

CHAPTER V

EXPORTS

1. MAIN DEVELOPMENTS

In 1978 the growth of exports slowed to 3 percent, after gains of 15 percent in 1976 and 12 percent in 1977. In services which benefited from the relatively large devaluation of October 1977, the relatively rapid advance which began in 1977 continued. This year's growth was concentrated in capital services and "other services", whereas in 1977 the advance was led by tourism. Commodities were mainly responsible for this year's slowdown: sales to the administered areas fell off, diamonds were down 15 percent in quantitative terms, citrus was a little weaker, and "other industrial exports" receded appreciably along a broad front of branches and goods, with the deceleration (quantitative) being most marked from the fourth quarter of 1977 to the beginning of 1979.¹ Whereas in 1977 the slowdown in industrial exports excluding diamonds was due entirely to a sharply lower gain in defense items, in 1978 it stemmed mainly from a slackening of civilian exports (15 percent in 1977 and 7 percent in 1978).

The decelerated expansion of nondiamond industrial exports occurred against the backdrop of a resurgent domestic demand in 1978 and signs of a slower devaluation of the real exchange rate. The strong advance made by exports in 1976 and 1977 can be largely credited to the continued weakness in domestic economic activity in 1975-77 and a big improvement in their relative price since 1975 (as well as to other important factors, such as the recovery of world demand in 1976 and the formidable headway made by defense exports in 1975 and 1976). In 1978 domestic demand picked up; this dampened the growth of exports owing to the reduction of the spare capacity which had built up during the previous years of stagnation. Hidden unemployment during this period was relatively small. Because of this, plus the fact the incremental manpower was absorbed mainly in public services and the nontradable sector, the resurgence of domestic demand had an immediate negative impact on exports; for if adequate labor is not available to the exporting sector, even if there is idle equipment, it has no significance. The

¹ Part of the growth of "other industrial exports" this year was of a special character. The large increase during the last quarter of 1978 consisted mainly of goods produced in previous years. Less these exports, the growth rate for industrial products other than diamonds would have been 6.6 percent in 1978, and not 8.9 percent (see also Table V-6).

TABLE V-1
EXPORTS ACCORDING TO THE BALANCE OF PAYMENTS AND NATIONAL ACCOUNTS, 1973-78

	1973	1974	1975	1976	1977	1978
Commodity exports (\$ million)						
1. Exports, foreign trade data (net)	1,391.9	1,736.6	1,834.8	2,305.8	2,962.7	3,716.2
2. Exports to administered areas	194.3	298.7	370.0	392.3	466.4	389.5
3. Balance of payments adjustments	-24.2	-30.4	-24.4	-28.4	-25.6	-35.9
4. Total according to balance of payments and national accounts (1 + 2 + 3)	1,562.0	2,004.9	2,180.4	2,669.8	3,403.5	4,069.8
Service exports (\$ million)						
5. Exports of services ^a	1,317.0	1,819.1	1,782.6	1,992.5	2,385.5	2,735.2
6. Exports to administered areas	51.1	77.0	59.4	80.3	84.6	70.2
7. Adjustment from c.i.f. to f.o.b. recording of commodity imports	-117.0	-182.1	-195.6	-178.2	-207.0	-243.6
8. Total exports, balance of payments data (5 + 6 + 7)	1,251.1	1,714.0	1,646.4	1,894.6	2,263.1	2,561.8
9. Interest receipts of the public sector	94.1	129.0	113.0	98.7	88.5	97.0
10. Total services according to balance of payments (5 + 6 - 9)	1,274.0	1,767.1	1,729.0	1,974.1	2,381.6	2,708.4
Total exports according to national accounts ^b						
11. \$ million (4 + 10)	2,836.0	3,772.0	3,909.4	4,643.9	5,785.1	6,778.2
12. IL million	12,946	18,812	27,021	40,458	67,329	119,178
13. Quantitative increase over previous year (percent)	4.6	6.8	1.3	15.2	11.7	3.3

^a On the basis of c.i.f. recording of commodity imports.

^b Including factor receipts from abroad, at the official exchange rate plus export incentives.

intimate connection between domestic demand and exports can be seen in the fact that the retreat in exports was particularly prominent in those branches where domestic demand rose to a relatively large extent, and vice versa. Thus, for example, there was a conspicuous slowdown in overseas sales by light industry and of civilian products of the metal and electronics industries. The principal domestic destinations of these industries are private consumption and investments, which did in fact grow relatively rapidly this year. Noncivilian exports, by contrast, fell off this year to a relatively smaller extent, mainly because there was no comparable recovery in domestic noncivilian consumption.

The relative price of exports had been on the rise since 1975. Most of the improvement occurred in diamonds and services, and this was even more pronounced in 1978. Following the devaluation of October, 1977, the exchange rate for services went up sharply. The real exchange rate for goods, excluding diamonds, rose by 2 percent, far lower than in the last few preceding years. Toward the end of 1978 and the beginning of 1979 there were signs of a downturn in the relative price and profitability of exports. The change in the exchange rate for services has had a rather limited effect on the export advance (see section 4 below); from this point of view, one should not attribute to it the same importance as the change in the real exchange rate for commodity exports.

The developments in domestic demand and relative prices do not fully explain the slowdown in exports. Additional factors are related to the foreign currency reform of October, 1977. The unification of exchange rate (replacing the previous multiple-rate system) and the floating of the Israeli pound exposed the unprofitability to the economy of certain exports, and these were discontinued or reduced. The slowdown of 1978 can also be ascribed to some extent to the fact that the gains scored by export industries which enjoyed a relatively steep rise in their exchange rate have not, in the short period which has elapsed since the reform, offset the harm suffered by industries hit by the change in the exchange rate.

The floating of the exchange rate, the central element in the reform, was responsible at first for some uncertainty² regarding the trend of the exchange rate and the nature of its future development. At the beginning of 1978 exporters were unclear as to whether the government intended to intervene in the determination of the exchange rate: they could expect fluctuations which would cause the rate to deviate widely and for a long time from a level desirable for exports. From the exporters' point of view, this factor increased the risk involved in the expansion of exports or entry into export branches this year.

There is reason to believe that during the first months of the year exporters held exaggerated expectations of a worsening of export terms, in regard both to a rapid erosion of

² See note 7 below.

TABLE V-2

EXPORT PRICES COMPARED TO PRICES OF OTHER DOMESTIC USES, 1971-78
(Percent annual increase)

	Ratio of exports to domestic uses					Value added: exports/domestic marketing		Value added: exports/ nontradables	
	Total exports	Diamonds	Commodities, excluding diamonds	Services	Total exports, excluding diamonds	Total exports	Commodities, excluding diamonds	Total exports	Commodities, excluding diamonds
1971	1.8	3.3	3.1	0.1	1.6	1.1	-0.4	-1.1	-0.5
1972	0.8	7.7	-2.5	1.7	-0.5	0.3	-5.4	0.2	-5.6
1973	-4.1	4.8	-2.9	-8.8	-5.9	-10.0	-10.2	-10.8	-11.4
1974	-1.1	-17.1	5.4	-0.5	2.5	-11.9	-2.5	-12.7	-2.9
1975	3.1	0.6	3.3	3.1	3.4	7.5	8.7	8.0	9.2
1976	2.3	8.5	-2.0	5.4	1.3	9.6	2.3	10.6	3.1
1977	4.4	26.6	3.1	0.3	1.8	5.9	5.0	6.6	5.4
1978	7.6	55.3	-3.3	5.1	0.8	14.8	1.0	16.8	1.9

NOTE: The price indexes on which the table is based were derived from national accounts data. Imputed housing services were not included in GNP. Exports were calculated at their domestic market value. Direct defense imports and imputed housing services were not included in domestic uses. As the price of the import component in exports we used the prices of inputs, excluding imported fuel (c.i.f.) at the effective exchange rate, and the domestic price of fuel inputs (in IL). The price of the product in domestic uses was derived as the difference between the price of the product originating in exports and GNP prices. The price of the nontradable product was derived as the difference between the price of the product originating in exports and other tradable uses and GNP prices; the calculations are approximations of factor prices, but do not take into account the subsidy to capital.

the profitability of export in the course of 1978 and to the creation of domestic demand pressures and a shortage of manpower. These expectations, even though they did not fully materialize, are what deterred exporters from boosting their foreign sales to an extent justified by actual events. The influences of the reform which restrained exports can therefore be regarded as only of a temporary nature.

The rising trend of recent years in the export share of uses, in the economy as a whole and in industry, came to a halt in 1978. Besides the rapid growth during these years in tourism, passenger transport, and other services, the past ten years or so have witnessed a vigorous growth in foreign sales of the metals and electronics industries. On the other hand, such traditional industries as food, textiles and clothing, and "other industries" continued to experience difficulties in expanding exports. In 1978 they scored much smaller gains than before, apparently because of the foreign currency reform. This continuing change in the branch structure of industrial exports reflects a change in the set of relative advantages of the domestic sectors. On the one hand, the importance of developing countries in the export of traditional mass-produced industrial goods has increased, and it is difficult for Israel to compete with these countries. On the other hand, the economic growth pattern has resulted in an increasing specialization in relatively new products, characterized by a high degree of original, independent development, and with human capital being a highly important productive factor.

2. FACTORS INFLUENCING EXPORTS

The change in exports was linked this year to the impact of domestic economic developments; the influence of world demand was, as in 1977, quite limited. The slower growth of exports mainly reflects the decline in diamond sales and the slackening in industrial goods excluding diamonds. The downturn in diamonds was the result of price and world market developments, while the sagging of nondiamond exports was due to developments in the local economy: the rapid recovery of domestic uses in 1978 and an apparent slowing of the rising trend in the relative price of exports other than diamonds. But these two factors do not fully explain the poorer export performance this year. The foreign exchange reform of October, 1977 also had an effect. The sale was discontinued of those products which became unprofitable to the economy at the exchange rate set by the market after the reform. There is reason to believe that exporters' expectations during the first months of 1978 were excessively pessimistic. The forecasts as to the rapidity of the erosion in export profitability, the degree to which domestic uses would rebound, and the shortage of manpower fell short of the mark. As a result, exports failed to expand as much as justified by actual developments. The harm dealt to exports

TABLE V-3
EXPORT GROWTH COMPARED TO OTHER USES, 1969-78

	Percent increase, annual averages				
	1969- 1972	1973- 1974	1975	1976- 1977	1978
Total economy					
GNP (excluding housing services)	11.2	4.0	3.1	0.4	4.7
Domestic uses (excluding direct defense imports and housing services)	10.4	7.6	0.9	-2.3	5.9
Exports (domestic market value)	11.0	5.7	1.3	13.5	3.3
Industry					
Industrial output (excluding diamonds)	12.0	5.1	2.6	4.9	7.8
Industrial output to domestic destinations	12.0	4.7	3.9	1.8	7.6
Industrial exports, excluding diamonds	12.0	5.2	-1.1	24.9	8.9

by these factors is of a temporary nature and should disappear in the future. On the other hand, no improvement is expected in the near future in the principal causes of the slowdown, viz. the profitability of exports and domestic demand pressure.

The rapid growth in commodity exports in 1976 and 1977 took place, it will be recalled, against the backdrop of economic stagnation in 1975-77, and to a large extent resulted directly from it (see Table V-3). The acceleration of domestic demand which began in 1977 and gathered strength in 1978 reversed the influence of the domestic market on exports. The rapid expansion of domestic demand reduced excess production capacity and the ability of manufacturers to step up production and output for domestic destinations. The domestic market makes less stringent demands than the foreign market in everything connected with the quality of the product, its suitability, supply dates, etc.

For this reason a relative rise in domestic demand magnifies its attraction to exporters by more than can be attributed to relative prices.

The real exchange rate for exports, expressed by the price ratio between value added in exports and those in the production of nontradables (see Table V-2), has been rising continually since 1974.³ During these years the devaluation was higher for exports of diamonds and services than for goods other than diamonds, which are more sensitive to the relative price than are the other two groups. In 1978 the real devaluation for commodity exports excluding diamonds was about 2 percent — a lower rate than in previous years; part of the deceleration in commodity exports can be attributed to this. It should be emphasized that these estimates of relative export prices have a downward bias in recent years, since they do not include the support extended to exports in the form of subsidized credit. This has expanded greatly in the last few years, and especially in 1978; it is almost certain that were it included in the estimates, the relative price of exports, particularly of commodities, would look far better.

The indicators of industrial export profitability permit an additional examination of the relative price of exports. This set of data, which is presented in Table V-4, is built from specific indexes of domestic and overseas prices for aggregate industrial exports excluding diamonds, quarried products, and fuel. It is not identical to the framework of Table V-2, which compares the relative price of exports to the prices of all domestic uses on the basis of price indexes derived from the National Accounts and which reflect averages with a much wider range of variation.

The picture which emerges for 1978 is similar to that for 1977, on an annual average: there were similar rises in the IL prices received by the exporter relative to producer prices in the domestic market, and in the rate of profit per unit of output; there was

³ The calculations of Table V-2 represent an approximation of the price ratio between the tradable and nontradable product, which reflects the real exchange rate. The price of the nontradable product is not measured directly, but is calculated as the difference between the price of the entire product and the price of the tradable product. Such a calculation necessitates assumptions, which are somewhat arbitrary, as to the size of the tradable portion of the product, the price which should be imputed to it, and the price of its import component. In comparing the price of the product that is exported with that of the product for other uses, these assumptions are more restricted, although the price of other uses includes in this comparison a component of nonexport tradable product. In comparing the price of exports with that of other uses there is no need for assumptions, and this is an advantage. Its disadvantage is that it compares prices of outputs and not those of factor returns.

TABLE

INDICATORS OF INDUSTRIAL EXPORT

	Prices received by the exporter (in IL)	Change from previous period	Price of imported inputs (in IL)	Wages per unit of output	Domestic input prices	Weighted price of inputs	Change from previous period
	(1)	(1'')	(2)	(3)	(4)	(5)	(5'')
1966	55.6		54.0	83.1	72.3	70.0	
1972	100.0	79.9	100.0	100.0	100.0	100.0	42.9
1973	125.5	25.5	129.0	113.6	118.8	120.3	20.3
1974	173.3	38.1	184.7	149.9	176.5	172.3	43.2
1975	246.8	42.4	246.8	207.5	242.6	235.3	36.6
1976	305.5	23.8	304.4	266.7	301.2	293.8	24.9
1977	423.2	38.5	420.3	374.0	392.8	395.7	34.7
1978	667.0	57.6	687.0	566.6	574.6	603.0	52.4
1976							
I	272.8	6.1	270.2	227.1	273.5	261.5	4.2
II	297.1	8.9	292.1	262.5	295.3	286.5	9.6
III	308.8	3.9	314.6	268.9	306.9	299.9	4.7
IV	344.3	11.5	342.2	307.0	329.2	327.4	9.2
1977							
I	369.6	7.3	361.3	320.2	347.1	344.5	5.2
II	391.5	5.9	383.6	365.6	367.7	371.4	7.8
III	426.2	8.9	418.1	385.3	399.0	400.9	7.9
IV	505.3	18.6	520.1	423.1	457.5	466.1	16.3
1978							
I	585.6	15.9	607.8	475.6	496.6	521.6	11.9
II	627.9	7.2	650.8	546.2	548.9	575.8	10.4
III	698.5	11.2	719.4	578.4	590.5	622.4	8.1
IV	756.2	8.3	774.8	662.6	662.3	692.7	11.3

NOTE: The data are for industrial exports excluding diamonds, minerals and fuel.

PROFITABILITY, 1966-78

Profit-ability of exports relative to inputs (1)/(5)	Change from previous period	Domestic output prices	Change from previous period	Relative return to exporter (1)/(7)	Change from previous period	Return to value added/wages per unit of output	Change from previous period
(6)	(6'')	(7)	(7'')	(8)	(8'')	(9)	(9'')
79.4		74.3		74.8		68.3	
100.0	25.9	100.1	34.6	99.9	33.7	100.0	46.2
104.3	4.3	118.2	18.1	106.2	6.3	108.0	8.0
100.6	-3.6	164.1	38.8	105.6	-0.5	109.3	1.2
104.9	4.3	219.9	34.0	112.2	6.3	119.0	8.9
104.0	-0.9	269.4	22.5	113.4	1.0	114.9	-3.4
106.9	2.9	350.1	30.0	120.9	6.6	113.8	-1.0
110.6	3.4	516.7	47.6	129.1	6.8	114.8	0.9
104.3	1.8	247.2	4.7	110.4	1.3	121.1	4.8
103.7	-0.6	263.7	6.7	112.7	2.1	114.7	-5.3
103.0	-0.7	273.3	3.6	113.0	0.3	113.0	-1.5
105.2	2.1	293.3	7.3	117.4	3.9	112.7	-0.2
107.3	2.0	310.7	5.9	119.0	1.3	117.5	4.2
105.4	-1.7	331.6	6.7	118.1	-0.8	108.9	-7.3
106.3	0.9	352.7	6.4	120.8	2.4	112.4	3.1
108.4	2.0	405.5	15.0	124.6	3.1	116.6	3.7
112.3	3.6	444.1	9.5	131.9	5.8	119.3	2.4
109.0	-2.9	494.1	11.3	127.1	-3.6	111.5	-6.6
112.2	2.9	534.6	8.2	130.7	2.8	117.8	5.7
109.2	-2.7	594.0	11.1	127.3	2.6	111.9	-5.0

no significant change in wages per unit of output, net of the return to added value.⁴ But there were changes of trend during the year: in the middle of the year the improvement in profitability came to a halt, and at the end of the year and the beginning of 1979 there was a decline. This path reflects in part the high relative profitability level immediately following the foreign currency reform, and in part the high wage increases awarded during the year, the sharpening of inflation, and the slower rate of devaluation at the end of 1978 and the beginning of 1979 (the rate of devaluation apparently grew stronger during March and April of 1979).

The effect of profitability on exports which compete for industrial output with domestic uses is partly dependent upon the ratio of export profitability to that of production for the domestic market. An examination of the profitability index together with the index of relative return shows that in the past few years there was a steady decline in the profitability of production for domestic uses.⁵ This was the result of the economic conditions which prevailed until 1977: the restraint of domestic demand combined with cost-inflation to prevent domestic producers from adjusting their nominal profits to inflation. The rise in export profitability, along with the decline in the profitability of production for the domestic market, brought up the relative profitability of the aggregate of industrial exports dealt with in Table V-4. During 1978, however, the trend slowed down owing to the relatively rapid expansion of domestic demands. This suggests that the picture in the near future will be different from that of the last few years.

The rebounding of domestic demands and the slower rise in the relative price of exports do not fully explain the slackening of exports in 1978. Additional factors were associated with the foreign currency reform of October, 1977.

The effective devaluation in October, 1977 involved different rates for different segments of the economy. While exports of services enjoyed a devaluation of more than 40 percent, the dollar exchange rate for commodity exports was devalued by an average of 6 percent.⁶ For hotel tourists services and know-how it was about 15 percent, far lower than the overall rate for service exports. Among commodities, the rate ranged

⁴ The implications of the wage data are not unequivocal this year. Table V-4 is calculated from data on industrial wages per standard Monday, whereas data from other sources might indicate different trends.

⁵ The calculation of the index of the profitability of production for domestic end uses appears in Table III-3.

⁶ The comparison is in terms of the exchange rate for the value added dollar. For details see Table V-13 in last year's report.

from 13 percent for diamonds to an upward revaluation of about 14 percent for rubber and plastic products. In imports for export production the devaluation was 28 percent, while the overall rate for imports was slightly less than this, due to the lifting of some customs duties and the liberalization of import arrangements. The formal devaluation rate of 47 percent applied to capital account transactions.

The differential devaluation for exports reflects the unification of exchange rates within the export sector and the elimination of distortions which had grown to excessive proportions in recent years. Elimination of these distortions drastically altered the relative profitability of various exports. The slacker growth of commodity exports this year can be partly attributed to the reduction of unprofitable exports which before the reform had benefited from incentive rates that did not reflect their actual value added. Overseas sales of industries that were hit by the devaluation presumably declined much faster than the rise in exports of those industries that benefited from the devaluation, so that the net effect in 1978 was negative. In the longer run the impact of the differential devaluation on total exports will depend on the price elasticity of various export groups and their weight in the total volume. There was a large effective devaluation precisely for those exports with a relatively low price elasticity, including diamonds and large parts of service exports (various transportation items, insurance services, and income from capital services).

As regards imports, the relatively large devaluation had a negative effect in two respects. One was the fact that the structure of customs duties was not reduced drastically upon the general unification of rates, so that import substitutes benefited from a large effective devaluation. The discrimination between exchange rates for (industrial) exports and import substitutes, in favor of the latter, which had already existed for a number of years, increased by about 10 percent. (This discrimination is offset to a certain extent by the subsidies granted to exports in the form of cheap credit, which also grew during 1978.) Thus a greater stimulus was given to the domestic uses which substitute for imports than was given to exports. In view of the recovery of the economy and the keener competition for productive factors in 1978, this aspect of the October, 1977 devaluation constrained the growth of exports. It should be noted that in the case of industrial import substitutes the existing capacity can be relatively easily integrated with profitable export production. Protecting this segment by artificial exchange rates does not encourage the diversion of these productive factors to more efficient export uses.

On one plane the reform of October, 1977 worked to the disadvantage of exports: by devaluing the IL more for imports than for exports, it gave a greater push to domestic prices than to export prices. The improvement in the relative price of exports due to the reform was in any case small compared to the other large devaluations carried out in

TABLE

COMMODITY EXPORTS (F.O.B.) BY BRANCH
(\$ million,

	1974	1975	1976	1977	1978
AGRICULTURAL EXPORTS					
Citrus	120.8	176.4	172.4	189.8	202.7
Other	71.4	101.4	152.6	195.0	252.5
Total	192.2	277.8	325.0	384.8	455.2
INDUSTRIAL EXPORTS					
Mining and quarrying	90.2	84.4	60.8	76.5	78.5
Potash	(44.8)	(55.4)	(38.3)	(54.9)	(55.9)
Phosphates	(21.1)	(14.3)	(12.5)	(13.5)	(14.4)
Food	128.4	125.4	154.2	177.8	211.1
Citrus preserves	(68.4)	(57.0)	(72.6)	(81.8)	(96.8)
Textiles	62.7	52.3	62.4	63.9	77.0
Clothing	97.6	104.1	125.4	149.3	169.5
Leather	7.0	5.4	7.9	9.1	8.2
Total textiles, clothing, leather	167.3	161.8	195.7	222.3	254.7
Wood	14.9	12.8	20.3	27.7	33.1
Plywood and building carpentry	(11.2)	(8.4)	(10.4)	(14.5)	(20.2)
Furniture	(2.8)	(3.3)	(8.2)	(10.3)	(9.3)
Paper	3.8	2.8	3.9	4.5	4.1
Printing and publishing	18.8	18.6	11.1	14.5	14.3
Rubber and plastics	36.3	44.7	53.6	67.5	72.1
Tires and tubes	(23.4)	(29.4)	(31.9)	(37.2)	(37.3)
Chemicals	218.7	185.9	221.5	269.9	338.7
Basic chemicals	(102.5)	(99.6)	(86.9)	(112.9)	(157.0)
Pharmaceuticals	(20.3)	(27.7)	(39.5)	(32.2)	(32.2)
Pesticides	(44.1)	(49.9)	(36.8)	(49.7)	(58.8)
Chemicals excl. fuel					
Nonmetallic minerals	5.8	6.5	7.1	9.7	14.2
Glass and glass products	(4.6)	(4.4)	(4.5)	(5.8)	(7.1)
Basic metals	23.3	26.1	19.8	34.0	29.1
Metal pipes	(13.4)	(19.5)	(8.7)	(13.0)	(8.1)
Metal products	45.9	67.4	118.8	147.5	230.5

AND MAJOR GROUP, 1974-78
 at current prices)

Percent annual increase							
Quantity				Price			
1975	1976	1977	1978	1975	1976	1977	1978
16.0	-1.9	1.9	-4.2	25.9	-0.4	8.0	11.5
34.2	28.7	19.1	20.7	5.8	17.0	7.3	7.2
23.1	9.2	9.9	8.0	17.4	7.1	7.7	9.1
-15.2	-2.8	44.9	-4.2	10.3	-25.9	-13.2	7.2
(-10.6)	(-9.9)	(70.1)	(-6.8)	(38.4)	(-23.3)	(-15.7)	(9.3)
(-40.5)	(35.3)	(14.1)	(4.8)	(13.8)	(-35.4)	(-5.3)	(1.8)
-8.5	22.0	5.3	2.1	6.8	0.8	9.5	16.3
(-22.2)	(21.0)	(2.4)	(-3.2)	(7.1)	(5.3)	(10.0)	(22.2)
-8.1	19.7	-5.4	9.1	9.1	-0.3	8.2	10.5
1.9	13.0	10.0	-0.5	4.7	6.6	8.2	14.1
-17.5	23.3	9.8	-16.1	-6.4	18.6	4.9	7.5
-3.5	15.2	5.1	1.5	0.3	5.0	8.1	12.9
-6.0	48.7	20.0	6.6	-8.7	6.7	13.8	12.1
(-3.5)	(13.7)	(23.6)	(28.5)	(-22.3)	(8.9)	(12.8)	(8.4)
(5.9)	(138.6)	(9.6)	(-24.0)	(11.3)	(4.1)	(14.6)	(18.8)
-12.6	38.1	8.9	-20.7	-15.7	0.9	6.0	14.9
17.4	-40.9	23.2	-14.2	-15.7	0.9	6.0	14.9
9.0	21.3	17.6	-4.7	12.9	-1.2	7.1	12.1
(5.3)	(9.4)	(10.0)	(-7.8)	(19.3)	(-0.8)	(6.0)	(8.7)
18.5	32.3	20.4	17.2	4.4	-9.9	1.2	7.1
(-5.0)	(3.9)	(32.0)	(38.5)	(2.3)	(-16.0)	(-1.5)	(0.4)
(39.9)	(49.6)	(-22.0)	(-11.7)	(1.9)	(-4.7)	(4.6)	(13.2)
(-3.5)	(-11.1)	(34.0)	(1.7)	(17.2)	(-7.1)	(0.4)	(16.8)
-1.6	8.9	19.9	20.8				
7.1	5.7	19.1	26.5	4.6	3.3	14.7	15.7
(-4.2)	(-1.8)	(14.5)	(5.1)	(-0.2)	(4.1)	(12.6)	(16.4)
2.3	-18.9	61.4	-15.0	9.5	-6.5	(6.4)	0.7
(29.6)	(-45.3)	(58.3)	(-33.5)	(12.3)	(-18.4)	(-5.6)	(-6.3)
35.1	75.6	11.5	34.8	8.7	0.4	11.4	16.0

TABLE
COMMODITY EXPORTS (F.O.B.) BY BRANCH
(\$ million,

	1974	1975	1976	1977	1978
Machinery	37.9	62.5	104.1	140.0	158.2
Transport equipment	47.8	43.8	100.2	162.6	240.1
Aircraft and parts	(34.1)	(35.6)	(83.2)	(110.0)	(200.0)
Ships and parts	(8.6)	(0.5)	(0.8)	(35.3)	(21.2)
Electrical and electronic equipment	59.6	97.7	112.3	130.7	137.2
Communications equipment	(20.5)	(48.5)	(60.2)	(60.5)	(55.4)
Total metals and electronics	214.5	297.5	455.2	614.8	795.1
Excluding defense exports					
Diamonds (gross)	641.1	640.8	799.8	1,099.0	1,477.4
Diamonds (net)	(562.2)	(548.6)	(712.0)	(1,002.7)	(1,317.5)
Various industries	29.2	31.1	44.0	66.0	107.0
Total industrial exports	1,569.0	1,612.3	2,027.2	2,650.2	3,400.3
Excl. diamonds	927.0	971.5	1,227.4	1,551.2	1,922.9
Excl. diamonds, minerals & fuel	800.7	888.3	1,120.1	1,414.9	1,775.5
Excl. defense exports					
Total industrial & agricultural exports	1,761.2	1,890.1	2,352.2	3,036.6	3,855.5
OTHER EXPORTS	63.7	50.9	62.2	46.6	65.8
Fuel & food for foreign ships & aircraft	28.8	18.2	23.2	23.5	33.9
Sale of old ships & aircraft	14.0	6.2	23.6	9.3	13.5
Total commodity exports (gross)	1,824.9	1,941.0	2,414.4	3,083.2	3,921.3
Excl. diamonds	1,183.8	1,300.2	1,614.6	1,984.2	2,443.9
Returned exports	88.3	106.2	108.6	118.9	205.1
Total commodity exports (net)	1,736.6	1,834.8	2,305.8	2,962.7	3,716.2
Commodity exports, excl. ships & aircraft (net)	1,722.6	1,828.6	2,282.2	2,955.0	3,702.7

SOURCE: Central Bureau of Statistics, foreign trade data.

V-5 (Cont.)

AND MAJOR GROUP, 1974-78

at current prices)

Percent annual increase							
Quantity				Price			
1975	1976	1977	1978	1975	1976	1977	1978
53.4	68.1	20.6	-2.7	7.5	-0.9	11.5	16.1
-21.3	125.8	46.1	26.1	16.4	1.3	11.1	17.1
(2.1)	(157.1)	(19.2)	(55.4)	(15.6)	(3.1)	(11.0)	(17.0)
(-95.1)	(57.0)	(3,875.2)	(-48.7)	(18.3)	(1.9)	(11.0)	(17.1)
55.9	15.0	8.6	-10.3	5.1	0.0	7.2	17.0
(125.5)	(23.9)	(-4.8)	(-21.4)	(4.9)	(0.2)	(5.6)	(16.6)
28.4	53.4	22.9	11.8	7.9	-0.3	9.9	15.7
-7.0	19.2	24.6	3.6				
1.6	16.4	1.3	-14.7	-1.6	7.3	35.6	57.6
(-0.8)	(21.0)	(3.9)	(-16.6)	(-1.6)	(7.3)	(35.6)	(57.6)
0.2	35.2	28.4	20.4	6.3	4.6	16.8	34.7
0.2	24.6	11.3	-1.6	2.6	0.9	17.4	30.4
-1.0	30.4	18.8	8.9	5.4	-3.1	6.4	13.8
5.2	28.4	17.0	9.7	5.4	-1.6	8.0	14.3
-4.5	15.8	15.2	7.0				
2.5	22.3	11.3	-0.3	4.7	1.8	16.0	27.3
1.6	22.2	10.1	-0.1	4.7	1.8	16.0	27.3
1.3	25.3	15.2	9.2	8.4	-0.9	6.6	12.8
0.9	23.5	10.8	-1.5	4.7	1.8	16.0	27.3
1.4	22.6	11.6	-1.6	4.7	1.8	16.0	27.3

TABLE
COMMODITY EXPORTS
(Index: 1972 = 100.0;

	Other agricultural exports	Mining and quarrying	Food	Textiles, clothing and leather	Other light industry ^b
1973	94	88	100	94	95
1974	98	104	99	91	90
1975	131	88	90	88	90
1976	169	86	110	101	106
1977	201	124	116	106	128
1978	243	119	118	108	136
1978 ^d					
1977 I	172	98	104	111	131
II	197	114	125	106	129
III	213	123	118	105	126
IV	231	156	125	105	129
1978 I	246	128	128	109	134
II	239	116	120	106	129
III	206	146	117	105	140
IV	255	86	121	112	142
1979 I	277	97			
				Percent quarterly	
1977 I	-3	15	-14	10	11
II	15	16	20	-5	-2
III	8	8	-6	-1	-2
IV	8	27	6	0	2
1978 I	6	-18	2	4	4
II	-3	-9	-6	-3	-4
III	-14	26	-2	-1	9
IV	24	-41	3	7	1
1979 I ^e	9	13			

^a The adjustment was made from quarterly constant-price data. The annual indexes are based on original constant-price data.

^b Wood, paper, printing, rubber and plastics, nonmetallic, and other industries.

^c Metal and metal products, machinery, transport equipment, electrical and electronics products.

AT CONSTANT PRICES, 1972-1978

seasonally adjusted data^{a)}

Chemicals, excl. fuel	Metal & electronics industries ^{c)}	Diamonds (gross)	Industrial exports, excl. diamonds	Industrial exports excl. diamonds, minerals & fuel	Industrial exports excl. diamonds minerals fuel & defense exports	Total net exports, excl. ships & aircraft
119	101	112	99	100	101	103
168	132	110	111	112	113	109
166	169	112	109	118	108	110
180	259	130	142	151	125	135
216	318	132	169	177	144	151
261	356	113	184	194	154	149
	338		180	189		147
202	255	152	152	160	137	149
212	282	129	160	168	147	146
224	350	117	182	187	146	152
228	363	126	183	190	146	158
256	340	114	183	192	157	147
252	379	112	185	195	151	149
280	290	120	176	181	154	148
260	401	102	194	207	155	150
	344		181	193		144
		89	192	205		143
increase						
-1	-4	7	2	1	0	4
5	11	-15	5	5	7	-2
6	24	-9	14	11	-1	4
2	4	8	1	2	0	4
12	-6	-10	0	1	8	-6
-2	11	-2	1	2	-4	1
11	-23	7	-5	-7	2	-1
-7	38	-15	10	14	1	1
	19		3	7		-3
		-13	-1	-1		-5

^d The data exclude exports which are not from 1978(1) output. See the note on the first page of this chapter.

^e Provisional data. The indexes are calculated from export data at 1978 IV prices.

the past, while the relatively large devaluation for imports caused the improvement to erode in the course of 1978. The reduction of the exchange rate differential between the current and the capital account in the balance of payments, along with the relatively large devaluation for capital transfers and foreign currency assets, magnified the expansionary impact of the devaluation on the current account itself. The mounting of domestic demand since the reform, whose negative repercussions on exports were noted above, had a part in this.

The floating of the Israeli pound at the end of 1978 was an innovation whose significance was not entirely clear at first. There was uncertainty as to the government's intentions to intervene in setting the exchange rate. The public felt that henceforth the government would not be obliged to modify the exchange rate so as to avoid harming exports, and consequently the rate would be likely to deviate significantly and for a prolonged period from a level conducive to exports. It appears, therefore, that the transition to a floating exchange rate regime in itself created uncertainty as to the trend of the exchange rate and its behavior⁷, if from the exporters' point of view this heightened the risk involved in the expansion of exports or entry into export branches.

Furthermore, it appears that exporters' expectations were excessively pessimistic shortly after the devaluation, and this caused them to be inordinately cautious in everything related to the boosting of exports throughout the year. The existence of pessimistic expectations can be learned from surveys conducted among exporters at the beginning of the year and from the outcry in the media at the time over the harsh implications of the reform for exports. This devaluation, like every other large one in the past, generated expectations of a faster rise in the domestic price level than in the exchange rate during the period immediately following. It may be that because of the unprecedentedly large gap between the effective devaluation for exports and that for other segments of the economy, such expectations were especially strong this time. In the event, it became clear that the overall relative profitability of exports did not decline in 1978, and the dim expectations did not materialize. The expectations as to the vigor of the domestic recovery and the fear of a shortage of manpower were also apparently exaggerated. Domestic demand grew by 6 to 7 percent in 1978, while the labor input in the business sector likewise grew to an appreciable extent (about 4 percent).

⁷ This is not to say that the floating exchange rate regime magnifies the variance of the real exchange rate (as a measurement of risk). Theoretically one could expect the opposite to occur, and a preliminary examination shows that the variance of the real exchange rate during the initial period of the float was in fact even smaller than during the period of creeping devaluation.

Toward the end of 1978 and the beginning of 1979 the anticipated worsening of export profitability began to materialize; this too was connected with the reform. The liberalization of capital movements, along with the floating of the exchange rate, which were the foremost features of the reform, tightened the connection between foreign capital movements and the domestic money markets. Economic developments (see Chapter XVII below) during 1978 resulted in rapid, conspicuous changes in the short-term inflow of foreign currency. From October, 1978 until February, 1979 this helped to sharply retard the rate of devaluation⁸ relative to the rate of inflation.

As already mentioned, the drastic slowing of the export growth rate in 1978 can be ascribed first and foremost to domestic economic developments and not to extraordinary demand developments during the year. In the last two years changes in world demand generally explained less of the change in exports than they did in 1975–76.⁹ There were sharp changes in the level of world economic activity between 1973 and 1976, but the growth rate has stabilized to a large extent since 1977. The steep jump in world trade which accompanied the recovery in 1976 gave way to a much more stable and moderate yearly growth rate of about 5 percent in both 1977 and 1978.

The link between the growth of the world economy and that in international trade changed in 1977 and 1978. For many years world trade expanded twice as fast as the world product. During the last two years, and apparently in 1979 as well, these two aggregates moved up more or less in step. Without delving into this development, it almost certainly will further weaken the influence of the world economic situation on Israeli exports.

⁸ During March and April of 1979 there was apparently a rapid acceleration in the rate of devaluation compared to domestic inflation.

⁹ One must distinguish the differences in the magnitude of the change according to various indicators (see Table V-8). Imports of the industrialized countries, the principal customers for Israeli exports, include raw materials, which Israel does not sell (except for quarried products). The exports of the industrialized countries are similar in nature to Israeli exports, and can serve as an approximation of changes in Israel's export markets; but their countries of destination are not always identical with those of Israel. World import figures take into account changes in the trade of countries to which Israel does not export, but which indirectly influence export markets through the trade of other nations. Attention is also directed to the influence of special conditions, in certain years, on the various indicators: in 1974, for example, exports of the industrial countries grew as a result of a larger import by the OPEC nations, while imports of the former reflected the beginning of a recession; in 1976 there was a significantly heavier trade in crude oil, in which Israel has no share, and this increased the import growth rate in that year while reducing it in 1977.

TABLE
CHANGES IN IL PRICES
(Per-

	Increase over					
	1973	1974	1975	1976	1977	1978
1. Export prices in dollars ^a	18.3	24.3	9.3	-1.4	7.8	12.8
2. Dollar exchange rate against basket of 15 currencies ^b	7.4	-0.7	3.3	-6.4	2.8	11.8
3. Export prices, adjusted for the effect of currency fluctuations (1)/(2) ^c	10.1	25.2	5.3	5.3	4.8	0.9
4. Average effective IL exchange rate against the dollar	4.9	10.6	34.6	25.8	27.6	37.0
5. Average effective IL exchange rate against basket of 15 currencies (2)x(4)	12.7	9.8	39.0	17.7	31.2	53.2
6. IL price to the exporter, excl. effect of currency fluctuations (3)x(4)	15.5	38.5	42.3	32.4	33.8	38.3
7. Exporter compensation in IL (3)x(5) or (1)x(4)	24.1	37.4	47.0	24.0	37.5	54.6

^a Commodity exports excluding diamonds and fuel.

^b The fluctuations in the dollar rate against the 15 currencies have been weighted

3. COMMODITY EXPORTS

In 1978 net commodity exports (excluding exports to the administered areas) were down about 1.5 percent in quantitative terms. Excluding diamonds, which have undergone radical changes over the last few years, there was an advance of 9 percent, compared with 15 percent in 1977 and 25 percent in 1976. The decline this year in the total figure masks contradictory trends in the various sectors and commodity groups (see Table V-5). In industry the rise in the export share of total output came to a halt with the growth of

TO THE EXPORTER, 1973-78
cent)

previous period								
1977				1978				1979
I	II	III	IV	I	II	III	IV	I
0.7	1.7	3.1	1.5	5.1	0.5	3.7	7.2	
1.2	0.5	1.1	2.4	6.0	0.1	3.6	4.0	0.2
-0.5	1.2	1.9	-0.8	-0.7	0.4	0.2	3.2	
5.6	4.0	6.7	14.7	9.4	6.1	6.8	2.5	5.0
6.9	4.5	7.9	17.4	15.9	6.2	10.6	6.6	5.2
5.1	5.2	8.8	13.7	8.6	6.5	7.0	5.7	
6.3	5.9	10.0	16.4	15.1	6.6	10.8	9.9	

according to the relative weight of each country in Israel's exports.

^c Reflects the export prices in the currency of the countries of destination.

domestic demand and the slowdown in exports. During the year diamond sales fell off, and there was a conspicuous slackening in industrial exports excluding diamonds. Non-citrus agricultural exports sagged toward the middle of the year, but picked up again at the end of 1978 and beginning of 1979.

Total agricultural exports grew this year by 8 percent quantitatively, which is a little slower than in both 1976 and 1977. The gain in such sales in recent years was achieved thanks to the relatively rapid advance in noncitrus produce, whereas citrus fluctuated only slightly. In 1978 the latter contracted by approximately 4 percent in quantitative

TABLE V-8

REAL TRADE CHANGES IN EXPORT MARKETS, 1973-78
(Percent)

	1973	1974	1975	1976	1977	1978
1. World imports	13.0	5.5	-5.0	12.0	4.5	5.0
2. Imports of industrial countries	12.5	1.5	-8.0	14.5	4.5	5.5
3. Exports of industrial countries	14.0	8.0	-4.5	11.0	4.5	5.5
4. Imports of industrial countries weighted by their share in Israel's exports ^a	9.4	0.3	-9.3	14.0	4.7	5.8

^a Imports of 14 countries weighted by their share in Israel's industrial exports, excluding diamonds, in the previous year.

SOURCE: Lines 1-2 - Based on International Monetary Fund data.
Line 4 - Bank of Israel calculations.

terms, owing mainly to several cases of poisoning of Israeli oranges and to the merchant marine strike at the beginning of the year. The stability of citrus exports over the past few years indicates that this branch has reached a certain equilibrium: a large part of the market is in Israeli hands, and there is no expansion to new markets, so that changes in exports are due to changes in demand. Recently there have been increasing signs of a downturn in supply, which is apparently due to a decline in the relative profitability of growing citrus fruits. In noncitrus agricultural produce the situation is different: here the potential market is very large, and these exports have been undergoing rapid expansion since 1975. The quantitative growth of these exports steadied during the last two years at about 20 percent per annum, following much higher rates during the trailblazing years of 1975 and 1976. In 1978 the advance was led by an unprecedented expansion of flower exports (up more than 80 percent quantitatively).

The discussion below revolves about groups of industrial exports subject, as far as possible, to the influence of identical factors. Thus, for example, there is good reason to exclude diamonds, quarried products, and fuel from "other industrial exports": diamonds and quarried products are overwhelmingly export-oriented and hence have no real substitute in the domestic market; overseas sales of fuel are largely of a fortuitous nature and have only a slight impact on the use of domestic productive factors.

The diamond industry experienced a sharp deterioration in its terms of trade in recent years. The dollar prices of polished diamonds went up 7 percent in 1976 and 36 percent

TABLE V-9

UNIT WAGE COSTS AND EXPORT PRICES IN ISRAEL AND INDUSTRIAL COUNTRIES, 1965-78
(Index: 1970 = 100.0)

Year	Israel	Eight largest industrial countries		Unit wage cost ratio between Israel and the Eight		Export price ratio of Israel and the Eight (6)
	Unit wage cost deflated by IL price to exporter (1)	Unit wage cost deflated by export prices and exchange rate (2)	Unit wage cost deflated by domestic prices (3)	(2):(1)	(3):(1)	
				(4)	(5)	
1965	123	102	102	121	121	111
1966	129	102	102	126	127	109
1967	118	100	99	117	119	107
1968	103	98	100	104	103	105
1969	99	98	99	101	99	104
1970	100	100	100	100	100	100
1971	92	103	100	89	92	96
1972	86	105	100	82	86	93
1973	78	103	97	76	80	94
1974	74	95	90	79	83	99
1975	72	98	98	74	74	93
1976	75	94	91	80	82	91
1977	76	96	91	79	83	89
1978	73	97	91	75	80	89

NOTES:

Column 2 – The data for the Eight are weighted by the share of each country in the total exports of the group.

Column 3 – The data for the Eight are weighted by the share of each country in Israel's industrial exports (excl. diamonds)

Column 6 – Israeli industrial export prices, excl. diamonds, divided by the eight industrial countries' export prices.

SOURCE: National Institute for Economic Research (NIER), IMF, and OECD.

in 1977, while prices of imported rough stones lagged behind, rising during these years by 1 and 16 percent, respectively. During these two years the quantitative growth of exports slowed and almost ground to a complete halt (from 16 percent in 1976 to only 1 percent in 1977), while imports continued upward at high rates (48 and 32 percent, respectively during these years). Import prices are dictated by the international diamond cartel, so there is no adequate explanation for their protracted lag behind the prices of the finished product.¹⁰ In any case, at the beginning of 1978 import prices began to rise much faster than export prices, moving up 63 percent as against 58 percent on an annual average. During the year there were increasing signs of difficulties in foreign sales: To some extent this was due to strong competition from other countries, but the main factor was the weakening of demand owing to the high prices of polished stones and the expectation that they would drop. Imports shrank more than exports: 25 percent and 15 percent, respectively in quantitative terms. This is explained by the large buildup of stocks in the past few years and the relative increase in import prices this year. Thus there was some destocking of imported roughs in 1978.

Potash and phosphates, the leading mineral products, showed different trends this year. The strong growth of potash exports in 1977 occurred after a two years' slump and the generation of surplus production capacity. In 1978, the slack capacity was taken up, with the result that the export advances slowed, and in fact sales declined 7 percent, owing principally to a strike at the Dead Sea Works at the end of the year. Exports of crude phosphate grew this year by 5 percent, due to the maturing of investments made in the branch itself and in handling facilities in recent years. A large portion of the phosphates is processed and is included in exports of basic chemicals. This branch experienced a large quantity increase in exports of fertilizers in 1977-78, this too due to heavy investments made over the past few years.

In industrial exports, excluding diamonds, quarried products, and fuel, there was a significant slowdown this year, on top of that recorded in 1977. It is important to note that the sources of the slowdown in these two years were different: in 1977, there was a much slacker expansion of noncivilian exports,¹¹ while there was no change in the

¹⁰It must be noted that diamond prices are of statistically low reliability, so that any discussion of the subject requires caution.

¹¹Data on defense exports in this chapter are based on the exports of the principal enterprises involved. Besides exports of military goods, a civilian goods component is also included here because there is no way to systematically differentiate between the two. It should be emphasized that the price indexes (and perforce the quantitative indexes derived from them) for defense exports are statistically less reliable than those for other commodity exports. A more detailed explanation of the growth of defense exports appears in the annual reports for 1976 and 1977.

TABLE V-10
**WEIGHT OF DIRECT EXPORTS IN INDUSTRIAL OUTPUT,
 BY INDUSTRY GROUP, 1969-78**
 (Percent)

	1972	1973	1974	1975	1976	1977	1978
Light industries							
Growth of exports	15.3	-5.2	-3.0	-2.1	18.3	8.9	2.3
Growth of total output	9.8	7.1	1.2	-1.2	5.0	6.8	7.5
Thereof: share of direct exports	2.4	-0.9	-0.5	-0.3	2.6	1.4	0.4
Weight of exports in output	16.7	15.0	14.4	14.3	16.1	16.4	15.6
Weight of exports in output ^a	15.7	16.4	14.2	13.1	14.5	15.3	15.9
Chemical industries							
Growth of exports	15.6	19.0	41.6	-1.6	8.8	20.0	20.8
Growth of total output	14.2	7.6	12.5	1.2	8.3	10.0	5.1
Thereof: share of direct exports	2.9	3.7	8.9	-0.4	2.3	5.3	6.0
Weight of exports in output	18.5	21.5	27.1	26.3	26.4	28.8	33.1
Weight of exports in output ^a	25.3	30.7	35.8	39.4	36.3	38.6	54.9
Metal and electronics industries							
Growth of exports	11.8	0.5	31.3	29.4	50.0	20.5	12.3
Growth of total output	15.1	3.3	10.6	9.7	4.2	5.3	6.6
Thereof: Share of direct exports	1.0	0.0	2.8	3.1	6.2	3.7	2.5
Weight of exports in output	8.9	8.9	10.6	12.5	17.9	20.5	21.6
Weight of exports in output ^a	11.2	12.1	12.3	15.5	22.0	27.3	27.6
Total industry							
Growth of exports	14.5	-1.5	9.8	6.0	26.7	14.6	8.6
Growth of total output	11.7	5.9	5.2	2.7	5.0	6.5	7.0
Thereof: Share of direct exports	2.0	-0.2	1.3	0.8	3.9	2.6	1.6
Weight of exports in output	14.3	13.6	14.2	14.6	17.6	19.0	19.3
Weight of exports in output ^a	14.9	16.0	15.4	16.2	18.9	21.3	23.1

^a At current prices and effective exchange rate. Elsewhere calculated at constant 1968 producer prices.

NOTE: Light industries comprise food, textiles, clothing, leather, wood, nonmetallic minerals, rubber and plastics, and other industries. Chemical industries comprise chemicals, excluding fuel exports. Metal and electronics industries comprise metal and metal products, machinery, transport equipment, electrical and electronics products. Total industry comprises all industries excluding diamonds, quarried products and fuel.

SOURCE: Bank of Israel calculations.

rate of quantitative growth of civilian exports. In 1978 the growth rate for civilian industrial exports, excluding diamonds, quarried products, and fuel, declined to about half that of 1977, reducing their contribution to the overall gain. The uptrend in non-civilian exports slowed more moderately in 1978, depressing contribution by a mere 1 percent.

The noncivilian component of industrial exports was thus harmed less by the economic developments of 1978 than was the civilian component. The recovery of domestic uses was concentrated principally in uses which compete with civilian exports, such as private consumption and investments, and not in domestic noncivilian consumption (which competes with noncivilian exports). It should also be noted that in the short run, defense exports are generally less sensitive to short-term economic conditions than are civilian exports.

The importance of domestic activity as a factor in the slacker growth of exports is also evident from an examination of the weight of direct exports in the output of the industrial branches. For the first time in several years, there was no significant change in the percentage of output exported in 1978 (in constant prices). In light industries, which produce primarily for private consumption, there was a decline in the weight of exports alongside an accelerated growth of total output. In the metal and electronics industries, whose principal domestic customer is the defense establishment, there was no decline in the weight of exports, either overall or in the various subbranches. The domestic use which most competes with the civilian exports of these branches is private consumption (durable goods). In this group (metals and electronics) the quantitative growth rate declined, as for other civilian industrial exports, from 25 percent in 1977 to 4 percent in 1978. Defense exports by these branches were almost untouched. The chemical industry fared especially well, showing a continued rapid rise in the weight of its export and increasing its contribution to the total output increment. The vigorous growth of exports has been achieved thanks to the expansion over the past few years of production capacity distinctly geared to the foreign market.

A significant portion of the incremental industrial exports this year was of a special character. During the last quarter there was a large quantitative rise in exports, consisting to an appreciable extent of goods produced before 1978. Had these exports not been included in the statistics, the fourth quarter growth rate for total industrial exports, excluding diamonds, quarried products, and fuel, would have dropped from 14 percent to 7 percent, depressing the annual growth rate by more than 2 percent and the quantitative growth of total commodity exports by 1 percent.

4. EXPORTS OF SERVICES

Exports of services (excluding those to the administered areas) grew in 1978 by \$ 351 million, compared to \$ 393 million in 1977 (with commodity imports valued c.i.f.). The real growth was of the order of 13 percent, similar to that for 1977 and double the figure for 1976. The gain was paced by capital services and "other services", following two years in which tourism¹² contributed most of the growth.¹³ Exports of services benefited this year from the sharp rise in the exchange rate compared to commodity exports: the foreign currency reform of October, 1977 resulted in an immediate devaluation of about 40 percent in the exchange rate for the value added dollar in service exports; on an annual average, the IL price of service exports rose in comparison to domestic uses by about 5 percent.

A high percentage of service exports are not very sensitive to the exchange rate and relative prices, so that a change in the exchange rate does not have a great effect on this category. Thus, for example, exports of transport services have a relatively small value added, and current developments in a broad range of subbranches, such as transport between foreign ports and other transport, are determined mainly by changes in overseas demand. Most of the receipts from insurance services, including premiums for risk coverage and claims payments, are not at all connected with the relationship between domestic and foreign prices. The same is true for receipts from capital services, including returns on investments abroad (the real return on assets abroad does not change because of devaluations), whereas the return on foreign currency deposits is affected by the exchange rate via the indirect impact of the rate on the foreign currency reserves themselves. The exchange rate can be expected to have a positive impact in the tourism and passenger transport items, and chiefly on "other services".

Income from tourism slowed greatly in 1978, along with the slacker growth in the number of visitors; the latter rose by 8 percent (the number of bed-nights in recommended hotels was up a mere 3 percent), as against an average annual 26 percent advance in 1976 and 1977. The poorer performance this year is particularly prominent in light of the rapid expansion of world tourism in 1978 and the strong competitive position of the local tourist industry during the last two years. Under the foreign currency reform tourism enjoyed a relatively larger devaluation than that for the other segments of the economy

¹²The method of estimating income and expenditures in the foreign travel item was revised this year. The corrected figures for 1973 onward are significantly different from those made earlier. Cf. Table V-12 in the Bank of Israel Annual Report for 1977.

¹³For a detailed discussion of developments in tourism and international transportation to Israel see Chapter XV below.

(the exchange rate for the value added dollar rose by 16 percent for tourist hotels and 40 percent for other tourist services, immediately after the devaluation). Moreover, the expansion of charter flights continued in 1978, and scheduled flight fares were reduced.

The character of the demand for tourist services has been undergoing a change during the past few years. World tourism is becoming more popular and younger than in the past. The very fact of its rapid expansion increases the information available to potential tourists concerning alternative tourist spots and encourages selectivity. In addition, there has been decline in the share of tourism from the United States and Canada during recent years. The downturn was quite sharp from 1972 to 1975, and the renewed boom in tourism since 1976 has not changed the situation in this respect.¹⁴ Thus the share of Jewish tourists, who come to Israel from very special motives (such as family ties, and special Israeli and Jewish events), has declined. The failure of the local industry to adapt itself to the changing nature of demand is reflected in the small number of hotels for mass tourism and in the level and quality of various tourist services, which are not competitive with those in alternative tourist centers.

Exports of other services consist chiefly of factor receipts from abroad for the export of know-how, management fees, import agents' fees, construction jobs abroad, commissions and royalties of various sorts, and salaries from abroad. This item grew during the year by a nominal 34 percent, with most of the increment ascribable to the rise in the exchange rate for these services in consequence of the foreign currency reform. It should be emphasized that the economy's potential in this sphere may not have been fully reflected in the statistical data. A wide variety of exports of know-how and jobs performed abroad may not have been caught by the statistics because of their "covert" character. Rectification of the discriminatory exchange rate in force for factor income in these items should encourage the transfer of such income to Israel in the future, though it is still premature to estimate the effect of this factor on the export figures for 1978.

Exports of transportation services were up 8 percent in nominal terms, after expanding twice as fast in 1977. The quantitative growth of this item decelerated chiefly as a result of the merchant marine strike at the beginning of the year. The sluggish gain in cargo haulage between foreign ports reflects the impact of the strike on the shipping industry, while throughput of the Eilat-Ashdod oil pipeline, which is also included in this item, picked up this year. The slowdown in export cargoes must be viewed against the upsurge

¹⁴The share of tourism from North America declined from 43 percent in 1972 to about 30 percent in recent years. In absolute terms the volume of American tourism returned in 1977-78 to its 1972 level (316,000 visitors a year versus 312,000 in 1972), while tourism from other countries rose from 415,000 to 745,000 from 1972 to 1978.

TABLE V-11

EXPORTS OF SERVICES,^a 1972-78
(\$ million, at current prices)

	1972	1973	1974	1975	1976	1977	1978	Percent annual increase					
								1973	1974	1975	1976	1977	1978
Transport	389.7	472.5	736.2	738.1	785.4	930.0	1,004.1	21	56	0	6	18	8
Export cargo	33.5	42.2	62.4	77.6	85.8	99.3	110.5	26	48	24	16	16	11
Shipments between foreign ports	134.3	164.4	284.5	263.8	306.9	331.8	359.5	22	73	-7	16	8	8
Import cargo by													
Israeli shipping companies	71.8	104.8	167.5	181.2	164.7	193.0	226.2	46	60	8	-9	17	17
Passenger	79.9	81.9	101.6	107.0	132.5	178.2	169.4	2	24	5	24	34	-5
Other	70.2	79.2	120.2	108.5	95.5	127.7	138.5	13	52	-10	-12	34	8
Insurance	151.8	182.5	249.7	221.3	241.6	272.0	321.2	20	37	-11	9	13	18
Export cargo	5.8	7.2	10.7	8.6	7.0	12.0	13.0	24	49	-20	-19	71	8
Import cargo by													
Israeli shipping companies	6.1	12.2	14.6	14.4	13.5	14.0	17.4	100	20	-1	-6	4	24
Other	139.9	163.1	224.4	198.3	221.1	246.0	290.0	17	38	-12	11	11	18
Tourism	212.2	258.0	281.0	292.6	424.8	558.8	582.0	22	9	4	45	31	4
Capital services	127.0	239.7	354.0	321.1	311.7	370.8	495.8	89	48	-9	-3	19	34
Government n.e.s.	27.0	19.0	26.0	24.0	21.0	22.0	22.0	-30	37	-8	-13	5	0
Other services	128.6	145.3	172.2	185.5	208.0	231.9	310.9	13	18	8	12	11	34
Total	1,036.3	1,317.0	1,819.1	1,782.6	1,992.5	2,385.5	2,736.0	27	38	-2	12	20	15

^a Based on f.o.b. recording of commodity exports and c.i.f. recording of commodity imports; excluding exports to the administered areas.

in air freight transport in 1977 with the start of operations by CAL (Cargo Airlines). In the transport of import cargoes, by contrast, there was apparently a quantitative growth, along with the accelerated expansion of imports themselves. A nominal drop was recorded in passenger conveyance, which includes El Al's revenues from carrying foreigners; the decline apparently reflects a quantitative decrease as well. This downswing was connected with the slackening of tourism in 1978, the El Al strike in April, and the increased importance of charter flights. The "other transport" item consists mainly of the provision of port services to foreign ships and aircraft and revenues from the chartering of ships.

Cargo insurance is a small item related to the transport of import and export cargoes and not subject to marked fluctuations. In the "other insurance" item there is a close connection between the credit and debit sides, with premium receipts being offset by claims payments by foreign insurers to Israelis and commissions paid to local agents of foreign companies. The net balance is negative, amounting to \$ 21 million in 1976, \$ 29 million in 1977, and \$ 17 million ... 1978.

The credit side of the capital services item breaks down more or less equally between dividends and profits on investments on the one hand and the yield on foreign currency reserves invested abroad on the other. In 1978 an increase in both reserves and interest abroad resulted in a larger inflow of receipts.