

CHAPTER II

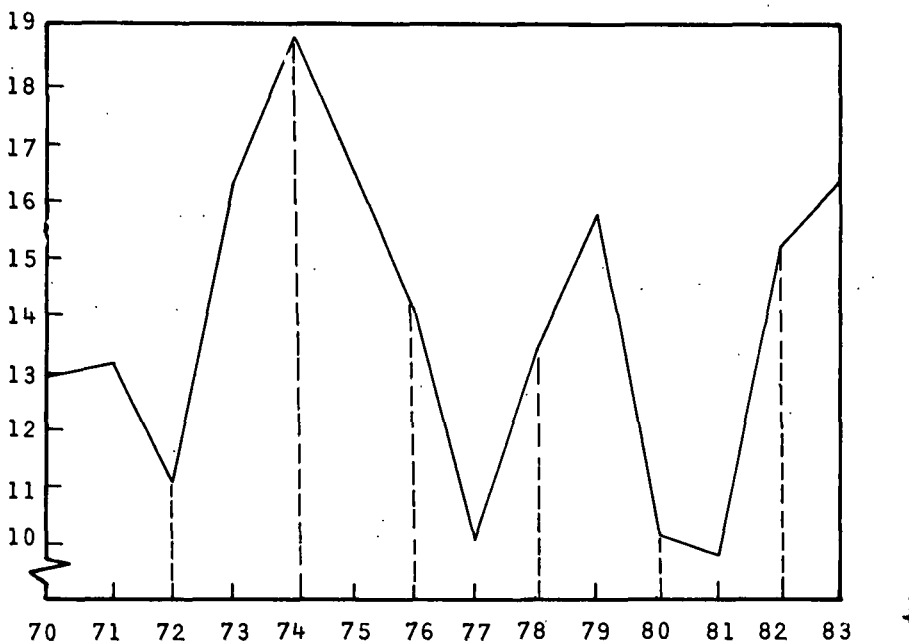
THE PRODUCT AND DOMESTIC DEMAND

1. MAIN DEVELOPMENTS

Local demand¹ continued to grow rapidly in 1983, with a rise of 6.3 percent (8.8 percent for the business sector),² rates which are similar to the average for the preceding two years. The rise was concentrated in the first three quarters of the

Figure II-1

CIVILIAN IMPORT SURPLUS AS PERCENT OF DOMESTIC RESOURCE USE,
1970-83^a



^a At current prices. Includes net factor payments to rest of world.

¹ Here and below the term "local" refers to aggregates excluding direct defense imports. Thus local demand consists of the domestic final expenditures *less* direct defense imports.

² Local final expenditure, excluding product originating in public services, imputed rent, and investment in inventories.

Table II-1
RESOURCES AND USE OF RESOURCES, 1982-83

	At current prices, IS million		Percent annual change							
			Quantity						Prices	
	1982	1983	1969-72	1974-79	1980	1981	1982	1983	1982	1983
Resources										
Gross domestic product	557,613	1,414,019	11.0	3.5	3.1	2.8	1.0	1.8	121.3	149.0
<i>thereof</i> Business sector GDP ^a	387,658	980,052	12.5	3.1	3.5	3.1	-0.1	2.1	123.0	147.5
Imports ^b	345,319	832,353	11.3	2.1	-6.4	10.1	4.1	5.6	107.0	128.2
<i>thereof</i> Civilian imports	303,175	759,354	10.7	4.5	-10.7	8.1	11.1	10.7	106.5	126.3
Total resources	902,932	2,246,372	11.1	3.0	-0.5	5.6	2.3	3.4	115.6	140.6
Use of resources										
Private consumption	352,930	919,040	7.3	5.6	-2.9	10.9	7.2	7.0	115.6	143.3
Public consumption										
Total	190,553	451,286	10.6	-2.1	9.1	6.4	-6.4	-4.2	122.6	147.3
Excluding direct defense imports	148,409	378,287	8.8	1.1	3.5	0.8	4.8	4.8	124.0	143.3
Gross domestic investment										
Total investment	131,147	325,949	18.5	-0.9	-15.2	-7.1	14.6	5.9	120.1	134.6
Fixed investment	131,369	335,801	19.4	-1.5	-9.8	4.0	4.6	9.7	119.5	133.1
Fixed nondwelling investment	83,325	232,557	10.1	1.1	-17.8	5.5	9.8	19.2	120.7	134.2
<i>subtotal: Domestic resources excluding direct defense imports</i>	632,486	1,623,276	10.3	3.0	-4.5	4.7	8.1	6.3	118.5	141.4
Exports ^b	228,302	550,097	13.6	7.2	6.3	4.4	-3.2	2.2	107.8	135.7
Total resource use excluding direct defense imports	860,788	2,173,373	10.9	3.9	-1.7	4.6	4.6	5.2	115.7	140.0
Total resources	902,932	2,246,272	11.1	3.0	-0.5	5.6	2.3	3.4	115.6	140.6

^a Defined as GDP less product of public services, private nonprofit institutions, and residential services.

^b Imports c.i.f., exports f.o.b., including respectively factor payments to and from abroad and valued at effective exchange rates.

SOURCE: Central Bureau of Statistics.

year (see Table II-1a), and in the last quarter demand declined. This is true also of GDP, which in the first three quarters rose by 3.8 percent over the level of the first three quarters of 1982. This is faster than the 1982 rise (1 percent) and close to the 1976-81 average (3 percent). The average for the whole of 1983 came to 1.8 percent, since there was a decline in the last quarter (compared with the last quarter of 1982). These figures refer to GDP measured from the expenditure side; the alternative estimate (B in Table II-2), shows a higher growth rate (3.5 percent).

This year too, the real civilian import surplus grew faster than real local demand, that is, net resources were again diverted to imports, and the weight of the civilian import surplus rose further. Thus (at current prices) the civilian import component of domestic demand rose from an average of 12.3 percent in 1978-81 and 15.2 percent in 1982 to 16.2 percent in 1983. At constant (1980) prices the rise was steeper, the corresponding figures being 13 percent, 17.7 percent, and 21.6 percent.

In the first nine months of 1983 economic developments were affected by a wide range of government measures: local public consumption rose, the tax rate was

Table II-1a
RESOURCES AND USE OF RESOURCES, 1983^a
(Percent change over corresponding period in 1982)

	January- September	October- December	January- December
Resources			
Gross domestic product	3.8	-3.5 ^b	1.8
Civilian imports ^c	9.8	13.2	10.7
Use of resources			
Private consumption	9.6	-0.4	7.0
Public consumption ^a	5.9	1.8	4.8
Gross domestic investment	7.2	2.5	5.9
<i>subtotal: Domestic uses of resources</i>	8.3	0.7	6.3
Exports ^c	0.4	7.2	2.2
Total use of resources	6.1	2.6	5.2
Other aggregates			
Product originating in public services	-0.8	1.8	-0.1
Business sector GDP (excl. residential services)	5.1	-5.7 ^b	2.1
Business sector domestic resources ^d	11.9	-0.0	8.8

^a Excluding direct defense imports.

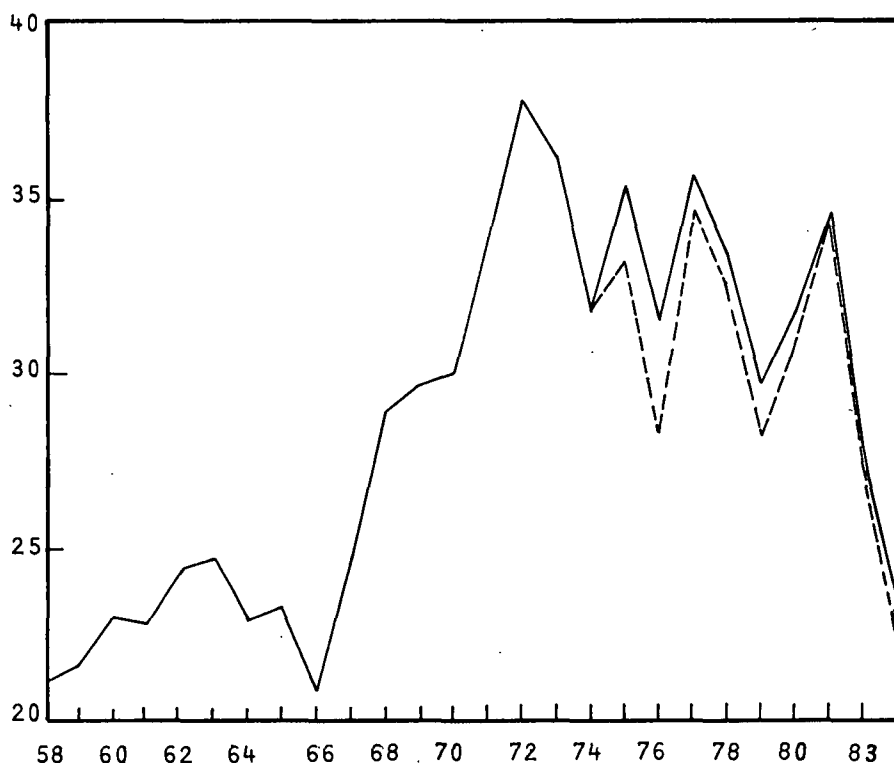
^b The fourth quarter decline in product is probably overstated because the increase in stocks is understated (imports for stock increased substantially, and if the increase in stocks is understated, so will the GDP be).

^c See note b to Table II-1.

^d Total domestic resource use less direct defense imports, product originating in public services, and change in inventories.

SOURCE: Central Bureau of Statistics.

Figure II-2
PRIVATE SAVING RATE, 1958-83^a
 (Percent)



^a Private saving as percent of gross disposable income from all sources (a) excluding net compulsory loan (solid line, aggregate B in Table II-8); or (b) excluding indirect and excluding direct loan subsidy (dashed line, aggregate C in Table II-8).

increased, and the slow devaluation policy continued—until mid-year the IS appreciated in real terms. The net outcome was to raise local demand. The last quarter saw a switch in policy which helped to reduce local demand.

The effect on expectations of the real appreciation of the IS, at a time of balance-of-payments deterioration, and the marked increase in local public consumption operated in two ways to raise domestic demand, particularly for imports: (a) Expectations for a change in exchange-rate policy intensified—a large devaluation, increased import taxes, especially on durables;³ as a result, the public indulged in speculative purchases of imported commodities. (b) As the balance-of-

³ Import duties were in fact raised in April and in June a 15 percent deposit requirement was imposed on a variety of imports. In August several purchase taxes were raised, chiefly on commodities most of which are imported (see Chapter V).

payments situation deteriorated, it was believed that financial assets would become vulnerable under a new policy. As a result, firms and households shifted from financial to real assets.

Furthermore, the rise in the proportion of financial assets in the public's portfolio (particularly in the last few years) and their high liquidity, enabled domestic demand to rise much faster than real disposable income, and savings, which had dipped sharply in 1982, again fell. (The 1982 decline reflected primarily the lagged response of consumption to the considerable 1981 rise in disposable income and the considerable rise in the market price of liquid assets including bank shares.)

The rate of gross private saving (from all sources) thus declined sharply, from 31 percent in 1978-81 to 27 percent in 1982 and 22 percent in 1983; this is a return to the level prevailing in the early 1960s and presumably signals a new trend (see Figures II-2 and II-3).⁴

The main features of public sector demand were that local public consumption rose by 5 percent in 1983 (this is similar to the 1982 rise, which reflected mainly increased defense purchases since the Lebanese war began), while public sector nondwelling investment rose by 13 percent (9 percent in 1982). Public sector residential construction, on the other hand, declined by 22 percent in 1982 and 19 percent in 1983; however, in the absence of data on sales, no conclusions can be drawn on the contractionary effects of this decline.⁵

Real gross tax revenue rose by 15 percent in 1982 and by 7 percent in 1983. Expenditure on subsidies and net transfers to the public dropped (in real terms) by 4 percent in 1982 and 2 percent in 1983. All in all, real net absorption (gross revenue less subsidies and transfers) rose by 65 percent in 1982 and 21 percent in 1983 (after declining by 32 percent in 1981).

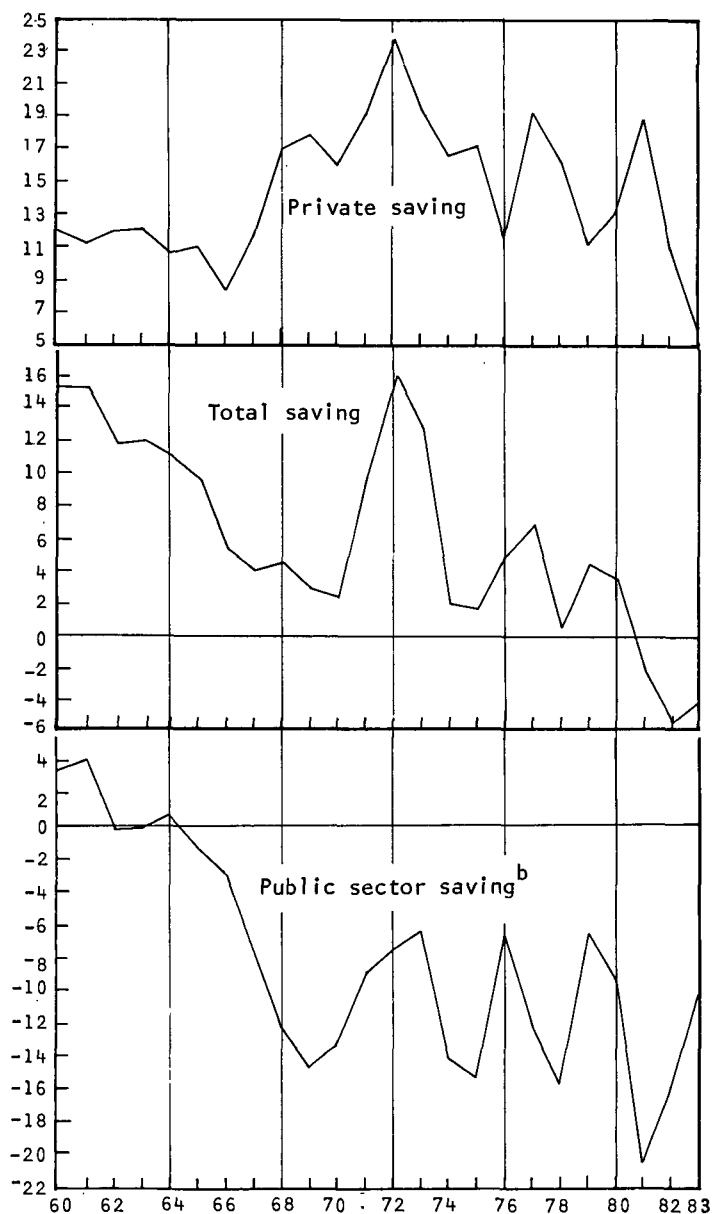
The contractionary effect of the increased absorption was outweighed by the expansionary effect of public consumption and investment, since it affects domestic demand indirectly, by reducing real private disposable income, and is thus dependent on the marginal propensity to consume of individuals and on short-run changes in it due to fluctuations of the tax rate.

The government affected domestic demand directly by increasing its consumption level and its fixed investment, and indirectly by raising taxes, on the one hand, and slowing down devaluation, on the other. However, the effects of the real appreciation of the IS and the consequent expectations of devaluation outweighed the effects of increased taxation, and private sector demand grew heavily.

⁴ The sharp fluctuations of tax and subsidy rates in recent years may have weakened the relationship between disposable income and private consumption. This would be reflected in the fluctuations of the saving rate but would not necessarily affect its trend.

⁵ When (as in 1983) the housing market is slack, the real decline in public sector proceeds from the sale of dwellings exceeds the decline in investments; in that case, the net figure (expenditure less income) would indicate that the government's demand surplus has risen because the government is forced to finance the increase in the stock of unsold dwellings.

Figure II-3
NATIONAL SAVING RATE, 1960-83^a
 (Percent)



^a Private and public sector saving as percent of GNP at market prices *plus* unilateral transfers.

^b Import taxes and export subsidies appear in the foreign trade account as respectively absorption and injection (this accords with the national accounts treatment of Table II-1, see note b there). Accordingly, in the public saving calculation, they are not included in income.

The 1983 increment includes receipt of part of the U.S. economic grant for fiscal year 1983/84.

All the final uses grew faster than their average long-run rate in 1983: private consumption by 7 percent, local public consumption by 5 percent, and fixed investment by 5 percent (see Table II-1).

Business sector product grew faster this year in spite of the shift of resources to imports. A combination of two factors is responsible: (a) the growth rate of the business sector's domestic demand rose in the first three quarters (see Table II-1a); even though a good part of the demand was for imports, the rest sufficed to revive domestic activity. Administrative protection of local production (under the Prevention of Dumping Law) may have checked the shift to imports, in the short-run. This is not a desirable way of achieving protection since it is liable to lead to serious resource misallocation. (b) The modest revival of exports (chiefly in the fourth quarter) had a distinct effect on the growth rate of product.

As mentioned, the persistent shift to imports is the result of the persistent decline in their relative price (15 percent over 1981-83) and of the expectation that it would be reversed. Exports have not yet returned to their 1981 level, but there

Table II-2
PRODUCT AND PRODUCTIVITY OF THE BUSINESS SECTOR, 1961-83
(Real average annual rate of change, percent)

	1961- 1972	1973- 1975	1976- 1983	1981- 1983	1981	1982	1983	Jan.- Sept. 1983
Product^a								
Estimate A	10.4	3.5	2.7	2.7	3.1	-0.1	2.1	5.1
Estimate B	9.1	3.5	3.4	3.7	4.1	2.4	4.6	..
Factor input								
Labor (man-hours)	3.6	-0.4	1.6	2.0	2.4	0.2	3.2	3.1
Capital stock ^b								
Assumption I	8.7	8.2	4.2	3.0	3.0	2.9	3.2	..
Assumption II	9.0	8.2	3.9	2.6	2.7	2.5	2.5	..
Productivity								
Product/man-hour								
Estimate A	6.6	3.9	1.1	0.7	0.7	-0.3	-1.1	1.9
Estimate B	5.3	3.9	1.8	1.7	1.7	2.2	1.4	..
Capital II/man-hour	5.2	8.6	2.3	0.6	0.3	2.3	-0.7	..
Total productivity ^c								
Estimate A	4.4	0.4	0.2	0.5	0.6	-1.2	-0.8	2.2
Estimate B	3.2	0.4	0.9	1.5	1.5	1.3	1.7	..

^a Estimate A is estimated from the expenditure side (national accounts). Estimate B is based on various indicators of output volume by industry. There are no estimate B figures for the fourth quarter of 1983; accordingly, the change from January-September 1982 to January-September 1983 enters the period averages.

^b The assumptions are: I, constant lifespan for all capital goods and II, declining lifespan for equipment.

^c The weights are 0.6 for labor and 0.4 for capital (II). As can be seen, the two capital assumptions yield similar productivity figures.

has been some increase, which moderated the rise in the ratio of the civilian import surplus to domestic resources. The rise in exports reflects some recovery in world trade and some recovery from the adverse effects of the Lebanese war (mainly on tourism and civil aviation). The relative price of exports (other than diamonds) declined this year too, but by only 0.2 percent (compared with 2 percent in 1982). This year's price decline reflects a stronger decline in the first three quarters and a rise in the fourth.

In October 1983 there was a drastic policy switch: the IS was devalued by 23 percent, subsidies on essentials were slashed, and it was decided to reduce public consumption. The timing of this change was determined by the events in the capital market. The price of bank shares dropped steeply with the cessation of share support. The measures described caused a marked acceleration of inflation and erosion of real wages (for details see Chapter III). The contraction of real income, wealth, and credit and the decline in the liquidity of bank shares resulted in an immediate drop in demand; domestic economic activity therefore slowed down in the last quarter.

The slow rate of growth—an average of 1.2 percent in GNP per capita in 1975–83 compared with 5.8 percent in 1961–72—has been one of the economy's basic problems in the last decade. If this problem is not solved, there is no way of gradually reducing the growth rate of the foreign debt while allowing private per capita consumption to grow moderately. (At some stage the debt should be reduced too.) Thus if the rate of economic growth is to rise without further increasing the—already high—ratio of foreign debt to product, domestic resources have to be allocated to investment. In other words, a rise in the net national saving rate is a prerequisite of future economic growth. The developments of the last three years have seriously detracted from the economy's growth prospects.

The net national saving rate dropped steeply in 1981, when, indeed, it became negative (–1.9 percent), declining further in 1982 (–5.3 percent). In 1983 it steadied at –4.0 percent. Throughout the 1960s and 1970s the rate was positive, averaging 4.5 percent in 1974–80 (the period after the Yom Kippur War).

The low real return on long-term financial investment may be another reason for the decline in the private saving rate. Thus, in the prevailing conditions of rapid inflation, the last-month indexation loss on long-term saving schemes sometimes entailed the loss of the entire cumulated real yield on the investment, and impaired confidence in such investments. In order to restore confidence in saving schemes the government promised that the real yield of the new schemes would be maintained or even increased.

This discussion points up the urgent need to increase public sector saving by cutting current expenditures. Any attempt to increase revenue by raising taxes (already quite high) is liable to do more harm than good, since it may well reduce private saving (see Bank of Israel, *Annual Report 1982*, Chapter II).

2. PRODUCT

In the first three quarters of 1983 business sector product rose by 5.1 percent the first three quarters of 1982, which is faster than the average for the last few years and was accompanied by increased productivity. In the fourth quarter there was a distinct decline (compared with the fourth quarter of 1982) which has not yet affected business sector labor input.

As can be seen in Table II-2, productivity grew much more slowly in 1976-83 (within the period the rate was steady). Product per man-hour grew at an average rate of 1.7 percent in 1981-83 (expenditure-side estimate) compared with 2.1 percent in 1975-82 (see Figure II-4). Capital stock per man-hour also slowed down from 1975-82 to 1981-83.

Since 1973, the long-run trend of business sector growth has been an annual rate of 3 percent. In the first three quarters of 1983, the rate was higher (5 percent), but unlike in the past, product growth was based on rapid growth of domestic final uses. In the last quarter of 1983 the trend changed. Domestic final uses slowed down considerably, whereas exports picked up. For the year as a whole, domestic final uses contributed 2.8 percentage points and exports 1.2 points (in 1982 their contribution was negative).

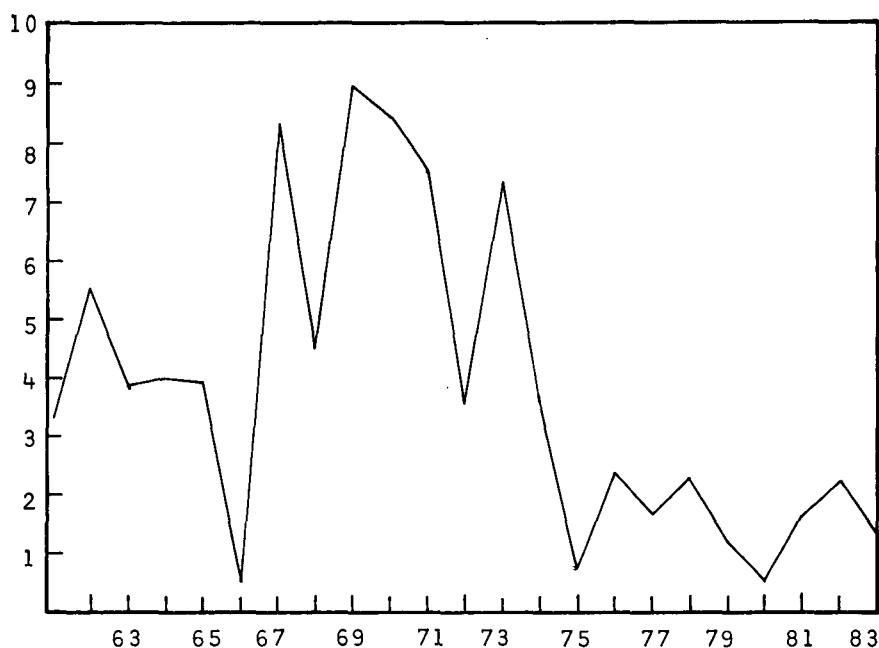
Table II-3
BUSINESS SECTOR GDP AT FACTOR COST, BY FINAL USE,^a 1975-83
(Percent)

	Percent of total					Contribution to change in product		
	1975	1980	1981	1982	1983	1981	1982	1983
Private consumption	37.9	36.6	37.6	39.3	39.4	2.8	2.4	1.7
Public consumption	11.2	8.3	8.3	8.2	8.7	0.4	0.1	0.8
Fixed investment	22.5	15.4	14.7	14.1	14.0	0.1	-0.3	0.5
Change in stocks	0.1	0.3	-0.6	-0.3	-0.5	-0.9	0.2	-0.2
Subtotal	71.7	60.6	60.0	61.3	61.6	2.4	2.4	2.8
Exports								
To Judea-Samaria	1.6	1.7	1.7	1.6	1.5	0.1	-0.1	-0.1
To rest of world	26.7	37.7	38.3	37.1	36.9	2.5	-0.5	1.3
Total	100.0	100.0	100.0	100.0	100.0	5.0	1.8	4.0

^a I.e., GDP excluding residential services and services of public sector and private nonprofit institutions. The breakdown shown here (based on input-output data) differs from the final-use data as follows: private consumption does not include compensation of employees of private nonprofit institutions and imputed rent; public consumption does not include compensation of employees; exports do not include factor payments from abroad.

SOURCE: The Bank of Israel's input-output table based on CBS input coefficients for 1977/78 and the national expenditure estimates of the CBS.

Figure II-4
BUSINESS SECTOR PRODUCT^a PER MAN-HOUR, 1961-83
 (Real annual change, percent)



^a Estimate B in Table II-2 (see note a there).

3. INVESTMENT⁶

Gross fixed investment rose by 10 percent in 1983 (having risen more moderately in 1981 and 1982). The high growth rate was due to a considerable increase in purchases of machinery and equipment and to the fact that the decline in nondwelling structures was arrested. However, purchases of transport equipment rose by 26 percent, which is less than last year; residential construction slumped further—the 1983 decline is concentrated chiefly in public sector residential construction, and is due, among other things, to demographic changes.⁷ As in the past, most of the incremental investment is imported, but this year domestic output of machinery and equipment also rose, and contributed to the 3 percent increase in the value added of gross fixed investment (in the preceding two years the value added of machinery and equipment declined in spite of the increase in investment).

⁶ This section concentrates on nondwelling investment. For investment in dwellings see the relevant section of Chapter V.

⁷ The population aged 25-34, the source of most housing demand, grew by no more than 1 percent in each of the last three years, compared with 5 percent in previous years.

Table II-4
GROSS DOMESTIC INVESTMENT BY TYPE OF CAPITAL GOOD, 1980-83

	At current prices IS million		Percent change over preceding year						
			Quantity				Prices		
	1982	1983	1980	1981	1982	1983	1981	1982	1983
Structures	72,625	163,464	-1.9	-0.1	-2.6	-3.5	133.4	120.2	133.2
Dwellings	48,044	103,244	5.6	1.8	-3.5	-7.1	133.4	118.0	131.2
Public	37,147	83,188	-5.4	4.5	3.5	-3.7	133.1	117.8	132.5
Private	10,897	20,056	48.6	-4.7	-21.7	-18.7	134.0	118.6	126.5
Other	24,581	60,220	-12.5	-3.9	-0.6	3.7	132.5	124.1	137.2
Structures	12,989	31,483	-15.5	-6.7	1.7	4.0	126.4	121.9	133.1
Earthworks	11,592	28,737	-8.5	-0.3	-3.3	3.4	142.1	128.7	139.7
Machinery and equipment	58,744	172,337							
Other than transport equipment	45,933	134,645	-10.8	6.9	9.7	24.9	124.6	126.6	134.6
Locally produced	14,772	41,786	0.4	8.5	-3.4	16.3	124.6	125.4	143.2
Imported	31,161	92,859	-16.8	5.9	17.4	29.1	124.7	127.1	130.9
Transport equipment	12,811	37,692	-44.0	25.7	32.8	26.2	125.5	96.7	133.1
<i>thereof</i> Ships and aircraft	1,484	5,499							
Total fixed investment	131,369	335,801	-9.8	4.0	4.6	9.7	129.8	119.5	133.1
Change in inventories	-222	-9,852							
Total gross domestic investment	131,147	325,949	-15.2	-7.1	14.6	5.9	130.7	120.1	134.6

SOURCE: Central Bureau of Statistics.

Table II-5
GROSS FIXED CAPITAL STOCK BY INDUSTRY (CONSTANT LIFESPAN
ASSUMPTION), 1960-84^a
(Average annual change, percent)

	1960-73	1973-80	1980-84	1983	1984
Total					
Agriculture	4.5	4.6	2.5	2.5	2.7
Water	5.6	2.4	3.4	2.8	2.9
Industry	7.1	7.1	4.7	4.9	5.5
Construction equipment	7.5	4.8	-0.4	-2.1	-0.1
Electricity	7.1	8.3	6.9	4.3	5.1
Transport and communications	12.8	5.3	1.4	1.5	3.0
thereof Excl. transport equipment	11.1	6.1	2.5	2.2	2.6
Private services	12.5	6.7	5.6	5.3	7.9
subtotal: Business sector	8.6	5.8	3.3	3.2	4.3
Public services	13.4	8.6	3.6	3.4	3.9
subtotal: Nondwelling stock	9.4	6.4	3.4	3.2	4.2
Excl. transport equipment	8.7	6.8	3.9	3.6	4.3
Dwellings	8.6	7.7	5.0	4.9	4.2
Total fixed capital stock	9.1	6.9	4.1	3.9	4.2
Structures					
Agriculture	4.5	3.6	2.4	2.2	2.1
Water	5.6	2.0	2.9	2.6	2.9
Industry	11.2	5.2	1.5	1.2	0.8
Electricity	9.2	6.2	4.4	3.6	2.2
Transport and communications	10.5	5.7	2.7	2.4	2.5
Private services	9.5	5.9	4.0	3.9	3.6
subtotal: Business sector	8.1	4.8	2.7	2.4	2.2
Public services	12.9	8.2	3.9	3.9	4.0
subtotal: Nondwelling stock	9.3	6.0	3.2	3.0	2.9
Dwellings	8.6	7.7	5.0	4.9	4.2
Total stock of structures	8.9	6.9	4.2	4.1	3.7
Machinery and equipment					
Agriculture	4.7	7.8	3.0	3.2	4.5
Water	5.2	6.1	7.0	4.2	2.8
Industry	7.5	8.0	5.9	6.3	7.2
Construction equipment	7.5	4.8	-0.4	-2.1	-0.1
Electricity	5.4	10.2	8.8	4.9	7.2
Transport and communications	14.7	5.0	0.5	0.4	3.4
thereof Excl. transport equipment	15.1	7.7	1.6	1.1	2.8
Private services	18.6	7.6	7.3	6.9	12.3
subtotal: Business sector	9.2	6.7	3.8	3.7	5.8
Public services	18.9	11.4	1.5	-0.2	3.0
Total stock of equipment	7.6	8.2	5.1	4.5	6.5
Total excl. transport equipment	9.5	7.0	3.7	3.5	5.6

^a Beginning-of-period data.

Table II-6
GROSS FIXED CAPITAL STOCK BY INDUSTRY (DECLINING LIFESPAN
ASSUMPTION), 1960-84^a

(Average annual change, percent)

	1960-73	1973-80	1980-84	1983	1984
Total					
Agriculture	4.5	4.6	2.5	2.5	2.7
Water	5.6	2.4	3.4	2.8	2.9
Industry	8.1	7.0	3.1	2.6	3.9
Construction equipment	7.5	4.8	-0.4	-2.1	-0.1
Electricity	7.1	8.3	6.9	4.3	5.1
Transport and communications	12.8	5.3	1.4	1.5	3.0
thereof Excl. transport equipment	11.1	6.1	2.5	2.2	2.6
Private services	12.2	5.6	5.9	5.7	8.1
subtotal: Business sector	9.0	5.7	2.9	2.5	3.8
Public services	13.4	8.3	3.6	3.6	4.5
subtotal: Nondwelling stock	9.7	6.2	3.0	2.8	3.9
Excl. transport equipment	9.0	6.5	3.4	3.1	4.0
Dwellings	8.6	7.7	5.0	4.9	4.2
Total fixed capital stock	9.2	6.8	3.9	3.7	4.1
Structures					
Agriculture	4.5	3.6	2.4	2.2	2.1
Water	5.6	2.0	2.9	2.6	2.9
Industry	11.8	5.3	1.5	1.3	0.8
Electricity	9.2	6.2	4.4	3.6	2.2
Transport and communications	10.5	5.7	2.7	2.4	2.5
Private services	9.5	5.9	4.0	3.9	3.6
subtotal: Business sector	8.1	4.8	2.7	2.4	2.3
Public services	12.9	8.2	3.9	3.9	4.0
subtotal: Nondwelling stock	9.3	6.0	3.2	3.0	2.9
Dwellings	8.6	7.7	5.0	4.9	4.2
Total stock of structures	8.9	6.9	4.2	4.1	3.7
Machinery and equipment					
Agriculture	4.7	7.8	3.0	3.2	4.5
Water	5.2	6.1	7.0	4.2	2.8
Industry	6.7	7.9	3.8	3.2	5.2
Construction equipment	7.5	4.8	-0.4	-2.1	-0.1
Electricity	5.4	10.2	8.8	4.9	7.2
Transport and communications	14.7	5.0	0.5	0.4	3.4
thereof Excl. transport equipment	15.1	7.7	1.6	1.1	2.8
Private services	17.9	5.3	8.3	8.1	13.9
subtotal: Business sector	9.8	6.4	3.0	2.6	5.0
Public services	18.3	8.7	1.1	0.6	8.5
Total stock of equipment	8.2	7.6	4.1	3.3	6.0
Total excl. transport equipment	10.1	6.5	2.9	2.5	5.2

^a Beginning-of-period data. It is assumed that the lifespan of machinery and equipment declines from 14 to 11 years (industry) and from 8 to 6½ years (private and public services).

Two factors were at work this year: the decline in the relative price of imported machinery and equipment and the expectations that this decline would cease; and a rapid rise in public sector investment. Investment demand was also stimulated by the acceleration of product growth and the increased volume of discards (though the latter contributed less than in previous years).

In 1982 (particularly in the fourth quarter), the volume of credit granted expanded considerably, beyond that year's investment requirements; as a result, the small decline in gross credit and the 8 percent drop in credit to the business sector did not constrain the sector's ability to finance investment. Perhaps too there was a shift from financial to real assets this year, as the public retreated from the financial assets acquired in the past few years because of their high yields.

The prevailing combination of import-price changes and expectations operates on two planes. In the first place, a decline in the relative price of imported producer durables improves the internal rate of return on all investment projects in a country which imports most of its capital goods, and therefore induces new projects. Such a process took place from 1981 to mid-1983 and this appears to have been long enough to set new projects going. Another reason for a higher relative return to capital goods was the high price of bank shares (as a result of which their expected yield fell).

Second, purchases of equipment for ongoing projects were advanced because the relative price of imports was expected to decline. As these expectations intensified and were reinforced by the fear that foreign-currency linked assets would be taxed, the advance purchases were stepped up.

Although investments in nondwelling structures rose for the first time in several years, the weight of machinery and equipment in nondwelling investment rose this year as well.⁸ Moreover, this year its weight in capital stock also rose. Nondwelling stock rose by 3.9 percent this year (see Table II-6), compared with 2.8 percent in 1982; within this aggregate, the stock of machinery and equipment rose by 5.2 percent, compared with 2.5 percent in 1982, or by 6.0 and 3.3 percent respectively when transport equipment is excluded.

Inventories dropped more steeply than in 1982, and this is why gross investment rose by only 5.9 percent compared with 14.6 percent in 1982. The decline in diamond stocks ceased this year, but fuel and industrial and agricultural stock contracted.

The Nondwelling Stock

The stock of nondwelling assets rose by rather more than last year (3.9 percent compared with 2.8 percent). As mentioned, this is because machinery and equipment rose much faster (5.2 compared with 2.5 percent), whereas structures rose by 2.9 percent, about the same as in 1982. The stock of machinery and

⁸ This is consistent with the long-run trend and reflects chiefly replacement needs. See Bank of Israel, *Annual Report 1982*, p.19.

equipment other than transport rose by 6 percent (3 percent in 1982), and its weight in nondwelling investment, which was 35 percent in the mid-1960s, reached 70 percent. However, this change in investment composition affects the stock only slowly, since it reflects mainly replacement.

Investment in nondwelling structures rose this year, although the growth rate of the stock again slowed down, to 2.3 percent (business sector). This year's increment is therefore consistent with a 4 percent rise in business sector product.⁹

The industrial composition of the capital stock has been changing throughout the past decade. The change is most marked in industry, and reflects stronger changes in investment. The share of food and textiles, which accounted for 32 percent in the early 1960s, dropped to 26 percent in the early 1970s and is today only 17 percent of industrial stock. The most dramatic change was the increase in the share of electric and electronic equipment which rose from 3 to 10 percent in the 1970s. The share of metal products, machinery, transport equipment, and chemicals and fuel rose more moderately.

The public sector's share of nondwelling stock grew rapidly in the 1960s and somewhat more slowly in the 1970s, when it rose from 20 to 24 percent. There were no drastic changes within business sector stock in the 1970s except for the rise in the share of electricity (from 5 to 8 percent).

4. PRIVATE CONSUMPTION, DISPOSABLE INCOME, AND SAVING

Private consumption rose by 7 percent in 1983, whereas real disposable income did not change. It follows that the rate of saving again declined—in 1982 it dropped below the average prevailing since the mid-1970s. Almost half of the 1983 consumption increment reflects consumer durables and the consumption of Israelis abroad; these items (whose weight in consumption is low) rose by 16.2 and 20.8 percent respectively.

Most of this year's consumption growth took place in the first quarter; in the second quarter consumption levelled off, with a slight tendency to decline, which gathered momentum in the last two quarters, and was almost certainly reinforced by the restrictive measures introduced in the second half of 1983¹⁰ and to the decline in wealth due to the fall in bank-share prices. However, the effect of these factors has presumably not yet run its course.

Current consumption rose by 4.6 percent in 1983. There was a marked rise of 6.3 percent in food, beverages, and tobacco (the principal current consumption item), in spite of a 4.6 percent increase in relative price. Consumption of fuel and lighting

⁹ A regression of investment in nondwelling structures on current and lagged GDP and the beginning-of-year stock of nondwelling structures has shown a high correlation for the past two decades.

¹⁰ Among other things, the imposition of a deposit requirement on some imports, cuts in subsidies on essential goods, two devaluations (7.5 and 23 percent), the abandonment of the slow devaluation policy, and announcements of the government's intention to pursue budgetary restraint.

Table II-7
PRIVATE CONSUMPTION, 1980-83

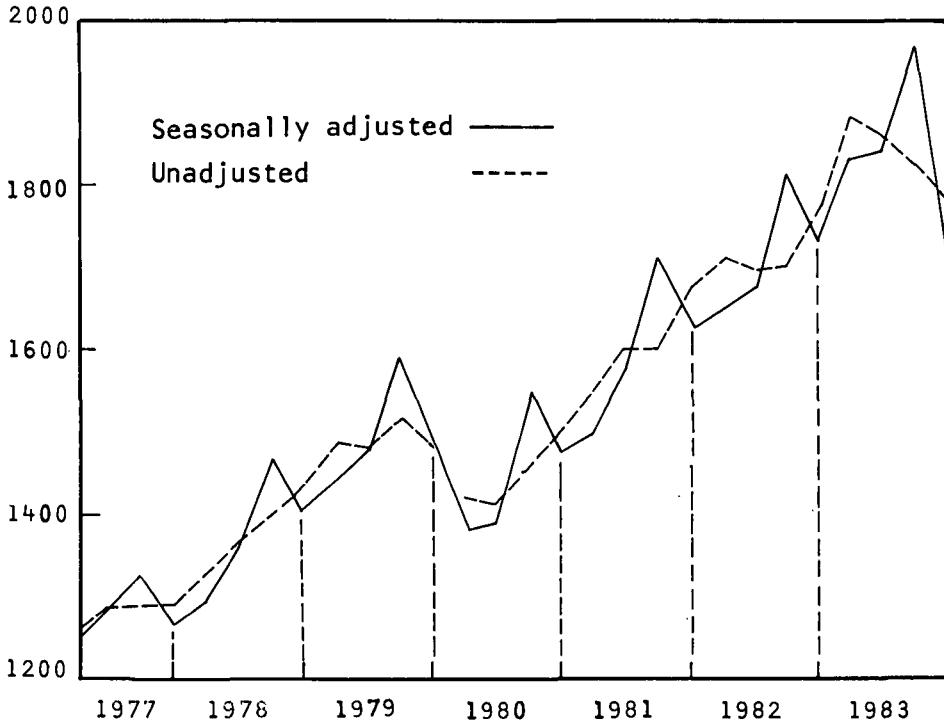
	1980	1981	1982	1983
At current prices (IS million)				
Goods for current consumption	27,325	61,678	141,515	360,084
Durables	6,239	16,992	40,076	109,575
Services ^a	13,096	31,579	73,739	196,595
Consumption of Israelis abroad	2,862	7,836	16,819	45,153
less Consumption of foreigners in Israel	5,089	12,171	24,406	65,429
Subtotal ^a	44,433	105,914	247,743	645,978
Residential services	10,912	27,954	64,515	168,163
Services of private nonprofit institutions	7,772	18,812	40,672	104,899
Total	63,117	152,680	352,930	919,040
Total excluding durables	56,878	135,688	312,854	809,465
Quantity (percent annual change)				
Goods for current consumption	-6.5	7.4	5.6	4.6
Durables	-8.4	37.6	17.1	16.2
Services ^a	-0.6	7.6	5.0	7.8
Consumption of Israelis abroad	2.9	27.7	3.6	20.8
less Consumption of foreigners in Israel	-2.1	1.4	-11.2	4.0
Subtotal ^a	-5.3	13.7	9.0	8.8
Residential services	4.2	4.2	4.2	3.7
Services of private nonprofit institutions	0.5	4.2	0.5	0.3
Total	-2.9	10.9	7.2	7.0
Total excluding durables	-2.0	8.0	5.8	5.6
Prices (percent annual change)				
Goods for current consumption	152.0	110.1	117.2	143.2
Durables	89.1	97.9	101.5	135.3
Services ^a	132.2	124.0	122.4	147.2
Consumption of Israelis abroad	128.6	114.4	107.1	122.2
less Consumption of foreigners in Israel	129.9	135.8	127.5	157.8
Subtotal ^a	136.6	109.6	114.7	139.7
Residential services	105.7	145.8	121.4	151.4
Services of private nonprofit institutions	120.5	132.2	115.1	157.2
Total	128.7	118.1	115.6	143.3
Total excluding durables	133.7	120.9	117.9	144.9

^a Excluding residential services and services of private nonprofit institutions.

SOURCE: Central Bureau of Statistics.

also rose sharply, by 9 percent, in part because of the 13 percent rise in the stock of vehicles and in part because of the 10.6 decline in relative price. Clothing, footwear, and personal effects dropped by 8.6 percent; this item exhibits strong fluctuations, which are not always in tune with changes in relative prices or the other consumption categories; this may be due to the problems of measurement encountered for this industry.

Figure II-5
PRIVATE CONSUMPTION, 1977-83
(Millions of 1975 IS)



Consumer durables, which rose by 37.6 and 17.1 percent in 1981 and 1982 respectively, went up by 16.2 percent in 1983. At the same time, the relative price declined by 20.6 percent over the three years (3.3 percent in 1983). Household equipment and private vehicles rose by 14.1 and 26.8 percent respectively; furniture, however, rose by only 7.7 percent—unlike other consumer durables, its relative price went up (by 5.9 percent), reflecting the low import component (16 percent for furniture compared with 80 percent for household equipment and 100 percent for private vehicles).

Consumption of services rose quite fast in 1983, by 7.8 percent. Within this category, transport services connected with foreign travel rose by 22 percent, accounting for over one third of the increase in services consumption.

The 1983 changes in the composition of consumption continue the trends of previous years: a decline in the share of current consumption and nonprofit institutions, and a rise in that of durables and the consumption of Israelis abroad.

Table II-8
DISPOSABLE INCOME, 1980-83

	Millions of current IS				Percent change over preceding year			
	1980	1981	1982	1983	1980	1981	1982	1983
1. National income	81,301	202,240	433,669	1,081,992	129.8	148.8	114.4	149.5
2. Public sector property and entrepreneurial income	3,199	5,383	17,970	55,451	151.3	68.3	233.8	208.6
3. Depreciation	14,405	34,309	77,111	187,209				
4. Gross private income from economic activity (1-2+3)	92,607	231,166	492,810	1,213,750	130.4	149.6	113.2	146.3
5. Direct taxes	25,955	61,137	135,327	339,148	149.5	135.5	121.3	150.6
Income tax	18,613	42,926	96,334	245,534	151.0	131.6	123.8	154.9
National insurance contributions	7,342	18,211	38,993	93,614	145.0	148.0	114.1	137.2
6. Net transfer payments	19,017	48,754	107,874	263,049	138.0	156.4	121.2	143.8
7. Gross private disposable income from domestic sources (4-5+6)	85,669	218,783	465,357	1,137,651	126.7	155.4	112.7	144.5
8. Personal transfers from abroad	5,851	13,177	26,030	51,769	112.0	125.2	97.5	98.9
9. Net compulsory loans	-1,070	-1,390	2,792	2,201				
10. Loan subsidy ^a	3,913	7,529	14,497	29,608				
11. Direct loan subsidy	2,562	6,045	12,724	26,593				
Gross private disposable income from all sources								
12. Aggregate A (7+8)	91,520	231,960	491,387	1,189,420	125.7	153.5	111.8	142.1
13. Aggregate B (12-9)	92,590	233,350	488,595	1,187,219	129.1	152.0	109.4	143.0
14. Aggregate C (13-10+11)	91,239	231,866	486,822	1,184,204	130.6	154.1	109.9	143.3

^a See note b to Table II-A1.

Disposable Income

Real disposable income¹¹ did not change in 1983 (in 1981 it rose by 16 percent and in 1982 it declined by 2 percent). In recent years there were frequent and sharp changes in fiscal policy, as a result of which nominal product and disposable income and the changes in product and consumption prices diverged markedly. These divergences generally cause real product and real disposable income to diverge also. Thus in 1980 and 1982 when fiscal policy was restrictive, real (and nominal) disposable income from domestic sources rose more slowly than real (and nominal) product. In 1981, on the other hand, policy was expansionary, and real disposable income for domestic sources rose by 19 percent, compared with 4 percent for real product. In 1983, nominal disposable income rose more slowly than nominal product; however, because of the real appreciation of the IS, consumption prices rose less than product prices. The net result was that real disposable income from domestic sources and real product both grew by 1 percent.

Frequent switches in policy reduce the correlation between disposable income and current private consumption; to put it another way such switches cause the saving rate to fluctuate, with very little effect on consumption, thereby reducing the efficacy of fiscal policy as a means of checking private consumption.

Table II-9
SAVING RATIOS, 1980-83^a
(Percent)

Ratio of saving to	1980	1981	1982	1983
Gross domestic disposable income	26.3	30.2	24.2	19.2
Total disposable income A	31.0	34.2	28.2	22.7
Total disposable income C	30.8	34.2	27.5	22.4

^a Saving ratio = (disposable income - private consumption) ÷ disposable income. The disposable income variants entering the calculations here are respectively from lines 7, 12, and 14 in Table II-A1.

¹¹ Gross disposable income from all sources, not net of compulsory loans and including the subsidy element of government loans (loan subsidy). See Table II-8 for alternative definitions.