion of foreign currency transfers into Israeli pounds,[14] but the changes in this item have been too steep to be attributed solely to this factor. Immigrant transfers are apparently the item most sensitive to economic developments, and presumably the special conditions prevailing in this country in recent years have given a strong boost to such transfers. Inflation has increased the immigrants' outlays on the purchase of homes, other basic equipment, etc., and expectations that prices would continue to spiral have induced many newcomers to convert their funds sooner than usual. The rising profitability level in Israel, the increase in financial yields, and the interest rate differential apparently contributed to the expansion of immigrant transfers for investment purposes; these factors were reinforced by the weakening of devaluation expectations, which have a deterring effect.

(c) *Foreign investment*

During the past two years there has been a drastic change in the composition of foreign investments: those made in Israel advanced notably and Israeli investments abroad declined. The amount invested in Israel went up by a record $ 141 million in 1972.

[13] In the balance of payments this item is defined as pensions, gifts, and legacies from abroad.

[14] Immigrant transfers are recorded in the official statistics only after conversion into local currency.

Table III–26

FOREIGN INVESTMENT IN ISRAEL, 1965–72

($ million)

	1965	1966	1967	1968	1969	1970	1971	1972
Investment in Israel by nonresidents								
In foreign currency	64.5	58.6	7.7	–1.5	7.3	11.7	62.5	124.5
Investments	92.4	85.6	38.8	31.2	41.0	39.5	85.9	172.0
Investments repatriated	–27.9	–27.0	–31.1	–32.7	–33.7	–27.8	–23.4	–47.5
In Israeli currency (from blocked accounts)	4.8	3.7	1.9	2.6	–0.5	–1.4	–0.7	3.0
In Development Bonds	9.4	9.7	7.0	7.1	4.7	4.8	5.3	7.3
In kind	8.3	5.3	3.9	1.0	1.0	1.5	2.0	1.0
Total	**87.0**	**77.3**	**20.5**	**9.2**	**12.5**	**16.6**	**69.1**	**135.8**
Reinvestment of profits	4.8	5.2	4.3	4.0	5.2	5.2	5.6	5.6
Total, net	**91.8**	**82.5**	**24.8**	**13.2**	**17.7**	**21.8**	**74.7**	**141.7**
Israeli investments abroad								
Direct	11.9	6.5	6.1	2.5	–2.7	8.8	4.2	10.1
Portfolio								
Private individuals	6.0	4.0	12.0	12.7	22.6	12.4	9.9	2.5
Banks	–0.5	0.8	–1.2	2.3	–1.9	2.4	–2.9	–1.4
Total	17.4	11.3	16.9	17.5	18.0	23.6	11.2	11.2
Net foreign investment in Israel	**74.4**	**71.2**	**7.9**	**–4.3**	**–0.3**	**–1.8**	**63.5**	**130.2**

SOURCE: Central Bureau of Statistics.

Direct cash investments rose steadily during the year to double in volume. There was also an impressive growth in portfolio investment, the level moving up from $ 20 million in 1971 and $ 11 million in 1970 to $ 35 million. These developments were apparently connected with such long-term influences as the vigorous pace of economic activity, rising profitability, and the relatively calm security situation, as well as with such short-term factors as the increase in interest rates and rates of return on securities, the evaporation of devaluation expectations, and the real estate boom. Presumably the short-run influences, which gained in importance during the past two years, were a major factor in the sharp upswing in investment—an assumption reinforced by the fact that the bulk of the investment this year was not made in approved enterprises.[15]

Support for this conclusion may be found in the changes that took place in Israeli investments abroad during this period. Investment in foreign securities

[15] Approved enterprises are entitled to various concessions under the Law for the Encouragement of Capital Investments.

fell noticeably during the past three years, and it is a safe inference that rising rates of return in Israel and the waning of devaluation expectations (such expectations enhance interest in foreign securities) dampened the demand for such paper. While direct Israeli investments abroad increased during the year, this type of investment is connected with special factors and is subject to control.

(d) *Long-term loans*

Long-term loan receipts were down 9 percent in 1972, after a gain of 15 percent in 1971 and an even sharper one in 1970. The year reviewed saw a marked change in this item, loans to the public sector declining noticeably while gross private loan receipts remained at a high level. These developments are explained by the reduction of the Government's finance requirements with the cutting-back of defense imports, the much heavier inflow of unilateral transfers from abroad, and the tougher restrictions placed on the receipt of foreign credit by the private sector because of the changed monetary situation since the early part of the year.

Table III–27

PRIVATE TRANSFERS AND INVESTMENT, QUARTERLY DATA, 1969–72

($ million)

		Personal cash transfers			Investments in foreign currency				
		Immigrants	Israeli residents	Total	In cash	In securities	Total, gross	Investments repatriated	Total, net
1969	I	9.1	34.7	43.8	7.9	4.7	12.6	9.5	3.1
	II	10.9	28.0	38.9	6.3	6.9	13.2	6.5	6.7
	III	8.6	27.2	35.8	3.9	2.4	6.3	8.7	–2.4
	IV	11.0	26.8	37.8	5.8	3.1	8.9	9.0	–0.1
1970	I	11.7	26.9	38.6	5.8	5.4	11.2	8.1	3.1
	II	12.9	27.7	40.6	7.2	0.8	8.0	6.3	1.7
	III	13.3	35.4	48.7	8.2	2.3	11.0	6.7	4.3
	IV	17.2	30.1	47.3	6.6	2.7	9.3	6.7	2.6
1971	I	19.0	32.1	51.1	14.5	3.4	18.1	4.5	13.6
	II	27.9	41.9	69.8	13.2	4.4	19.2	5.9	13.3
	III	30.8	56.5	87.3	14.8	6.0	20.8	7.4	13.4
	IV	35.1	60.1	95.2	23.5	6.1	29.6	5.6	24.0
1972	I	39.4	53.9	93.3	25.2	5.0	30.2	12.0	18.2
	II	40.4	61.8	102.2	34.3	18.5	52.8	11.1	41.7
	III	41.2	53.3	94.5	36.2	4.5	40.7	12.6	28.1
	IV	45.7	50.3	96.0	41.1	7.1	48.2	11.8	36.4

SOURCE: Central Bureau of Statistics.

Net foreign loan receipts of the public sector fell precipitately in 1972. As already noted, this was connected with the Government's diminished need for overseas financing, which led to the reduction of "other loans"[16] and a heavier volume of repayments. Development Bond sales were up by a sluggish 5 percent and U.S. Government loans remained at their 1971 level. These two items did not decline as they are preferred sources—they carry a low rate of interest and have fairly long maturities. By contrast, "other loans", which have less attractive terms, were down sharply, reflecting both a much greater redemption and a drop in gross receipts.[17]

Gross private sector borrowing remained at its high 1971 level, with the curve continuing upward during the first half of the year and then turning downward. The slashing of ship and aircraft imports depressed the foreign loan receipts of Israel's shipping companies and airliners, while other borrowers surpassed their 1971 figures.

Because of the Government's dominant control over the capital market, no clear distinction can be made between private and public sector loan receipts. The Government supplies credit to the private sector both directly—through the channelling of loan proceeds from abroad—and indirectly—through private intermediaries such as financial institutions. The shrinkage of public sector loan receipts and the plateauing of private sector receipts at a high level may partly reflect a switch from direct to indirect supply of credit.[18]

Table III-28

GROSS PRIVATE SECTOR BORROWING AND SHIP AND AIRCRAFT IMPORTS, 1969-72

($ million)

	1969	1970	1971	1972	1972, quarterly			
					I	II	III	IV
Total gross loans to the private sector	102	152	317	308	84	87	67	70
Loans to shipping and air companies	[a]	[a]	102	55	11	25	17	2
Ship and aircraft imports	32	58	187	64	14	14	16	20
Other loans to the private sector			215	253	73	62	50	68

[a] No details available.

[16] Public sector loans other than U.S. Government loans and Development Bonds.

[17] In the balance of payments gross receipts from "other loans" include the refunding of the money paid to France for Mirage aircraft; minus this sum, net receipts were negative, compared with an inflow of $ 50 million in 1971.

[18] The data on the long-term borrowing of the public and private sectors do not correspond with those presented in the chapter on public sector operations (which are based on the reports of the Accountant General) or in the chapter on financial institutions (based on the institutions' balance sheets), since in these chapters loans procured through the intermediation of financial institutions for the Treasury are treated as public sector and not financial institution loans.

Long-term foreign borrowing is under the complete control of the Government, and changes in its volume are not due solely to economic factors. Nevertheless, it appears that the big increase in the domestic-foreign interest rate differential and the tighter-money policy induced a livelier demand for foreign credit. The widening of the interest rate differential weakened the deterrent effect of devaluation, since it was clear that the rate of a possible devaluation would be lower than the interest differential. These factors continued to operate in 1972, but at the beginning of the year steps were taken to restrict foreign credit, and they succeeded in reducing foreign borrowing during the second half of the year.

The effects of this policy may be seen in the decline in the value of foreign loan permits issued by the Government to private borrowers in the course of the year. Following are the quarterly figures on such permits:

Quarter	Value of permits in 1972 ($ million)
1	179
2	131
3	125
4	111
Total	546

It will be seen that the value of foreign loan permits moved steadily downward. Since some time elapses between the issue of a permit and receipt of the loan, the impact of the Government's measures began to be felt only in the second half of the year.

Along with the much smaller import of ships and aircraft in 1972, foreign credit to shipping and air companies fell from $ 102 million in 1971 to $ 55 million. Gross borrowing by the rest of the private sector rose by $ 38 million to reach $ 253 million, with more than half of the sum going to financial institutions.

Loans to shipping and air companies do not have a direct monetary influence on the economy,[19] whereas other loans from abroad are mostly connected with the financing of domestic activities. The heavier foreign borrowing by the private sector, excluding shipping and air companies, reflected the increased pressure for foreign credit, which probably impaired somewhat the effectiveness of the measures taken to restrict such finance.

19 These loans are granted by foreign suppliers and are not available for use in the domestic market.

(e) *Short-term capital and reserves*

The country's foreign currency reserves grew by a record $856 million during the year to reach $ 2,134 million. The increment consisted of $ 498 million in foreign currency holdings of the Bank of Israel, $ 337 million in commercial bank deposits abroad, and $ 21 million in Government deposits. The economy's liquid liabilities in the form of nonresidents' and foreign bank deposits totalled $ 862 million, similar to the 1971 figure.

Net foreign currency assets (gross assets less liquid foreign currency liabilities) doubled in volume to stand at $ 1,271 million. It should be noted in this connection that the revision of the foreign currency regulations in 1968, which permitted the reconversion of certain types of transfers to Israel, diminished the significance of the definition of net assets, since capital transfers carrying the right of conversion were included with the economy's liquid liabilities.

Foreign currency reserves held by the Bank of Israel expanded by $ 497 million to $ 1,230 million. The Bank's liquid liabilities, on the other hand, rose by only $ 3 million to $ 160 million. As a result, net reserves doubled to $ 1,070 million. This strong accumulation continued the trend begun in 1971, when a special effort was made to replenish the reserves after their heavy depletion in the two preceding years. It also reflected the much larger inflow of capital from abroad, which was accompanied by the contraction of the adverse balance on current account.

The past two years have seen the stepping-up of the banking sector's operations abroad, reflected by a big increase in both its assets and liabilities.

The overseas transactions fall into two categories: those carried out on the banks' own initiative, such as the granting of loans to foreign clients, and transactions in which the banks play a passive role, such as the channelling of credit to other borrowers in the economy. Since the available data do not permit a differentiation between these two types of transactions, only some general observations can be made.

The foreign currency assets of the banking sector doubled in volume over the past two years, with the biggest increase being in liquid overseas deposits. Foreign liabilities also doubled during this period, with foreign bank loans and deposits moving up to about the same extent. In 1972 the net foreign liquid asset holdings of the banking sector expanded by $ 138 million, after declining $ 67 million the year before.

The year reviewed witnessed a rise in trade credit to the foreign sector; this reflected the expansion of exports, which was accompanied by an increase in financing from the Export Fund for suppying credit to foreign customers. Short-term credit from abroad fell sharply in 1972; this was apparently connected with the policy of the currency control authorities, who granted fewer foreign loan permits because of the swelling of foreign currency reserves and the restrictive monetary policy.

Table III–29

FOREIGN CURRENCY RESERVES, 1967–72

($ million)

End of year	1967	1968	1969	1970	1971	1972	Annual increase or decrease (–)		
							1970	1971	1972
A. Net balances with Bank of Israel									
1. Assets with Bank of Israel	714.6	662.8	412.4	458.6	732.0	1,229.5	46.2	273.4	497.5
Foreign currency reserves	646.2	594.3	366.7	405.2	675.5	1,154.4			
Gold	45.9	46.0	45.7	43.4	43.4	43.4			
Gold with I.M.F.	22.5	—	—	10.0					
Special Drawing Rights					13.1	31.7			
Less: Foreign currency valuation adjustments and SDR							15.1	64.1	32.7
Change due to transactions and transfers							31.1	209.3	464.8
2. Deposits with Bank of Israel	38.4	35.6	73.7	97.4	156.9	159.9	23.7	59.5	3.0
Foreign banks	1.0	1.0	30.0	37.5	10.7	3.5			
Patach	37.4	34.6	43.7	59.9	146.2	156.4			
3. Net balances with Bank of Israel	**676.2**	**627.2**	**338.7**	**361.2**	**575.1**	**1,069.6**	**22.5**	**213.9**	**494.5**
B. Net foreign currency assets									
4. Other foreign currency balances	253.6	253.4	316.7	390.1	545.9	904.2	73.4	155.8	358.3
Government deposits abroad	133.6	91.6	49.5	24.4	35.9	57.1	–25.1	11.5	21.2
Bank deposits abroad	120.0	161.8	267.2	365.7	510.0	847.1	98.5	144.3	337.1
Less: Foreign currency valuation adjustments								3.1	0.2
Change due to transactions and transfers								152.7	358.1
5. Total gross foreign currency assets	968.2	916.2	729.1	848.7	1,277.9	2,133.7	119.6	429.2	855.8
Less: Foreign currency valuation adjustments and SDR							15.1	67.2	32.9
Change due to transactions and transfers							104.5	362.0	822.9
6. Foreign-held deposits	186.3	231.3	326.6	451.8	663.3	862.3	125.2	211.5	199.0
With commercial banks	185.3	230.3	296.6	414.3	652.6	858.8			
Foreign banks	22.2	59.6	86.7	96.9	124.4	186.2			
Nonresidents	163.1	170.7	209.9	317.4	528.2	672.6			
With Bank of Israel (excl. Patach)	1.0	1.0	30.0	37.5	10.7	3.5			
7. Net foreign currency assets (B5-B6)		**781.9**	**684.9**	**402.5**	**614.6**	**1,271.4**	**–5.6**	**211.7**	**656.8**

SOURCE: Central Bureau of Statistics.

(f) *Foreign currency liabilities*[20]

The upward trend in the country's foreign currency liabilities, a perennial feature of the economy, continued in 1972, when the level rose by $ 652 million to $ 4,081 million. This increase fell short of the all-time high of the previous year—$ 806 million—but was greater than in any other year.[21] For the first time, the balance of payments deficit on current account was covered entirely by unilateral transfers, and consequently the increase in liabilities was accompanied by a notable growth in foreign currency reserves.

The Government's direct foreign currency liabilities was up $ 450 million to $ 3,127 million; this increase was smaller than the $ 655 million recorded in 1971. Nongovernmental liabilities developed differently. After moving up slightly in 1971, they jumped steeply in the year reviewed to reach $ 954 million. The net result of these contrasting trends was a slight fall in the weight of Government liabilities, to 77 percent of the total.

Outstanding liabilities on account of the Defense Loan reached $ 709 million in 1972, and its weight went up from 12 to 18 percent.

Development Bonds rose to $ 1,391 million, but their weight fell to 33 percent, continuing the trend evident since the early sixties. The other items showed no significant change in weight.

The country's foreign currency indebtedness has been mounting at an unprecedented pace since 1967, and this has imposed a heavy debt servicing burden on the economy—both current interest payments and future payments on account of principal and interest.[22] However, there has been an improvement in the maturity schedule of the foreign currency liabilities, with a reduction in the share of short-term loan repayments. A classification of the loans by redemption period[23] shows that 35 percent of the total will mature within five years—a lower figure than in previous years. This situation also holds for loans with shorter maturities, as may be seen from Table III—30.

An especially striking feature of 1972 was the $ 40 million decline in short-term loan repayments.

[20] The foreign currency liabilities are not identical with the economy's external debt, which also includes Israeli currency liabilities abroad, balances in clearing accounts, foreign investments in Israel, and deposits of foreign nationals in Israeli banks.

[21] The change in foreign currency liabilities includes revaluations but not other adjustments; hence it does not completely correspond to the change in loans as shown in the balance of payments.

[22] One way of measuring the increase in the debt servicing burden is to compare it with the growth of the gross national product. In 1955–66 both aggregates moved up at the same rate—approximately 9.5 percent. During the period 1967–72, however, GNP continued to advance at this pace, whereas foreign liabilities went up by an average of 21 percent p.a.

[23] A classification of outstanding loans by redemption period does not accurately reflect the actual debt servicing burden because of possible future changes in the external debt and the option granted to owners of Development Bonds to cash them in before maturity. Nevertheless, such a classification provides a good indicator of the anticipated repayment burden.

Table III–30

ISRAEL'S FOREIGN CURRENCY LIABILITIES, BY REPAYMENT DATE, 1966–72

($ million)

	1966	1967	1968	1969	1970	1971	1972
			Repayment date				
Up to one year	198	198	301	244	398	475	434
One to two years	87	141	135	195	195	224	263
Two to three years	131	82	114	135	174	202	241
Three to four years	75	87	112	122	136	159	268
Four to five years	79	85	110	109	117	192	238
Five years or more	750	963	1,130	1,319	1,602	2,178	2,637
Total	**1,320**	**1,556**	**1,902**	**2,124**	**2,622**	**3,430**	**4,081**
			Percentage distribution by repayment date				
Up to one year	15.0	12.7	15.8	11.5	15.2	13.9	10.6
One to two years	6.6	9.0	7.1	9.2	7.4	6.5	6.4
Two to three years	9.9	5.3	6.0	6.4	6.6	5.9	5.9
Three to four years	5.7	5.6	5.9	5.7	5.2	4.6	6.6
Four to five years	6.0	5.5	5.8	5.1	4.5	5.6	5.8
Five years or more	56.8	61.9	59.3	62.0	61.1	63.5	64.6
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
			Cumulative percentage distribution				
Up to one year	15.0	12.7	15.8	11.5	15.2	13.9	10.6
Up to two years	21.6	21.7	22.9	20.7	22.6	20.4	17.0
Up to three years	31.5	27.0	28.9	27.1	29.2	26.3	22.9
Up to four years	37.2	32.6	34.8	32.8	34.4	30.9	29.5
Up to five years	43.2	38.1	40.6	37.9	38.9	36.5	35.3
Five years or more	100.0	100.0	100.0	100.0	100.0	100.0	100.0

SOURCE: Ministry of Finance.

The easing of the debt servicing burden is explained by the improvement in the maturity schedule of the Government's liabilities following the early repayments made in 1972, which reduced the proportion of short-term loans. Almost all the payments due from the Government next year are on long-term loans. As regards nongovernmental liabilities, half the sum due next year is on account of short- or medium-term loans. Any further alleviation of the debt servicing burden must come primarily through a change in the composition of private sector loans.

The currency distribution of the debt remained unchanged in the past two years. About 82 percent was in dollars, 2 percent in sterling, and the rest in hard currencies". There is reason to believe that the developments in the world currency markets have affected the composition of Israel's foreign currency liabilities, particularly those with short maturities: borrowers tend to cut down on loans in currencies that seem likely to be revalued and increase those in currencies expected to be devalued. The stability prevailing in the currency markets in 1972 may have contributed to the stable currency distribution of the liabilities.

Table III–31

ISRAEL'S FOREIGN LIABILITIES, BY CURRENCY, 1971–72[a]

($ million)

	1971		1972	
	$ m.	Percent of total	$ m.	Percent of total
Direct Government liabilities	2,619	78.4	3,092	77.6
In dollars	2,185	65.4	2,608	65.4
In other hard currencies	429	12.8	477	12.0
In sterling	5	0.1	7	0.2
Nongovernmental liabilities	722	21.6	893	22.4
In dollars	541	16.2	683	17.1
In other hard currencies	116	3.5	139	3.5
In sterling	65	1.9	71	1.8
Grand total	**3,341**	**100.0**	**3,985**	**100.0**

[a] Excluding liabilities to the World Bank denominated in various currencies.
SOURCE: Ministry of Finance.