CHAPTER III

THE BALANCE OF PAYMENTS

1. MAIN DEVELOPMENTS[1]

In 1971 commodity exports rose 24 percent and service exports by an even faster 42 percent. Commodity imports also grew rapidly, but defense imports declined while imports of other services increased at a fairly sluggish rate. As a result, the balance of payments deficit on current account decreased by about $90 million (7 percent), from $1,282 million to $1,196 million.

Long-term capital imports rose by $300 million to reach $1,560 million, some $360 million more than the current deficit.[2] This was reflected in a similar ($360 million) increase in the country's foreign exchange reserves.[3]

The much bigger export gain in 1971 (6 percent in 1970) was primarily due to a spurt in two major items, citrus and diamonds, as a result of heavier foreign demand. Overseas sales of several other products which are influenced by special factors also accelerated in 1971.

Industrial exports, other than diamonds, mine and quarry products, and some special items, advanced at a high annual average rate of over 20 percent, as in the three preceding years. During this four-year period most of the country's incremental exports came from this source, with the result that its weight in total exports and the proportion of industrial output exported both went up. However, the high 1971 figure was the net outcome of a rapid growth in the first half of the year and a marked slowdown in the second half.

The dominant factor behind the strong export gain is the cumulative effect of rising relative export profitability. This began in 1967 and is explained by the fact that the effective exchange rate for exports has gone up faster than domestic costs and prices.

1. Besides Israel's overseas trade, the balance of payments data on imports and exports include trade with the administered areas. The discussion here, however, is concerned mainly with overseas trade and, unless otherwise specified, the figures in the tables do not include transactions with the administered areas. There are several reasons for this procedure: first, the figures for trade with the areas are only rough estimates, some of them very weak indeed; second, they are not available in the same detail as the rest of the data; third, the administered areas actually constitute part of the protected market available to Israeli producers, so that sales to them do not reflect Israel's export problems, and are thus essentially different from the rest of the country's exports.
2. Excluding transactions with the administered areas.
3. This represents the increase due to transactions only; it does not include currency revaluations or Special Drawing Rights. The total increase in foreign exchange reserves was $430 million.

Most of the rise – in both the effective exchange rate per value-added dollar and the direct profit component – occurred up to 1970. During this period input prices (wages and domestic and imported intermediates) lagged well behind export receipts. The economy was moving from recession to a high level of economic activity, accompanied by the re-employment of idle factors of production. In 1970 the upward trend in export profitability started to slow down as costs began to catch up with receipts. The general economic climate changed: demand pressure built up and led to higher labor and intermediate costs, to a growing balance of payments deficit, and – indirectly – to the Government's dearer-imports policy, which was implemented by the introduction of an import surcharge in August 1970 and the devaluation of August 1971. Devaluation raised the effective exchange rate much more for imports than for exports: for imported intermediates it went up 19 percent,[4] while for the bulk of industrial exports the increase was 10 percent. As a result, the exchange rate per value-added dollar rose by only 6 percent.

During 1971 it became increasingly clear that export profitability was levelling off as costs began to mount more rapidly, and apparently it even started to turn downward toward the end of the year. The uptrend in IL proceeds per value-added dollar was checked and nominal direct profit per unit of output decreased. At the same time the price of capital per unit of output rose steeply (largely as a result of the devaluation), which means that profit per unit of capital declined.

The advancing trend in costs and domestic prices carried over into the first part of 1972, but export proceeds depend mainly on the effective exchange rate. Obviously the current export trend only partly reflects recent developments, and as regards export investments it is affected to some extent by developments three to four years earlier. The impact of recent developments, less favorable to exports, will make themselves increasingly felt with the passage of time.

The change in export profitability has coincided with a slackening in the expansion of world markets on the one hand and with heavier demand at home and a consequent stiffening of competition from the domestic market on the other.

Vigorous export growth, such as that of the last four years, means an increase in the proportion of industrial output marketed abroad. If the share of exported output is to go on rising – a prerequisite of rapid export expansion – it may well be necessary not only to maintain relative export profitability at the level achieved, but to increase it further.

Service exports gained $270 million in 1971 as a result of three factors: (1) a $100 million increase in proceeds from tourism and passenger transport; (2) a notable growth in shipping revenues, largely made possible by the heavy investment of recent years (in certain respects capital spending here is more akin to foreign than to domestic investment); and (3) a $60 million rise in interest receipts.[5]

The much greater volume of commodity imports in 1971 was accounted for by two

4. In direct inputs for export production the increase was 20 percent.

5. This is a somewhat surprising development. Most of the increase represented income earned by banks on assets held abroad; although the banks' foreign liabilities (and the rest of the country's foreign debt) increased by more than the banks' foreign assets, interest paid went up less than interest received.

items that are only weakly connected with internal economic developments. The first is rough diamonds, the larger import of which was connected with the expansion of overseas sales and inventory fluctuations; the second is ships and aircraft, whose heavy import in 1971 reflected the enlargement of the merchant marine, mainly in connection with the Eilat-Ashkelon oil pipeline. Excluding these two items, imports were up 8 percent. Intermediates went up by 8 percent, which is what might have been expected on the basis of constant import coefficients for the various branches of the economy. This seems to suggest that the raising of import prices had not yet reduced the economy's resort to imports by year's end.

Imports of capital goods were up 11 percent from 1970; as with total expenditure on equipment, the curve turned downward in the third quarter of 1971, followed by a rise at the end of the year. This may be a sign that domestic investment began to pick up in response to the measures taken to stimulate it (primarily the expansion of cheap directed credit). There may also have been some speculative advancing of purchases because of the possible effects of the currency revaluations expected to be implemented by a number of countries in the latter part of 1971.

The steep 1970 uptrend in long-term capital imports carried over through 1971, although there was a marked change in the sources of growth. The ratio of capital imports to the current deficit also changed, as did their monetary impact.

In 1970 most of the capital import growth was due to the public sector's need to finance its much larger deficit resulting from heavier defense spending abroad. In 1971 both the public sector's capital imports and its defense imports declined. On the other hand, capital imports of the private sector jumped from \$540 million to \$940 million; growth began to pick up at the end of 1970 and it continued accelerating throughout 1971. The three main component items are personal transfers (a rise of \$125 million), investment (up \$70 million), and loans from abroad (up \$165 million). A combination of several factors was at work here. The boom in the real estate market was one reason for the increase in investment and personal transfers. Another, less dramatic, reason was the easing of the security situation since the end of hostilities on the Suez front. An important contributory factor was the relaxing of foreign exchange controls and the guaranteeing of the convertibility and repatriation of capital. Loans increased partly because of the much larger import of ships and aircraft (which involves larger supplier credits) and partly because of a striking change in interest rate differentials between Israel and the world capital market. The dominant factor, however, was the revision of control policy, i.e. the larger number of permits to borrow from abroad granted to the private sector during the year. Behind the new policy lay the intensified effort to mobilize foreign funds in the face of the 1969-70 drain on foreign exchange reserves, which was expected to continue in 1971. The devaluation further stimulated a process that was already in full swing – it increased the IL value of capital imports and reduced the risk involved in transferring capital by making another devaluation a more remote matter. One of its secondary effects was to increase conversions out of funds that are normally partly converted and partly held in Pazak and Tamam foreign currency accounts.

Several aspects must be borne in mind in discussing the effect of devaluation. The

Table

CURRENT ACCOUNT,

	Imports					Exports	
				Total			
	Goods	Defense imports	Services	Incl. defense imports	Excl. defense imports	Goods	Services
A. $ million							
At current prices							
1965	794	110	365	1,269	1,159	404	345
1966	795	116	406	1,317	1,201	475	397
1967	729	283	444	1,456	1,173	518	412
1968	1,057	249	506	1,812	1,563	598	534
1969	1,259	334	595	2,188	1,854	679	587
1970	1,374	624	659	2,657	2,032	723	651
1971	1,727	525	767	3,018	2,493	900	923
At 1968 prices							
1965	794	111	384	1,289	1,178	416	371
1966	779	115	418	1,311	1,196	461	414
1967	715	280	462	1,457	1,177	508	420
1968	1,057	249	506	1,812	1,563	598	534
1969	1,199	318	578	2,095	1,777	647	564
1970	1,284	567	610	2,461	1,894	702	597
1971	1,584	461	679	2,724	2,263	849	817
B. Percent annual change							
Prices							
1966	2	2	2	2	−2	6	3
1967	–	–	−1	−1	−1	−1	2
1968	−2	−1	4	–	–	−2	2
1969	5	5	3	4	4	5	4
1970	2	5	5	3	3	−2	5
1971	2	4	5	3	3	3	4
Quantity							
1966	–	4	9	2	2	11	12
1967	−8	144	10	11	−2	10	1
1968	48	11	10	24	33	18	27
1969	13	28	15	16	14	8	6
1970	7	78	6	17	7	8	6
1971	23	−19	11	11	19	21	37
Value							
1966	–	6	11	4	4	18	15
1967	−8	144	9	11	−2	9	4
1968	45	−12	14	24	33	15	30
1969	19	34	18	21	19	14	10
1970	9	87	11	21	10	6	11
1971	26	−16	16	14	23	24	42

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

SOURCE; Central Bureau of Statistics.

III–1

1965–71[a]

	Deficit					Current account with administered areas	Overall current account
				Total			
Total	Trade balance	Defense imports	Services	Incl. defense imports	Excl. defense imports		
749	–390	–110	–20	–520	–410		
873	–321	–116	–9	–445	–328		
930	–211	–283	–32	–527	–243	–4	–532
1,132	–459	–249	28	–680	–431	32	–648
1,265	–580	–334	–8	–922	–589	54	–869
1,374	–650	–624	–8	–1,282	–658	49	–1,234
1,823	–827	–525	156	–1,196	–671	24	–1,171
787	–378	–111	–13	–502	–391		
875	–318	–115	–4	–437	–322		
928	–207	–280	–42	–529	–249		
1,132	–459	–249	28	–680	–431		
1,211	–552	–318	–12	–884	–566		
1,299	–582	–567	–13	–1,162	–595		
1,666	–735	–461	138	–1,058	–597		
5							
–							
–							
4							
1							
3							
11	–16	4		–13	–18		
6	–35	143		21	–23		
22	122	–11		29	73		
7	20	28		30	31		
7	5	78		31	5		
28	26	–19		–9	–		
17	–18	5		–14	–20		
7	–34	144		18	–26		
22	118	–12		29	77		
12	26	34		36	37		
9	12	87		39	12		
33	27	–16		–7	2		

relative-price effect was a large rise in import prices and a smaller one for exports, the combined effect of which was a still smaller increase in the exchange rate per value-added dollar.[6] The latter increase was also small[7] relative to the expected rise in costs, given the intensification of demand pressure. The devaluation itself also helped to augment costs, both by making direct and indirect imports dearer and by sparking a general increase in the price level.

There are several aspects to the raising of import prices. The effective exchange rate for inputs imported directly for export production went up 20 percent, from IL 4.20 to IL 5.04 per dollar. This means that the exchange rate was equalized for imports and exports; it also means that the production of import substitutes became more profitable for local industry. The effective exchange rate for total imports rose from IL 4.74 to IL 5.58 per dollar (18 percent).[8]

Import substitution is a complex matter. In many cases substitution took place at well beyond the official exchange rates, under conditions of strong (tariff and administrative) protection; this is the source of the considerable dispersion of effective import exchange rates and of protection rates. The existence of some import substitution at well above the official exchange rates implies that the potential for its continuation within the same range of exchange rates has been reduced, and therefore the economy's import demand elasticity within this range is low, unless devaluation is accompanied by the upping of rates for imports already enjoying higher protection. Under these conditions most of the contribution to the narrowing of the current deficit must come from the export side, and hence the stress should be put on raising the export exchange rate.

The matter can be looked at from a slightly different angle. The average effective exchange rate for imports (computed in the usual way, according to the actual composition of imports) reflects the high weight of noncompeting imports, on which the tariff is *ipso facto* generally low.[9] If we were to weight the exchange rates according to the composition of domestic output – and this is the relevant aspect of the matter – we would obtain a much higher average rate. The generally cheaper noncompeting imports became dearer because of endogenous factors. This development may be regarded as the lagged adjustment of import to export rates;[10] as regards import substitutes, there was a large increase in the already high exchange rate, compared with the small increase in the much lower exchange rate for exports. Such a change produces a greater distortion in

6. The August 1970 import surcharge, levied as part of the same policy and within a relatively short time of the devaluation, can also be included here; the general picture remains the same.
7. This is true also if we look at the post-August 1970 period as a whole.
8. See Valery Dan Amiel, "Effective Rates of Exchange in Israel's Foreign Trade, 1962-70", Bank of Israel, *Economic Review*, No.39 (September 1972).
9. Competing imports carry a high tariff and are therefore underrepresented (or nonexistent where the tariff is prohibitive).
10. This is true of the period since 1967 (when the present phase of export encouragement began), taking into account the increase in the exchange rate for exports and in export incentives, as well as the imposition of an import surcharge. The other import duties are often considered to be fiscal duties, and, given the composition of imports, this is in fact the dominant element from the quantitative aspect.

resource allocation. In order to prevent this, devaluation must be accompanied by a corresponding cut in the tax element of the effective exchange rate for competing imports, and the degree of protection for local products already enjoying a high rate must not be raised. This would, of course, also help to ease the pressure of domestic demand, from which exports are the principal sufferer.

Another aspect of devaluation is its effect on private sector incomes. In its balance of payments current account plus unilateral transfers the private sector has a surplus in dollar terms. A calculation in IL values yields, of course, a different result because of the application of disparate exchange rates to the debit and credit sides. Since the effective exchange rate was initially higher for imports than for exports, and since the increase in the rate was also higher for imports,[11] the devaluation had a contractionary effect on private sector incomes.

Account must also be taken of the appreciation of the private sector's foreign currency assets due to the devaluation. It is impossible to say which of these two influences has had a greater impact on the sector's demand. Since the devaluation was comparatively small, it seems that capital gains were not realized to any great extent; this reflects the assessment of the owners of such assets that over a range of several years the yield will still be high.

Lastly, devaluation stimulated the inflow of foreign transfers and to some extent also the proportion converted, increasing their contribution to monetary expansion even if the direct effect on current demand was more limited.

Although 1971 saw dramatic balance of payments developments, there were apparently no striking changes in the basic situation. The swelling of foreign exchange reserves after several years of contraction is not evidence of a radical change. Export growth was exceptionally strong,[12] and the current deficit was trimmed by some $90 million. The heavy investment in ships and aircraft (a nonrecurrent item) offset the decline in defense imports. Excluding both of these items, there was a decline of about 10 percent (a little over $100 million) in the current deficit, thanks to the exceptional export gain. However, it should be borne in mind that 1971 was also a year of vigorous economic activity and rapid product growth.[13]

There was also no essential change in the financing of the deficit. To be sure, unilateral transfers grew enormously, and their weight (in relation to the current-account deficit) reverted to the pre-1967 level, i.e. to what it was before the marked deterioration in the balance of payments;[14] but this increase was in large measure due to transitory factors.[15] The same holds for the expansion of investment. Even if there is no large-scale

11. The reference is to the imposition of an import surcharge in August 1970, the increase in export incentives in January 1971, and the devaluation of August 1971.
12. This was partly a random change (i.e. it departed considerably from any foreseeable long-range trend) and partly an initial spurt (e.g. in tourism) which cannot be sustained.
13. There have been boom years in the past when the nonincrease of the deficit might be considered an achievement; however, because of the recent change, the orders of magnitude involved are now such that the deficit is a much more serious matter.
14. In absolute terms, however, the portion of the deficit not covered by unilateral transfers doubled.
15. Personal restitution payments from Germany are also expected to decline in the next few years.

Table III–2

CURRENT DEFICIT, TRANSFERS, AND THE CAPITAL ACCOUNT (SUMMARY),[a] 1965–71

(IL million)

	1965	1966	1967	1968	1969	1970	1971	Total 1963-66	Total 1967-70
1. Current account and long-term capital movements									
Balance on current account excl. administered areas	–520	–445	–527	–680	–922	–1,282	–1,196	–1,986	–3,404
Balance on current account with administered areas			–4	32	54	49	24		123
Unilateral transfers	327	292	521	435	459	649	798	1,300	2,064
Investments from abroad	92	83	24	27	46	53	121	494	151
Long-term loans	156	113	295	178	168	559	641	474	1,200
Surplus of transfers and long-term capital over current account deficit, excl. administered areas	54	42	310	–8	–196	28	389	282	134
2. Change in foreign exchange reserves due to economic transactions	–106	19	–230	52	218	–105	–362	–224	–65
3. Nonresidents' deposits and loans by foreign to Israeli banks	17	10	5	35	115	121	219	40	276
4. Israeli investments abroad	–17	–11	–17	–18	–18	–23	–20	–70	–76
5. Other short-term capital	33	–32	–53	–20	–55	29	–82	–51	–99
6. Errors and omissions	19	–27	–15	–42	–64	–49	–144	23	–170

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

[a] See Table III–20 for further details.

Table III–3

TRADE ACCOUNT, QUARTERLY DATA, 1969–71

($ million)

		Imports[a]		Exports[a]		Trade deficit		Ships and aircraft	
		Un-adjusted	Seasonally adjusted	Un-adjusted	Seasonally adjusted	Un-adjusted	Seasonally adjusted	Ex-ports	Im-ports
1969	I	275.1	279.6	197.2	155.0	77.9	124.6	0.1	14.0
	II	330.2	335.4	166.5	168.0	163.7	167.4	1.5	8.2
	III	296.2	308.8	137.7	177.4	158.5	131.4	1.0	–
	IV	368.9	345.7	175.9	187.0	193.0	158.7	3.2	9.8
	Total	**1,270.4**	**1,269.5**	**677.3**	**687.4**	**593.1**	**582.1**	**5.8**	**32.0**
1970	I	343.5	532.5	204.6	165.6	138.9	186.9	–	35.3
	II	360.8	353.0	173.8	177.0	187.0	176.3	–	–
	III	311.7	328.7	157.7	193.6	154.0	135.1	1.4	10.1
	IV	348.1	328.6	192.6	199.7	155.5	128.9	0.6	13.1
	Total	**1,364.1**	**1,362.8**	**728.7**	**735.9**	**635.4**	**627.2**	**2.0**	**58.5**
1971	I	367.8	376.6	242.7	197.2	125.1	179.4	–	106.6
	II	401.7	385.3	222.8	222.1	178.9	163.2	–	23.3
	III	368.6	401.0	182.3	232.8	186.3	168.2	–	19.3
	IV	439.5	410.5	260.4	267.6	179.1	142.9	4.5	37.3
	Total	**1,577.6**	**1,573.4**	**908.2**	**919.7**	**669.4**	**653.7**	**4.5**	**186.5**

[a] Excluding ships and aircraft.

outflow of funds because of a change in conditions, the current level will certainly go down. There remains that part of the deficit that must be financed by loans, with a concomitant increase in the national debt out of all proportion to the pre-1967 situation: $400-500 million of loans will be needed per annum to cover the deficit, compared with an average of $50 million p.a. in 1963-66.

2. COMMODITY IMPORTS

In 1971 commodity imports grew by 26 percent at current prices, compared with 9 percent the year before. Import prices moved up 2 percent, so that the real increase was 23 percent (7 percent in 1970). The faster growth rate is explained by two items only remotely connected with internal developments: ships and aircraft and rough diamonds, which together went up by $200 million (out of a total increase of $334 million). Exclusion of these two from the calculation reduces the growth rate to 8 percent, about the same as in 1970.

The $70 million increase in diamond imports, which far exceeded the export gain posted by this commodity, was partly due to the fact that the speculative stocks built up at the end of 1969 were being run down in 1970, so that current imports were low in that year. Another reason was the resumption of speculative stockpiling at the end of 1971 in anticipation of a revaluation of the pound sterling.

Imports of ships and aircraft added up to $186 million, much higher than any previous figure. The heavy investment in ships was partly connected with the opening of the Eilat-Ashkelon oil pipeline. This item, which has expanded considerably in recent years, is in some respects closer to a foreign than a domestic investment, since it hardly employs other domestic factors of production and its few input-output links with the rest of the economy are very tenuous.

The other commodity import groups rose at rates fairly similar to those in 1970, even though imports became dearer. The effective exchange rate went up 35 percent within one year: the August 1970 import surcharge added 14 percent to the annual average rate for commodity imports (other than rough diamonds), and the August 1971 devaluation raised it by a further 18 percent. According to the data presently available, there is no sign that the price increase has had any dampening effect on imports. However, it is still too early for the devaluation to make its impact felt to any significant degree.

The volume of imported intermediates other than unpolished diamonds rose 8 percent in 1971, compared with 10.5 percent the year before. The actual imports were consistent with the figures yielded by constant import coefficients (see Table III-5). In earlier years there were small differences between actual and expected imports,[16] and in 1970 actual imports were greater than expected, with the deviation being larger than in the preceding years.

The central cause of these differences appears to be connected with speculative inventory fluctuations. In the second half of 1968 stocks piled up in the wake of disturbances in the European money markets, accompanied by expectations of the revaluation of the German mark and the devaluation of other currencies, which in turn might have led to the devaluation of the IL. When expectations changed, stocks were run down in the final part of 1968 and the early months of 1969 (see Figures III-1 and III-2).[17] Toward the end of 1969 stocks were built up again, this time because the raising of import prices was expected to follow the November 1969 elections, in view of the country's deteriorating balance of payments situation. The buildup continued into early 1970, owing to the shelving of economic policy decisions until conclusion of the "package deal".[18] Stocks were once again drawn down in the second half of 1970, as expectations changed and the tighter money situation made it more difficult to maintain them.

Comparisons of actual with expected imports calculated according to constant input coefficients are made on an annual basis and thus cannot be used to examine within-year fluctuations. However, it appears that since 1970 was on balance a year of stock buildup, 1971 began with a high level of stocks. The fact that actual and computed imports were more or less equal signifies that no substantial degree of import substitution has as yet been produced by the increase in import prices.

The most striking feature of the demand for imported intermediates in 1971 was the

16. The disparity between the two is generally due to the difference in the computational base. For example, if actual imports in a given year exceed expected imports by 1 percent, then if they are equal in the next year, actual imports will increase less than expected imports.
17. The deseasonalized figures rather than the trend are relevant here.
18. See Bank of Israel, *Annual Report 1970*, pp. 43-44.

Table III–4

REQUIRED AND ACTUAL IMPORTS OF CURRENT COMMODITY INPUTS (EXCL. DIAMONDS), 1968–71

	Exports	Domestic destinations: Total	Domestic destinations: Investment	Domestic destinations: Consumption		Total required imports	Total actual imports	Difference
				Private	Public			
1. At current prices ($ million)								
1968	133	455	86	284	85	588	593	2
1969	155	548	120	325	103	703	692	–11
1970	176	592	138	341	113	768	787	19
1971	215	651	149	367	135	866	865	–1
2. At 1968 prices ($ million)								
1968	133	455	86	284	85	588	593	5
1969	149	523	112	313	98	672	665	–7
1970	165	548	123	321	104	713	735	22
1971	197	598	137	337	124	795	794	–1
3. Percent annual quantitative change								
1969	12.0	14.9	30.2	10.2	15.3	14.3	12.1	
1970	10.7	4.8	9.8	2.6	6.1	6.1	10.5	
1971	19.4	9.1	11.4	5.0	19.2	11.5	8.0	
4. Quantity index: 1968 = 100								
1968	100.0	100.0	100.0	100.0	100.0	100.0	100.0	
1969	112.0	114.9	130.2	110.2	115.3	114.3	112.1	
1970	124.1	120.4	143.0	113.4	122.4	121.3	123.9	
1971	148.1	131.4	159.3	118.7	145.9	135.2	132.4	
5. Percent of total imports								
1968	22.6	77.4	14.6	48.3	14.5	100.0		
1969	22.2	77.8	16.7	46.6	14.6	100.0		
1970	23.1	76.9	17.2	45.1	14.6	100.0		
1971	24.8	75.2	17.2	42.4	15.6	100.0		
6. Percent of incremental imports								
1969	19.1	80.9	30.9	34.5	15.5	100.0		
1970	39.0	61.0	26.8	19.6	14.6	100.0		
1971	39.1	60.9	17.0	19.5	24.4	100.0		

Table III–5

COMMODITY IMPORTS,[a] BY ECONOMIC DESTINATION, 1968–71

($ million)

	1968	1969	1970	1971	Percent annual increase or decrease (–)											
					Quantity				Price				Value			
					1968	1969	1970	1971	1968	1969	1970	1971	1968	1969	1970	1971
Consumer goods																
Food	37.7	43.6	48.8	44.9	19	13	8	–12	–5	3	4	5	13	16	12	–8
Other nondurables	35.1	36.2	40.7	55.9	49	–	10	29	–4	3	2	6	43	3	12	37
Durables	38.5	61.6	50.0	58.7	110	55	22	12	–1	3	4	4	108	60	–19	17
Total	**111.3**	**141.4**	**139.5**	**159.5**	**51**	**23**	**–4**	**9**	**–3**	**3**	**3**	**5**	**46**	**27**	**–1**	**14**
Intermediate inputs																
To agriculture	51.0	50.5	66.7	77.3	4	1	27	9	–6	–2	4	6	–2	–1	32	16
To industry (excl. diamonds)	407.4	475.8	538.4	575.8	48	11	10	8	–3	5	3	–1	44	17	13	7
To construction	15.5	18.9	21.5	34.1	107	16	11	61	–3	5	3	–1	101	22	14	59
Spare parts, tools, etc. for current use	55.9	77.0	89.9	87.4	75	33	8	–2	–3	4	8	–1	70	38	17	–3
Fuel	62.8	69.9	70.1	90.3	15	9	–	5	–2	–2	–	23	13	11	–	29
Subtotal	**592.6**	**692.1**	**786.6**	**864.9**	**42**	**13**	**11**	**8**	**–3**	**4**	**3**	**2**	**38**	**17**	**14**	**10**
Rough diamonds (net)	162.0	192.8	154.4	224.2	27	11	–12	46	2	8	–9	–1	29	19	–20	45
Total	**754.6**	**884.9**	**941.0**	**1,089.0**	**38**	**11**	**6**	**15**	**–2**	**5**	**–**	**1**	**36**	**17**	**6**	**16**
Capital goods																
For agriculture	6.4	8.2	6.8	9.4	34	22	–21	33	–1	5	5	4	33	28	–17	38
For industry and construction	109.4	160.7	186.1	206.4	125	40	10	7	–1	5	5	4	123	47	16	11
For inland transport	31.7	44.8	57.6	76.0	37	34	23	27	–1	5	5	4	36	41	29	32
Other	25.6	38.7	41.4	42.9	34	44	2	–	–1	5	5	4	33	51	7	4
Subtotal	**173.1**	**252.4**	**291.9**	**334.7**	**82**	**39**	**10**	**11**	**–1**	**5**	**5**	**4**	**80**	**46**	**16**	**15**
Ships and aircraft	57.6	34.3	58.4	186.0												
Total gross imports	**1,096.6**	**1,313.0**	**1,430.8**	**1,769.6**	**47**	**14**	**7**	**22**	**–2**	**5**	**2**	**2**	**44**	**20**	**9**	**24**

Imports returned (excl. diamonds)	9.1	10.5	8.1	5.6
Total net imports	**1,087.5**	**1,302.5**	**1,422.7**	**1,764.0**
Less: Balance of payments adjustments	28.1	42.8	49.2	37.3
Total net imports (according to the balance of payments)	**1,059.4**	**1,258.7**	**1,373.5**	**1,726.7**
Commodity imports from administered areas	13.5	13.3	18.5	24.9
Total net imports, incl. administered areas (according to the balance of payments)	**1,072.9**	**1,272.0**	**1,392.0**	**1,751.6**

[a] Imports c.i.f.

SOURCE: Central Bureau of Statistics.

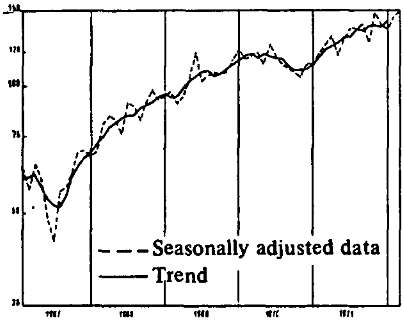
Table III–6

COMMODITY IMPORTS, BY FINAL DESTINATION, 1968–71

($ million)

	1968	1969	1970	1971	Percent of total imports, excl. diamonds				Percent of increment, excl. diamonds			Percent annual quantitative increase		
					1968	1969	1970	1971	1969	1970	1971	1969	1970	1971
Private consumption	395	450	453	483	42.5	41.3	38.5	34.2	34.4	3.4	12.9	13.9	0.7	6.6
Investment, excl. ships and aircraft	259	360	403	443	27.9	33.0	34.2	31.4	63.1	48.8	17.2	38.9	11.9	9.9
Ships and aircraft	58	33	53	164	6.2	3.0	4.5	11.6	–15.6	22.7	47.6	–43.1	60.6	209.4
Total private domestic uses	712	843	909	1,090	76.6	77.3	77.2	77.2	81.9	75.0	77.7	18.4	7.8	19.9
Public consumption	85	98	104	124	9.1	9.0	8.8	8.8	8.1	6.8	8.6	15.3	6.1	19.2
Total domestic uses	797	941	1,013	1,214	85.7	86.3	86.0	86.0	90.0	81.8	86.3	18.1	7.7	19.8
Exports, excl. diamonds	133	149	165	197	14.3	13.7	14.0	14.0	10.0	18.2	13.7	12.0	10.7	19.4
Total uses, excl. diamond exports	930	1,090	1,178	1,411	100.0	100.0	100.0	100.0	100.0	100.0	100.0	17.2	8.1	19.8
Diamonds	162	179	156	231								10.5	–12.8	48.1
Total imports	1,092	1,269	1,334	1,642								16.2	5.1	23.1

Figure III–1
NET IMPORTS, EXCL. SHIPS AND AIRCRAFT, 1967-71
($ million)



SOURCE: Central Bureau of Statistics.

change in the sources of growth. Imports of inputs for domestic final uses rose 9 percent, compared with 19 percent in the case of exports. And whereas the share of domestic uses in total intermediate imports held steady at around 77 percent in the three preceding years, their share in the 1971 increment was only 60 percent. The corresponding figures for exports are 23 and 40 percent (see Table III-5).

There were also marked changes within the final domestic uses. The most conspicuous was the fall in the weight of private consumption, which took only 20 percent of the incremental imported intermediates, with the consequence that its share in total imports of intermediates dropped from 48 percent in 1968 to 42 percent in 1971. Most of the decrease occurred in the last two years, and reflected the sharply lower growth rate of private consumption. The other side of the coin was the increase in investment and exports, which together accounted for two-thirds of the 1971 incremental demand for imported inputs.

This trend stands out all the more if we also take account of the direct imports to each final destination: the weight of private consumption in total merchandise imports other than diamonds declined more steeply, from 42 to 34 percent (see Table III-6), and its share of the 1971 increment came to only 13 percent; on the other hand, investment inclusive of ships and aircraft accounted for 65 percent of the import increment.

Real imports of capital goods other than ships and aircraft went up 11 percent in 1971, or about the same as total investment in machinery, equipment, and motor vehicles (10 percent). The proportion of imported equipment thus remained unchanged. However, this broad comparison does not reveal much about whether the dearer imports led to the substitution of local for imported equipment, and it is necessary to examine the detailed figures in order to arrive at any conclusions.

Imports of consumer durables were up 12 percent, following a marked drop in 1970. The latter was only partly due to the steep price rise of these products (notably passenger cars); another cause was the advancing of purchases of durables in 1969 in anticipation of an increase in import prices. The 1971 figure for consumer durables was close to the average of the two preceding years.

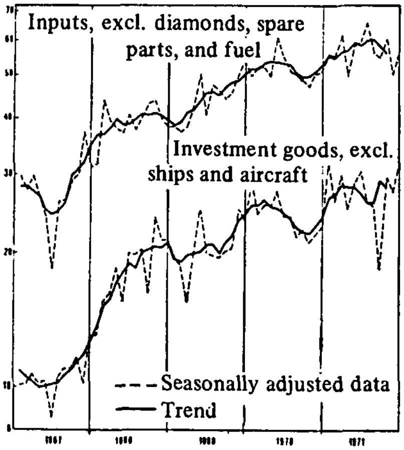
The initial spurt in imports at the beginning of 1971 was followed by a steady, slow increase during the remaining months. This is explained by the fact that speculative stocks were being drawn down in the second half of 1970,[19] so that imports fell below current production requirements. Imports of intermediates moved up at a moderate rate and then levelled off (see Figure III-2). In the last quarter there was a downturn; however,

19. See Bank of Israel, *Annual Report 1970*, p. 43.

a glance at the trend of total imports excluding ships and aircraft (Figure III-1), for which there are later data, suggests that this was a temporary deviation.

Imports of capital goods rose sharply in the last quarter, after declining in the third. This spurt may have reflected the response to the efforts made to stimulate economic activity by providing more cheap credit for investment purposes. It may also have been partly due to the advancing of purchases because of price increases expected (since July and August) to follow the upward revaluation of several currencies in relation to the dollar. Other contributory factors were the precipitate fall in interest rates in the international market and the more liberal policy of the exchange control authorities in grant-

Figure III–2
IMPORTS OF INPUTS AND INVESTMENT GOODS, 1967–71
($ million)



SOURCE: Central Bureau of Statistics.

Table III–7

IMPORTS, BY ECONOMIC DESTINATION, QUARTERLY DATA, 1969–71

		Total[a]		Consumer durables		Intermediates[b]		Capital goods[a]	
		Un-adjusted	Seasonally adjusted	Un-adjusted	Seasonally adjusted	Un-adjusted	Seasonally adjusted	Un-adjusted	Seasonally adjusted
1969	I	275.1	279.6	13.9	14.0	115.6	114.5	73.1	54.0
	II	330.2	335.4	15.8	15.5	131.9	134.3	81.8	65.3
	III	296.2	308.8	12.6	14.5	128.4	138.6	67.4	59.7
	IV	368.9	345.7	18.9	17.2	163.2	150.4	69.8	69.7
	Total	**1,270.4**	**1,269.5**	**61.2**	**61.2**	**539.1**	**537.8**	**292.1**	**248.7**
1970	I	343.5	352.5	13.9	13.7	155.4	154.8	73.1	79.1
	II	360.8	353.0	11.7	11.4	164.1	166.6	81.8	77.4
	III	311.7	328.7	11.8	13.5	142.5	150.3	67.4	68.6
	IV	348.1	328.6	12.4	11.4	159.6	149.8	69.7	66.2
	Total	**1,364.1**	**1,362.8**	**49.8**	**50.0**	**621.6**	**621.5**	**292.0**	**291.3**
1971	I	367.8	376.6	14.3	14.2	174.9	173.6	81.9	88.3
	II	401.7	385.3	13.9	13.3	168.8	168.0	91.1	84.9
	III	368.6	401.0	12.2	14.4	164.6	180.1	67.1	70.2
	IV	439.5	410.5	18.3	16.7	179.2	166.3	94.6	97.1
	Total	**1,577.6**	**1,573.4**	**58.7**	**58.6**	**687.5**	**688.0**	**334.7**	**340.5**

[a] Excluding ships and aircraft.
[b] Excluding diamonds, fuel, and spare parts.
SOURCE: Central Bureau of Statistics.

ing permits to borrow abroad' – foreign trade credit and other long-term loans to the private sector came to $280 million (gross) in 1971, compared with $136 million in 1970.

Imports of intermediates may also have included a speculative element. However, the picture is more complicated here. In the first place, there was a factor working in the opposite direction – the rise in domestic interest rates, which increased the cost of holding stocks.[20] As against this, the expansion of directed, low-interest credit undoubtedly helped to offset such costs. Finally, it was plausible to assume that the devaluation of the Israeli pound and the resulting immediate jump in export prices would subsequently drive up domestic prices, making it worthwhile to hold stocks of local goods.

3. COMMODITY EXPORTS

Exports of locally produced goods advanced by a respectable 24.5 percent (at current prices) in 1971. This far surpassed the preceding year's 6.7 percent gain and that for any other recent year; in fact, it was the fastest rate since the mid-1950s. Export prices went up by 3 percent, so that most of the nominal increase resulted from a 21 percent quantitative growth.

The 1971 spurt cannot be ascribed primarily to internal factors but was concentrated in two export-oriented commodities – citrus (up 31.2 percent) and diamonds (up 31.9 percent). These two items, whose weight in total overseas sales had been declining steadily, accounted for $92 million or half of the 1971 export increment, compared with a decline of $19 million in 1970; in other words, their contribution to the increment rose by $111 million. Their development is almost exclusively a function of demand conditions abroad, with domestic factors playing a very minor part, at least in the short run.

Exports of the broad group of manufactures that are not exclusively export-oriented but go also to the domestic market expanded appreciably in 1971, as in the three preceding years. This strong advance can be credited to the cumulative effect of the sharply rising trend in the relative profitability of exports evident since 1967. The latter development reflects the faster rise in the effective exchange rate compared with costs and domestic prices, which for the greater part of the period occurred under conditions of factor underutilization and subsequently against the backdrop of the measures adopted to restrain domestic demand.

During 1970, however, the relative importance of the various factors underlying this process began to change: the uptrend in export profitability started to sag and toward the end of 1971 it may even have turned downward. This was one of the reasons for the slackening of industrial export growth in the second half of 1971. Two other factors working in the same direction were the more sluggish expansion of world trade because of a slump in several major industrial countries (see Table III-16), and mounting domestic demand pressure and the consequent stiffening of competition from the local market, which in general enjoys a relatively greater profitability.

20. Permits to obtain supplier credit are not as a rule granted for intermediates, apart from imports-for-exports.

Table III–8

NET COMMODITY EXPORTS, 1966–71

($ million, at current prices)

	1966	1967	1968	1969	1970	1971	Percent annual increase or decrease (–)				Percent of total increment.			
							1968	1969	1970	1971	1968	1969	1970	1971
Agricultural exports														
Citrus	74.7	85.3	88.4	91.1	87.2	114.4	3.6	3.1	–4.3	31.2	3.1	3.5	–8.7	15.5
Other	19.7	22.4	23.7	26.7	42.1	40.5	5.8	12.7	57.7	–3.8	1.3	3.9	34.2	–0.9
Total	**94.4**	**107.7**	**112.1**	**117.8**	**129.3**	**154.9**	**4.1**	**5.1**	**9.8**	**19.8**	**4.4**	**7.4**	**25.5**	**14.6**
Industrial exports														
Diamonds (net)	164.7	157.9	194.8	215.5	203.1	267.9	23.4	10.6	–5.7	31.9	36.4	26.8	–27.7	37.0
Minerals and scrap	36.4	30.8	33.7	38.5	41.8	42.9	9.4	14.1	8.6	2.6	2.9	6.2	7.3	0.6
Copper-cement	12.2	10.4	11.6	15.0	14.6	11.3								
Phosphates	4.4	4.6	6.0	7.5	4.9	3.4								
Potash	12.9	13.6	13.5	13.2	21.1	26.7								
Scrap	4.5	2.0	1.3	2.5	2.5	1.0								
Textiles and clothing	45.5	51.9	63.7	80.6	96.4	119.1	22.7	26.5	19.6	23.5	11.6	21.8	34.9	13.0
Citrus products	19.0	25.1	26.4	32.6	35.0	43.6	5.2	23.5	7.4	24.6	1.3	7.9	5.3	4.9
Other chemicals	15.8	16.3	18.0	15.6	14.0	8.7	10.4	–13.3	–10.3	–37.9	1.7	–3.1	–3.6	–3.0
Other metal products	10.8	8.0	26.4	24.1	18.2	31.0	230.0	–8.8	–24.5	70.3	18.1	–3.0	–13.1	7.3
Aircraft and parts	1.8	5.8	8.6	7.0	5.9	6.8	48.2	–18.6	15.3	–15.3	2.8	–2.1	–2.4	0.5
Edible oils and oil-cake	7.1	2.3	5.5	7.5	9.3	13.5	139.1	36.4	24.0	45.2	3.4	2.6	4.0	2.4
Other industrial products	71.4	86.4	104.0	131.3	162.8	202.7	20.4	26.3	24.0	24.5	17.4	35.5	70.0	22.8

Total industrial exports	372.6	384.5	481.4	553.0	586.5	736.2	25.2	14.9	6.1	25.5	95.6	92.6	74.5	85.4
Total industrial exports, excl. diamonds and minerals	171.5	198.5	252.9	299.0	341.6	425.4	27.4	18.2	14.2	24.5				
Total exports from domestic output	467.0	492.2	593.5	670.8	715.8	891.1	20.6	13.0	6.7	24.5	100.0	100.0	100.0	100.0
Sale of old ships and aircraft	5.1	18.8	3.4	5.9	2.0	4.5								
Equipment shipped by Israeli firms operating abroad	0.3	1.0	0.1											
Works of art, collections, antiques, personal effects, etc.	4.6	5.4	5.6	4.9	7.8	8.0								
Fuel and stores supplied to foreign ships and aircraft				7.4	8.1	11.1								
Total commodity exports (foreign trade definition)	477.0	517.4	602.6	689.0	733.7	914.7	16.5	14.3	6.5	24.7				
Adjustments and returned exports	−2.4	0.4	−4.7	−10.2	−10.3	−14.8								
Total commodity exports (balance of payments definition)	474.6	518.1	597.9	678.8	723.4	899.9	15.4	13.7	6.4	24.4				
Exports to administered areas		15.0	51.1	67.4	78.5	77.0								
Total net commodity exports (balance of payments)	474.6	533.1	649.0	746.2	801.9	976.9								

(a) *Export-oriented and other special products*

In 1971 commodities produced almost exclusively for the overseas market (citrus, diamonds, mine and quarry products, and citrus products) accounted for much of the export increment. In most of these items Israel commands a fairly large share of the markets taking its goods and therefore they are subject to demand and supply limitations which other products are largely free of. The absence of a domestic market and of the possibility of substitution between the domestic and export markets results in a low short-run elasticity of supply. What is more, Israel's large share of the market for these commodities results in a relatively low elasticity of demand. Another characteristic of these products is the sharp ups and downs in foreign demand and in competing sources of supply. In these circumstances export developments are decisively influenced by the foreign demand situation, while fluctuations in the profitability of exports because of changes in the effective exchange rate and domestic production costs play no more than a secondary role in the short run.

Table III–9

GROWTH OF COMMODITY EXPORTS, BY MAJOR GROUP, 1967–71

($ million, at current prices)

	Total commodity exports		Percent increase 1967-71	Percent of 1967 exports	Percent of 1967-71 increment
	1967	1971			
Citrus	85.3	114.4	34.1	17.3	7.3
Other agricultural exports	22.4	40.5	80.8	4.6	4.5
Minerals	30.8	42.9	39.3	6.3	3.0
Diamonds	157.9	267.9	69.7	32.1	27.6
Textiles and clothing	51.9	119.1	129.4	10.5	16.8
"Special" items[a]	57.5	103.6	80.2	11.7	11.6
Other industrial products[a]	86.4	202.7	134.6	17.6	29.2
Total	**492.2**	**891.1**	**81.0**	**100.0**	**100.0**

[a] See Table III-8: "special items" are all those listed in Table III-8 that are not detailed here.
SOURCE: Central Bureau of Statistics.

Citrus exports rose strongly in 1971, in both physical and price terms, after slipping in the previous year. Israel commands a formidable share of its overseas outlets for this item, and therefore its demand elasticity is low in comparison with other products. However, the principal cause of the price changes of the last two years was the sharp fluctuations in competing supplies (from Spain and North Africa).

The price and quantity figures do not always reveal the expected interrelationship of these two factors. It should be remembered that for citrus it is not only the annual supply

DEVELOPMENT OF CITRUS EXPORTS, 1966-71

	1966	1967	1968	1969	1970	1971
$ million	74.7	85.3	88.4	91.1	83.0	115.0
Percent annual change						
Value	4.9	14.2	3.6	3.1	−8.9	38.6
Price	3	−5	−6	6	−6	−7
Quantity	1.8	20.2	10.2	−2.7	−3.1	29.6

that is relevant but also its distribution over the year, and that both supply and prices fluctuate widely during any one season.

As already noted, citrus has an alternative outlet in the form of sales to industry, the final output also being destined primarily for export. However, in contrast to other commodities, this is an inferior alternative, utilized in order to influence the prices of direct exports. In recent years the ratio of processed to fresh citrus exports has risen steadily; this can apparently be attributed to the steady softening of fresh citrus prices during this period. Even after climbing precipitately in 1971, they were still below the 1965 and 1966 level, despite the general rising trend of world commodity prices.

The impressive 1971 growth in diamonds, the country's second principal export commodity, was also due to stronger foreign demand, mainly in the principal market – the United States. Demand there began to ebb in 1969 and continued downward through 1970, a development that led to excess supply in the other markets. This weakening of demand, which dampened prices,[21] is explained by the high sensitivity of this commodity to changes in the economic climate. Polished stones are a distinct luxury good, and the stock market losses and declining income level of Americans in the high-income brackets during the recession caused sales to slump badly. With the picking up of economic activity in the U.S. there was an upsurge of demand, and Israel's exports advanced notably in 1971 in both price and quantity terms.

Diamonds are an extreme example of an export-oriented commodity; in fact, nearly all of the production is marketed abroad and there is no possibility of substitution between the domestic and overseas markets. The principal purchased input (uncut stones) is imported, and the sole connection between this industry and general economic developments is the need to compete with other branches for labor. However, in contrast to other export branches, the weight of fixed capital is negligible and a rise in labor costs can adversely affect exports even in the short run.

Israel has a dominant position – in fact almost a monopoly – in the world market for those types of stone in which it specializes, with the consequence that the demand for them is not very elastic. Any attempt to respond to a fall in foreign demand[22] by raising the effective exchange rate (as was done in 1970) may depress the foreign price and hence the country's foreign currency receipts. Moreover, the supply of uncut stones is con-

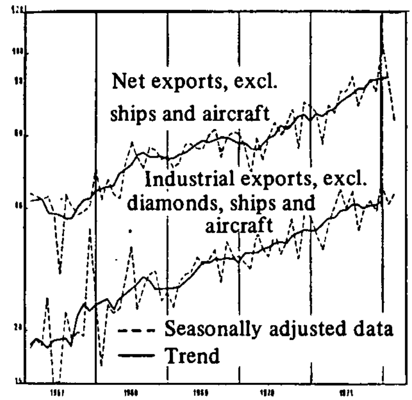
21. The price indexes for diamond imports and exports are very deficient.

22. Or to stimulate exports when demand is stable.

trolled by a near monopoly (the London Diamond Syndicate), and the slump and price decline in the polished diamond market were not reflected in the prices of uncut stones from this source.[23] A drop in the price of polished stones, with prices of imported rough (which account for 75-80 percent of the output) remaining constant, means a drop several times larger in the value-added component.

The price of other alternatives must be taken into account. Israel's near-monopolistic position is not unconditional, and if it is used to hike prices, this may encourage others to enter the industry. But this consideration applies under normal demand conditions, not when there is a temporary slack accompanied by sharply receding prices. Another problem is the possible effect of a contraction of output on the work force and of the possibility of expanding it again once export trends change.

Figure III–3
NET EXPORTS AND INDUSTRIAL EXPORTS, 1967-71
($ million; monthly data)



SOURCE: Central Bureau of Statistics.

Domestic demand also plays no role in exports of minerals (copper-cement, potash, phosphates). In contrast to diamonds, however, mineral extraction involves a heavy fixed investment, so that even large fluctuations in current costs have little effect on profitability in the short run. In 1970 the dominant factors were the reversal of the sharply rising trend in the world price of copper-cement and an opposite development in the case of potash.

Exports of noncitrus farm products consist of both items that are grown primarily for the overseas markets (winter vegetables, flowers, and some fruits) and surpluses of other products that are disposed of by marketing boards (eggs, bananas) in order to regulate the domestic market. The export of one commodity, cotton, declined because of heavier local demand and the constancy of supply due to the land and water constraints. In previous years production was expanded following an increase in the relative profitability of this crop due to a rise in both foreign prices and the effective exchange rate for exports.

The uptrend in some distinctly export commodities (winter vegetables and flowers) slackened, mainly because crops were affected by bad weather, and partly because of a labor shortage. Certain stages of production are labor-intensive, and the difficulty of obtaining workers at the right time was a brake on expansion. Smaller supplies and the rise of domestic market prices also had some effect, diverting output from exports.

Finally, mention should be made of several commodities that are influenced by

23. However, the price of rough diamonds from secondary sources did decline during the recession. These sources are mainly dealers who are committed to purchase a fixed sight of uncut stones from the Syndicate. The 1970 drop in rough diamond prices reflected both this decline and Israel's growing utilization of these secondary sources of supply.

Table III–10

GROWTH OF INDUSTRIAL EXPORTS AND THEIR SHARE IN OUTPUT, 1968–71

	Exports, f.o.b. ($ million, at current prices)				Percent annual quantitative change				Exports as a percent of output (at 1969 prices)				
	1968	1969	1970	1971	1968	1969	1970	1971	1967	1968	1969	1970	1971
Food	38.1	48.4	55.3	68.1	28.5	25.4	11.8	27.8	8.0	9.0	10.4	11.0	12.9
Textiles and clothing	63.7	80.6	96.3	119.1	23.1	22.9	22.7	16.2	30.6	29.4	31.7	34.4	34.5
Wood	8.1	9.2	9.6	9.6	–2.1	13.0	–1.4	3.1	12.5	9.4	9.8	9.2	9.1
Paper	2.2	2.2	3.1	2.5	20.8	–6.2	45.8	–2.0	4.3	4.3	3.9	5.2	3.7
Printing	3.9	5.0	5.9	11.2	–0.4	22.0	13.6	82.9	8.0	7.0	7.5	8.4	16.0
Leather	1.9	3.5	3.5	4.8	23.9	69.4	5.2	40.0	7.6	7.6	11.9	12.0	16.0
Rubber and plastics	12.7	16.5	23.5	27.4	16.9	26.6	48.4	17.9	18.1	14.7	15.5	20.0	20.0
Chemicals	50.2	55.0	62.2	67.1	31.1	21.4	17.5	19.5	17.1	17.6	19.2	19.4	20.6
Nonmetallic minerals	3.8	3.4	3.0	3.7	–17.3	–14.8	–14.3	23.3	7.4	4.8	3.7	2.8	3.1
Basic metals	5.3	5.2	10.1	8.1	12.8	–9.0	92.5	–19.8	10.1	7.8	5.8	11.3	11.5
Metal products	33.0	33.1	28.5	44.6	158.7	–8.8	–14.4	57.2	10.7	20.2	15.4	12.2	16.1
Machinery	4.6	6.5	7.3	6.4	7.8	33.3	4.8	–17.3	6.5	4.9	5.3	4.7	3.7
Electrical and electronic equipment	6.0	11.3	16.0	28.1	77.2	18.2	41.5	65.6	5.7	5.9	7.1	9.3	14.0
Motor vehicles	11.7	11.2	9.8	18.4	42.7	–9.2	–10.0	42.9	12.9	13.1	9.3	6.5	7.9
Miscellaneous	8.6	9.6	12.1	15.2	49.3	16.4	17.6	27.0	32.2	35.8	33.1	36.0	34.6
Total, excl. diamonds and minerals	253.2	300.7	346.2	434.3	28.4	17.1	15.6	24.7	14.1	14.5	14.8	15.6	17.3

Table III–11

QUARTERLY EXPORT DATA, 1969–72

	Net exports excl. ships and aircraft		Industrial exports excl. diamonds, ships, and aircraft		Industrial exports excl. products sold mainly abroad and special items[a]	
	Un-adjusted	Seasonally adjusted	Un-adjusted	Seasonally adjusted	Un-adjusted	Seasonally adjusted
1969 I	197.2	155.0	73.4	77.4	60.3	64.5
II	166.5	168.0	89.2	87.8	70.1	67.8
III	137.7	177.4	86.2	88.7	64.7	64.1
IV	175.9	187.0	103.3	95.0	80.1	76.5
Total	**677.3**	**687.4**	**352.1**	**348.9**	**275.2**	**272.9**
1970 I	204.6	165.6	87.8	92.9	70.9	76.1
II	173.8	177.0	100.5	98.9	83.0	79.7
III	157.7	193.6	100.3	101.6	81.3	83.0
IV	192.6	199.7	116.7	108.3	92.5	86.5
Total	**728.7**	**735.9**	**405.3**	**401.7**	**327.7**	**325.3**
1971 I	242.7	197.2	100.5	103.6	82.4	89.7
II	222.8	222.1	124.9	124.5	103.4	98.2
III	182.3	232.8	118.4	119.7	94.8	96.8
IV	260.4	267.6	137.5	125.9	113.7	105.0
Total	**908.2**	**919.7**	**481.3**	**473.7**	**394.3**	**389.7**
1972 I	282.4	230.5	117.4	126.5	87.1	95.4

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

special demand or supply conditions (such as the products of the military and aircraft industries). These made good headway in 1971, after losing ground in previous years, a development that partly explains the difference between the 1970 and 1971 export growth rates.

(b) *Other industrial exports*

In 1971 exports of the broad group of products manufactured predominantly for the local market expanded considerably. Total industrial exports other than diamonds and mine and quarry products went up 24.5 percent (at current prices), compared with 14-27 percent in the three preceding years (see Table III-8). This category includes products whose development is largely determined by special factors.

Table III–12

CHANGES IN THE EFFECTIVE EXCHANGE RATE FOR EXPORTS, 1966–71[a]

Value-added group	1966		1967		1970		1971	
	April	Nov.	March	Nov.[b]	Feb.	Aug.	Jan.	Aug.[c]
A. IL/$ above beginning-of-period official rate[d]								
1. (up to 25 percent)	1.0	1.8		50	60	120	122	204
2. (26-45 percent)	3.5	10.5		60	70	130	133 140	205
3. (46-65 percent)	7.5	18.0	(34.5[e])	70	85	140	145 150	206 702
4. (66 percent +)	10.5	25.5	(45.0[e])	85	105	155	162	208
B. Percent above beginning-of-period official rate[d]								
1.	0.3	0.6		16.7	17.1	40.0	40.7	68.0
2.	1.2	3.5		20.0	23.2	43.3	44.3 46.7	68.3
3.	2.5	6.0	(11.0[d])	23.3	28.3	46.7	48.3 50.0	68.7 69.0
4.	3.5	8.5	(15.0[d])	28.3	35.0	51.7	54.0	69.3
C. Exchange rate for import component (percent above beginning-of-period official rate[d])				16.7			40.0[f]	68.0

[a] The computation includes only changes in the official rate and direct incentive payments. Of the other incentives (whose relative importance has been declining), most were concentrated in textiles and agricultural products, while the remainder were only weakly connected with current exports and were unevenly distributed.

[b] IL 0.5 (16.7 percentage points) was due to the devaluation.

[c] IL 0.7 (23.3 percentage points) was due to the devaluation.

[d] IL 3/$1.

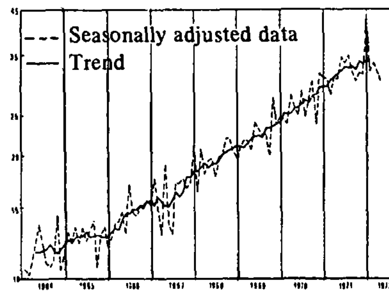
[e] In March 1967 certain products in groups 3 and 4 began to get preferential treatment, the incentives on them gradually increasing beyond the level for the rest of the products in these groups. These additional incentives were abolished in November 1967.

[f] There are three reservations concerning this datum: (1) The August 1970 import surcharge did not apply to services; however, their weight in imports of inputs to industry is negligible (only 1.7 percent of total imported intermediates in 1970). (2) Some essential commodities, such as basic foodstuffs, were also not subject to this duty (see *Annual Report 1970*, p. 45); these commodities accounted for 15 percent of total nondiamond imports, but they represent a negligible proportion of imports-for-exports. As a result of these two factors, the figure shown here somewhat overstates the actual increase in the exchange rate. (3) About 30 percent of the imported intermediates are not imported directly by the producer and are therefore subject to ordinary customs duties. However, before the imposition of the August 1970 surcharge the average customs duty on inputs was only 8 percent. The effect of these factors on the effective exchange rate for the import component appears to be small, and the trend of the exchange rate per value-added dollar would not change substantially if they were taken into account.

Apart from the latter, industrial exports other than diamonds and minerals can be classified into two major groups: textiles and clothing (about one quarter of the total), where the effective exchange rate is influenced by special branchwide arrangements, and all the remaining items (about one half). The latter group is not subject to any particular supply or demand constraints, such as special factors of production or heavy dependence on the export market, as is the case with citrus, diamonds, and minerals. Here direct substitution between exports and the local market is often possible, so that exports can be quickly stepped up in the fairly short run[24] and are thus sensitive to changes in relative profitability.

It is this group of manufactures that constitutes the chief potential for rapid export expansion, as the data for the recent period indicate. In the last four years, during which vigorous efforts were made to encourage them, overseas sales rose 83 percent (16 percent per annum). The export-oriented products (the first four items in Table III-9) contributed only 42 percent of the increase, although their share in total commodity exports was 60 percent at the beginning of the period,[25] while textiles and clothing and "other industrial products" accounted for 46 percent of the 1971 increment, bringing up their weight in total commodity exports from 28 percent in 1967 to 36 percent in 1971.

Figure III–4
INDUSTRIAL EXPORTS, EXCL. DIAMONDS, MINERALS, AND SPECIAL ITEMS[a], 1964–72



[a] Ships and aircraft, exports of the military industry, and commodities not from domestic output (works of art, antiques, collectors' pieces, personal effects, etc.)
SOURCE: Central Bureau of Statistics.

This rapid growth was achieved by stepping up the proportion of output exported: at constant prices, the share of exports in industrial output (excluding diamonds and minerals) went up from 14.1 percent in 1967 to 17.5 percent in 1971 (see Table III-11).[26]

If the export share rose on the average, it follows that it rose even more on the margin: the weight of exports in the output increment increased from 15.8 percent in 1968 to 32.1 percent in 1971. During this period the producer prices of exports far outpaced producer prices in the local market; at current prices, the exported share of output rose even more than at constant prices – from 13 percent in 1967 to 20 percent in 1971. The detailed data, however, by no means reveal a uniform picture, and there are considerable interbranch differences.[27] This apparently reflects *inter alia* interbranch

24. The price constraint must not of course be ignored. In many instances of highly protected local production at prices far above the international level it appears that even a steep increase in the effective exchange rate would not be enough to permit export, even at a price covering only the variable costs.
25. This comparison somewhat overstates the contribution of the export-oriented products, because 1971 was a particularly good year for citrus and diamond exports, both volume- and pricewise.
26. Computed at 1969 prices, with exports valued at the effective exchange rate. Presumably the export share is overestimated at these prices too.
27. The greater the breakdown, the less uniformity there will be.

differences in domestic demand. In nonmetallic minerals, and apparently also in wood, the export share declined because of much heavier demand by the local construction industry; metal products and transport equipment reflected the fluctuations in the exports of the military and aircraft industries; the entire increase in overseas food sales was accounted for by citrus products, and this because of the larger quantities supplied to the canneries;[28] in basic metals the export share was affected by the shrinkage of domestic demand upon the completion of the Eilat-Ashkelon oil pipeline. But in addition to this incomplete list of special factors, there are two others that help explain why the various branches responded differently to the general export profitability trend. First of all, because of the system of incentive payments and the fact that for a time the effective exchange rate changed more slowly for imports than for exports, the changes in the effective exchange rate per value-added dollar were not uniform for all manufactures: some showed a strong rise over the last two years, while in others there was a slowdown or even a decline.[29] Secondly, the degree of protection differs widely between products, and this causes a similarly wide dispersion in domestic-international price differentials. In this situation a rise in the effective exchange rate will not induce the export of commodities enjoying a high degree of protection.

The impressive headway made in industrial exports can be attributed primarily to the basic factors affecting exports:[30] changes in relative export profitability due to changes in the effective exchange rate on the one hand, and in the level of domestic costs and prices on the other, and the balance between domestic demand pressure and the availability of unutilized resources.

The dominant factor has been the cumulative effect of the rising relative export profitability since the adoption of a policy of stimulating overseas sales by increasing the effective exchange rate. The rate was upped gradually between April 1966 and August 1971 by an average of about 70 percent (see Table III-12), though there were differences between products. The increase was achieved partly by the granting of direct incentives, which were more important at the beginning of the period, and partly by raising the official exchange rate. The effective exchange rate for merchandise imports (which also rose) lagged behind the export rate until the two were largely equalized by the devaluation of August 1971.[31]

The effective exchange rate per value-added dollar eventually rose to the same extent as the effective rate for exports and direct imports-for-exports, though not always at the same pace during the period for all commodities (see Table III-13). The increase was faster in the first part of the period, when the import rate lagged behind the export rate, and slower in the second part, when the lag was reduced.

If we include foreign prices (which in 1965-71 went up about 7 percent for both

28. See p. 49 above.
29. See Tables III-13 and III-14 and the discussion below.
30. It should not be inferred from this that special factors are not important for certain exports, but if we eliminate the above major examples of goods influenced by such factors, we are left with a large group that primarily reflects the general trends affecting exports (see Figure III-4).
31. With the import rate including the August 1970 import surcharge but not other levies.

Table III–13

EFFECTIVE EXCHANGE RATE PER VALUE-ADDED DOLLAR IN INDUSTRIAL EXPORTS,[a] 1965-71

Value-added group and percent value added	1965	Nov. 1966	Nov. 1967	Feb. 1970	Aug. 1970	Jan. 1971	Aug. 1971
Index, 1965 = 100							
(a) 2 35 percent	100	110.0	126.0	135.4	149.4	152.3	168.9
(b) 3 55 percent	100	110.9	128.7	137.8	152.2	155.1	169.2
(c) 4 70 percent	100	112.1	133.3	142.9	156.7	160.0	169.9
(d) 4 55 percent	100	115.5	137.8	150.0	161.3	165.5	170.4
(e) 4 35 percent	100	124.3	149.7	168.9	173.4	180.0	171.7
Percent increase over preceding period							
(a)		10.0	14.5	7.5	10.3	1.9	10.9
(b)		10.9	16.1	7.1	10.4	1.9	9.1
(c)		12.1	18.9	7.2	9.7	2.1	6.2
(d)		15.5	19.3	8.9	7.5	2.6	3.0
(e)		24.3	20.1	12.8	2.7	3.8	–4.6

[a] The figures take account of changes in the official exchange rate and export incentives and of the August 1970 import surcharge (see Table III-12). Duties on indirect imports-for-exports are not taken into account; however, they would not raise the price level of imported intermediates by more than 2-3 percent, according to a rough estimate, and the period trend would not be affected.

The calculation was made for five value-added levels. The first three are the mid-points of value-added groups 2, 3, and 4 (in which industrial exports are included); in 1969 these groups accounted for respectively 7, 9, and 83 percent of industrial exports other than diamonds and textiles (see *Annual Report 1970,* Table III-14). The weight of group 4 suggests that it includes a large number of products whose actual value-added proportion falls short of that set by the official classification; two alternatives are therefore presented for group 4 commodities whose value added is below the official estimate.

exports of manufactures and imports of intermediates), the total increase in the price of value added[32] came to 80 percent (see Table III-14).

This far exceeded the increase in either domestic prices or costs: whereas there was a 70 percent rise in the effective exchange rate for exports and one of 80 percent in the prices received by the exporter and in the price of value added (in IL), domestic prices of industrial output went up 29 percent in 1965-71. It should be borne in mind that the last-mentioned are market prices and include the indirect tax element. Since taxes were raised during the period, producer prices went up less.

The comparison called for in this context is the relative changes in the product prices and the direct profit component as between exports and domestic destinations. There are no direct data on the relative changes, but a comparison of the ratio between the increase

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

Table III–14

INDICATORS OF INDUSTRIAL EXPORT PROFITABILITY, 1966–71[a]

	1966	1967	1968	1969	1970	1971	End-1971 as against Average 1971	End-1971 as against Average 1970
Prices received by the exporter								
Percent annual change	4.5	5.8	12.6	3.5	14.6	16.7	4.6	22.1
Index (1965=100)	104.5	110.6	124.5	128.9	147.7	172.4	180.3	
Prices paid by the importer for imported intermediates[b] (in IL)								
Percent annual change	1.0	2.8	10.2	4.0	11.5	22.3	10.8	35.5
Index (1965=100)	101.0	103.8	114.4	119.0	132.7	162.3	179.8	
Price of export value added[c]								
70 percent value added								
Percent annual change	6.0	7.2	13.5	3.3	15.8	14.7	2.2	17.2
Index (1965=100)	106.0	113.6	128.9	133.1	154.1	176.7	180.6	
50 percent value added								
Percent annual change	8.0	8.7	14.7	3.1	17.1	12.2	–0.5	11.6
Index (1965=100)	108.0	117.4	134.6	138.8	162.6	182.4	181.4	
Domestic market prices								
Percent annual change	4.8	1.2	2.3	1.9	6.8	9.2	6.9	16.8
Index (1964=100)	104.8	106.1	108.5	110.6	118.1	129.0	137.9	
Wages per unit of output								
Percent annual change	13.5	–2.1	–7.6	1.1	7.5	7.6	1.0	8.7
Index (1965=100)	113.5	111.1	102.7	103.8	111.6	120.1	121.3	
Price of capital per unit of output[d]								
Percent annual change	(10.1)	(8.4)	(–16.8)	–2.3	8.8	18.0	8.5	28.0
Index (1965=100)	(110.1)	(119.4)	99.4	97.1	105.6	124.6	135.2	

[a] See detailed figures and notes in the appendix (in Hebrew only).

[b] Imports-for-exports.

[c] Based on the incentives for the value-added group getting the highest incentive rate, using two alternative assumptions regarding the proportion of value added.

[d] The product of the increase in the price of capital goods and the decline in the volume of capital per unit of output in fixed physical terms. The figures in parentheses indicate not the actual price changes but the decline in capital utilization during the recession.

Table III–15

CHANGES IN PRICE INDEXES OF PRODUCT AND USES, 1967–71

(percentages)

	1967	1968	1969	1970	1971	1971 (1966 =100)
Total domestic final uses	1.0	3.6	3.6	8.2	14.0	133.7
Exports (at effective exchange rate)	4.3	13.8	4.4	2.9	14.2	145.6
Imports (at effective exchange rate)	1.7	12.9	5.6	4.5	15.4	144.8
For domestic uses	1.7	12.7	5.8	5.4	16.7	148.4
For export production	1.7	13.7	4.4	–	11.0	134.0
Gross product component (at market prices) of:						
Exports	5.7	13.8	4.4	4.2	16.3	152.2
Domestic uses	0.6	–0.3	2.4	9.9	12.3	126.7
Total GNP at market prices	1.5	2.3	2.7	8.9	13.2	131.6
Product component of domestic uses at factor cost	0.3	0.6	2.2	9.4	12.4	126.8
GNP at factor cost	1.2	3.3	2.7	8.2	13.5	131.8

SOURCE: Prices of final uses, imports, and product at market prices are from the national accounts. The 1967-70 index for imports-for-exports (c.i.f.) is based on imports as derived from the input-output coefficients and on price indexes for the sectors of origin. The effective exchange rate includes the official rate and the August 1970 import surcharge. The index for the import component of domestic uses was derived from total imports less imports-for-exports. The index for product at factor cost is estimated on the assumption that the sum of indirect taxes at constant prices rose at the same rate as the final uses on which they are imposed (private consumption and investment).

in output prices and those in the various cost components shows that the profitability developments, which favored exports, were even more marked than the relative changes in export prices.

Export prices also far outstripped the increase in costs. They went up more than twice as fast as domestic costs: wages per unit of output stood 20 percent higher in 1971 than in 1965, and purchased intermediates 29 percent higher.[33]

The notable advance in industrial exports in 1971 must be viewed against the backdrop of the changes that have occurred since 1967. The process is clearly cumulative, and part of the increase in export profitability is making itself felt after the lapse of considerable time because of the investment processes involved; in other words, the 1971 export gain was partly the outcome of decisions taken three or four years earlier.

Export profitability did not move up at a uniform pace: the curve apparently began to slope less steeply in 1970 and flattened out further in 1971, in the latter part of which

33. According to the wholesale price index of industrial output for the domestic market.

it may even have turned downward. This is one of the reasons why industrial exports slackened after mid-1971 (see Figure III-4).

There are three aspects to this development. First is the method whereby the effective exchange rate was raised and the fact that the import rate lagged behind the export rate. At the beginning of the period direct incentives were the principal factor pushing up the effective exchange rate, and the lag in the import rate was greater (see Table III-12). Exports were classified into four value-added groups,[34] with the incentives, expressed as a percentage of gross exports, being uniform within each group but differing between groups. The intergroup differentials were designed to assure a more or less uniform incentive payment on the value-added dollar. Under this system there was, of course, also a within-group dispersion, with the effective exchange rate going up more for low value-added commodities. Moreover, the group classification does not appear to have been very realistic: a fairly large percentage of the exports were put into a higher group than warranted by their actual value added, so that the highest incentive group contained quite a few products with less than the "official" value-added estimate.[35] Given this lack of uniformity in the value-added proportion, we find that when there is a difference between the effective exchange rate for exports and that for the import component, then the lower the value added the higher will be the effective exchange rate per value-added dollar. The low value-added commodities included in the highest subsidy group did in fact enjoy a faster increase in their effective exchange rate than correctly classified products until August 1970 (see Tables III-13 and III-14). Once the gap between the import and export exchange rates was closed, the exchange rate per value-added dollar for these commodities rose much more slowly and in some cases apparently even declined.[36]

Another aspect of the change in export profitability is connected with the relative rates of change in export returns on the one hand and of costs on the other. This also applies to the relative prices of exports and output sold in the domestic market. In both cases the turning point came in 1970. Until then a rapid increase in the effective exchange rate for exports was accompanied by a mild increase in the prices of all current inputs – wages per unit of output and domestic and imported intermediates (see Table III-15). As

34. I.e. the total value added from the viewpoint of the economy as a whole.

35. The classification of industrial exports other than diamonds and textiles was as follows (see Bank of Israel, *Annual Report 1970,* Table III-14, p. 55):

Percent value added	Percent of exports
26-45	7
46-65	9
66+	83

36. The existence of differential value-added exchange rates produces a distortion from the standpoint of the economy, since it favors certain products and encourages exports which *ceteris paribus* are less profitable to the economy than those that receive no encouragement. Moreover, relatively more encouragement is given to commodities which, even if they were equally profitable as regards their price to the economy, are less desirable because of their low value added, which renders them more vulnerable to a decline in profitability following a drop in prices. The equalization of import and export exchange rates therefore corrects to some extent the distortion in the relative export incentives, but this conflicts with the goal of export encouragement (this is discussed below).

a result of the import-export exchange rate differential, the effective rate[37] for value added rose by 33 percent from 1965 to 1969,[38] while wages per unit of output went up by 4 percent and the price of domestic intermediates by 11 percent.

The sluggish increase in costs is explained by the special conditions obtaining during that period – the existence of unutilized factors of production as the economy moved from recession to full employment.

The outcome of the above developments was a sharp rise in the price of the direct value-added component of exports (since the price of the value-added component of purchased intermediates rose only slightly) and in the direct profit component.[39]

In 1970 the input-output price differential began to narrow gradually. This was due primarily to the attainment of full employment and the growing demand pressure. One major reflection of this was the large wage hikes awarded, which pushed up wages per output unit by over 7 percent p.a. in the last two years. Another manifestation was a deterioration in the balance of payments and the drawing down of foreign reserves, which led indirectly to the dearer-imports policy: the 20 percent import surcharge of August 1970 and the devaluation a year later. These two measures together raised the effective exchange rate for direct imported inputs by 44 percent.[40] The effective exchange rate for exports went up much less – by 25 percent in the highest incentive group (which covers the bulk of industrial exports). The net result was a 19 percent increase in the effective exchange rate per value-added dollar (see Tables III-12 and III-13). As far as exports are concerned, the official alteration of the exchange rate partly replaced the incentives. The effective devaluation for exports was only 10 percent,[41] and this means no more than 6 percent per value-added dollar – and less in quite a few commodities.[42]

37. The term "effective rate", unless otherwise specified, will hereinafter refer to a typical export commodity with 70 percent value added and belonging to the highest incentive group.
38. The raising of incentives in February 1970 brought the effective rate to 35 percent above its level in 1965 and the rate per value-added dollar to 43 percent above 1965.
39. In each case the increase depends on the weight of the different outputs: moreover, the profit component may increase from a large negative to a small positive value, which is not sufficient to move the commodity over the export profitability threshold. There are grounds for believing that there is considerable variability in export profitability owing to the variability of protection rates, and a rise in profits due to a given change in prices and costs is effective in expanding the exports of only a small number of commodities – at least this is the impression gained from the figures. In any event, for a typical input basket in domestic production the various price changes lead to a considerable increase in direct profits.
40. Direct imports accounted for 70 percent of the total import component of exports. For total imports of inputs the increase was slightly less.
41. For the highest incentive group. For the others the effective devaluation came to 14-17 percent, thus equalizing the effective rates for all groups.
42. As mentioned, the object – in itself important – of equalizing the effective rates for imports and exports, and thus of eliminating the consequent distortions, was thereby achieved. However, there is a conflict here between the two targets: the expansion of exports and the attainment of a more efficient resource allocation in export. For besides the export exchange rate distortion, there is a no less serious distortion arising from the differential between the effective rate for the export product and the product for domestic use. The small effective devaluation for the principal group of exports helped to eliminate distortions within exports but exacerbated the export-domestic use distortion.

Table III–16

GROWTH OF ISRAEL'S EXPORT MARKETS,[a] 1965–71

(percentages)

	Developed countries	Others	Total
1965	8.2	23.7	10.5
1966	7.7	7.5	7.7
1967	5.3	4.6	5.2
1968	13.8	12.2	13.6
1969	11.3	10.4	11.3
1970	8.5	10.3	8.8
1971	4.4		

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

In previous Reports nominal imports were used as the measure. This year it was difficult to compile such estimates because of the numerous changes in exchange rates. The drawback of the constant-price computation is that it does not adequately reflect situations of excess supply in which the quantitative increase is accompanied by an absolute or relative drop in international prices. The indicator presented here is therefore biased upward in years of declining demand accompanied by a small quantitative increase.

Yet another manifestation of mounting domestic demand pressure was the rise in the price of domestically produced intermediates, which came to 7 percent in 1970 and 9 percent in 1971. The ratio between the increase in export prices and that in costs thus changed drastically in the last two years, especially in 1971 when costs went up much faster relative to export prices than in the previous period. The change was even more striking when the increase in costs is compared with that in the price of export value added.[43] In consequence, the growth of the direct profit component slackened considerably. A similar picture emerges as regards the export-domestic market price ratio. Here the ratio is still changing in favor of exports (on the average for the whole year), but much more slowly.

In the absence of data it is not possible to compare the product prices of the two destinations (exports and the domestic market) of industrial production. But a general idea may be gained from the global national accounts data, which show the same movement as other series: the product prices of the domestic destinations rose by 9 and

43. See note 32.

12 percent respectively, compared with an average of 1 percent in the three preceding years (see Table III-15).[44]

From both points of view – export prices relative to costs and relative to domestic-use prices – 1971 saw a marked weakening of the hitherto favorable trends. But a comparison of annual average levels does not show any actual deterioration; in fact, there may have been a slow improvement, or at least maintenance of the 1970 level.

But in certain circumstances the mere absence of improvement in profitability constitutes a drag on the expansion of overseas sales. The high growth rates recorded by industrial exports in the last four years signifies an increase in the export share of industrial output and an even bigger increase in the incremental share of exports. Under conditions of a large profitability gap in favor of domestic sales, this was achieved by raising the relative profitability of exports. There are grounds for assuming that for at least a good part of the industrial exports the profitability gap has not been closed, despite the notable gain during the past four years in the relative profitability of exports. For a fairly large number of commodities, although the gap undoubtedly narrowed, this was not sufficient to render exports profitable even if only current costs are taken into account.[45] It is therefore very likely that under these conditions a further increase in relative export profitability is necessary if industrial exports – and the export share of output – are to continue forging ahead.

The above discussion is based primarily on annual averages, but what happened in the course of the year reviewed must also be considered. Developments in the latter part of the year are only partly reflected in the annual averages, and it is desirable to examine the situation from as recent a vantage point as possible. The end-year picture brings out more clearly the turnabout in relative export profitability (Table III-14). The price of both total exports and export value added lagged behind domestic prices. When we look at a longer period, comparing the end of 1971 with the average for 1970, we find that domestic prices and costs did not trail far behind export prices, in marked contrast to 1967-70. Moreover, the prices of domestic inputs continued to climb in the first months of 1972, and there is reason to believe that the uptrend will persist over the next few months; export prices, on the other hand, depend chiefly on the effective exchange

44. The product price data for exports in Table III-15 give an entirely different picture for 1970 from those of Table III-14. The latter, however, refer only to industrial exports (other than textiles, diamonds, and minerals), while Table III-15 refers to total exports including services not eligible for incentive payments. Table III-15 includes all price supports, among them the supports granted under the branchwide arrangements. Finally, diamond and citrus prices receded noticeably in 1970, a fact that partly explains the small percentage increase in export product prices in 1970 as shown in Table III-15.

Nevertheless, the domestic-use data of Table III-15 serve our purpose. Services presumably have a greater weight in the domestic-use price increase, while the direct competitor of exports is industrial output for the domestic market; the general picture, however, is fairly plausible.

45. The composition of the export increment (Table III-11) provides some evidence on this point. The growth in the export share of output was confined to a fairly small number of branches, apparently those in which the profitability gap was closed or at least narrowed enough so that in a calculation based on current costs alone a greater proportion of production moved over the export profitability threshold.

rate.[46] The actual changes in exports only partly reflect developments in the recent past, with the influence of more remote developments carrying considerable weight. However, the most recent developments will obviously assume greater importance with the passage of time, and the present data indicate that the deceleration of export growth will become more pronounced.

Another factor connected with current inputs for export production, which cannot be easily quantified, has recently helped to enhance export profitability. Exporters have been obtaining cheap credit at 6 percent interest, and the differential between this rate and the free-market rate has widened considerably since the general increase in the interest rate at the beginning of 1970; this is tantamount to a relative reduction of export costs.[47]

The last aspect of the changes in relative export profitability is connected with the effect of the price of capital. The discussion so far has referred to current costs, an increase in relative profitability being expressed as an increase in profit per unit of output. This is an adequate indicator for an analysis of short-run factors. But in examining long-term influences the relevant indicator with respect to investment in export industries is the unit return to capital. It is extremely difficult to evaluate this, but it appears that here, too, the year reviewed witnessed a turnabout: the uptrend begun in 1967 apparently came to a halt and may even have been reversed. In the past two years the price of capital rose steeply (see Table III-14) following a sharp rise in the price of capital goods (due in large measure to the 44 percent increase in the effective rate for imports of such commodities) and a slow increase in output per unit of capital. At the same time the advancing trend in profit per output unit slowed down or levelled off, with the result that the rise in the return on export investment apparently came to an end.[48] On the other hand, a much larger volume of cheap investment credit was granted in 1971, and this of course will stimulate investment. But it is difficult to gauge the effect of this factor on exports.

4. Exports and Imports of Services

Excluding defense imports, the surplus on services account totalled $160 million in 1971;[49] in all previous years imports and exports of services more or less balanced, with minor fluctuations in one direction or the other. This surplus is the outcome of a 42

46. The currencies of several industrial countries were revalued at the end of 1971. This should show up in higher dollar prices of exports, but so far there is no sign of this – the index of export prices for the last quarter of 1971 was below the average for the year.
47. This should not, of course, be taken into account in computing actual profitability trends in terms of the ratio between output and input prices. But it is certainly relevant in comparing the profitability of exports and domestic sales.
48. Anything that may be said on this point is merely a rough estimate. There is no way of quantifying this development without making assumptions about the composition of inputs. But the general trend does not seem to be affected very much by even large changes in the assumptions.
49. Excluding transactions with the administered areas.

percent gain in exports and a 16 percent increase in imports. Tourism, transport, and interest receipts accounted for most of the $270 million export growth.

In transport services there was a large increase in the inflow ($93 million) and a much smaller increase ($24 million) in the outflow. Maritime freight revenues were up strongly, thanks to the sizable expansion of the merchant marine and the opening of the Eilat-Ashkelon oil pipeline. Income from passenger conveyance went up by a respectable 37 percent owing to the expansion of tourism to Israel. A third source of growth was the larger 1971 expenditure of foreign shipping companies in Israeli ports,[50] reflecting the expansion of their passenger business and their operations in connection with the oil pipeline.

A striking feature is the relatively modest 14 percent increase in the foreign currency outlays of Israeli shipping companies and airlines, which was much smaller than the growth of receipts. The rise was particularly mild in shipping, even in comparison with the average for any number of previous years. The disparate growth rates of receipts and expenditures explains much of the net increase in the transportation item.

Aviation prices were stable in 1971, with a slight tendency to decline. Shipping prices went up by 7 percent despite a sharp drop in tramp rates. This can be ascribed to the long-term contracts concluded before such rates began to recede, and to the raising of tariffs in the liner trade, where the carriers are generally organized into conferences.[51]

Income from tourism went up by $75 million (close to 75 percent). Together with the passenger revenue of Israeli carriers, the increment came to nearly $100 million. This notable gain can be credited primarily to the calmer security situation since the second half of 1970. Tourist receipts went up by more than the number of tourists, reflecting a 15 percent rise in average outlay per tourist.

The larger amount spent overseas by Israelis in 1971 is mainly explained by the larger number going abroad, since foreign currency for this purpose is rationed. The decline from 1969 to 1970 was due to the cut in the travel allowance at the beginning of 1970.

The third item to post a large increase is, somewhat surprisingly, capital services, where receipts almost doubled – from $65 million in 1970 to $123 million. Although the foreign asset holdings of the banking system grew,[52] there was also a considerable increase in its foreign indebtedness and an even bigger increase in the rest of the country's foreign debt.[53] Interest paid abroad (excluding direct investment income and other profits) went up by only $41 million, from $157 to $198 million. Moreover, this was a period of falling interest rates in the world money markets, which should have shown up more on the receipts side, since assets expanded faster than liabilities. The disproportion between the changes in capital servicing and those in foreign assets and liabilities is surprising and may have been due to deficient data.

50. In Table III-13 this item is included in "other transportation income".
51. See Chapter XIII, "Transportation and Communications", section 4 (a).
52. The balance outstanding rose by 50 percent between the end of 1970 and the end of 1971 (see Table III-25).
53. According to the Foreign Exchange Department of the Ministry of Finance, the country's foreign debt went up from $2,622 million at the end of 1970 to $3,430 million at the end of 1971.

Table III–17

IMPORTS AND EXPORTS OF SERVICES,[a] 1965–71

($ million)

	1965	1966	1967	1968	1969	1970	1971
A. Excl. administered areas and defense							
Transportation							
Credit	148	158	161	200	214	257	350
Debit	94	103	100	129	137	174	199
Net	54	55	61	71	77	83	151
Travel							
Credit	55	59	52	96	86	103	178
Debit	44	49	44	52	66	54	60
Net	11	10	8	44	20	49	118
Cargo insurance							
Net	4	4	4	7	8	10	12
Other insurance							
Net	–6	–5	–11	–11	–	–12	–16
Capital services							
Credit	37	48	55	65	73	65	123
Debit	94	107	123	136	151	183	230
Net	–57	–59	–68	–71	–78	–118	–108
Other servcies							
Credit	37	49	52	69	81	87	115
Debit	47	44	68	69	79	79	91
Net	–10	5	–16	–	2	8	24
Government, n.e.s.							
Credit	20	25	31	33	33	28	34
Debit	37	43	41	46	71	54	60
Net	–17	–18	–10	–13	–38	–26	–27
Net total, excl. defense imports	–21	–8	–32	27	–9	–8	156
B. Defense imports	–110	–116	–283	–249	–334	–624	–525
Net total, incl. defense imports	–131	–124	–315	–222	–343	–632	–369
C. Net transactions with the administered areas			–17	–6	–1	–11	–28
Total balance on services account	–131	–124	–332	–228	–344	–643	–397

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

SOURCE: Central Bureau of Statistics.

Table III–18
EXPORTS OF SERVICES,[a] 1965–71
($ million)

	1965	1966	1967	1968	1969	1970	1971	Annual increase or decrease (–)					
								$ million			Percent		
								1969	1970	1971	1969	1970	1971
Transportation	148.0	157.7	160.8	200.2	214.4	257.2	350.1	14.2	42.8	92.9	7.1	20.0	36.1
Passenger	24.5	41.3	43.4	54.3	50.7	54.1	74.1	–3.6	3.4	20.0	–6.7	6.7	37.0
Freight	86.8	93.6	92.93	115.0	128.2	157.6	194.0	13.2	29.4	36.4	11.5	22.9	23.1
Other income	18.7	22.8	24.5	30.9	35.5	45.5	82.0	4.6	10.0	36.5	14.9	28.2	80.2
Travel	55.0	59.1	52.2	96.0	85.8	103.0	178.3	–10.2	17.2	75.3	–10.7	20.1	73.1
Insurance	47.7	58.1	60.9	71.2	98.8	111.3	123.1	27.6	11.5	11.8	38.8	12.7	10.6
Capital services	36.9	48.2	54.5	65.4	72.9	64.8	122.8	7.5	–8.1	5.0	11.5	–11.1	89.5
Government, n.e.s.	20.2	25.0	30.7	32.6	33.2	28.0	33.7	0.6	–5.2	5.7	1.8	–15.7	20.4
Other services	37.1	49.4	52.4	68.9	81.3	86.7	114.8	12.4	5.4	28.1	18.0	6.6	32.4
Total	**344.9**	**397.5**	**411.5**	**534.3**	**586.4**	**651.0**	**922.8**	**52.1**	**46.6**	**271.8**	**9.8**	**11.0**	**41.8**
Exports to the administered areas			4.6	15.3	16.4	16.1	18.9	1.1	–0.3	2.8	7.2	–1.8	17.4
Grand total	**344.9**	**397.5**	**416.1**	**549.6**	**602.8**	**667.1**	**941.7**	**53.2**	**64.2**	**274.6**	**9.7**	**10.7**	**41.2**

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

SOURCE: Central Bureau of Statistics.

Table III–19

IMPORTS OF SERVICES,[a] 1965–71

($ million)

	1965	1966	1967	1968	1969	1970	1971	Annual increase or decrease (–)					
								$ million			Percent		
								1969	1970	1971	1969	1970	1971
Transportation	93.5	102.8	99.8	128.7	137.1	174.5	198.6	8.4	37.4	24.1	6.5	27.3	13.8
Passenger	12.5	14.9	13.8	15.7	17.5	17.7	19.8	1.8	0.2	2.1	11.5	1.1	11.9
Other	81.0	97.9	86.0	113.0	119.6	156.8	178.7	6.6	37.2	21.9	5.8	31.1	14.0
Travel	43.7	48.8	44.0	51.7	65.9	53.8	60.1	14.2	–12.1	6.3	27.5	–18.4	11.7
Insurance	49.5	60.2	67.8	75.3	91.5	114.5	126.6	16.2	23.0	12.1	21.5	25.1	10.6
Capital services	94.1	106.9	123.3	135.9	150.8	183.1	230.4	14.9	32.3	47.3	11.0	21.4	25.8
Government, n.e.s.[b]	37.1	42.7	41.3	45.8	71.0	53.8	60.3	25.2	–17.2	6.5	55.0	–24.3	12.1
Miscellaneous	46.7	44.3	68.4	68.8	78.6	79.1	90.8	9.8	0.5	11.0	14.2	0.6	14.8
Total, excl. defense	**364.6**	**405.7**	**444.6**	**506.2**	**594.9**	**658.8**	**766.8**	**88.7**	**63.9**	**108.0**	**17.5**	**10.7**	**16.4**
Defense imports	110.3	116.0	283.0	249.2	333.7	624.4	524.9	84.5	290.7	99.8	33.9	87.1	–15.9
Service imports from the administered areas			21.7	20.7	17.0	27.5	46.8	–3.7	10.5	19.3	–17.9	61.8	70.2
Grand total	**474.9**	**521.7**	**749.3**	**776.1**	**945.6**	**1,310.7**	**1,338.5**	**169.5**	**365.1**	**27.8**	**21.8**	**38.6**	**2.1**

[a] On the basis of c.i.f. recording of commodity imports.
[b] Excluding defense imports.

The insurance item is large on both the credit and debit sides, but the net balance is small since the inflow and outflow are closely linked – premiums are offset by claims payments by foreign insurance companies to Israelis and commissions paid to local agents of foreign companies.

"Other services" is a heterogeneous item, with the credit side increasing more than debits in 1971. The main subitems here are agents' fees (foreign exporters' commissions to their local agents), which went up noticeably along with imports, and the expenditures of foreign companies (principally in shipping, aviation, and insurance) operating in Israel. There was also an increase in income transferred by returning residents. On the debit side the main subitems are connected with the operations of Israeli companies abroad: agents' fees (Israeli exporters' commissions to agents) and management fees (office maintenance) and advertising abroad.

The services account with the administered areas shows a big increase on the debit side, reflecting the growth of income from employment in Israel of the areas' residents.

5. The Capital Account[54]

The sharp upswing in capital imports begun in 1970 carried over through the year reviewed. However, there was a change in their composition and in their ratio to the current account deficit, as well as in their monetary impact.

Long-term capital imports came to $1,560 million; this compares with $1,262 million in 1970, $650 million in 1968 and 1969, and $840 million in 1967 (which was an exceptional year).

The notable 1970 increase was due primarily to a marked widening of the current account deficit, attributable in the main to heavier direct defense imports (up $375 million within two years). Capital imports expanded chiefly because of the Government's efforts to finance the sharply higher deficit, itself due to noneconomic causes. Most of the additional capital was mobilized by the public sector from two sources: U.S. Government loans, which were up $290 million, and sales of the Development Loan and proceeds from the various overseas fund-raising campaigns (U.J.A. and U.P.A.), where the increase came to $180 million; these two sources together accounted for 80 percent of the incremental capital inflow. A large percentage of the other loans raised abroad also went to the public sector.

The growth of long-term capital imports in 1971 was the resultant of several contrasting developments. The public sector's direct import of capital declined along with defense imports by $100 million. (Receipts from U.S. Government loans, the Development Loan, and the fund-raising campaigns were down $85 million and other loans by $40 million; the drop was partly offset by a $25 million increase in intergovernmental transfers.)

54. The "errors and omissions" item in the 1971 balance of payments amounted to IL 144 million. In view of this large figure, the other items lose much of their reliability. From the quality of the statistical data it appears that the main source of errors is the capital account, particularly short-term movements. This view is strengthened by the experience of the past, when most of the subsequent revisions were made in capital items.

Table III–20

DEFICIT, TRANSFERS, AND THE CAPITAL ACCOUNT, 1968–71

($ million)

	1968	1969	1970	1971
A. Current account and long-term capital movements				
Balance on current account				
Excluding administered areas	–679.7	–922.3	–1,282.2	–1,195.6
Administered areas	32.2	53.5	48.6	24.2
Unilateral transfers	434.7	459.2	649.4	797.8
Balance on current account plus transfers	–212.8	–409.6	–584.2	–373.6
Long-term capital movements				
Investments from abroad, net	26.6	46.0	53.3	120.8
Independence and Development Loans, net	78.0	63.3	135.6	184.4
U.S. Government loans	35.1	53.9	343.5	260.3
Other loans	65.0	50.7	80.2	196.6
Total long-term capital movements	**204.7**	**213.9**	**612.6**	**762.1**
Total capital imports	**639.4**	**673.1**	**1,262.0**	**1,559.9**
Total (A) – Surplus of capital imports over deficit on current account	**–8.1**	**–195.7**	**28.4**	**388.5**
B. Israeli investments abroad, net	–17.5	–18.0	–22.8	–19.6
C. Nonfinancial sectors				
Short-term credit from rest of the world	16.5	–24.9	23.2	43.9
Short-term credit to rest of the world	–41.6	–31.9	–59.3	–89.7
Trade credit	–17.7	–29.2	–0.4	–61.6
Other short-term assets	–23.9	–2.7	–58.9	–28.1
Total	**–15.1**	**–56.8**	**–36.1**	**–45.8**
D. Financial sectors				
Foreign deposits	34.6	115.3	120.5	218.7
With commercial banks	46.0	66.1	117.8	237.4
With Bank of Israel	–11.4	49.2	2.7	–18.7
Loans to foreigners	5.6	1.5	64.6	–36.1
Commercial banks	5.4	2.9	63.3	–30.0
Bank of Israel (incl. clearing accounts)	0.2	–1.4	1.3	–6.1
Foreign currency balances				
Change in reserves[a]	52.0	187.1	–119.6	–429.2
Central monetary institutions	93.8	292.5	–21.1	–284.9
Other monetary institutions	–41.8	–105.4	–98.5	–144.3
Less: Adjustments				
Foreign currency valuation adjustments		–30.7		–53.3
Special Drawing Rights			–15.1	–13.9
Total change in reserves due to economic transactions	**52.0**	**217.8**	**–104.5**	**–362.0**
E. Errors and omissions	–41.5	–64.1	–49.2	–143.7

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

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

Table III–21

CAPITAL IMPORTS, BY ORIGIN AND RECIPIENT, 1967–71

($ million)

	1967	1968	1969	1970	1971
To the private sector					
Unilateral transfers	254	331	346	443	607
Personal restitution	123	143	138	204	228
Other private transfers, net	84	134	152	172	297
Nonprofit institutions	47	54	56	67	82
Net investments from abroad	25	27	46	53	121
Long-term loans	5	27	31	45	210
Total private sector	**284**	**384**	**423**	**541**	**938**
To the public sector					
Unilateral transfers	267	104	113	206	190
National Institutions	278	111	118	223	182
Intergovernmental transfers	–11	–7	–5	–17	8
Long-term loans	291	151	137	515	431
Independence and Development Loans, net	172	78	63	136	184
U.S. Government loans	28	36	51	339	247
Other loans	91	37	23	40	–
Total public sector	**558**	**255**	**250**	**721**	**621**
Total capital import	**841**	**639**	**673**	**1,262**	**1,560**
Less: Israeli investments abroad	17	18	18	23	20
Total, excl. Israeli investments abroad	**824**	**622**	**655**	**1,239**	**1,540**

In contrast to the decline in the public sector, the private capital inflow rose steeply, from $540 million to $940 million. All component items shared in the increase, in each case because of a different combination of factors. The chief reasons were the boom in the real estate market; the relaxation of tension along the borders, which allayed the apprehension of foreign investors; the liberalization of foreign exchange control, which made the IL freely convertible for many transactor groups; other changes in control policy which made it easier for the private sector to borrow abroad (as part of the Government's effort to stem the drain on foreign exchange reserves); the marked widening of interest rate differentials between Israel and the international money market; and the devaluation, which increased the IL value of foreign currency and made another imminent devaluation a very unlikely prospect, thereby diminishing the exchange rate risk to persons transferring funds.

The outcome of all this was that the long-term capital inflow exceeded the current deficit by $390 million,[55] much more than in previous years. Even before devaluation

55. Including transactions with the administered areas.

the proportion of the capital import which the recipients intended to convert into IL was greater than in the past; the devaluation further stimulated conversions, thereby intensifying the expansionary monetary effect of the capital import.

Short-term capital movements continued to expand. There was a big increase in the liquid foreign liabilities of the banking sector, exceeding the increase in liquid assets. The figures on short-term capital are the least reliable part of the balance of payments; but the picture that emerges is a rapid growth in the country's liquid foreign debt over the past four years, outpacing the increase in liquid asset holdings (see Table III-2). If we assume that the errors and omissions are mostly in short-term movements, then the small surplus of long-term capital over the current deficit and the large increase in liquid liabilities served partly to augment reserves, but mainly to finance short-term capital exports.

The growth of foreign exchange reserves in 1970 was due mainly to the heavier short-term capital inflow. In 1971 the banking sector continued to import short-term capital, and the long-term capital import far exceeded the current deficit. This made it possible to build up reserves and to export short-term capital.

(a) *Transfers*

Unilateral transfers went up 23 percent in 1971: those by the National Institutions were down by almost 20 percent, but other items showed big increases.

Personal restitution payments from West Germany were 12 percent greater than in 1970.[56] This reflects the revaluation of the mark, which began in May and eventually totalled 13.6 percent in terms of the dollar; in addition, the scope of the restitution law was widened and pensions were adjusted to the rise in the cost of living in Germany.

Transfers of private nonprofit institutions were up by an appreciable 20 percent, after a moderate increase in earlier years due to growing competition from the fund-raising campaigns.

These two items are independent of internal economic developments. But this is not so for personal remittances, which were decisively affected by developments in the real estate market, changes in foreign currency control, and the improved security situation. These pushed up the level by 72 percent, from $175 million in 1970 to $301 million (immigrant transfers were up 105 percent and those by Israeli residents by 56 percent).[57]

The increase in immigrant transfers was proportionately far greater than the growth of immigration from the affluent countries. There is, of course, a time-lag between immigration and transfers, but the change here was too steep to be attributed to this factor (in addition, there were presumably some transfers of business capital by immigrants under the Law for the Encouragement of Capital Investments – these are recorded in the balance of payments under the heading of investments). This development stands out even more clearly in the quarterly figures (Table III-24), which reveal that the inflow tripled within 18 months. There were apparently two reasons for this: the rocketing of real estate prices and the fact that the repatriation of foreign funds is now guaranteed.

56. The 1971 increase comes to 30 percent if a special nonrecurring transfer received in 1970 is deducted.

57. Residents' personal transfers are defined as pensions, gifts, and legacies from abroad.

Table III–22
UNILATERAL TRANSFERS, 1964–71

($ million)

	1964	1965	1966	1967	1968	1969	1970	1971
Personal restitution from Germany and Austria	134.2	112.7	110.4	123.2	143.3	137.9	203.6	228.4
Personal transfers in cash	90.4	94.5	81.9	87.5	130.8	156.3	175.2	300.8
Immigrants					30.5	39.6	55.1	113.3
Others					100.3	119.1	120.1	187.5
Personal transfers in kind	9.8	9.4	6.9	3.4	9.8	5.1	4.6	6.8
Total personal transfers from abroad	**234.4**	**216.6**	**199.2**	**214.1**	**283.9**	**299.3**	**383.4**	**536.0**
Personal transfers abroad	4.3	5.9	5.5	6.8	6.6	9.2	7.5	11.1
Total net personal transfers	**230.1**	**210.7**	**193.7**	**207.3**	**277.3**	**290.1**	**375.9**	**524.9**
Institutional transfers								
In cash	76.8	92.7	93.7	321.8	162.6	172.4	287.4	260.9
In kind	2.7	3.6	3.3	2.7	1.8	2.2	2.8	4.2
Total institutional transfers	**79.5**	**96.3**	**97.0**	**324.5**	**164.4**	**174.6**	**290.2**	**265.1**
Net transfers to the Government	25.3	20.2	1.2	−10.8	7.0	−5.5	−16.7	7.8
Total unilateral transfers	**334.9**	**327.2**	**291.9**	**521.0**	**434.7**	**459.2**	**649.4**	**797.8**

SOURCE: Central Bureau of Statistics.

Immigrant transfers were moving strongly upward even before devaluation, ever since the beginning of 1970, when expectations of an imminent change in the exchange rate began to wane. The devaluation of August 1971, which was unexpected, further reduced the risk of a change in the exchange rate in the immediate future.

Presumably part of the immigrant transfers was connected with investments in financial assets. Interest rates in the principal world money markets were more than halved within two years,[58] while the yield on financial assets in Israel rose considerably. The large interest rate differential and the diminished risk of devaluation constitute an inducement to the immigrant with foreign assets to shift some of his holdings to Israeli assets.

Transfers by Israelis doubled between the end of 1970 and the end of 1971 (see Table III-24), and the picture is similar to that for immigrant transfers. The official definition of this item does not appear to fully reflect its composition, and there is nothing in the official components to explain the steep rise. Here, too, the real estate boom played a major role: Israelis who held foreign assets (in contravention of the control regulations) may have had the money transferred as "gifts" once domestic real

58. For example, the rate on U.S. 3-month treasury bills dropped from 8 percent at the beginning of 1970 to below 3.5 percent at the end of 1971, and that on bank acceptances from over 8.5 percent to below 4 percent. In the U.K. the rate on treasury bills dipped from 8 percent to a little over 4 percent.

Table III–23

FOREIGN INVESTMENT IN ISRAEL, 1965–71

($ million)

	1965	1966	1967	1968	1969	1970	1971
Investment in Israel by nonresidents							
In foreign currency	64.5	58.6	7.7	–1.5	7.3	11.7	54.7
Investments	92.4	85.6	38.8	31.2	41.0	39.5	87.7
Investments repatriated	–27.9	–27.0	–31.1	–32.7	–33.7	–27.8	–33.0
In Israeli currency (from blocked accounts)	4.8	3.7	1.9	2.6	–0.5	–1.4	–0.7
In Development Bonds	9.4	9.7	7.0	7.1	4.7	4.8	5.3
In kind	8.3	5.3	3.9	14.4	29.3	33.0	55.9
Total	**87.0**	**77.3**	**20.5**	**22.6**	**40.8**	**48.1**	**115.2**
Reinvestment of profits[a]	4.8	5.2	4.3	4.0	5.2	5.2	5.6
Total, net	**91.8**	**82.5**	**24.8**	**26.6**	**46.0**	**53.3**	**120.8**
Israeli investment abroad							
Direct	11.9	6.5	6.1	2.5	–2.7	8.8	9.3
Portfolio							
Private individuals	6.0	4.0	12.0	12.7	22.6	12.4	10.2
Banks	–0.5	0.8	–1.2	2.3	–1.9	2.4	0.1
Total	**17.4**	**11.3**	**16.9**	**17.5**	**18.0**	**22.8**	**19.6**
Net foreign investment in Israel	**74.4**	**71.2**	**7.9**	**9.1**	**28.0**	**30.5**	**101.2**

[a] This is a weak estimate.
SOURCE: Central Bureau of Statistics.

estate investment became lucrative.[59] Another possible reason is that the receipt of funds in the form of "gifts" is a way of "laundering" black money stashed away without paying income tax. This might very well have happened in 1971: with the soaring of dwelling prices, nominal investment in housing rose steeply in relation to declared income. Insofar as such a "laundering" of undeclared income took place, it involved not an actual transfer of funds from abroad but the acquisition on the black market of foreign currency of unspecified origin (from the point of view of balance of payments classification).

(b) *Long-term loans*

The composition of long-term loans changed drastically in 1971: public sector borrowing was down $84 million following the cutback in defense imports, and private borrowing was up $165 million (from $45 million to $210 million). The differentiation between the two sectors is not always significant, since the public sector is a

59. The reference here is generally to self-employed in the medium- and high-income brackets. Large firms wishing to repatriate funds usually do so by way of investments of companies of unknown ownership registered abroad.

source of credit for the private sector, and a change of such proportions as occurred in the year reviewed may simply mean that part of the funds that were formerly channelled through the public sector no longer flow through it. But the combined total also rose appreciably. There were several reasons for this: the heavy import of ships, which involves a large element of supplier credit; the greater propensity of the private sector to borrow abroad because of the marked change in the Israeli-foreign interest rate differential; and even more important, the granting of more permits to borrow abroad (it was the need to mobilize foreign funds from a variety of sources in order to check the serious depletion of foreign exchange reserves in 1969 and 1970, and the expectation that reserves would continue to shrink in 1971, that lay behind this policy change).

(c) *Foreign investment*

In 1971 there was a sharp upturn in the inflow of foreign investment capital, the net figure rising from $53 million in 1970 to $121 million, and less reinvested profits,[60] from $48 million to $115 million.

In recent years investment in kind has grown appreciably, from 6-7 percent of total gross foreign investment in 1964-65 to 43 percent in 1970. In 1971 the absolute amount continued upward, but the proportion dropped to 36 percent. It is difficult to pinpoint the reasons for this increase, although it is certain that this is business investment.

Gross investment in cash rose from $40 million in 1970 to $88 million and net, from $12 million to $55 million (see Table III-23). The contrast between 1971 and the preced-

Table III–24

PRIVATE TRANSFERS AND INVESTMENT, QUARTERLY DATA, 1969–71

($ million)

		Personal cash transfers		Cash investment in foreign currency
		Immigrants	Israeli residents	
1969	I	9.1	34.7	12.6
	II	10.9	28.0	13.2
	III	8.6	27.2	6.3
	IV	11.0	26.8	8.9
1970	I	11.7	26.9	11.2
	II	12.9	27.7	8.0
	III	13.3	35.4	11.0
	IV	17.2	30.1	9.3
1971	I	19.0	32.1	18.1
	II	27.9	40.8	19.2
	III	30.8	53.3	20.8
	IV	33.1	60.8	29.6

60. This is an unreliable datum.

ing years is particularly great in this item. The recent period was one of vigorous economic expansion, rising profitability, and intensive efforts to stimulate investment, but none of these factors had a significant effect on this item. Most of the upward thrust in 1971 apparently came from the real estate boom, as is suggested also by the detailed data of Table III-24.[61] Another factor, as mentioned, was the more tranquil security situation since the end of the Suez hostilities, which were undoubtedly a deterrent in the two preceding years.

Devaluation had a stimulative effect, as it raised the IL value of foreign currency and reduced the likelihood of another imminent change in the exchange rate.

The increase in cash investment must be viewed against the background of the monetary developments on the one hand and the changes in foreign currency control on the other. The control changes of the last few years have in effect granted unlimited repatriation rights for nearly all types of investment, and this has certainly constituted a significant incentive. Two other factors were at work in 1971: the diminished risk of devaluation and the widening of the interest rate differential between Israel and the world capital markets. Devaluation expectations ebbed after the introduction of the August 1970 import surcharge, and again after the devaluation of August 1971. This heightened investors' readiness to borrow abroad. Direct credit is subject to control, but it is possible to obtain funds from overseas by selling redeemable shares under a repurchase agreement – a procedure that does not deter firms and institutions with foreign contacts.

(d) *Short-term capital and reserves*

Short-term capital movements to the nonmonetary sectors were subject to the same factors influencing the rest of the capital account: the widening of the interest rate differential and the weakening of expectations of a devaluation in the near future resulted in a greater willingness to borrow from foreign sources. Until almost the end of the year, the depletion of foreign exchange reserves was considered a real danger, and the control authorities therefore greatly liberalized the granting of foreign loan permits. It was against this setting that short-term credit expanded rapidly.

Trade credit to the rest of the world also rose substantially, reflecting the rapid expansion of exports, which was accompanied by a corresponding increase in financing from the Export Fund.

The upward trend of the last few years in the commercial banks' foreign transactions grew stronger in 1971, as reflected by the large increase in their overseas liquid asset holdings and an even bigger growth in their liquid foreign liabilities in the form of nonresidents' and foreign bank deposits. Deposit balances abroad rose by $140 million in 1971, and the banks' foreign indebtedness by $240 million.

Gross foreign currency reserves held by the Bank of Israel expanded by $273 million,

61. An appreciable part of the additional approved investment in 1971 was made in hotels following the expansion of tourism. But the bulk of the increment represented investments initiated in earlier years, when tourism was growing much more slowly. The fact that investors obtained land at well below the market price probably played an important role here.

Table

FOREIGN CURRENCY

($

End of year	1965	1966	1967	1968
A. Net balances with Bank of Israel				
1. Assets with Bank of Israel				
Foreign currency reserves	574.7	552.7	646.2	594.3
Gold	45.8	45.8	45.9	46.0
Gold with IMF	22.5	22.5	22.5	22.5
Special Drawing Rights				
Total	**643.0**	**621.0**	**714.6**	**662.8**
Less: Foreign currency valuation adjustments and SDRs				
Net change due to transactions and transfers				
2. Deposits with Bank of Israel				
Foreign banks	0.7	1.0	1.0	1.0
Patach	26.8	25.5	37.4	34.6
Total	**27.5**	**26.5**	**38.4**	**35.6**
3. Net balances with Bank of Israel	**615.5**	**594.5**	**676.2**	**627.2**
B. Net foreign currency assets				
4. Other foreign currency balances				
Government deposits abroad	47.7	34.4	133.6	91.6
Bank deposits abroad	84.2	100.7	120.0	161.8
Total	**131.9**	**135.1**	**253.6**	**253.4**
Less: Foreign currency valuation adjustments				
Total change due to transactions and transfers				
5. Total gross foreign currency assets	774.9	756.1	968.2	916.2
Less: Foreign currency valuation adjustments and SDRs				
Total change due to transactions and transfers				
6. Foreign-held deposits				
Foreign banks	20.4	33.2	22.2	59.6
Nonresidents	128.3	131.6	163.1	170.7
Subtotal	**148.7**	**164.8**	**185.3**	**230.3**
With Bank of Israel (excl. Patach)	0.7	1.0	1.0	1.0
Total	**149.4**	**165.8**	**186.3**	**231.3**
7. Net foreign currency assets (B5–B6)	**625.5**	**590.3**	**781.9**	**684.9**

III–25

RESERVES, 1965–71

million)

	1969	1970	1971	Annual increase or decrease (–) 1965	1966	1967	1968	1969	1970	1971
	366.7	405.2	675.5							
	45.7	43.4	43.4							
	–	10.0	–							
		–	13.1							
	412.4	**458.6**	**732.0**	**98.0**	**–22.0**	**93.6**	**–51.8**	**–250.4**	**46.2**	**273.4**
						–13.9		28.7	15.1	64.1
				98.0	**–22.0**	**107.5**	**–51.8**	**–279.1**	**31.1**	**209.3**
	30.0	37.5	9.8							
	43.7	59.9	146.2							
	73.7	**97.4**	**156.0**	**5.0**	**–1.0**	**11.9**	**–2.8**	**38.1**	**23.7**	**58.6**
	338.7	**361.2**	**576.0**	**93.0**	**–21.0**	**81.7**	**49.0**	**–288.5**	**22.5**	**214.8**
	49.5	24.4	35.9	–0.2	–13.3	99.2	–42.0	–42.1	–25.1	11.5
	267.2	365.7	510.0	8.0	16.5	19.3	41.8	105.4	98.5	144.3
	316.7	**390.1**	**585.9**	**7.8**	**3.2**	**118.5**	**–0.2**	**63.3**	**73.4**	**155.8**
						–4.0		2.0		3.1
						122.5		**61.3**		**152.7**
	729.1	848.7	1,277.9	105.8	–18.8	212.1	–52.0	–187.1	119.6	429.2
						–17.9		30.7	15.1	67.2
						230.0		**–217.8**	**104.5**	**362.0**
	86.7	96.9	124.4							
	209.9	317.4	528.2							
	296.6	**414.3**	**652.6**							
	30.0	37.5	9.8							
	326.6	**451.8**	**662.4**	**9.7**	**16.4**	**20.5**	**45.0**	**95.3**	**125.2**	**210.6**
	402.5	**396.9**	**615.5**	**96.1**	**–35.2**	**191.6**	**–97.0**	**–282.4**	**–5.6**	**218.6**

and the Bank's liquid foreign currency liabilities by $59 million. This added $215 million to the net reserves in the Bank.

The economy's net foreign currency reserves – which consist of the gross balances of the Bank of Israel, Government, and banking institutions, less their liquid liabilities to the rest of the world – grew by $219 million.