

CHAPTER II

RESOURCES, USES, AND INCOME

1. MAIN DEVELOPMENTS

The lines of development that had characterized 1975 reappeared with greater intensity in 1976. The Gross National Product, which in 1975 grew by 2 percent, edged up by only one percent in 1976. The Gross Domestic Product of the business sector did not increase at all, after growing by 1.5 percent in 1975. As result of these developments, the potential product was about 15-20 percent higher than the actual product in 1976¹. The potential product is that which could have been produced if production means had been fully utilized (had there not been a serious balance of payments problem). In spite of this, no overt unemployment developed until 1976, for two reasons: the slowdown in the growth of the labor supply, and the accretion of latent unemployment. An upward trend in prices went hand in hand with these developments: the average annual increase was 25-30 percent (GNP prices increased by 25 percent in 1976), while the price increases were higher during the year.

The slowdown in the growth of production and the standstill in 1976 were mainly the result of the government restraint policy. This was expressed in lower domestic public consumption and lower government investments, as well as a considerable increase in direct and indirect taxes in order to reduce private sector demand. The private sector reacted by greatly reducing savings, and this moderated the effect of the restraint policy.

The demand surplus of the public sector (namely, surplus expenditures for goods and services over income taxes) declined in 1976 by 20 percent in real terms, following a standstill in 1975². The decline in the demand surplus of the public sector resulted in most cases from the directed restraint policy adopted in view of the worsening balance of payments deficit following the Yom Kippur War. The import surplus increased considerably, and policy measures taken during this period were intended to restrict imports by slowing down domestic activity in the short run, and to promote exports in the long run. In spite of the restraint goals of the policy, a few contradictory measures were taken: the number of employees in the public sector increased in the last two years, contrary to

¹ It should be remembered, however, that product loss in the long run is lower, due to surplus capacity which will enable a future increase of the product above the increase in the means of production and in productivity.

² The discussion here refers to the demand surplus if one regards taxes levied on imports and export promotions as substitutes for the adjustment of exchange rates. The demand surplus obtained by including these factors also indicates similar trends (see Chapter X).

TABLE
RESOURCES AND

	1973	1974	1975	1976
(IL million, at current prices)				
RESOURCES				
1. GNP	37,621	54,272	75,329	95,317
2. Imports ^b	26,910	38,466	56,805	73,915
3. Imports, excl. ships, aircraft, & direct defense imports ^c	19,376	30,895	43,550	58,660
4. Import surplus (2)–(14)	14,091	20,054	30,153	34,664
5. Total resources for domestic use (1)+(4)	51,712	74,326	105,482	129,981
6. Total resources (1)+(2)	64,531	92,738	132,134	169,232
USES				
7. Private consumption	21,817	32,640	45,668	61,160
8. Public consumption	16,396	22,073	34,049	41,435
9. Public consumption, excl. direct defense imports	9,806	15,250	21,090	26,610
10. Civilian public consumption	4,145	5,710	8,155	11,150
11. Gross domestic investment ^d	13,499	19,613	25,765	27,386
12. Gross domestic investment, excl. ships & aircraft	12,592	18,934	25,508	27,149
13. Total domestic uses (7)+(8)+(11)	51,712	74,326	105,482	129,981
14. Exports ^e	12,819	18,412	26,652	39,251
15. Exports, excl. ships & aircraft	12,782	18,343	26,613	39,058
16. Total uses, excl. ships, aircraft, & direct defense imports ^c (7)+(9)+(12)+(15)	56,997	85,167	118,879	153,977
17. Total uses (13)+(14)	64,531	92,738	132,134	169,232
18. Net factor payments abroad	1,147	1,673	2,840	3,562
19. Gross domestic product (1)+(18)	38,768	55,945	78,169	98,879
20. Gross product of housing services	3,730	5,788	7,996	10,162
21. Product of public services & nonprofit institutions	6,799	9,263	12,831	16,727
22. GDP of business sector (19)–(20)–(21)	28,239	40,894	57,342	71,990

a Calculated at constant 1970 prices.

b Valued at CIF prices and at the effective rate of exchange. Includes imports from the administered areas; excludes interest paid by the public sector to the rest of the world.

c The definition was changed (in previous definition the series included a component for ship and aircraft exports).

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USES, 1973-1976

Annual increase or (-) decrease											
Quantity ^a					Price						
Average	1971-1976	1973	1974	1975	1976	Average	1971-1976	1973	1974	1975	1976
(percent)					(percent)						
11.3	5.6	6.6	2.1	0.9	13.4	20.8	35.3	35.9	25.4		
7.0	34.0	2.6	3.3	-2.8	18.2	20.2	39.3	43.0	33.9		
12.2	15.5	11.6	-2.4	1.4	17.2	20.4	42.9	44.4	32.8		
-8.7	92.1	-0.5	4.5	-20.1	23.3	17.5	43.0	43.9	43.8		
7.4	-18.8	4.9	2.7	-4.1	15.0	21.9	37.1	38.2	28.5		
9.8	15.4	5.0	2.6	-0.6	14.5	21.1	36.8	38.9	28.8		
7.0	9.3	8.0	0.0	4.1	13.5	19.6	38.5	40.0	28.6		
-0.3	46.4	2.1	10.5	-7.8	17.6	21.2	31.8	39.6	32.0		
5.7	19.0	14.1	0.0	-2.6	15.1	22.4	36.3	38.4	29.5		
6.5	6.9	4.0	6.6	5.1	16.7	27.3	32.5	34.0	30.1		
17.2	10.4	2.7	-1.8	-14.4	15.0	25.0	41.5	33.8	24.2		
18.1	5.5	6.8	0.3	-14.3	15.1	24.7	40.8	34.3	24.2		
7.4	18.8	5.0	2.6	-4.1	15.0	21.9	36.9	38.3	28.5		
19.3	3.6	5.6	2.2	13.3	15.4	18.2	36.0	41.6	30.0		
19.0	3.9	5.6	2.4	12.9	15.4	18.1	37.4	41.7	30.0		
11.6	8.7	8.2	0.6	1.1	14.6	20.8	38.1	38.8	28.1		
9.8	15.4	5.0	2.6	-0.6	15.1	21.1	36.9	38.9	28.8		
9.0	83.6	6.4	5.1	6.5	17.9	20.8	37.1	61.5	17.8		
11.3	6.9	6.6	2.2	1.0	17.0	20.9	35.4	36.7	25.2		
10.0	10.5	9.1	7.7	8.9	21.7	31.9	42.2	28.3	16.7		
4.7	18.9	5.2	2.9	1.5	16.8	25.3	29.5	34.6	28.4		
12.8	4.3	6.6	1.5	0.1	12.0	18.4	35.8	38.1	24.4		

^d Less ship and aircraft exports.^e Valued at FOB prices and at the effective rate of exchange. Includes exports to the administered areas; excludes interest received by the public sector from the rest of the world.

NOTE: In May 1977, the National Account data from 1968 onward was corrected.

the declared objective of diverting production means from the services to exports; measures taken in the capital market, and especially the lower linkage rate on government bonds, caused a decrease in savings and an increase in private consumption.

As mentioned above, one of the goals of the restraint policy was to direct resources towards export expansion. To this end measures were taken to encourage exports, mainly the introduction of a series of creeping devaluations. Another positive factor was the expansion of the Israeli export markets following the economic recovery in the world market. All these factors caused exports to increase by 13 percent in 1976 (2.4 percent in 1975). However, in view of the standstill and later decline in domestic uses, the increase in exports over the last two years was not high enough to cause the product to grow, and it only succeeded in neutralizing the downward trend of the domestic product.

Private investments decreased in 1976 as a result of the slowdown in economic activity and special developments in certain investment items. Investments in housing decreased as a result of the drop in disposable income and in the number of new immigrants.

It seems that the developments in above-mentioned uses (public consumption, investment and exports) were strong enough to cause a standstill or even a decline in the product, and therefore in incomes as well. Real private income, however, decreased even further, due to a heavy taxation policy which accompanied these developments. In spite of lower private incomes, private consumption increased in the last two years, and private savings decreased considerably. This odd situation can be explained as follows: a different division of incomes – an increase of the share of wage income in the national income (the tendency to use wages for consumption is higher than for other sources of income); the delayed adjustment of consumption to income; the policy measures taken in the capital market, and especially the lowering of linkage on bonds, etc. (for a wider discussion, see Chapter VII).

Besides the standstill in the product, there was an obvious stagnation of imports in the last two years (excluding direct defense imports, ships and aircraft). This factor, in addition to the increase in exports, significantly improved the balance of payments current account in 1976. However, this improvement derived mainly from a low level of domestic economic activity. The slump conditions in the domestic market in 1976 caused savings in imports, and encouraged the diversion of production to export. In addition, the markets abroad expanded. However, it seems that higher exports could have been achieved by increasing the profitability of exports, even though it would have involved a further price rise.

Economic policy in the last two years created, in addition to the product slowdown, a process of large price increases, reaching as high as 40 percent annually. Indirect taxes were increased in order to absorb public purchasing power, and a series of devaluations was introduced in order to raise the profitability of exports. These measures put pressure on prices due to rising expenditures. The price increases caused a stir on the wage front and as a result, considerable wage increases were granted, above the Cost-of-Living allow-

TABLE II-2

DISTRIBUTION OF TOTAL RESOURCES AND USES^a, 1973-1976
(percent, at 1970 prices)

	Average				
	1971- 1972	1973	1974	1975	1976
Including direct defense imports and ships and aircraft					
RESOURCES					
Gross National Product	64.7	60.2	61.1	60.8	61.7
Imports	35.3	39.8	38.9	39.2	38.3
Total resources	100.0	100.0	100.0	100.0	100.0
USES					
Private consumption	37.0	35.2	36.2	35.3	36.9
Public consumption	20.2	24.3	23.7	25.5	23.7
Civilian	6.4	5.9	5.9	6.1	6.5
Noncivilian	13.8	18.4	17.8	19.4	17.2
Gross domestic investment	20.8	20.3	19.8	18.9	16.3
Exports	22.0	20.2	20.3	20.3	23.1
Total uses	100.0	100.0	100.0	100.0	100.0
Excluding direct defense imports and ships and aircraft					
RESOURCES					
Gross National Product	69.1	67.4	66.4	67.4	67.3
Imports	30.9	32.9	33.6	32.6	32.7
Total resources	100.0	100.0	100.0	100.0	100.0
USES					
Private consumption	39.6	39.4	39.3	39.1	40.2
Public consumption	16.2	16.8	17.7	17.6	17.0
Gross domestic investment	20.8	21.2	20.9	20.9	17.7
Exports	23.4	25.6	22.1	22.1	25.1
Total uses	100.0	100.0	100.0	100.0	100.0

^a See note to Table II-1.

SOURCE: Central Bureau of Statistics.

ance. These wage increases, in turn, also increased upward pressure on prices. However, under the conditions of weakened demand in the economy, manufacturers could not increase prices to a sufficient extent to leave the share of capital return in income at its previous level. Had the restraint policy been based mainly on decreasing expenses and only partially on tax increases, the rate of price increases would have been lower; the growth in export profitability would have been greater and, possibly, exports would have grown even more than they actually did.

2. USES

Total uses, excluding ships, aircraft and direct defense imports, rose by one percent in 1976, after a rise of half a percent in the previous year. The growth of total demands in the last two years was insignificant. It is likely that the decrease from a demand level which assured maximum possible growth in the product to a demand level which did not exploit most of the production means in the economy, began in 1974 or even 1973. The war and the subsequent recovery blurred economic trends and it is therefore impossible to draw definite conclusions. Assuming that the recession did in fact begin in 1973 or 1974, its dimensions nevertheless increased greatly over the last two years.

The stability in uses was mainly the result of restraining those uses under governmental control. For example, there was a considerable drop in investments in the government and the nonprofit institutions sectors (see Chapter VIII). This drop was accompanied by a decline in public consumption, excluding direct defense imports. The rising trend of the previous two years was checked in 1975. Public construction of housing declined sharply in 1976, after a certain slowdown in 1975. Exports increased only slightly in 1975, paralleling the stabilization of uses under government control: even the rapid increase of exports in 1976 was unable to reverse the declining trend of uses, but could only halt it.

The slowdown in economic activity and the strict taxation policy are reflected in the real decrease of disposable income. However, all of these did not cause a decline in private consumption, which grew in spite of the decline in disposable income during the last two years, and was expressed instead in lower savings. Investments of the private sector were also affected by the lack of growth of incomes, and fell extensively in 1976, after only a slight drop in 1975 (see Table II-3). The restrained monetary development contributed towards a moderate level of economic activity and assisted in achieving the prime goal of the economic policy, namely, an improvement in the balance of payments. The Bank of Israel took policy measures that moderated the growth of free credit and increased the interest rate on it. These measures helped to maintain a low level of economic activity and created incentives for limiting the volume of inventories, helping in this manner to reduce imports and to divert production means to exports; they were applied selectively in order not to hurt exports.

TABLE II-3
CONTRIBUTION OF FINAL USES TO THE GROWTH OF TOTAL USES, 1973-1976

	1973	1974	1975	1976	Annual increase or (-) decrease				Contribution of uses to growth of total uses			
					1973	1974	1975	1976	1973	1974	1975	1976
	(IL million)				(percent, 1970 prices)				(percent, 1970 prices)			
1. Investments of the government sector and nonprofit institutions, excl. ships and aircraft	1,529	1,541	1,573	1,345	2.6	0.8	2.1	-14.5	0.1	0.0	0.0	-0.6
2. Building of public housing	981	1,148	1,248	892	10.8	17.0	8.7	-28.5	0.3	0.5	0.3	-0.9
3. Public consumption, excl. direct defense imports	6,046	6,897	6,894	6,717	19.0	14.1	0.0	-2.6	2.9	2.3	0.0	-0.4
4. Total (1)+(2)+(3)	8,556	9,586	9,715	8,954	14.7	12.0	1.4	-7.8	3.3	2.8	0.3	-1.4
5. Exports, excl. ships and aircraft	8,114	8,570	8,774	9,908	3.9	5.6	2.4	12.9	0.9	1.4	0.5	2.9
6. Total (4)+(5)	16,670	18,156	18,489	18,862	9.2	8.9	1.8	2.0	4.2	4.2	0.8	1.0
7. Private consumption	14,150	15,287	15,282	15,910	9.3	8.0	0.0	4.1	3.7	3.1	0.0	1.6
8. Other investments, excl. ships and aircraft	5,106	5,443	5,339	4,754	5.4	6.6	-1.9	-11.0	0.8	0.9	-0.3	-1.5
9. Total (7)+(8)	19,256	20,730	20,621	20,664	8.3	7.7	-0.5	0.2	4.5	4.0	-0.3	0.1
Total uses, excl. direct defense imports ships and aircraft (6)+(9)	35,926	38,886	39,110	39,526	8.7	8.2	0.6	1.1	8.7	8.2	0.6	1.1

SOURCE: Central Bureau of Statistics.

The restraint policy adopted by the government was inconsistent, containing measures that acted against the major trend. As mentioned above, the number of employees in the public sector rose in the last two years, making it more difficult to transfer workers to export industries. Terms of government bonds worsened, and this affected savings and increased consumption.

Total uses, excluding direct defense imports, ships and aircraft, showed zero growth in each of the last two years (as mentioned earlier). However, the contribution of each of the various uses to the increase in total uses in 1976 differed from the previous year. The extensive contribution of exports to the increase of uses was outstanding, while investments acted in the opposite direction (see Table II-3). A similar picture can be seen in Table II-4 which analyses the effect of uses on the business sector product: exports contributed considerably to the growth of the product and investments, to its decline.

TABLE II-4

EFFECT OF RESOURCE USE ON THE BUSINESS SECTOR PRODUCT^a, 1973-1976
(percent, 1968-69 prices)

	Distribution of the product by final use				Contribution of uses to growth of the product			
	1973	1974	1975	1976	1973	1974	1975	1976
Private consumption	40.6	40.1	40.0	41.2	2.1	1.8	0.3	1.7
Public consumption	11.4	13.1	12.7	11.5	0.9	2.5	-0.3	1.0 ^c
Gross domestic investment ^b	23.1	21.8	21.6	18.2	1.4	0.0	0.0	3.2 ^d
Exports	24.8	24.9	25.7	29.1	-0.2	1.6	1.0	3.8
Total product	100.0	100.0	100.0	100.0	4.3	5.9	1.0	1.3

^a Gross domestic product at factor cost, excluding the product originating in public sector and nonprofit institution services.

^b Excludes changes in stocks. Due to this, and to the different definitions and estimation techniques, the difference in this table is not the same as the difference shown in Table II-1.

^c The effect of public defense consumption was to lower the product by 1.1 percent.

^d The effect of the public sector investments was to lower the product by 2.2 percent.

NOTE: The data here have been calculated on the basis of input-output coefficients. In order to render them comparable with the data on resource uses, the latter have been adjusted downward as follows: private consumption excludes ownership of dwellings and compensation of employees (wages and salaries plus fringe benefits) of nonprofit institutions; public consumption excludes compensation of public sector employees; and exports exclude factor payments abroad, rent, and sundry domestic factor income. In addition, the direct import component has been deducted from all uses.

SOURCE: Central Bureau of Statistics data adjusted according to input-output data for 1968-69.

Public consumption decreased by 8 percent in real terms, including a large decrease in direct defense imports; excluding the latter, the decrease was 3 percent. As a result, the share of public consumption within the uses decreased in fixed prices. It should be noted that the decrease in public consumption, excluding direct defense imports, was mainly in defense consumption. This means that the restraint policy was applied to defense consumption rather than to civil consumption.

Total investments, and investments excluding ships and aircraft, fell by 14 percent, which is the steepest decrease of all uses. The investments of the public sector³ decreased by 22 percent, while other investments, more sensitive to market conditions, decreased by 11 percent.

The development in investments in 1976 was the result of various factors:

a. There was a sharp drop in investments under government control due to a policy of restrictions on domestic demands.

b. Investments in housing construction declined due to lower demand, following a decline in immigration and in private incomes, and a rise in the number of unsold flats. Due to the long building period for housing, the decrease in demand shows immediately in the number of building starts, which are less investment intensive. As the completion of construction is investment intensive, investments do not adjust immediately to the developments in the demand for housing. In public housing construction, there was a delay in the adjustment of the number of building starts to the decrease in demands. That number continued to increase until the beginning of 1975, after which it declined rapidly. As a result, investments in public housing construction continued to increase considerably in 1975, but declined rapidly in 1976. Private housing construction adjusted earlier and more gradually to the decrease in demand, so that in 1976 there was no further drastic decline. Moreover, the drastic decline in the number of public housing building starts apparently moderated the decline in private starts.

c. Investment in inventories was affected by special factors, namely, expectations for lower price increases of raw materials in the world, higher interest rates which raised the cost of inventories, and adjustment to a lower level of inventories. Investment in inventories increased substantially in 1974, then began to decline in 1975, and continued to decline more sharply in 1976. A comparison of actual imports of raw materials to imports required for economic activity (according to input-output analysis) indicates that in 1976 investment in imported inventories was negative. However, it should be noted that the data pertaining to investments in inventories is not as reliable as other data used for the National Accounts.

³ Investments of the government, the local authorities, national institutions, government industries, nonprofit institutions and public construction for housing.

d. The utilization of capital stock in the economy has apparently decreased in recent years (see Chapter VIII), justifying the slowdown in investments. It can be assumed that this slowdown would have been greater if not for the large subsidy for investments latent in the Law for the Encouragement of Investments, in view of the inflationary conditions of recent years. The drop in investments in 1976 caused a decrease of 3 percent in total uses (excluding direct defense imports, ships and aircraft), as against a decrease of under one percent in total uses due to the decline in public defense consumption. These lower investments also caused a 3 percent drop in the business sector product.

Exports, excluding ships and aircraft, increased by 13 percent, the outstanding factors being the growth of industrial defense exports and of agricultural exports, excluding citrus.

The growth in exports, which contributed to an increase of nearly 3 percent in uses and a similar increase in the product of the business sector, was affected by the growth of export markets, sluggish domestic demand (in relation to the potential supply), and an increase in the relative price of exports.

The development of exports in the last two years was affected to a great extent by developments in the world market. The slow increase in exports, in 1975, can be explained as a result of the slump in export markets, whereas the accelerated increase in 1976 came as result of the recovery of those markets. However, the growth of exports did not bring parallel growth in the product. It would seem that it is not possible to increase the uses to their full potential growth in the short run when their composition is changed by heavy balance of payments restrictions which do not allow growth of the import surplus to any significant degree. However, it should be remembered that the policy of changing the uses composition, which was intended to promote exports, began even before 1975. It can therefore be concluded that a more drastic policy adopted to raise the profitability of exports would have led to further growth, even though it would have involved additional price increases. It is possible that the profitability of exports as well as exports themselves could have been increased, had the restraint policy been based on reducing expenditures and not on raising taxes. In this case there would have been smaller wages and price increases, and the profitability of export would have grown.

The development in private consumption must be seen in light of the development of incomes. The standstill of the product in the last two years played a major role in the decline of incomes. But real disposable income declined even more, due to the strict direct and indirect taxation policy. Net indirect tax revenues increased by 50 percent, while the Gross National Product rose by 26 percent in current prices; direct tax revenues increased by 64 percent. The decrease in disposable income was partially offset by a 40 percent growth of net transfer payments, and by a transition to net redemption of compulsory loans.

As a result of all those factors, real disposable per capita income declined by 6 percent in 1976 after a 3 percent decline in 1975⁴. In 1976 real per capita consumption rose by 2 percent after a 2 percent decline in the previous year, so that its level this year was similar to that of 1974. If housing services consumption (which is a function of the stock of flats for dwelling) and nonprofit institutions consumption (which does not reflect household decisions) are deducted, it can be seen that per capita consumption declined; but there is still a substantial gap between the development of disposable incomes and of the above-mentioned consumption in 1976 as against 1974.

The reasons for this gap are discussed in Chapter VII. We shall refer to them here only briefly: the weight of labor in the national income rose, and since the average tendency to consume from wage incomes is higher than this tendency from other incomes, the general average tendency to consume from total incomes increased. It is possible that this tendency became stronger due to the large increase of direct tax revenues from the self-employed and the increase in transfer payments to low-income earners. Another reason is the decrease in the value of unlinked household debt, due to the acceleration of price increases. Another possible reason is the decline in the rate of savings following the effect of measures taken in the capital market on the rate of return on bonds, and the fear that additional measures might be taken in the future. A lag in the full adjustment of consumption to the decrease in incomes in the last two years is also possible⁵.

3. RESOURCES

Imports declined by 3 percent in 1976 after a 3 percent rise in 1975. Excluding direct defense imports, ships and aircraft, imports rose by approximately one percent in 1976 after a decline of 2 percent in 1975. The rise in imports in 1976 was similar to the rise in uses (without ships, aircrafts and direct defense imports). This took place during changes in the composition of uses in a direction necessitating increased imports of production inputs. One reason for the moderate rise in imports was a certain replacement of imports which arose from the cumulative growth (nearly 20 percent) of the price of imports in relation to the product price over the last three years. Another reason was the large decrease in investments in imported raw material inventories in 1976 as against 1975: these inventories may have even declined this year (see Chapter V).

4 Real disposable per capita income from internal sources, after deducting compulsory loans. Real disposable per capita income from all sources decreased at a higher rate due to a relatively small increase in private transfers from abroad in the last two years.

5 It should be remembered that the reliability of the savings data is lower than the reliability of most of the national accounts data, since they are composed as the difference between two sizes.

TABLE II-5
COMPOSITION OF RESOURCES FOR DOMESTIC USE, 1973-1976
(percent)

	Average 1971- 1972				
	1973	1974	1975	1976	
(At current prices)					
A. Total resources for domestic use					
Import surplus ^a	18.6	27.2	27.0	28.6	26.7
GNP	81.4	72.8	73.0	71.4	73.3
Total	100.0	100.0	100.0	100.0	100.0
B. Total resources for domestic use, less direct defense imports					
Import surplus	16.4	16.6	19.6	18.6	17.2
GNP	83.6	83.4	80.4	81.4	82.8
Total	100.0	100.0	100.0	100.0	100.0
(At 1970 prices)					
A. Total resources for domestic use					
Import surplus ^a	17.1	24.6	23.3	23.7	19.8
GNP	82.9	75.4	76.7	76.3	80.2
Total	100.0	100.0	100.0	100.0	100.0
B. Total resources for domestic use, less direct defense imports					
Import surplus	11.3	14.6	15.5	13.3	10.4
GNP	88.7	85.4	84.5	86.7	89.6
Total	100.0	100.0	100.0	100.0	100.0

^a Calculated at the effective rates of exchange.

SOURCE: Central Bureau of Statistics.

The share of imports in resources (excluding ships, aircraft and direct defense imports) remained stable in 1976, at a higher level than the average during 1971-72. The decrease of import surplus as a part of total resources for domestic use stands out due especially to the increase in exports.

The GDP of the business sector remained stable in 1976. In 1975 the product of the business sector had also increased at a lower rate than the product of the total economy. This resulted from a high increase in the products of the housing services, the public

services, and the nonprofit institutions during these years. This increase was higher than the increase of the product of the whole economy. The latter reflects the fact that the number of employees in the public sector and nonprofit institutions rose in the past two years, which was contrary to the declared policy of restraining domestic activity, and made it difficult to transfer workers to export industries.

In spite of the decelerated growth in demand for workers following the decelerated growth of the business sector product in the years 1973-75 and its standstill in 1976, no overt unemployment developed. Manpower surveys indicate that towards the end of 1976 conditions in the labor market somewhat loosened.

TABLE II-6
NET DOMESTIC PRODUCT CHANGE AT FACTOR COST, BY SECTORIAL ORIGIN,
1973-1976
(percent)

	Average				
	1971- 1972	1973	1974	1975	1976
1. Agriculture	6.2	0.3	21.7	15.1	5.9
2. Industry	6.4	-3.3	2.8	3.5	4.2
3. Construction	-2.3	0.6	3.2	3.1	-8.0
4. Transportation	10.1	0.7	-0.6	2.3	8.8
5. Total business sector	4.1	-1.1	4.4	3.2	1.1

SOURCE: Central Bureau of Statistics

Because of the slow growth in the product compared to its potential growth, the increase of demand for workers ceased. A partial explanation for the absence of overt unemployment is the slowdown in the labor supply. The population has grown slowly in recent years as a result of the decline in immigration; the rate of participation in the labor force decreased, and the number of workers from the administered areas declined, as did the number of work-hours per employee (see Chapter XII). These reasons constitute a partial explanation of the absence of overt unemployment, from the point of view of the labor supply. A further reason is the development of latent unemployment (see Table II-6). This was expressed by a slowdown in the growth of the product per employee which was true of all branches of the economy. In the construction branch there was even a substantial decline in the product per employee in 1976.

A possible reason for the existence of latent as opposed to overt unemployment is the employers' expectations for renewed economic growth: the present economic slowdown is not as clear-cut as the slowdown of 1966-67, and therefore they prefer not to fire workers in the meantime.

TABLE II-7
NET DOMESTIC PRODUCT AT FACTOR COST^a, BY SECTORIAL ORIGIN, 1966-1967 AND 1972-1976

	Current prices (IL million)	Real annual increase or (-) decrease						Sectorial structure				
		1970	1966	1967	1973	1974	1975	1976	1972	1973	1974	1975
		(percent at 1970 prices)						(percent at 1970 prices)				
1. Agriculture, forestry, fisheries	1,039	3.3	15.5	-1.8	11.0	9.1	8.2	6.5	6.0	6.5	6.8	7.3
2. Industry, mining, quarrying	3,854	1.3	-3.1	5.5	5.0	2.2	4.2	24.9	24.7	25.1	24.9	25.3
3. Construction, electricity, water	1,936	-12.4	-17.0	2.4	0.7	4.1	-13.3	13.2	12.8	12.5	12.6	10.7
4. Transportation & communication	1,427	0.0	1.0	3.0	4.7	-0.9	6.6	9.7	9.4	9.5	9.1	9.5
5. Finance, trade, services	3,713	2.1	-1.9	2.4	-3.8	3.3	3.4	22.0	21.2	19.8	19.8	20.0
6. Ownership of housing	975	7.0	5.5	9.9	8.1	6.8	8.9	6.2	6.4	6.7	6.9	7.4
7. Public & community services	3,052	7.7	12.2	18.9	5.2	2.9	1.5	17.5	19.5	19.9	19.9	19.8
8. Net domestic product ^a												
9. Total economy	15,996	1.4	0.9	6.3	3.2	3.2	2.1	100.0	100.0	100.0	100.0	100.0
10. Business sector (excl. housing) ^b	11,969	-0.9	-2.7	3.1	2.2	3.0	1.6					

a Before inventory and depreciation adjustments.

b Defined as the total product less public and community services.

NOTE: The absolute figures for the base year 1970 are from the national accounts. The real rates of change listed here do not necessarily coincide with those in Tables II-1 and II-9, since they have been calculated here according to sector.

SOURCE: The sources for calculating the real rates of change are as follows:

- (1) Current account of agriculture, with the data converted from agricultural into calendar-year terms, except for 1976, which has been calculated according to the agricultural year.
- (2) Index of industrial production. In 1974 the data on diamonds were revised, and therefore the rate of change differs from that in the index.
- (3) Construction output, as calculated in Chapter VIII; electricity and water are calculated according to input-output data.
- (4) As calculated in Chapter XV. In calculating the rates of change there the change in the output of each subbranch was weighted by its share in the 1968/69 product, as estimated on the basis of input-output data.
- (5) According to the rates of change in employment, as measured by manpower surveys.
- (6) According to national accounts data.
- (7) According to national accounts data.

The growth of the domestic product of the business sector as measured by the branches of the economy (Table II-7) indicates a higher increase in the product in the years 1975 and 1976 than the increase measured by the uses. The agricultural product grew rapidly as in 1974 and 1975. Agriculture was not affected by the moderate economic activity in the last two years, one of the reasons being the growing demand for agricultural products in the export markets. In industry, mines, and quarries growth was higher than the average growth of the product, but this derived entirely from the growth during 1975, because during 1976 the industrial production did not grow at all. The high growth in industrial exports and the decrease in sales to the domestic market are striking.

The product of the construction branch declined by 13 percent, expressing a late reaction of public housing construction to the decline in the demand for housing in recent years and to a large decline in defense construction. It should be noted that the development in the construction branch product is similar to that of 1966. The product of the transport branch increased by 7 percent as a result of the increase in tourism to Israel and the flow of crude oil through Israeli pipelines.

4. THE ACTUAL AND POTENTIAL PRODUCT

The Gross Domestic Product increased by only one percent in 1976 after 2.2 percent in 1975, 6.6 percent in 1974, and 6.9 percent in 1973. This steep decline in the growth rate of the GDP in the last two years resulted from the strict restraint policy of the government. Export growth was not sufficient to cause a significant increase in the GDP. It would seem appropriate to examine and evaluate the potential product, which could have been produced by the production means at the disposal of the economy. The potential growth of the GDP could have been achieved only at the price of a substantial increase in the import surplus.

FIGURE II-1
INDEX OF POTENTIAL AND ACTUAL PRODUCT
(1965=100)

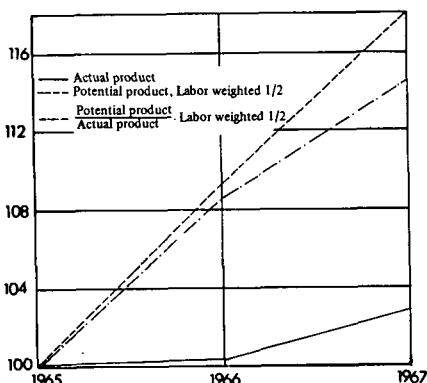
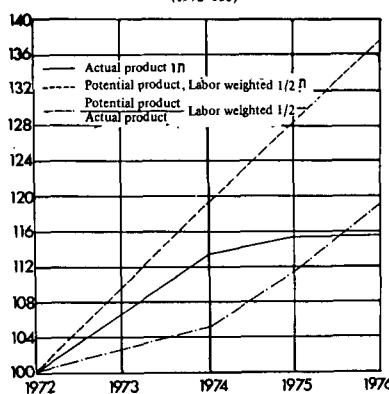


FIGURE II-2
INDEX OF POTENTIAL AND ACTUAL PRODUCT
(1972=100)



A comparison of the actual product and the potential product (Table II-8) indicates that in 1976, it would have been possible to achieve a product 20 percent higher than that actually achieved. In calculating the potential product, the following assumptions were made:

a. The increase in labor input is represented with the highest reliability by the increase in the working age group within the population⁶.

b. The product could be increased at the same rate as the growth of production means and the long-term growth in productivity.

Similar conclusions were drawn from calculations regarding the business sector, excluding housing, where the increase in the labor input was measured according to the increase in the number of employees⁷.

The gap between the potential and actual product was wider in 1976 than in 1967, which was the low point of the previous recession. Moreover, it seems that the effect of the nonutilization of production means on their growth was greater in recent years in relation to the 1967 recession, perhaps because the gap between the potential product and the actual product grew over a much longer period⁸.

6 In the years 1966–72 there was no real gap between the growth in the working age group in the population and the growth in the number of employees. In contrast, in the years 1973–1976 the growth in the number of employees was much lower than the growth in the working age group. A weakening of the aggregate demand is expressed by the decline in the rate of participation in the labor force and the rise in the rate of unemployment. For the calculation of the product that could have been obtained under conditions of full employment, it is justified to assume that the rate of participation and the rate of unemployment would remain stable. Two other factors affect the number of employees, namely the number of employees from the administered areas and the rate of enlistment in regular military service. It can be assumed that under conditions of full employment, the number of employees from the administered areas would grow. The number of soldiers in the compulsory and regular service grew due to the defense situation. Because of these developments, namely the growth in the number of employees from the administered areas and the number of soldiers in regular military service, occurring in 1966–1972, which more or less canceled each other out, the number of employees increased at the same rate as the rise in the working age population.

In 1973–1976 there was also an increase in the rate of enlistment, but the number of workers from the administered areas did not grow further. This also weighs in the decision to choose the growth of the working age population as representing the potential increase in labor in 1973–1976.

7 Calculations of the potential product (excluding housing) of the private sector are more significant than those for the entire economy. The exclusion of housing does not raise any problems, while, on the other hand, excluding the public sector raises the problem of estimating the increase in labor input in the private sector. This estimate requires assumptions which we prefer to avoid. Therefore, Table II-8 shows only calculations of the potential domestic product.

8 It is possible that in a period of changes in the composition of demands, such as in recent years, the potential increase in the product was lower. It should, however, be remembered that the difference in the demand composition does not derive from exceptional increases in particular demands. In previous periods, when the product increased greatly, such increases occurred. The change in the demand composition derives mainly from a standstill and decline in other demands. (continuation on p. 34)

TABLE II-8
CHANGE IN ACTUAL AND POTENTIAL DOMESTIC PRODUCT, 1973-1976
(Quantitative changes, percent)

	Average									1966-1967	1973-1976
	1961-1965	1973-1976	1966	1967	1973	1974	1975	1976			
1. GDP, excl. housing	10.4	3.7	0.7	2.2	6.6	6.4	1.7	0.3	2.9	15.7	
2. Gross fixed capital stock ^a	11.2	8.6	9.6	7.3	9.0	9.6	8.5	7.5	17.6	39.3	
3. Working-age population	4.3	2.9	3.9	3.5	4.7	2.9	2.0	1.9	7.5	12.1	
4. Domestic workers	4.5	2.1	-0.6	-4.3	4.6	0.7	1.0	2.1	-4.9	8.6	
5. Potential product ^b											
a. Labor weighted 1/2		8.3	9.4	7.9	9.5	8.9	7.8	7.2	18.0	37.8	
b. Labor weighted 2/3		8.6	9.6	8.6	9.9	8.9	8.0	7.5	19.0	38.9	
6. Potential product/actual product (5/1)											
a. Labor weighted 1/2		4.4	8.6	5.6	2.7	2.3	6.0	6.9	14.7	19.1	
b. Labor weighted 2/3		4.7	8.8	6.3	3.1	2.3	6.2	7.2	15.6	20.1	

^a Capital stock at the beginning of the year.

^b In calculating the potential product, it has been assumed that the growth in the potential labor input is represented by the growth in the working-age population (see text for explanation). The growth in productivity which is assumed for calculating the potential product is the growth during the period 1961-1965, when growth took place at full employment (productivity growth during 1966-1972 was slightly greater than during 1961-1965).

5. INCOMES

Disposable per capita income, from internal resources, after deducting the compulsory loans, suffered a 6 percent decline in real terms in 1976, after a 3 percent decline the previous year — meaning that incomes were 10 percent lower than those of 1974. The reasons for this development were the standstill in domestic activity and the heavy taxation policy, which was the government's main tool in its policy to restrain domestic activity over the last two years. In comparison to the previous recession in 1966–67, when disposable per capita income was frozen, this time, in addition to the standstill of domestic activity, real income was also affected by the heavy taxation policy.

The taxation policy was reflected mainly in the increase of the indirect tax rate. In 1976, net revenues from indirect taxes on domestic production rose by more than 50 percent, as against an increase of 26 percent in the Gross National Product at market prices. In 1975 they rose by 62 percent as against an increase of 39 percent in the product. In 1974 the increases of tax revenues and the product were 53 and 44 percent respectively. It should be remembered that the Value Added Tax went into effect in 1976.

Direct tax revenues also increased considerably in the last two years: in 1976, by more than 60 percent, as against 22 percent in the national income; in 1975, the increase was 55 and 35 percent respectively; and in 1974, 48 and 42 percent respectively. Considering the compulsory loans as direct taxes reduces the strength of direct taxation in the last two years, since the redemption of loans in those two years nearly equaled the amount collected from new loans. With the addition of compulsory loans, direct tax revenues increased by 46 percent in 1976, and by 38 percent in 1975. It should be emphasized that the vast increase in transfer payments in recent years to a great extent reduced absorption by way of direct taxation. In the years 1974 and 1975 transfer payments increased more than compulsory payments; in 1976 the growth rate of compulsory payments increased more than that of transfer payments, but not to a meaningful extent. It can not be concluded from this fact that the share of direct taxes within total taxes actually changed;

As mentioned earlier it can be concluded from Table II-8 that the potential product in 1976 was 20 percent higher than the actual product. This result is obtained by weighing the change in labor input both by two-thirds and by one-half, which are the two accepted alternatives for calculating the changes in a weighted unit of production means in the Israeli economy.

Similar results are obtained when using the growth of productivity in 1961–1975 or in 1966–1972.

It is possible that the potential product in 1976 has been under-estimated for the following reasons: (a) The increase in labor input which was calculated exogeneously is not in fact exogeneous, but is affected by the fact that the actual product began to lag behind the potential product a few years ago. Thus, for example, the number of immigrants declined, which caused a deceleration in the growth of the labor input. (b) The growth of capital stocks was also affected by the increase in the product. Under conditions of growing full-production capacity, investments would have increased more, causing capital inventories to grow at a higher rate, and causing the product to grow further.

TABLE II-9
THE NATIONAL PRODUCT AND INCOME, 1973-1976

	1973	1974	1975	1976	Annual increase or (-) decrease		
					1974	1975	1976
(IL million, at current prices)							(percent)
1. GNP at market prices ^a	37,621	54,272	75,329	95,317	44.3	38.8	26.5
2. Depreciation	4,058	6,210	9,407	12,655	53.0	51.5	34.5
3. Net national product (1)-(2)	33,563	48,062	65,922	82,662	43.2	37.2	25.4
4. Indirect taxes on domestic production	3,583	5,243	8,722 ^b	13,580	46.3	66.4	55.7
5. Subsidies on domestic production	875	1,108	2,037	3,440	26.6	83.8	68.9
6. Net taxes on domestic production	2,708	4,135	6,685	10,140	52.9	61.7	51.7
7. National income (3)-(6)	30,855	43,927	59,237	75,522	42.4	34.9	22.4
8. National income per capita (IL)	9,414	13,006	17,144	20,537	38.2	21.8	24.7

a At effective rates of exchange

b Includes the payroll tax, whose collection began in 1975.

SOURCE: Central Bureau of Statistics.

TABLE
TOTAL AND DISPOSABLE GROSS

	1973	1974
	(IL million,	
1. National income	30,855	43,927
2. Public sector property and entrepreneurial income ^a	543	1,020
3. Depreciation	4,058	6,210
4. Gross private income from economic activity (1)-(2)+(3)	34,370	49,117
5. Income tax ^b	4,329	6,300
6. National insurance payments	1,751	2,806
7. Total direct taxes (5)+(6)	6,143	9,106
8. Net compulsory loans ^c	1,035	2,475
9. Total compulsory payments (7)+(8)	7,448	11,581
10. Net transfer payments	5,075	8,702
11. Gross disposable income from domestic sources		
a. Incl. net compulsory loans (4)-(7)+(10)	33,302	48,713
b. Excl. net compulsory loans (4)-(9)+(10)	31,997	46,238
12. Personal transfers from abroad	3,268	3,443
13. Gross disposable income from all sources.		
a. Incl. net compulsory loans (11a)+(12)	36,750	52,156
b. Excl. net compulsory loans (11b)+(12)	35,265	49,681

^a The data in this item have been revised because of a change in the CBS definition of the public sector's interest from abroad.

^b Excludes the change in the estimated balance due under the tax debt payment arrangement, as follows: 1972 - IL 26 million; 1973 - IL 333 million; 1974 - IL 323 million; 1975 - IL 968 million; 1976 - IL 42 million. In our calculations, tax receipts (including collections on account of previous years) are recorded on a cash basis; hence we have deducted the above sums (which are included in the figures of the State Revenue Admi-

PRIVATE INCOME, 1973-1976

1975	1976	1974	Annual change	
			1975	1976
at current prices)			(percent)	
59,237	75,522	42.4	34.9	22.4
1,635	1,102	87.8	60.3	-32.6
9,407	12,655	53.0	51.5	34.5
67,009	87,075	42.9	36.4	29.9
10,063	17,034	43.4	59.7	69.3
4,077	6,147	60.3	45.3	50.8
14,140	23,181	48.2	55.3	63.9
1,883	221	89.7	-23.9	-88.3
16,023	23,402	55.5	38.4	46.1
13,289	18,638	71.5	52.7	40.3
66,158	82,532	46.3	35.8	24.8
64,275	82,311	44.5	39.1	28.1
4,616	5,469	5.4	34.1	18.5
70,774	88,001	42.6	35.7	24.3
68,891	87,780	40.9	39.7	27.4

nistration). The U.N. recommends that data on tax revenue pertain to the period when the income on which the taxes were levied was earned; however, this system cannot be applied here, since the information on tax debts is received after a lag of at least two years. Admittedly, according to permanent income theory, the balance due under the tax debt payment arrangement may be treated as tax revenue, but the data on disposable income in this chapter do not refer to permanent income.

^c Collections less loan certificates distributed and Compulsory Loan redemptions.

since the classification of taxes as direct or indirect is not always clear. For instance, the payroll tax is defined as indirect, but it may also be regarded as additional labor costs and an income tax.

TABLE II-11
GROSS PRIVATE SAVING^a, 1973-1976

	1973	1974	1975	1976	Annual change							
					1974	1975	1976					
					(IL million, at current prices)					(percent)		
1. Gross disposable private income from domestic sources												
a. Incl.compulsory loans	33,302	48,713	66,158	79,532	46.3	35.8	20.2					
b. Excl.compulsory loans	31,997	46,239	64,275	79,311	44.5	39.1	23.4					
2. Gross disposable private income from all sources												
a. Incl.compulsory loans	36,574	52,156	70,774	85,001	42.6	35.7	20.1					
b. Excl.compulsory loans	35,265	49,689	68,891	84,780	40.9	38.7	23.1					
3. Private consumption	21,817	32,640	45,668	61,160	49.6	39.9	33.9					
4. Gross private saving from domestic sources (1)-(3)												
a. Incl. compulsory loans	11,485	16,007	20,490	18,372	40.0	27.5	-10.3					
b. Excl.compulsory loans	10,180	13,598	18,607	18,151	33.6	36.8	-2.4					
5. Gross private saving from all sources (2)-(3)												
a. Incl.compulsory loans	14,753	19,516	25,106	23,841	32.3	28.6	-5.0					
b. Excl.compulsory loans	13,448	17,041	23,223	23,620	26.7	36.3	1.7					
6. Rate of gross saving from domestic sources (4)+(1)												
a. Incl.compulsory loans	34.5	33.0	31.0	23.1								
b. Excl.compulsory loans	31.8	29.4	29.0	22.9								
7. Rate of gross saving from all sources (5)+(2)												
a. Incl.compulsory loans	40.3	37.4	35.5	28.0								
b. Excl.compulsory loans	38.1	34.3	33.7	27.9								
a. Of households, business, and nonprofit institutions, for which there are no separate data.												

The differentiation of income into the categories *labor income* and *nonlabor income* reveals a large increase in the share of labor in the income of the private sector (excluding housing) in the last two years. This fact found expression in a real increase in labor costs per man-hour in 1976. On the other hand, the rate of return per unit of capital decreased radically. The reason for this was not only the increase of labor costs, but also the large accumulation of unutilized capital, mainly in the construction sector. The increase in labor costs and the decline in capital return would be steeper if we considered the payroll tax as labor costs. However, it should be remembered that the income tax reform increased labor costs which were previously classified as expenses (such as car maintenance, telephone, etc.). There was, however, a sharp decline in production profitability, but as a rule it did not lead to firing of workers. Only in the construction sector, which showed a striking decline in profitability, was the number of workers reduced.

6. NATIONAL SAVINGS

National savings, calculated from the Gross National Product, dropped from the high negative nominal level which it had reached in the previous year. In relation to the GNP, national savings declined slightly (the negative level of the rate of savings rose).

TABLE II-12
NATIONAL SAVINGS, 1973-1976
(At current prices)

	1973	1974	1975	1976
(IL million)				
1. Gross private saving ^a	11,485	16,073	20,490	18,372
2. Public sector saving	-12,077	-16,514	-24,878	-25,650
Net public sector income ^b	4,319	5,559	9,171	15,785
Less: Public consumption	16,396	22,073	34,049	41,435
3. Gross national saving from GNP (1)+(2)	-592	-441	-4,388	-7,278
4. Unilateral transfers from abroad ^c	9,067	7,631	10,245	16,636
5. Gross national saving from all sources (3)+(4)	8,475	7,190	5,857	9,358
6. Depreciation	4,058	6,210	9,407	12,655
7. Net national saving from NNP (3)-(6)	-4,650	-6,836	-14,475	-19,933
8. Net national saving from all sources (5)-(6)	4,417	795	-4,230	-3,297
(percent)				
9. Rate of gross saving from GNP	-1.6	-1.2	-6.7	-7.6
10. Rate of gross saving from all sources	13.1	7.6	3.9	5.5
11. Rate of net saving from GNP	-13.9	-14.2	-22.0	-24.1
12. Rate of net saving from all sources (less depreciation)	7.3	0.9	-3.5	-5.8

^a Out of income from domestic sources, before deduction of compulsory loans.

^b Excludes net taxes on imports, which are included in the import surplus when calculating the effective rate of exchange.

^c Less net interest payments of the public sector.

The high rate of negative savings expresses the high dependence on external sources for financing consumption, a dependence that rose in 1975 and continued to rise in 1976. The drop in the rate of national savings in 1976 resulted from an increase in the rate of public savings and a decrease in the rate of private savings. Public savings increased as a result of the increase in tax revenues and a real decrease in most components of public consumption (see Part 2, above).

The large increase in unilateral transfers in 1976 (due to the growing share of grants within American aid) caused the rate of gross savings from all sources to rise. This indicates that a larger part of the import surplus was financed in a way that did not create liabilities for the economy.