

CHAPTER III

THE BALANCE OF PAYMENTS

1. MAIN DEVELOPMENTS

ISRAEL'S BALANCE of payments situation worsened appreciably in 1973, when the trade deficit shot up and the share financed by unilateral transfers dropped sharply. These developments were already evident at the beginning of the year and before the effects of the October war became apparent. The fourth-quarter data reflect the impact of the war: a reduction of the trade deficit following the contraction of economic activity, a big surge in defense imports, and an enormously larger inflow of unilateral transfers. These postwar developments, however, failed to materially alter the balance of payments situation.

A conjunction of several factors, both domestic and international, brought about the deterioration in the balance of payments. In the course of 1973 the negative trends gradually became more pronounced, but their effect is only partially reflected in the data for this period. Some of the adverse trends have carried over into early 1974; since changes of this sort generally make their full effect felt after a certain time-lag, sometimes of considerable duration, the possibility of a further intensification of the balance of payments strain in the future cannot be ruled out.

The adverse balance on current account¹ jumped 62 percent during the first nine months of 1973—from \$ 798 million to \$ 1,290 million. The commodity trade deficit was entirely responsible for this, while defense imports dipped slightly and there was a slight improvement in the services account. The trade deficit soared 91 percent—from \$ 581 million to \$ 1,110 million. Rising prices accounted for 39 percent of the increase,² while the remaining 61 percent was due to imports outpacing the real growth of exports.

Commodity imports were up 61 percent during the first nine months of the year. Part of the rise stemmed from a huge increase in ships, which is a highly irregular item and should be disregarded when evaluating year-to-year developments. Excluding ships and aircraft, the level rose 51 percent in current and

¹ Excluding trade with the administered areas.

² During the period discussed import prices went up only slightly faster on an average than export prices (most of the deterioration in the terms of trade took place in the final quarter of the year); the increase in the deficit attributable to advancing prices primarily reflects the fact that when two magnitudes rise to the same extent, the difference between them grows proportionally.

Table III-1
CURRENT DEFICIT, TRANSFERS, AND CAPITAL ACCOUNT (SUMMARY^a), 1967-73
(\$ million)

	1967	1968	1969	1970	1971	1972	1973		
							Jan.- Sept.	Oct.- Dec.	Entire year
Balance on current account (incl. administered areas)	-532	-648	-869	-1,234	-1,227	-1,081	-1,288	-1,272	-2,560
Unilateral transfers	521	435	459	649	765	1,052	777	1,413	2,190
Investments from abroad, net	8	-4	—	-2	64	142	142	17	159
Long- and medium-terms loans, net	295	168	168	559	642	580	417	394	812
Total long- and medium-term capital imports, net	824	599	627	1,207	1,471	1,775	1,337	1,824	3,161
Surplus of long-term capital over current account deficit	293	-49	-242	-27	244	693	49	552	601
Short-term capital	-51	-10	-55	-36	-54	-75	28	15	43
Increase in nonresidents' deposits and loans by foreign banks to Israeli banks, gross	5	35	115	185	291	299	57	1	58
Change in foreign exchange reserves due to economic transactions	-230	52	218	-105	-526	-942	-323	-339	-662
Errors and omissions	-15	-28	-36	-18	-46	24	190	-229	-40

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

^a See Table III-24 for further details.

SOURCE: Central Bureau of Statistics.

23 percent in constant prices, while exports forged ahead by 38 and 11 percent respectively.

In the financing of the deficit there was also a turn for the worse. To be sure, unilateral transfer receipts moved up from \$ 753 million during the first nine months of 1972 to \$ 777 million during the corresponding period in the year reviewed, or by 3 percent, but this is in nominal terms. Given the appreciation of assets and incomes because of the accelerating global inflation, this represents a real decline, at a time when the deficit that had to be financed widened greatly in real terms. As a result, the proportion of unilateral transfers plunged from 94 percent of the deficit in the first nine months of 1972 to 60 percent during the period reviewed.

The final quarter of the year reviewed was overshadowed by the aftermath of the war and the consequent severe contraction of economic activity, reflected by a slump in imports and exports. A development with grave implications for the economy, which appeared in the third quarter of the year and was greatly aggravated in the final quarter, was the marked worsening of Israel's terms of trade, which implies a drop in real national income.

(a) *Imports*

Imports accelerated greatly during the first nine months of the year; excluding ships and aircraft and rough diamonds, the rise was 17 percent in real terms, as against 8 percent in the same period the year before. Most items contributed to the faster growth rate; one exception is industrial investment goods, which inched up by a mere 2 percent as against 23 percent in 1972. The slackening of the uptrend here was a concomitant of a more sluggish expansion of investment in industrial equipment in general, and is not indicative of a decline in the import component of this item.

Imports of consumer durables were up by a formidable 32 percent. This was due primarily to a precipitate rise in prices, which was to be expected following the hiking of taxes on cars, and which led to the advancing of purchases. Other contributory factors were the generally higher level of consumption induced by the growth of incomes and the expectation that the severe inflation would persist.

Imports of inputs also expanded strongly during the period reviewed—18 percent in real terms, compared with zero growth in 1972. An examination on the basis of input-output coefficients shows such imports to have been a little greater than required for current production. Their relatively fast rise compared with that of the product and uses is explained by the fact that in 1972 such imports were far below current production requirements. The main reason for the latter development is apparently that the economy moved to a lower level of inventories because of a change in expectations and in relative profitability: the ebbing of devaluation expectations on the one hand and the increased cost

Table
CURRENT ACCOUNT,^a
(\$

	Imports					Exports	
	Goods	Defense imports	Services	Total		Goods	Services
				Incl. defense imports	Excl. defense imports		
A. \$ million							
At current prices							
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	586
1970	1,372	624	653	2,649	2,025	717	644
1971	1,759	555	768	3,082	2,527	900	914
1972							
Jan.-Sept.	1,352	358	634	2,344	1,986	771	775
Entire year	1,900	490	850	3,240	2,750	1,082	1,047
1973							
Jan.-Sept.	2,174	353	801	3,328	2,975	1,064	974
Entire year	2,862	1,253	1,084	5,199	3,946	1,363	1,272
At 1971 prices							
1967	776	318	525	1,619	1,301	545	454
1968	1,137	283	591	2,011	1,728	636	619
1969	1,298	359	662	2,319	1,960	686	663
1970	1,400	643	700	2,743	2,100	732	690
1971	1,759	555	768	3,082	2,527	900	914
1972							
Jan.-Sept.	1,294	352	620	2,266	1,914	736	779
Entire year	1,794	472	823	3,088	2,616	987	1,023
1973							
Jan.-Sept.	1,682	317	701	2,700	2,383	817	888
Entire year	2,117	1,086	914	4,117	3,031	987	1,105
B. Percent annual change							
1968	-1	-1	2	—	—	-2	-4
1969	4	6	5	5	5	6	3
1970	1	4	4	3	2	-1	6
1971	2	3	7	4	3	2	8
1972	6	5	4	5	5	9	2
1973							
Jan.-Sept.	24	9	12	19	20	24	11
Entire year	28	11	15	20	24	26	12
Quantity							
1968	47	-11	13	24	33	17	36
1969	14	27	12	15	13	8	7
1970	8	79	6	18	7	7	4
1971	26	-14	10	12	20	23	32
1972	2	-16	7	—	4	10	13
1973							
Jan.-Sept.	30	-10	13	19	25	11	14
Entire year	19	130	11	33	16	—	8
Value							
1968	45	-12	15	24	33	15	30
1969	19	34	18	21	19	14	10
1970	9	87	10	21	9	6	10
1971	28	-11	18	16	25	26	42
1972	8	-12	11	5	9	20	15
1973							
Jan.-Sept.	61	-1	26	42	50	38	26
Entire year	51	156	28	60	43	26	21

^a Imports c.i.f., exports f.o.b.

III-2
1967-73
(million)

Total	Deficit					Current account with administered areas	Over-all current account
	Trade balance	Defense imports	Services	Total			
				Incl. defense imports	Excl. defense imports		
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
1,361	-655	-624	-9	-1,288	-664	57	-1,234
1,814	-859	-555	146	-1,268	-713	40	-1,228
1,546	-581	-358	141	-798	-440	20	-778
2,129	-818	-490	197	-1,111	-621	31	-1,080
2,038	-1,110	-353	173	-1,290	-937	3	-1,287
2,635	-1,499	-1,253	188	-2,564	-1,311	4	-2,560
999	-231	-318	-71	-620	-302		
1,255	-501	-283	28	-756	-473		
1,349	-612	-359	1	-970	-611		
1,422	-668	-643	-10	-1,321	-678		
1,814	-859	-555	146	-1,268	-713		
1,515	-558	-352	159	-751	-399		
2,009	-808	-472	200	-1,080	-608		
1,705	-865	-317	187	-995	-678		
2,092	-1,130	-1,086	191	-2,025	-939		
-3							
3							
3							
4							
6							
17							
19							
26	117	-11		22	57		
7	22	27		28	29		
5	9	79		36	11		
25	29	-14		-5	5		
10	-6	-15		-15	-15		
13	55	-10		32	79		
4	40	130		88	64		
22	118	-12		29	77		
12	26	34		36	37		
8	13	87		40	13		
33	30	-11		-2	16		
17	-5	-12		-12	-13		
32	91	-1		62	70		
24	83	156		131	54		

SOURCE: Central Bureau of Statistics.

Table III-3
TRADE ACCOUNT, QUARTERLY DATA, 1970-73
(\$ million)

	Imports ^a			Exports ^a			Trade deficit ^a			Ships and aircraft	
	Un-adjusted	Seasonally adjusted	Quantity Index ^b	Un-adjusted	Seasonally adjusted	Quantity Index ^b	Un-adjusted	Seasonally adjusted	Quantity Index ^b	Imports	Exports
Annual data											
1970	1,367.9	1,366.3	100.0	731.6	733.0	100.0	635.6	633.3	100.0	58.5	2.0
1971	1,606.3	1,599.9	113.2	910.2	913.3	120.0	689.1	687.0	105.1	189.3	4.5
1972	1,893.5	1,893.1	126.5	1,088.8	1,098.9	134.6	804.7	794.2	116.8	63.8	13.1
1973	2,721.3	2,743.5	142.6	1,370.3	1,395.2	135.5	1,351.0	1,348.3	149.1	224.8	8.7
Quarterly data											
1970											
I	343.3	347.8		204.6	169.7		138.7	178.1		35.3	—
II	360.5	351.7		173.8	176.7		186.7	175.0		—	—
III	313.4	331.8		157.7	191.5		155.7	140.3		10.1	1.4
IV	350.7	335.0		196.2	195.1		154.5	139.9		13.1	0.6
1971											
I	377.4	375.9		343.3	202.8		129.9	173.5		106.5	—
II	407.4	387.6		223.4	223.2		182.6	164.8		23.3	—
III	381.8	408.5		183.8	231.8		197.8	189.1		19.3	—
IV	439.7	428.0		259.7	255.5		178.8	159.6		37.5	4.5
1972											
I	454.9	459.2	126.5	287.2	244.7	125.1	167.7	214.5	128.1	13.8	—
II	478.8	459.0	122.6	259.7	260.1	129.5	219.1	198.9	114.4	13.8	8.2
III	413.9	462.6	124.4	228.8	295.5	144.8	185.1	167.1	100.1	16.1	0.5
IV	545.9	512.3	132.6	313.1	298.6	138.8	232.8	213.7	125.2	20.1	4.4
1973											
I	579.1	533.4	144.1	353.3	298.5	130.7	225.8	248.9	159.9	4.7	2.1
II	705.9	678.4	150.2	359.0	362.6	142.1	346.9	315.8	159.8	94.7	3.9
III	761.2	818.2	159.4	356.4	428.1	156.3	404.8	390.1	163.2	94.7	0.3
IV	675.1	663.5	116.6	301.6	306.0	114.3	373.5	357.5	119.2	30.7	2.4

^a Excluding ships and aircraft.

^b Calculated by deflating the seasonally adjusted series by the appropriate price index. It is assumed that the price index is not significantly affected by seasonality; otherwise the quantity index is somewhat biased. The base of the index is the average for 1970.

SOURCE: Central Bureau of Statistics.

of holding stocks on the other. The data for 1973 would seem to indicate that the drawing down of stocks came to an end, but they remained on a low level with no substantial replenishment taking place. This was probably due to some aggravation of the liquidity situation during part of the period, to rising interest rates and financial yields, and the continued absence of expectations of an imminent devaluation.³ It is also possible that the rise in the relative price of imported final consumer goods compared with locally produced articles during the past three years, especially in 1973, induced some switching from imported to domestic manufactures, thereby retarding the expansion of imports.

Table III-4
ISRAEL'S TERMS OF TRADE, 1968-73

	Including diamonds			Excluding diamonds			Effect on current deficit ^c
	Import price index	Export price index	Terms of trade ^a	Import price index	Export price index	Terms of trade ^b	
Annual data							
1968	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1969	105.0	104.7	99.7	104.4	103.7	99.3	100.7
1970	105.6	104.4	98.9	107.2	103.5	96.5	102.7
1971	109.2	108.4	99.3	111.9	105.6	94.4	101.9
1972	115.8	116.2	100.3	118.0	109.9	93.1	99.5
1973	148.4	145.1	97.8	151.9	131.6	86.6	105.6
Quarterly data							
1972							
I	112.2	111.5	99.4	114.1	106.1	93.0	
II	115.7	114.5	99.0	117.9	109.8	93.1	
III	115.0	116.3	101.1	117.1	108.9	93.0	
IV	119.4	122.6	102.7	122.3	115.2	94.2	
1973							
I	115.1	130.1	104.0	125.7	117.9	93.8	
II	139.6	145.4	104.2	141.8	131.3	92.6	
III	158.6	156.1	98.4	163.1	140.3	86.0	
IV	175.9	152.6	86.8	179.2	142.2	79.4	

^a Export price index divided by import price index.

^b The diamond price index is statistically problematic; hence the terms of trade were calculated exclusive of this item.

^c The change in the current deficit due solely to the change in the terms of trade.

(b) *Exports*

The first nine months of 1973 saw a slackening in the real growth of exports. There was an even greater slowdown in real export value added, for

³ As evidenced by the standstill in the Natad and free-market dollar rates.

diamonds, which have a relatively low value-added component, accounted for much of the incremental overseas sales.

In industrial exports other than diamonds and mine and quarry products, the flattening out of the growth curve evident since the end of 1971 became more pronounced during the period reviewed, when a 3 percent real rise was posted, as contrasted with 9 percent in 1972 and an average of 20 percent in the four preceding years. The situation remains virtually unchanged even if we deduct various items that are affected strongly by special factors and only to a minor extent by general trends in the economy.

The factors determining the growth of exports in the period reviewed do not reveal a uniform picture; there were contradictory influences and even some reversals of trend. After holding steady between 1970 and the end of 1972, export profitability⁴ improved during the first half of 1973 and then turned downward. Between 1966 and 1970 it had risen appreciably following a jump in the effective rate of exchange for exports, while costs mounted slowly in an economy marked by much more moderate demand pressures than at present. This gain in profitability goes far to explain the impressive headway made by industrial exports until the end of 1971. When demand pressures began to sharpen, costs started to rise rapidly, halting the uptrend in export profitability. After a certain lag, the industrial export curve began to flatten noticeably. It is against this background, together with the expansion of domestic demand, that the further severe slackening of export growth in 1973 should be viewed.

The profitability trend began to turn in the first half of 1973, but because of the lagged nature of such a change, this cannot be attributed to current developments. The floating of leading European currencies against the dollar and the devaluation of the dollar shaved off some 14 percent from the external value of the Israeli pound,⁵ causing export proceeds to outrace costs, which continued to climb steeply.

The strengthening of the dollar in the second half of 1973 dramatically changed the impact of this factor. The Israeli pound appreciated and regained its beginning-of-the-year level. In contrast, input prices continued to rise precipitately, and export profitability turned downward; by the beginning of 1974 it was back to its 1970 level. This factor has a lagged effect, and its full impact on exports will probably be felt in the future.

Another factor undergoing a change in trend is overseas demand. The prosperity enjoyed by the developed countries in the second half of 1972 and the first half of 1973 resulted in the expansion of Israel's export markets and a more buoyant demand for its products. In the second half of 1973 economic

⁴ As measured by the ratio between the returns to the exporter and the level of costs.

⁵ Between January and July 1973 the exchange rate of the Israeli pound fell by an average of 14 percent against the currencies of the developed countries (which take 70 percent of Israel's exports).

activity in these countries began to flag noticeably, a trend that has since become more pronounced. This too has dampened the expansion of Israel's exports, and its influence will apparently grow stronger.

A third factor in the development of exports is the pressure of domestic demand. The mounting of such pressure was a major, and growing, cause of the retardation of the export advance in recent years. But its effect was mixed. Most industrial branches, and above all those producing mainly for consumption, enjoyed a surging domestic market, and this led to a much slower expansion of their exports. The picture is similar for some of the industries manufacturing investment goods. On the other hand, the building materials industry posted a much bigger export gain. This reflects the weakening of domestic demand for their output, which began sooner than in several other industries—chiefly some of those specializing in investment goods—and was relatively more pronounced. Those manufacturers of investment goods who were affected by the easing of domestic demand (e.g. producers of machinery and equipment) responded not by stepping up exports but by cutting back production. One possible reason for this is that the gearing of production to exports following a slump in domestic demand is a fairly protracted process. But it is also likely that the competitive position of these branches in foreign markets is not strong enough to enable them to utilize their slack productive capacity to expand overseas sales.

This last point highlights the importance of ensuring the ability of Israel's goods to stand up to foreign competition when the reference is to the diversion of commodities from the home to the foreign markets. With the faltering of demand in the immediate postwar period, the need to adopt a reflationary policy became a real possibility. In these circumstances, if the competitiveness of Israel's goods had been maintained, this would have permitted the introduction of reflationary measures, with a subsequent improvement rather than a deterioration in the balance of payments.

(c) *Capital account and the financing of the deficit*

The outstanding feature in the country's capital account during the first nine months of 1973 was a drop in the share of the convenient sources of financing the deficit. While unilateral transfer receipts hovered close to their record 1972 level—\$ 777 million as against \$ 753 million during the first three quarters of 1972—these are nominal values and expressed in dollar terms. Given the weakening of the dollar and the exacerbation of the global inflationary trends, which appreciated the nominal value of assets and incomes, there was actually a real decline of no insignificant proportions,⁶ a trend which gathered

⁶ The average rate of exchange of the Israeli pound (which is pegged at a fixed rate against the dollar) was down 7 percent from the corresponding period in 1972. This reflects the fact that among the currencies of Israel's trading partners the dollar occupies a leading place. But it does not fully mirror the inflation of nominal values. The appropriate measure

momentum in the course of the year. At the same time there was a big increase in the balance of payments deficit on current account, even after adjusting for the effect of the price rises; in real terms, it amounted to fully 33 percent.⁷

These developments affected the financing of the deficit very adversely. During this period unilateral transfer receipts covered 60 percent of the deficit, as opposed to 95 percent in the first three quarters of the previous year. But 1972 was, as already noted, a record year in this respect, and in comparison with the long-run average for the period preceding the Six Day War, there was apparently no great deterioration; then such transfers covered 65 percent of the deficit. Such a comparison, however, does not fully reflect the gravity of these developments for the economy; it does not make allowance for the drastic change in the size of the deficit relative to the other economic magnitudes. To finance that part of the deficit not covered by unilateral transfers during the first nine months of 1973 necessitated the import from other sources of an additional \$ 700 million of capital (at annual rates), compared with a \$ 170 million average in 1963–66. If the net foreign investment in Israel is included in the calculation, the growth of the deficit involved a \$ 500 million increase (in annual terms) in the external debt, compared with an average of \$ 50 million in 1963–66. In this respect, there was a return to the grave position of 1970, with the difference that at the beginning of 1973 the external debt was already double that of 1970 and the possibilities of a further rapid growth were diminished.

These capital account changes in the first nine months of 1973 must be viewed against the backdrop of several other developments. Personal transfers remained close to their level in the same period in 1972 in nominal terms, but in real terms they were down approximately 20 percent. The basic long-run determinants—the level of economic activity, profitability, and the security situation—did not change during the period reviewed. But a weakening of the real estate boom during part of the period and the currency restrictions imposed in April 1972 on investment in homes had a dampening effect. Despite the worsening of the balance of payments position and the approaching elections, devaluation expectations apparently did not have any great effect, to judge by the standstill in the Natad and free-market dollar rates.⁸ The de-

for this is the price rise of those imports that were financed by transfer receipts. These went up by an average of 23 percent over the corresponding period in 1972. Deflating the transfers by this index shows that in real terms they were 20 percent below their level in the first nine months of 1972.

⁷ Excluding defense imports, the deficit was up 79 percent in real terms; if the highly erratic ships and aircraft item is also deducted, the figure falls to 57 percent.

⁸ These, however, are primarily indicators of short-term capital movements. Devaluation expectations may conceivably have a disparate effect on short- and long-term capital movements. While those transferring short-term funds are likely to assume that they have sufficient time to get out of Israeli pounds before an anticipated devaluation, those contemplating the transfer of long-term funds will tend to wait until after the devaluation.

preciation of the dollar, which shaved off an average of 14 percent from the IL exchange rate between December 1972 and July 1973, undoubtedly contributed to this development and allayed fears of a devaluation of the IL. On the other hand, as the dollar continued to lose ground, expectations of a further retreat ebbed⁹ and there was less incentive to switch from dollars to other currencies—which also involved the deferment of the conversion of such currencies into Israeli pounds, whose value is pegged to the dollar.¹⁰

Two other factors helped to attract money from abroad. One was the widening of the differential between local and foreign financial yields. To be sure, interest rates in the international money markets moved up faster than the nominal bank rate in this country, but the return on index-linked bonds, the leading financial asset in Israel's money market, soared during this period. Secondly, the intensification of inflation in this country created a feeling that this trend would persist, and induced the advancing of transfers from abroad in anticipation of a further strong price rise.

Finally, it should be borne in mind that the surging capital inflow (in the form of personal transfers and investment capital), which began at the end of 1971 and continued through 1972, came on the heels of a sharp change in the basic determinants of capital movements, in particular short-term (e.g. the rate of return differential and devaluation expectations). Changes of this sort involve the reshuffling of investors' (actual and potential) asset portfolios. This process lasts for a limited time and is reflected by a huge inflow of capital, which is followed by a decline, even if there is no further change in the determinants of the relative profitability of financial assets. Thus it could a priori be expected that at a certain stage the uptrend in capital imports would slow and even reverse direction, even without the appearance of any additional factors.

In contrast to the trend in the other capital account items, and also to the much slacker expansion of domestic capital formation, foreign investment in Israel nearly doubled in volume. All the increase was in direct investments and unlisted securities. This cannot be satisfactorily explained at present, but it probably reflects the impact of the same factor that caused this item to respond with a lag when capital imports were expanding strongly.

Foreign loans to the private sector, apart from credits connected with the import of ships and aircraft, sagged noticeably during the period reviewed. This item is fully controlled by the Government, although presumably the demand for such credit, which varies in accordance with its relative profitability, ultimately also influences the volume. At the beginning of 1972 it was decided to issue fewer foreign credit permits as part of the tighter-money policy. This

⁹ Against the backdrop of the growing improvement in the U.S. balance of payments.

¹⁰ One possible indication of this is the accelerated movement to Israel of personal transfers and of German restitution payments in the form of pensions (which are paid regularly) between January and September 1973.

policy affected developments in 1972 and 1973, but it also seems that the rise in international interest rates, along with mounting expectation of an imminent devaluation of the Israeli pound, made it less worthwhile to borrow from overseas sources.

The final quarter of 1973 was overshadowed by the October war. Personal transfers and foreign investment capital shrank considerably, but the capital inflow to the public sector swelled following an intensive fund-raising campaign abroad to meet Israel's emergency needs.

(d) *International developments*

In 1973 the country's balance of payments trends were decisively influenced by world economic developments, which found expression in several different ways:

1. The floating of various major currencies against the dollar indirectly resulted in the floating of the Israeli pound.
2. The steep rise in raw material and basic commodity prices, together with the jump in oil prices, resulted in a marked deterioration in Israel's terms of trade and may strongly affect the level of domestic prices.
3. The drastic change in the business situation in the major world economies hurt the demand for Israel's exports.

The steep advance in raw material prices, which began at the end of 1972, was due to a combination of factors: burgeoning demand due to the more buoyant level of economic activity in the industrialized nations; supply constraints, some of which were of a transitory nature and others a result of low profits and investments in the past; and the upheavals in the international currency system, which eroded the public's confidence in various exchange rates and triggered a flight from financial assets to commodities, thereby further fueling the already heated rise in prices.

In the final quarter of 1973 crude petroleum prices were jacked up steeply, owing to a combination of factors, whose ramifications and exact character are still not entirely clear.

These developments pushed up import prices sharply, and in the fourth quarter of 1973 they stood 52 percent above the average level for the year. Export prices also moved up, reflecting the global inflation and to a certain extent the depreciation of the dollar. However, they trailed far behind import prices, the fourth-quarter index being 31 percent above the 1972 average. The export-import price increase differential widened at the end of the year, mainly because of the petroleum price rise.

As a result of these developments, Israel's terms of trade¹¹ in the final quarter

¹¹ The index of export prices divided by the index of import prices.

of 1973 were 13.5 percent below their average level in 1972.¹² It is difficult to predict future trends. There is reason to expect a softening of raw material prices, especially if business in the developed countries falls off further, but such an eventuality and its timing are far from certain.

Such a worsening in Israel's terms of trade implies a deep dent in the economy's real income. To illustrate this, it should be noted that in order to maintain the deficit at its 1972 level, given the terms of trade at the end of 1973, the economy would have had to step up exports (and reduce domestic uses) by IL 1,000 million¹³—equal to 3.5 percent of GNP and 8 percent of private consumption in 1972.¹⁴

The changes in the world business situation affect the expansion of Israel's overseas sales, although this is apparently a secondary factor compared with the profitability of exports. But insofar as a low level of activity and demand abroad puts a damper on exports, it throws a heavier burden on the export profitability factor. In 1972 and the first half of 1973 the world economy was buoyant, with most of the leading countries enjoying prosperity. Foreign demand had a favorable bearing on Israel's exports during this period compared with the two preceding years, but in the second half of 1973 the uptrend began to falter following the introduction of stringent fiscal and monetary measures in the major economies in an attempt to harness the inflation, which grew more rampant in recent years. The cooling off process is now in full swing, and it received added impetus from the fuel crisis (because of the ensuing balance of payments deficits and the resulting accelerated spiralling of prices), which is liable to lead to a further tightening of the restrictive measures. In such a climate, Israel's exporters will face growing hardships, and this, of

¹² The import and export price indexes include diamonds, and the measurement of this item, especially export prices, suffers from serious deficiencies. A calculation of Israel's terms of trade exclusive of diamonds reveals an even more striking deterioration, particularly when examining a longer period: according to this calculation, the index of Israel's terms of trade in the final quarter of 1973 stood at 79 percent of the 1968 average, while the index inclusive of diamonds came to 87 percent.

¹³ If we ignore the fact that numerous commodities command a higher price in the domestic than in the foreign market, so that the diversion of goods to export reduces domestic uses by more than their dollar value converted into IL equivalents at the effective rate of exchange.

¹⁴ This computation does not fully indicate the loss suffered by the economy from the worsening of the terms of trade. It implicitly assumes that the proportion of the deficit financed by unilateral transfers remains unchanged; this, however, is not necessarily a realistic assumption, for there are no grounds for expecting unilateral transfers to grow by the full amount required for financing the deficit at the higher price level. This means that to finance the same deficit in real terms, the economy will have to borrow more heavily, and the additional loans will ultimately constitute a real burden on the economy, for their repayment will necessitate the allocation of real resources over and above the amount required for financing the same real deficit at the previous terms of trade.

course, will render the profitability factor even more telling in stimulating overseas sales.

In 1973 export profitability was influenced by yet another major international development: the switch to a system of floating exchange rates. As a result, the Israeli pound has been floated de facto; but this is not an independent float: it does not reflect the operation of market forces on Israel's balance of payment, nor is it an outcome of steps initiated by the Israeli authorities under a coordinated economic policy; it is determined by those forces that cause the dollar to fluctuate against the other major currencies.

Israel's exchange rate policy has preserved the external appearance of a fixed rate (pegged to the U.S. dollar), but while this had some significance in a world of fixed parities, it became meaningless in the realities of 1973 when many currencies were floated. A fixed exchange rate policy should have called not for the floating of the IL together with the dollar, but for preserving the average international monetary value of the IL—i.e. a rate fixed against the average of the other currencies. This can be attained only through an independent float.

The pegging of the IL to the dollar suited the economy's needs as long as it depressed the average rate of the IL. In the realities of 1973, with the wage-price spiral in this country being twice as rapid as in the developed nations, such a change was imperative if Israel were not to price itself out of the foreign market.

Between December 1972 and July 1973 the average exchange rate of the IL fell 14 percent, but between then and January 1974 the strengthening of the dollar automatically brought it up by 10 percent. Between January and April 1974 there was again a reversal of trend, with the IL following the dollar down by 5 percent. In April the average rate stood 6 percent above its trough, reached in July 1973. Were it not for the downturn of the dollar in January,¹⁵ the de facto upvaluing of the IL would have dealt a serious blow to the profitability of Israel's exports. But this was forestalled because of factors unrelated to internal economic developments. It is hard to foresee how the dollar will move in the near future, but there is no doubt that the IL exchange rate should be determined in accordance with the economy's needs, and not depend on factors totally unconnected with the prevailing domestic conditions.

2. COMMODITY IMPORTS

Commodity imports expanded rapidly during the first nine months of 1973—by 60 percent at current prices as compared with the corresponding period

¹⁵ This downward turn was largely due to the lifting in that month of the restrictions on U.S. capital exports, which had been in force for 11 years. This move, originally scheduled for the end of 1974, was probably motivated chiefly by the desire to keep the dollar from rising further and even to push it down.

in 1972 and by 30 percent in real terms (import prices advanced 24 percent). Ships and aircraft totalled \$ 194 million, as against \$ 45 million in the first nine months of 1972, \$ 65 million for all of 1972, and \$ 189 million in 1971. This item is subject to sharp fluctuations and its behavior is not directly connected with developments in the economy. Another commodity that is not directly affected by general trends in the economy is rough diamonds; here imports jumped from \$ 216 million in the first nine months of 1972 to \$ 403 million during the same period in the year reviewed—a rise of 47 percent in quantitative terms. Less these two items, commodity imports rose 17 percent in quantitative terms, after an 8 percent increase in 1972.

Among the major categories, consumer goods posted the highest real quantitative growth—32 percent during the period reviewed as opposed to 12 percent in 1972 and 16 percent in 1971. Nondiamond intermediates were also up appreciably—18 percent as against a mere 1 percent in 1972—while in capital goods other than ships and aircraft the uptrend slowed from 23 to 11 percent (see Table III-5).

All subgroups contributed to the accelerated expansion of consumer goods imports. Foodstuffs were up 14 percent as against 2 percent in 1972, while nonfood items rose 17 percent after moving up 2 percent in 1972. The latter group was paced by durables, with an increase of 57 percent as contrasted with 27 percent in 1972 and 19 percent in 1971. This item was headed by furniture, household equipment, and motor cars.

These products are apparently influenced by the growth of real disposable income, devaluation expectations, the profitability of alternative private investments, and the Government's indirect tax policy. During the first three quarters of 1973 the uptrend in private consumption gathered momentum, with consumer durables (both imported and locally produced) leading the way. The latter development is explained by several factors. First, during the period discussed large retroactive wage and salary increments were paid after the renegotiation of collective wage agreements for 1972 and 1973, and the proportion of such income spent on consumer durables is generally high. Secondly, in the first three quarters of 1973 several major European currencies were revalued upward, making imports from these countries more expensive and setting off a wave of purchases of such commodities in anticipation of a further price increase. The precipitate climb of domestic prices, rumors about the Government's intention of imposing a value-added tax, and the issuance of regulations limiting the import concessions granted to new immigrants, with effect from the beginning of 1974, also operated in this direction. As regards passenger cars, the revision of the method of computing the tax induced many to buy earlier than originally planned.

The increased acquisition of consumer durables helps to explain the sharply higher growth of imports of such products. A comparison of real imports during the first nine months of 1973 with the same period the year before

Table
COMMODITY IMPORTS,^a BY
(\$

	1969	1970	1971	1972		1973	
				Jan.-	Entire	Jan.-	Entire
				Sept.	year	Sept.	year
Consumer goods							
Food	43.6	50.6	67.5	55.4	80.7	87.4	119.4
Other nondurables	36.2	42.0	56.7	44.7	62.0	65.4	83.8
Durables	61.6	50.0	60.1	54.6	82.0	100.9	129.9
Total	141.1	142.6	184.3	154.7	224.7	253.7	333.1
Intermediate inputs							
To agriculture	50.5	66.9	78.7	53.5	72.0	75.8	112.6
To industry (excl. diamonds)	476.1	547.8	598.2	443.6	613.4	654.8	893.0
To construction	18.9	21.5	33.9	32.5	47.2	50.0	64.1
Spare parts, tools, etc. for current use	77.0	91.7	89.3	80.4	107.1	98.1	123.6
Fuel	69.9	70.0	89.4	69.5	97.3	105.6	209.7
Subtotal	692.4	797.9	889.5	679.5	937.0	984.3	1,403.0
Rough diamonds (net)	192.8	154.4	224.1	216.4	316.1	403.4	448.0
Total	885.2	952.3	1,113.6	895.9	1,253.1	1,387.7	1,851.0
Capital goods							
For agriculture	8.2	6.9	9.2	8.3	11.1	10.5	13.8
For industry and construction	160.7	181.9	196.7	184.9	251.3	228.5	295.4
For land transport	47.1	57.9	77.4	75.2	110.1	113.3	160.5
Other	40.1	41.9	46.5	34.5	47.9	55.3	70.8
Subtotal	256.1	288.6	329.8	302.9	420.4	407.6	540.5
Ships and aircraft	32.0	58.4	189.3	44.5	64.5	194.1	224.8
Total gross imports	1,314.7	1,441.9	1,817.0	1,398.0	1,962.7	2,243.0	2,949.4
Total imports, excl. ships and aircraft and diamonds	1,089.9	1,222.9	1,382.2	1,137.1	1,582.1	1,645.5	2,276.6
Imports returned (excl. diamonds)	10.5	8.1	21.5	4.1	5.1	2.6	3.2
Total net imports	1,304.2	1,433.8	1,795.6	1,393.9	1,957.6	2,240.3	2,946.2
Less: Balance of payments adjustments	45.5	61.8	53.0	41.9	57.6	66.3	84.2
Total net imports, excl. the administered areas (according to the balance of payments)	1,258.7	1,372.0	1,758.6	1,352.0	1,900.0	2,174.0	2,862.0
Commodity imports from the administered areas	13.3	18.5	28.3	27.0	38.0	46.0	62.0
Total net imports, incl. the administered areas (according to the balance of payments)	1,272.0	1,390.5	1,786.9	1,379.0	1,938.0	2,220.0	2,924.0

^a Imports c.i.f.

III-5

ECONOMIC DESTINATION, 1969-73

million)

Percent annual increase or decrease (-)														
Quantity					Price					Value				
1970	1971	1972	1973		1970	1971	1972	1973		1970	1971	1972	1973	
			Jan.- Sept.	Entire year				Jan.- Sept.	Entire year				Jan.- Sept.	Entire year
11	8	2	14	6	5	23	18	39	39	16	33	20	58	48
14	21	2	17	9	2	12	7	25	24	16	35	9	46	35
-21	19	27	57	30	3	1	7	18	22	-19	20	36	85	58
-2	16	12	32	17	3	11	9	24	27	1	29	22	64	48
25	8	-8	11	20	6	9	-1	28	30	32	18	-9	42	56
13	6	-2	19	13	2	3	5	24	29	15	9	3	48	46
12	54	32	24	5	2	3	5	24	29	14	58	39	54	36
17	-4	16	2	-4	2	1	3	20	20	19	-3	20	22	15
2	5	-2	32	52	-2	22	11	15	42	—	28	9	52	116
14	7	1	18	15	1	4	4	23	30	15	11	5	45	50
-12	48	27	47	13	-9	-2	11	27	26	-20	45	41	86	42
8	14	7	25	15	—	3	6	24	29	8	17	13	55	48
18	28	16	4	1	-29	4	4	22	23	-16	33	21	27	24
10	3	23	2	-4	3	5	4	22	23	13	8	28	24	18
19	29	37	24	19	3	4	4	22	23	23	34	42	51	46
2	6	-1	31	20	2	5	4	22	23	4	11	3	60	48
10	10	23	11	5	3	4	3	22	23	13	14	27	35	29
74	209	-68	257	184	5	5	6	22	23	83	224	-66	336	249
9	22	2	29	17	1	3	6	24	28	10	26	8	60	50
11	10	8	17	12	2	3	5	24	29	13	13	13	45	44
9	21	2	30	18	1	3	6	24	28	10	25	8	61	51

SOURCE: Central Bureau of Statistics.

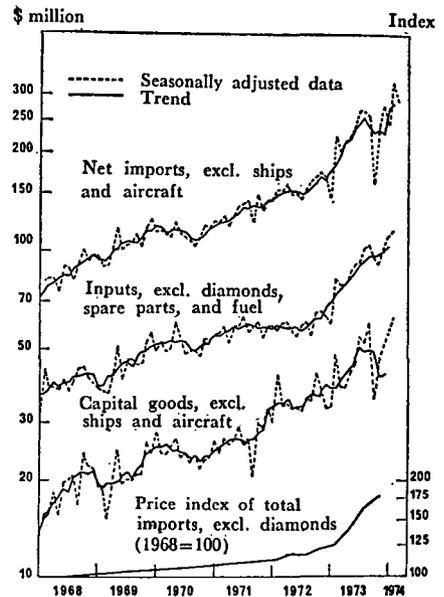
shows that they outpaced sales of locally produced items. This may have been due primarily to constraints on domestic production, but there may also have been a change in consumption habits, namely a switch to luxury items with the rise in real disposable income during the period reviewed (the relative price of imported durables compared with those produced locally went up during the first nine months of 1973 in comparison with the same period in 1972).

The deceleration in capital goods imports encompassed all sectors of the economy, apart from services and trade. In agriculture, industry, and construction the real increases were very low (4 percent in agriculture and 2 percent in industry and construction, after rises of 16 and 23 percent respectively in 1972). This can perhaps be explained by the completion in 1973 of a number

of big projects which accounted for a large percentage of the sectors' investments, while the initiation of new projects had not yet showed up in the investment data for this period. The uncertainty about economic developments after the elections, scheduled for October 1973, and the fear that the Government might deem it necessary to introduce restrictive measures undoubtedly also had an effect. The smaller percentage rise in capital goods imports for the construction industry came on the heels of a more sluggish expansion of its activity during the period discussed. In land transport, on the other hand, there was a strong rise during the first nine months of 1973, although the rate was lower than in 1972—24 as against 37 percent. Cars for business purposes, trucks, pickup vans, and buses accounted for most of the increase under this head. Sales started to become brisk in 1972, and it seems that here too the anticipation of a change in the system of taxes in April and the announced abrogation of some of the new immigrants' rights in January 1974 were the underlying factors.

Imports of inputs other than uncut diamonds were up 18 percent, after holding steady in 1972. In industry the rates were close to the 19 percent group average, following a 2 percent decline in 1972. Construction inputs rose 24 percent, but this was below the 32 percent posted in the previous year.

Figure III-1
NET IMPORTS, SELECTED COMPONENTS, AND IMPORT PRICE INDEX, 1968-74



The lower growth rate is apparently explained by some slackening of activity in this sector during the period reviewed. Inputs for agriculture were up 11 percent, after declining 8 percent in 1972; this was apparently due to the drought and the frost in the winter of 1973, which severely affected inputs from local output.

Actual imports of inputs during the first nine months of 1973 were close to what was required for current production, as calculated according to constant input coefficients for the various sectors of the economy (see Table III-8). In the previous year actual imports fell short of current requirements, edging up by a mere 1 percent in real terms. The main reason for the difference between the two periods compared apparently lies in inventory fluctuations, due to speculative considerations regarding import prices and exchange rate changes. In 1972 stocks of imported inputs (other than diamonds) apparently were run down owing to the absence of devaluation expectations, the calm prevailing in European money markets, and the high cost of maintaining inventories because of the high alternative rates of return obtainable. During the first three quarters of 1973 nondiamond imports were apparently close to current production requirements, and inventories remained at more or less the previous year's level. This may have been due to some aggravation of the liquidity situation during part of the period and to the absence of expectations of a devaluation before the October 1973 elections. A comparison of data on Government stocks at the end of September 1973 and September 1972 shows that stocks of most items were reduced, with only wheat and frozen beef showing higher figures. It should be noted here that among the uses of domestic output for which the import requirements were calculated, the increase in inventories from domestic output was not included. This understates the total required input, and therefore the positive differences between actual and required imports of inputs in Table III-8 are actually smaller and the negative differences larger in absolute values.

The surplus of actual over required nondiamond imports during the first nine months of 1973 conceivably indicates some substitution of imported for domestic inputs because of heavy domestic demand, which could not be met under the prevailing full-employment conditions in the economy (this applies especially to cement).

The import component of domestic output uses increased during the first three quarters of 1973: whereas total domestic output use was up 10 percent, required imports of inputs rose more than 12 percent (see Table III-7). This trend has been very much in evidence since 1971 and is explained by the big export gains chalked up by diamonds, where the import component is high. Excluding this item, required imports moved up almost in step with output use—about 9 percent; nondiamond exports and investment were less import-intensive than in 1972, public consumption more import-intensive (apparently because of a drop in the share of construction in output demand), while in

Table III-6
IMPORTS, BY ECONOMIC DESTINATION, QUARTERLY DATA, 1970-73
(\$ million)

	Total ^a			Consumer durables			Intermediates ^c			Capital goods ^a		
	Unad-justed	Seasonally adjusted	Quantity index ^b	Unad-justed	Seasonally adjusted	Quantity index ^b	Unad-justed	Seasonally adjusted	Quantity index ^b	Unad-justed	Seasonally adjusted	Quantity index ^b
1970 I	343.3	347.8		13.9	13.7		155.4	154.8		73.1	77.2	
II	360.5	351.7		11.7	11.4		164.1	166.6		81.8	75.5	
III	313.4	331.8		11.8	13.5		142.5	150.3		66.4	70.7	
IV	350.7	335.0		12.4	11.4		159.6	149.8		69.7	67.9	
Total	1,367.9	1,366.3	100.0	49.8	50.0	100.0	621.6	621.5	100.0	291.0	291.3	100.0
1971 I	377.4	375.9		14.5	13.2		175.8	173.6		77.9	81.5	
II	407.4	387.6		14.2	14.6		171.2	168.1		90.3	81.8	
III	381.8	408.5		12.4	15.0		166.9	182.1		67.7	73.4	
IV	439.7	428.0		18.7	16.6		180.0	169.8		94.5	91.3	
Total	1,606.3	1,599.9	113.2	60.1	59.6	117.5	693.6	693.6	109.1	330.4	328.0	107.9
1972 I	454.9	459.2	126.5	17.6	17.2	127.4	186.0	181.7	111.8	102.7	106.8	142.5
II	478.8	459.0	122.6	19.4	19.5	144.4	147.7	176.5	105.6	109.2	99.3	126.8
III	413.9	462.6	124.4	17.6	21.5	156.3	166.3	182.5	109.1	91.9	104.7	134.3
IV	545.9	512.3	132.6	27.4	23.4	169.9	205.1	190.0	107.9	117.6	113.1	140.9
Total	1,893.5	1,893.1	126.5	82.0	81.6	149.5	732.1	730.7	108.6	421.4	423.9	135.0
1973 I	579.1	583.4	144.1	30.5	29.4	208.9	232.8	226.4	124.7	119.7	123.5	148.0
II	705.9	678.4	150.2	35.5	35.9	220.8	252.7	255.8	127.5	139.1	126.4	134.0
III	761.2	818.2	159.4	34.9	40.4	220.0	294.7	317.5	135.7	149.8	168.4	157.2
IV	675.1	663.5	116.6	29.0	25.6	139.3	288.9	276.2	108.0	133.0	130.4	124.0
Total	2,721.3	2,743.5	142.6	129.9	131.3	197.2	1,069.1	1,075.9	124.0	541.6	548.7	141.0

^a Excluding ships and aircraft.

^b See note to Table III-6.

^c Excluding diamonds, fuel, and spare parts.

SOURCE: Central Bureau of Statistics.

private consumption of domestically produced items the import component held steady.

The principal changes in the sources of the incremental demand for imported inputs were a decline in the weight of nondiamond exports from 20 percent in 1972 to 8 percent during the first three quarters of 1973 and a rise in domestic uses from 70 to 83 percent (see Table III-8). Trends in domestic uses were mixed, with the share of investment dropping and that of private and public consumption rising.

In import prices the outstanding developments during the period reviewed were the precipitate rise in foreign prices and the exchange rate changes in the European markets. The jump in world raw material prices, which was the sharpest since the Korean War, was connected with several factors: brisk demand on the part of industrialized nations, combined with numerous supply difficulties due to a variety of causes (the cutting back of output in response to falling prices in recent years, poor yields, small stocks, transport difficulties, and strikes).

Commodity prices in dollars or sterling went up even faster, owing to the depreciation of these currencies against most of the other major currencies, particularly in the first half of 1973. This instability in the foreign exchange markets led to speculative transactions in commodities and the shifting to these markets of resources which are generally invested in other markets. The attempt of the exporting countries to achieve a greater degree of cooperation among themselves so as to obtain higher prices was another contributory factor in the price rises.

Toward the end of 1973 it seemed that numerous commodity prices were beginning to plateau somewhat, but in February 1974 they resumed their rapid advance. This may have been due to the upping of fuel prices (which affected many other commodity prices).

A comparison of the breakdown of Israel's actual imports, other than diamonds and ships and aircraft, by country of origin in the first nine months of 1973 with what it would have been had the branch composition of imports alone changed while the distribution of each branch by country of origin remained the same as in the corresponding period in 1972 shows that not only was there no switch to countries whose goods became "cheaper" in the wake of the European currency changes, but on the contrary, the share of West Germany moved up a notch and those of the U.K. and U.S.A. dipped slightly (see Table III-19). This may have been due to the uncertainty as to how the currency markets would continue to develop, as well as to a natural tendency to preserve established commercial ties. It is also conceivable that some of the contracts included a clause providing for the adjustment of prices to variations in the exchange rates.

Table III-7

USES OF DOMESTIC OUTPUT AND THEIR IMPORT COMPONENT, 1968-73

	Exports			Domestic uses				Total uses	
	Incl. diamonds	Excl. diamonds	To administered areas	Total	Private consumption	Public consumption	Investment	Incl. diamonds	Excl. diamonds
Uses of domestic output									
(IL million, at 1968/69 producer prices)									
1968	3,935	3,239	170	10,196	6,450	1,525	2,221	14,302	13,606
1969	4,317	3,592	242	11,632	6,936	1,788	2,908	16,190	15,465
1970	4,739	4,064	265	12,720	7,326	2,084	3,310	17,724	17,049
1971	5,820	4,992	337	13,997	7,751	2,458	3,788	20,153	19,325
1972									
Jan.-Sept.	4,863	4,084	317	11,484	6,282	1,828	3,374	16,664	15,885
Entire year	6,576	5,498	435	15,540	8,433	2,478	4,629	22,550	21,472
1973 ^b	5,300	4,304	366	12,642	7,022	1,808	3,812	18,309	17,313
Required imports of current inputs									
(\$ million, at 1971 prices)									
1968	307	150	14	447	290	72	85	768	611
1969	333	170	22	511	315	83	113	866	703
1970	344	192	22	554	338	88	128	920	768

1971	412	226	29	614	357	113	144	1,055	869
1972									
Jan.-Sept.	355	180	28	497	289	81	127	880	705
Entire year	485	243	38	675	392	109	174	1,198	956
1973 ^b	409	185	33	547	323	82	142	989	765

Percent increase in uses of domestic output (at constant prices)

1969	9.7	10.9	41.8	14.1	7.5	17.2	30.9	13.2	13.7
1970	9.8	13.1	9.6	9.4	5.6	16.5	13.8	9.5	10.2
1971	22.8	22.8	27.3	10.0	5.8	18.0	14.4	13.7	13.3
1972	13.0	10.1	29.0	11.0	8.8	0.8	22.2	11.9	11.1
1973 ^b	9.0	5.4	15.3	10.1	11.8	-1.1	13.0	9.9	8.9

Percent increase in required imports of current inputs (at constant prices)

1969	8.5	13.3	57.1	14.3	8.6	15.3	32.9	12.8	15.1
1970	3.3	12.9	—	8.4	7.3	6.0	13.3	6.2	9.2
1971	19.8	17.7	31.8	10.8	5.6	28.4	12.5	14.7	13.2
1972	17.7	7.5	31.0	9.9	9.8	-3.5	20.8	13.6	10.0
1973 ^b	15.2	2.8	17.9	10.1	11.8	1.2	11.8	12.4	8.5

^a The import component is calculated here according to the 1968/69 input-output table; in the 1972 *Annual Report* the table for 1965/66 was used.

^b January-September.

Table III-8
REQUIRED^a AND ACTUAL IMPORTS OF CURRENT COMMODITY INPUTS, 1969-73

	Required imports								Total actual imports, excl. diamonds	Difference between required and actual imports	
	Exports			Domestic destinations				Total required imports			
	Incl. diamonds	Excl. diamonds	To administered areas	Total	Investment	Private consumption	Public consumption	Incl. diamonds			Excl. diamonds
1. At current prices (\$ million)											
1969	342	161	20	476	107	291	78	838	657	692	35
1970	342	187	21	530	126	319	85	893	738	798	60
1971	412	226	29	614	144	357	113	1,055	869	890	21
1972											
Jan.-Sept.	377	186	29	511	129	299	83	918	726	680	-46
Entire year	522	254	40	704	180	411	113	1,266	998	937	-61
1973 ^b	542	232	42	694	181	411	102	1,278	968	984	16
2. At 1971 prices (\$ million)											
1969	333	170	22	511	113	315	83	866	703	726	23
1970	344	192	22	554	128	338	88	920	768	828	60
1971	412	226	29	614	144	357	113	1,055	869	890	21
1972											
Jan.-Sept.	355	180	28	497	127	289	81	880	705	660	-45
Entire year	485	243	38	675	174	392	109	1,198	956	897	-59
1973 ^b	409	185	33	547	142	323	82	989	765	778	13
3. Percent annual quantitative change											
1969	8.5	13.3	57.1	14.3	32.9	8.6	15.3	12.8	15.1	10.0	
1970	3.3	12.9	—	8.4	13.3	7.3	6.0	6.2	9.2	14.0	

1971	19.8	17.7	31.8	10.8	12.5	5.6	28.4	14.7	13.2	7.5
1972	17.7	7.5	31.0	9.9	20.8	9.8	-3.5	13.6	10.0	0.8
1973 ^b	15.2	2.8	17.9	10.1	11.8	11.8	1.2	12.4	8.5	17.9

4. Quantity index (1968=100)

1969	108.5	113.3	157.1	114.3	132.9	108.6	115.3	112.8	115.1
1970	112.1	128.0	157.1	123.9	150.6	116.6	122.2	119.8	125.7
1971	134.2	150.7	207.1	137.4	169.4	123.1	156.9	137.4	142.2
1972									
Jan.-Sept.	115.6	120.0	200.0	111.2	149.4	99.7	112.5	114.6	115.4
Entire year	158.0	162.0	271.4	151.0	204.7	135.2	151.4	156.0	156.5
1973 ^b	133.2	123.3	235.7	122.4	167.1	111.4	113.9	128.8	125.4

5. Percent of total imports, excl. diamonds (at 1971 prices)

1969		24.2	3.1	72.7	16.1	44.8	11.8		100
1970		25.0	2.9	72.1	16.7	44.0	11.4		100
1971		26.0	3.3	70.7	16.6	41.1	13.0		100
1972									
Jan.-Sept.		25.5	4.0	70.5	18.0	41.0	11.5		100
Entire year		25.4	4.0	70.6	18.2	41.0	11.4		100
1973 ^b		24.2	4.3	71.4	18.5	42.2	10.7		100

6. Percent of incremental imports (at 1971 prices)

1969		21.7	8.7	69.6	30.4	27.2	12.0		100
1970		33.8	—	66.2	23.1	35.4	7.7		100
1971		33.7	6.9	59.4	15.8	18.8	24.8		100
1972		19.5	10.3	70.1	34.5	40.2	-4.6		100
1973 ^b		8.3	8.3	83.4	25.0	56.7	1.7		100

^a See note to Table III-7.

^b January-September.

Commodity imports in the fourth quarter

In the last three months of 1973 commodity imports other than ships and aircraft added up to \$ 675 million, as against \$ 546 million in the previous quarter. Compared with the corresponding period in 1972, the figure was down 15 percent in real terms (see Table III-3). There was a sharp cutback in October, but toward the end of the year and the beginning of 1974 the trend turned upward to almost regain its prewar level. The main reason for the decrease was apparently congestion in the ports and the overburdening of civilian transport because of the war and the protracted mobilization. In the final quarter import prices were 9.5 percent up on the previous quarter, and by year's end stood 28 percent above the average for 1972.

The most striking decrease was in consumer goods, which slipped 21 percent in real terms below their level in the final quarter of 1972. From a \$ 32 million monthly average between April and September 1973, the figure fell to a seasonally adjusted \$ 25 million in the last three months of the year. The decline took place in October, and was apparently due to congestion in the country's ports. Between November and January 1974 the trend turned slightly upward but failed to return to its prewar level. Besides port congestion, a slump in sales in the immediate postwar period was probably a basic cause.

Imports of production inputs amounted to \$ 463 million in the final quarter of 1973. If diamonds, fuel, and spare parts are disregarded, the average monthly level in the final quarter was not much lower than in the second half of the previous year—\$ 72 million as against \$ 95 million (seasonally adjusted data, at current prices). Compared with the corresponding quarter of 1972, there was a real drop of 3 percent. At the beginning of 1974 the level began to pick up and head towards its prewar average.

Imports of unpolished diamonds plunged from an average monthly figure of \$ 56 million in the half year preceding the war to \$ 15 million. The curve started to turn down in September, apparently because of some faltering of world demand for polished stones. For this reason, and also because of the war, the London Diamond Syndicate released Israeli diamond industrialists from their prior purchase commitments during this period. Imports were still low in January and February 1974, but in March there was a vigorous upswing.

Fuel imports spurted during the period discussed, from a monthly average of \$ 13 million in the half year before the war to \$ 35 million in the final quarter. This reflects a rise of 54 percent in prices and of 75 percent in quantity, which were due to the war and the oil embargo.

Imports of investment goods totalled \$ 164 million in the final quarter of 1973. This includes \$ 31 million in ships and aircraft, so that net of this item, the figure was \$ 133 million, compared with a quarterly average of \$ 144 million in the preceding half-year. Here too the sharpest drop took place in

Table III-9
FOREIGN TRADE PRICE INDEX, 1969-73
(1968=100)

	Commodity imports							Commodity exports					
	Total		Excl. diamonds and fuel	For consumption		Inputs industry, to excl. diamonds	Fuel	Capital goods	Total		In-dustrial exports, excl. diamonds	Agricultural exports	
	Incl. diamonds	Excl. diamonds		Total	Food				Incl. diamonds	Excl. diamonds		Total	Citrus
Annual averages													
1969	105.0	104.4	104.6	102.8	103.1	105.4	102.1	105.1	104.7	103.7	103.5	104.5	105.9
1970	105.6	107.2	107.6	106.1	107.9	107.1	100.5	108.1	104.4	103.5	105.1	99.4	99.9
1971	109.2	111.9	111.3	117.5	132.0	122.1	112.8	108.4	108.4	105.6	105.7	105.1	107.6
1972	115.8	118.0	117.1	128.5	155.9	115.3	135.2	117.1	116.2	109.9	110.9	107.2	107.7
1973	148.4	151.9	148.7	161.2	216.9	149.1	191.5	144.1	145.1	131.6	133.8	124.8	121.4
Quarterly													
1972													
I	112.2	114.1	111.5	121.3	136.0	112.0	132.0	114.8	111.5	106.1	109.0	102.5	101.7
II	115.7	117.9	115.9	130.7	164.5	115.2	136.8	116.3	114.5	109.8	108.8	113.3	123.5
III	115.0	117.1	115.1	126.1	147.7	115.4	137.5	115.7	116.3	108.8	109.4	99.5	96.8
IV	119.4	122.3	120.9	130.1	160.1	121.4	135.4	119.2	122.6	115.1	115.8	113.0	113.1
1973													
I	125.1	125.7	124.7	130.9	163.7	125.1	145.8	123.9	130.1	117.9	117.9	117.9	119.7
II	139.6	141.8	141.1	157.7	218.8	138.3	153.6	140.0	145.4	131.3	131.3	131.5	116.8
III	158.6	163.1	162.8	181.0	242.0	161.3	167.0	159.1	156.1	140.3	140.0	145.2	117.3
IV	175.9	179.2	168.8	178.5	243.5	176.4	247.5	155.3	152.6	142.2	145.8	130.1	127.7

SOURCE: Central Bureau of Statistics.

October, while toward the end of 1973 and the beginning of 1974 the level approached its prewar average.

Table III-10

PRICE INDEX OF SELECTED IMPORTED COMMODITIES, QUARTERLY, 1972-73

(1st quarter 1972=100)

	1972				1973			
	I	II	III	IV	I	II	III	IV
Wheat	100.0	100.8	95.8	113.7	143.5	153.1	183.4	230.8
Sorghum	100.0	99.6	96.4	101.4	112.2	125.5	177.4	211.4
Corn	^a	100.0	103.6	104.7	119.9	138.3	206.2	219.0
Barley	^a	—	100.0	101.9	159.0	175.2	216.5	192.4
Soybean	100.0	106.9	111.2	108.4	116.6	119.0	251.9	195.7
Sugar	100.0	133.7	125.4	122.4	147.0	155.7	143.9	147.0
Meat	100.0	99.0	100.9	112.3	113.1	150.8	184.3	202.4

^a No imports.

3. COMMODITY EXPORTS

Exports of locally produced goods were up 37 percent in current prices during the first nine months of 1973 as compared with the same period in 1972. This is the most impressive advance achieved in the last few years—in 1972 and 1971 gains of 24 and 21 percent respectively were posted. But the extraordinary results during the period reviewed were largely due to the 24 percent higher prices commanded abroad; the real increase came to only 12 percent, as against 15 percent in 1972 (see Table III-15).

The advance was paced by diamonds, which forged ahead by a formidable 28 percent in quantitative terms—from \$ 272 million in the first three quarters of 1972 to \$ 455 million during the same period in 1973. This brought up the weight of this item in incremental exports to 63 percent in nominal terms, and in real terms to a resounding 96 percent as against 65 percent the year before (see Table III-13).

The real rise in value added was slower than in total exports, owing to the increased weight of diamonds, which has a relatively high import component.

Overseas sales of citrus inched up less than 2 percent in value terms, with quantities being down 9 percent.

In the broad group of manufactures that are not preponderantly export-oriented but are sold to both the local and overseas markets, the advance lost considerable steam in physical terms, continuing the trend begun in the previous year. Exports of nondiamond industrial goods and mine and quarry

Table III-11
COMMODITY EXPORTS, 1970-73
(\$ million)

	Net exports, excl. ships and aircraft			Industrial exports, excl. diamonds, ships and aircraft			Industrial exports, excl. products sold mainly abroad and special items ^b		
	Unadjusted	Seasonally adjusted	Quantity index ^a	Unadjusted	Seasonally adjusted	Quantity index ^a	Unadjusted	Seasonally adjusted	Quantity index ^a
Annual data									
1970	732.3	733.0	100.0	404.5	403.3	100.0	328.1	324.8	100.0
1971	910.2	913.3	120.1	494.6	488.8	120.5	401.6	395.2	121.6
1972	1,088.8	1,098.9	134.6	549.2	547.2	128.6	456.1	454.6	132.1
1973	1,370.3	1,395.2	135.5	641.8	642.8	125.2	524.1	524.5	126.0
Quarterly data									
1970 I	204.6	169.7		87.7	95.2		69.9	75.7	
II	173.8	176.7		100.4	97.0		83.8	80.8	
III	157.7	191.5		100.1	107.3		82.1	83.0	
IV	196.2	195.1		116.3	103.8		92.4	85.3	
1971 I	243.3	202.8		101.4	110.6		82.9	92.2	
II	223.4	223.2		126.1	121.5		98.7	92.7	
III	183.8	231.8		119.8	126.8		96.5	99.0	
IV	259.7	255.5		147.3	129.9		123.3	111.4	
1972 I	287.2	244.7	125.1	118.0	130.5	124.9	94.5	108.1	128.3
II	259.7	260.1	129.5	144.6	137.3	131.5	126.1	119.2	142.5
III	228.8	295.5	144.8	126.7	135.5	129.2	105.1	110.4	131.0
IV	313.1	298.6	138.8	159.9	143.9	129.6	130.4	116.9	130.2
1973 I	353.3	298.5	130.7	135.4	148.9	131.7	106.5	120.5	130.9
II	359.0	362.6	142.1	167.2	159.5	126.7	136.6	129.5	127.1
III	356.4	428.1	156.3	179.7	188.8	140.5	147.6	153.6	142.0
IV	301.6	306.0	114.3	159.5	145.6	104.0	133.4	120.9	103.9

^a See note ^b to Table III-3.

^b Industrial exports, excluding minerals, diamonds, other metal products, other products not from domestic output, bunkers and stores supplied to foreign ships and aircraft, used and locally produced ships and aircraft.

SOURCE: Central Bureau of Statistics.

Table
NET COMMODITY
(\$ million, at

	1968	1969	1970	1971	1972	
					Jan.- Sept.	Entire year
Agricultural exports						
Citrus	88.4	91.3	86.1	113.9	85.0	108.4
Other	24.5	27.6	43.5	41.0	34.6	51.4
Total	112.9	118.9	129.6	154.9	119.6	159.8
Industrial exports						
Diamonds (net)	194.8	215.9	201.0	265.3	272.1	385.7
Minerals and scrap	33.7	38.5	41.8	42.9	31.7	43.3
Copper-cement	11.6	15.0	14.6	11.3	7.7	11.1
Phosphates	6.0	7.5	4.9	3.4	3.1	4.7
Potash	13.9	13.2	21.1	26.7	19.5	26.1
Scrap	1.3	2.5	2.5	1.0	0.7	1.1
Textiles and clothing	63.7	80.6	98.2	119.1	88.4	123.3
Citrus products	26.4	32.6	35.0	43.6	49.3	55.3
Other chemicals	18.0	15.6	14.0	7.7	2.4	2.5
Other metal products	26.4	24.1	18.2	31.1	26.4	31.8
Aircraft and parts	8.6	7.0	5.9	6.8	2.9	6.0
Edible oils and oilcake	5.5	7.5	9.3	13.4	11.0	14.5
Other industrial products	103.5	130.1	161.4	202.0	169.2	254.8
Total industrial exports	440.6	551.9	583.0	731.9	647.4	917.2
Total industrial exports, excl. diamonds and minerals	252.1	297.5	340.2	423.7	342.4	488.2
Total exports from domestic output	593.5	670.8	721.6	886.8	767.0	1,077.0
Sale of old ships and aircraft	3.4	5.9	2.0	4.5	8.7	13.9
Equipment shipped by Israeli firms operating abroad	0.1					
Works of art, collections, antiques, personal effects, etc.	5.6	4.9	7.8	8.5	5.1	6.2
Bunkers and stores supplied to foreign ships and aircraft		7.4	8.1	11.2	8.8	10.6
Total commodity exports (foreign trade definition)	602.6	689.0	730.5	911.0	789.6	1,107.7
Adjustments and returned exports	-4.7	-10.2	-13.8	-11.1	-18.6	-25.6
Total net commodity exports, excl. ad- ministered areas (balance of payments definition)	597.9	678.8	716.7	899.9	771.0	1,082.0
Exports to administered areas	51.1	67.4	85.2	93.8	93.0	130.0
Total net commodity exports, incl. ad- ministered areas (balance of payments definition)	649.0	746.2	801.9	993.7	864.0	1,212.0

SOURCE: Central Bureau of Statistics.

III-12

EXPORTS, 1968-73

(current prices)

1973		Percent annual increase or decrease (-)						Percent of total increment			
Jan.- Sept.	Entire year	1969	1970	1971	1972	1973		1971	1972	1973	
						Jan.- Sept.	Entire year			Jan.- Sept.	Entire year
86.4	110.1	3.3	-5.7	32.3	-4.8	1.7	1.6	15.9	-2.9	0.5	0.6
46.5	61.7	12.7	57.6	-5.7	25.4	34.4	20.0	-1.4	5.5	4.1	3.6
132.9	171.8	5.3	9.0	19.5	3.2	11.1	7.5	14.5	2.6	4.5	4.2
455.1	556.8	10.8	-6.9	32.0	45.4	67.2	44.4	36.9	63.2	64.5	60.5
40.0	48.2	14.2	8.6	2.6	0.9	26.2	11.3	0.6	0.2	2.9	1.7
10.7	14.7										
2.7	3.2										
25.5	29.5										
0.7	0.8										
108.5	147.6	26.5	21.8	21.3	3.5	22.7	19.8	12.0	2.2	6.9	8.6
49.3	61.8	23.5	7.4	24.5	26.8	13.9	11.7	4.9	6.1	2.1	2.3
1.0	1.1	-13.3	-10.3	-45.0	-67.5	58.3	-54.0	-3.6	-2.7	-0.5	-0.5
21.1	27.4	-8.7	-24.5	70.9	2.3	20.1	-13.8	7.4	0.4	-1.8	-1.6
7.8	11.9	-18.6	-15.7	15.3	-11.8	169.0	98.3	0.5	-0.4	2.1	2.1
7.7	8.0	36.4	24.0	44.1	8.2	-30.0	-44.8	2.4	0.6	-1.1	-2.3
236.6	335.2	25.7	24.1	25.2	26.1	39.8	31.5	23.3	27.8	23.0	28.4
927.7	1,188.0	14.8	5.6	25.5	25.3	43.3	29.5	85.8	97.4	95.5	95.8
424.1	583.0										
1,060.0	1,359.8	13.0	6.2	24.4	21.5	37.4	26.3	100.0	100.0	100.0	100.0
6.3	8.9										
5.4	7.1										
7.9	9.3										
1,079.6	1,385.1	14.3	6.0	24.7	21.6	36.7	25.0				
-15.6	-22.1										
1,064.0	1,363.0										
132.0	169.0										
1,196.0	1,532.0										

Table III-13
INCREASE IN COMMODITY EXPORTS, BY MAJOR GROUP, 1967-73

(\$ million, at current prices)

	Total commodity exports						Per- cent of 1967 ex- ports	Percent annual increase or decrease (-)						Percent of increment		
	1967	1971	1972		1973			Value			Quantity			Aver- age 1967- 1971	1972	1973 ^a
			Sept. Jan.-	Entire year	Jan.- Sept.	Entire year		Aver- age 1967- 1971	1972	1973 ^a	Aver- age 1967- 1971	1972	1973 ^a			
Citrus	85.3	113.9	85.0	108.4	86.4	110.1	13.3	7.5	-4.8	1.6	7.1	-5.0	-9.4	7.2	-2.9	0.5
Other agricultural exports	22.2	41.0	34.6	51.4	46.5	61.7	4.5	16.6	25.4	34.4	16.7	17.7	4.8	4.8	5.5	4.1
Minerals and scrap	30.8	42.9	31.7	43.3	40.0	48.2	6.3	8.6	0.9	26.2	3.9	-1.1	-0.9	3.1	0.2	2.8
Diamonds, net	157.9	265.3	272.1	385.7	455.1	556.8	32.1	13.8	45.4	67.3	9.8	30.3	27.9	27.2	63.3	62.5
Textiles and clothing	51.9	119.1	88.4	123.3	108.5	147.6	10.5	23.1	3.5	22.7	21.4	-0.6	-3.0	17.0	2.2	6.9
"Special" items ^b	57.5	102.6	86.0	110.1	86.9	100.2	11.7	15.6	7.3	1.0	14.0	3.6	-9.5	11.4	3.9	0.3
Other industrial products	86.6	202.0	169.2	254.8	236.6	335.2	17.6	23.6	26.1	39.8	22.4	17.2	12.3	29.2	27.8	23.0
Total	492.2	886.8	767.0	1,077.0	1,060.0	1,359.8	100.0	15.9	21.4	38.2	13.8	13.3	10.0	100.0	100.0	100.0
Industrial exports, excl. diamonds and minerals	196.0	423.7	343.6	488.2	432.0	583.0	39.8	21.3	15.2	25.7	19.8	9.0	2.9	57.7	33.9	30.2
Industrial exports, excl. diamonds, minerals, and "special" items	138.5	321.1	257.6	378.1	345.1	482.8	28.1	23.4	17.8	34.0	22.0	10.8	7.0	46.3	30.0	30.0

^a January-September, 1973 compared with January-September, 1972.

^b "Special items" are all those listed in Table III-12 that are not detailed here.

SOURCE: Central Bureau of Statistics.

products grew only 3 percent in the first nine months of 1973, after gains of 9 and 21 percent in 1972 and 1971 respectively. The slowdown was due to various, and sometimes contrasting, factors. After a steady uptrend in export profitability in 1966–70 as the result of a deliberate policy of encouraging overseas marketing, reflected by a steep increase in export proceeds while input and domestic output prices were moving up at a sluggish pace because of relatively weak demand pressure in the home market, the profitability curve flattened out between 1970 and 1972, when demand in the economy grew stronger and sharply drove up production costs as well as the returns earned by producers in the home market in relation to exports. Some of the factors influencing exports underwent a change in trend in 1973 (although this did not show up in the export figures for the year): a rise in profitability in the first part of the year, followed by a downturn toward the end, the intensification of domestic demand pressure, and the expansion of the world market, especially in the first half of 1973.

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

The share of items produced overwhelmingly for the overseas market amounted to 60 percent of total domestically produced commodity exports in the first nine months of 1973. The products in this group—which include citrus, diamonds, mine and quarry products, and citrus products—are sold almost entirely abroad and hence are little affected by domestic demand conditions. Another distinguishing feature of several of these items is that Israel commands a formidable share of their overseas outlets. These factors constrain the stepping up of exports of these goods from the both the demand and the supply side, for the absence of a local market results in a low short-run elasticity of supply, while Israel's large share of the export markets results in a relatively low income elasticity of demand.

Citrus exports during the first three quarters of 1973 were less than 2 percent higher in current prices than in the same period in 1972. Tonnage was off approximately 9 percent, while prices rose about 12 percent in dollar terms (see Table III-14). The quantitative retreat was due to frost damage, which reduced the volume of exportable fruit. The higher dollar prices can be attributed to two factors: the better prices obtained abroad because of the contraction of supplies from Israel, Italy, and Morocco due to natural causes; and the depreciation of the dollar against the major European currencies in the first half of 1973. In citrus exports the distribution of sales over the year is a very significant factor, and sharp weekly swings in prices and aggregate supply during the season are not uncommon.

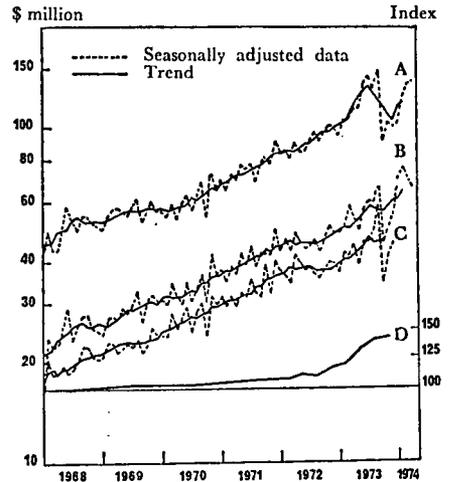
Citrus products moved ahead by only 14 percent in current prices during the period reviewed, after a 27 percent gain in 1972. This branch absorbs the fruit that is unsuitable for export or for direct consumption in the domestic

market, and sometimes exportable fruit is diverted to the canneries in order to prop up foreign or domestic prices. Although the frost reduced the citrus crop, the quantities sold to industry were stepped up owing to the higher percentage of nonexportable fruit and in order to prevent any softening of domestic prices. The slacker expansion of exports of citrus products in the first nine months of 1973 despite the larger volume supplied to industry is explained by the sharp rise in overseas sales in 1972, a substantial proportion of which was made out of storage.

Diamonds, Israel's second principal export commodity, soared by a record 67 percent in current prices, which came on top of a 45 percent advance in 1972 (see Table III-12). This brought up the weight of diamonds in incremental exports of domestically produced goods from 36 percent in 1972 to 43 percent during the first nine months of the year reviewed. In real terms, growth was 28 percent (the prices obtained abroad rose 30 percent, but it should be noted that the index of diamond export prices is statistically problematic and of low reliability). Nearly all Israel's diamond production is marketed abroad, and in the types of stone in which the country specializes it holds a near-monopolistic position in the world markets. Exports of this item are therefore greatly dependent on the behavior of foreign demand, the price elasticity of which is relatively low. The only connection between this industry and the domestic market is the need to compete with other branches for labor, for all the other inputs are imported. The weight of fixed capital in this industry is low, and its exports are therefore sensitive to changes in the wage level.

Israel continued to work medium-sized stones (between 0.3 and one full carat), after beginning their processing in 1972. Previously the industry had specialized in small stones, whose processing is very labor-intensive. When demand for medium stones grew brisker in 1972, there was a switch to this size. The boom during the first half of 1973 was fueled by two sources. One

Figure III-2
NET EXPORTS, INDUSTRIAL EXPORTS, AND INDUSTRIAL EXPORT PRICE INDEX, 1968-74



- A — Net exports, excl. ships and aircraft.
- B — Industrial exports, excl. diamonds, ships, and aircraft.
- C — Industrial exports, excl. sales of old ships and aircraft, minerals, diamonds, bunkers and fuel supplied to foreign ships and aircraft, aircraft and parts, other metal products, and other commodity exports not from domestic output.
- D — Price index of industrial exports, excl. diamonds (1968=100).

Table III-14
CITRUS EXPORTS, 1967-73

	1967	1968	1969	1970	1971	1972		1973	
						Jan.- Sept.	Entire year	Jan.- Sept.	Entire year
\$ million	85.3	88.4	91.3	86.1	113.9	85.0	108.4	86.4	110.1
Percent annual change									
Value	14.2	3.6	3.3	-5.7	32.3	-7.0	-4.8	1.6	1.6
Price	-5.0	-6.0	5.9	-5.7	7.7		0.1	12.2	12.7
Quantity	20.2	10.2	-2.5	—	22.8		-4.9	-9.4	-9.8

SOURCE: Central Bureau of Statistics.

was the surging demand for diamonds as jewelry with the continuation of the economic boom in the U.S. and Japan (the latter is becoming an increasingly important customer for Israel's diamonds) and because of the vogue effect (in many countries the purchase of diamonds for personal adornment has become fairly widespread even among relatively low income groups). The second major reason for the buoyant world demand was the desire to possess diamonds as an asset, as an alternative to holding money balances (mainly dollars) with the weakening of the dollar on the European exchange markets in the first half of 1973. Such demand was mainly for medium-sized stones, and this explains Israel's growing specialization in this type.

In the final months of the year a crisis set in, with the underlying causes being the strengthening of the dollar from July and signs of an economic retreat in Japan. Demand fell off mostly for medium-sized stones, while that for small stones was less affected. This had an adverse impact on the industry's exports, which in 1973 consisted mainly of medium stones. This development coincided with a decline in the supply of workers because of the war and the protracted mobilization. Difficulties were encountered in filling export orders for small stones, since workers trained to process one type of stone were not necessarily equipped to work with the other type.

In mineral exports domestic demand plays no part. But in contrast to diamonds, fixed investment is very large here; hence export profitability is less sensitive to current outlays. Exports of this industry were up 26 percent in current prices during the first nine months of 1973 (see Table III-13). All the gain can be credited to the higher prices obtained, for tonnage was down 1 percent, with a rise in potash failing to fully offset the decline in copper-cement and phosphates.

Overseas sales of noncitrus agricultural products, some of which are distinctly export-oriented (winter vegetables, flowers, and certain fruits) scored a 34 per-

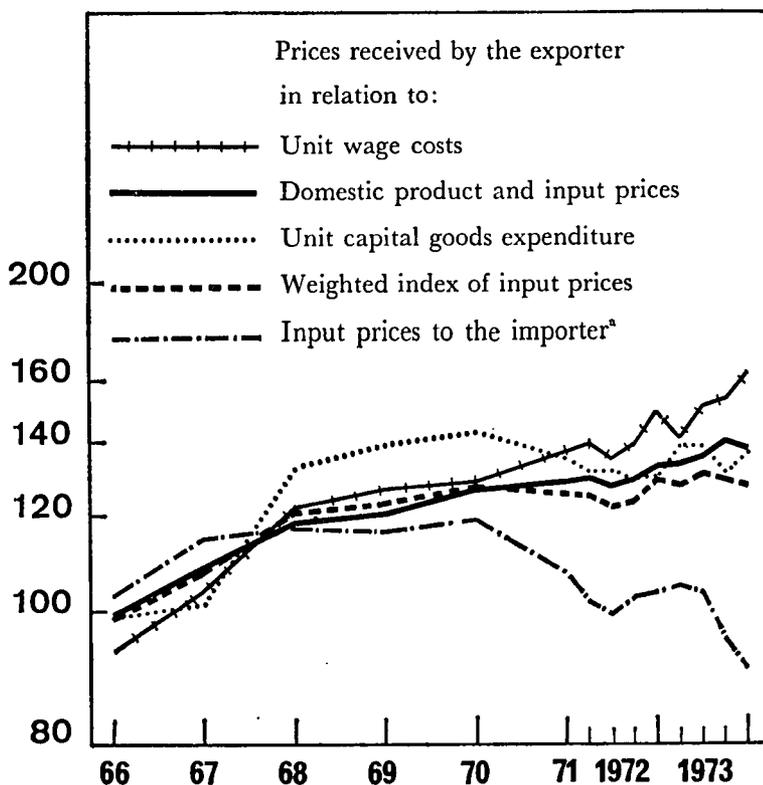
cent gain during the period reviewed, but the quantitative increase was only 5 percent, as contrasted with 18 percent in 1972 (see Table III-13). The slackening of the uptrend was due primarily to frost damage; this resulted in a smaller consignment of bananas, avocados, and flowers, which was only slightly offset by a larger shipment of vegetables, which were diverted from the home to the overseas market because of the higher prices obtainable in the latter.

(b) *Other industrial exports*

In the broad group of manufactures which are not intended predominantly for the overseas market the real advance slowed during the first nine months of 1973: excluding diamonds and minerals, the curve went up 3 percent as

Figure III-3

RATIO OF PRICES RECEIVED BY THE EXPORTER^a TO VARIOUS COSTS AND DOMESTIC PRICES, 1966-73



^a In Israeli currency, at the effective rate of exchange.

Table III-15

INDUSTRIAL EXPORTS, BY MAIN BRANCH, 1970-73

(\$ million, at current prices)

	1970	1971	1972		1973		Percent annual real increase or decrease (-)		
			Jan.- Sept.	Entire year	Jan.- Sept.	Entire year	1971	1972	1973
Mining and quarrying ^a	40.8	41.7	31.0	42.2	39.3	48.1	-8.1	-0.9	-0.4
Food	62.9	79.0	69.0	94.9	82.4	105.5	18.7	14.7	7.2
Textiles and clothing	98.2	119.1	88.4	123.3	108.5	147.6	16.5	-0.6	-3.0
Wood and wood products	9.6	10.3	7.5	11.4	11.5	15.6	12.2	11.8	15.5
Paper, printing, and publishing	8.6	13.8	10.3	15.3	12.5	17.3	46.0	0.9	-6.2
Leather and leather products	3.3	4.9	4.7	6.4	5.5	7.0	44.4	24.6	-2.7
Rubber and plastic products	23.5	27.4	22.5	30.5	22.7	29.3	12.5	2.5	-3.5
Chemicals	38.8	46.2	40.9	59.3	57.5	78.1	17.7	23.3	23.4
Refined petroleum products	14.1	7.7	2.5	2.7	1.7	1.9	-46.7	-65.2	-32.1
Glass, ceramics, cement and products thereof	3.0	3.7	1.5	2.2	2.2	2.7	23.3	-44.4	16.7
Diamonds, net	201.0	265.3	272.1	385.7	455.1	556.8	22.7	30.3	27.9
Basic metals and pipes	7.9	8.1	5.7	8.0	9.3	13.7	3.8	7.4	51.9
Metal products	28.5	45.6	37.2	48.5	33.7	45.2	74.1	3.5	-19.6
Machinery	10.5	9.1	9.1	12.8	13.8	19.8	-16.8	31.3	17.1
Electrical and electronic equipment	12.8	25.7	19.0	29.8	20.2	27.8	107.8	6.4	-16.9
Production and repair of transport equip.	15.1	13.9	7.0	13.3	16.7	29.5	-9.4	-8.3	93.2
Miscellaneous	11.6	15.3	19.5	28.7	26.2	35.9	29.8	80.4	23.7
Total industrial exports	590.2	736.8	653.3	914.0	918.7	1,177.0	20.8	14.8	12.0

NOTE: The annual figures for total industrial exports differ from those in the other tables in this chapter since this table is based on unrevised monthly data. In addition, it includes products that are not from domestic output. The real rates of change in the total were obtained by deflating total industrial exports as published by the Central Bureau of Statistics, and not by summing the deflated data for the individual branches listed in the table.

^a Including potash from the Dead Sea.

against 9 percent in 1972 (see Table III-13). It should be noted that this group includes a number of commodities whose development is governed by special factors (the military and aviation industries, fuel, etc.). These special items were down 10 percent in real terms during the period reviewed, after moving up 4 percent in 1972. Not counting these commodities, the real increase came to 7 percent, compared with 11 percent the year before.

Besides the special items, industrial exports other than diamonds and minerals consist of two large groups: textiles and clothing, where the effective rate of exchange is affected by special branchwide arrangements, and all the remaining items sold in both the home and overseas markets. Exports here are sensitive to the pressure of domestic demand and changes in relative profitability, which are influenced by changes in both production costs and relative prices.

Textile and clothing exports were up by a formidable 23 percent in value during the period reviewed, compared with only 4 percent in 1972. In real terms, however, the level was down 3 percent, after slipping 1 percent in 1972.

The weight of these branches in the real export increment is on the decline—during the period reviewed they accounted for -3 percent of the export gain, compared with -1 percent in 1972 and 18 percent between 1967 and 1971. The reason for the setback in these items, which are produced mostly for consumption, apparently lies in the heavy domestic demand pressure, which grew sharper at the end of 1972 and the first half of 1973 with the accelerated rise in private consumption.

In the group of the remaining industrial exports, which encompass the bulk of Israeli industry, the uptrend slowed during the first nine months of 1973 compared with the corresponding period the year before. In real terms the rise was 12 percent, as against 17 percent in 1972 and an average of 22 percent in 1967-71 (see Table III-13). Trends in this group were mixed. A classification of the export industries by principal economic destinations shows the deceleration to have been most pronounced in those branches producing primarily for consumption. These diverted part of their output from the foreign to the home market (see Table XI-10).

Overseas sales of those branches producing mainly for consumption were 2 percent higher in the first three quarters of 1973 than in the same period the year before, after rising 8 percent in 1972. Less textiles and clothing and food,¹⁶ the slowdown was even more pronounced—a real rise of 3 percent compared with 31 percent in 1972. Food exports expanded more rapidly during this period owing to the enlargement of production capacity. No demand pressure was felt in this industry, for its sales are chiefly influenced by the income elasticity of demand, which is not high, and by the growth of population.

In the manufacture of investment goods a distinction must be made between

¹⁶ In this classification citrus products, which are marketed mostly abroad, are not included in foodstuffs.

those branches producing mainly for the construction industry and those specializing in plant and equipment. The former group, although experiencing a more sluggish growth of production in 1973, performed better as far as exports go—an advance of 18 percent during the first nine months of the year as against 4 percent in 1972. Exports of machinery and equipment, on the other hand, tumbled 20 percent, after falling 14 percent the year before. Demand trends in these industries were mixed: heavier domestic nondefense sales of electronic products—mainly telecommunication and postal equipment—which partly compensated for the reduction in military orders in the previous year, led to the contraction of exports; while the slackening of domestic demand for machinery resulted in the cutting back of production rather than the stepping up of exports. The reason for the latter development may have been the difficulties involved in finding markets for these items.

The influence of domestic demand on exports during the period reviewed must be viewed against the fact that between the end of 1971 and the end of 1972 the vigorous uptrend in industrial exports and profits begun in 1966 was arrested. From the time that the economy began to pull out of the slump of 1966–67 through 1971 the improvement in export profitability was accompanied by a laggard rise in domestic demands and in input prices. Between 1966 and 1970 the weighted index of input prices (see Table III–16) moved up 11 percent, as opposed to a 44 percent jump in export returns; the latter even outpaced the rise in domestic output prices (13 percent).

In 1971 and 1972 demand pressure began to build up under conditions of full factor utilization. Costs started to climb steeply and in some cases even outstripped the gain in export proceeds. In addition, the rise in export prices relative to domestic output prices faltered. In this connection it should be pointed out that, since world demand for Israel's exports is generally more elastic than domestic demand, a rapid mounting of costs is liable to harm exports more than domestic marketing, even if the relative price of exports continues upward. The more sluggish increase in export profitability tended to brake the growth of overseas sales of industrial products.

In the final quarter of 1972 and the first half of 1973 there was an improvement in export profitability. The main factor was the plummeting of the dollar in foreign exchange markets following the floating of various European currencies. Between January and July the value of the Israeli pound (which, it will be recalled, is pegged to the dollar) sank 14 percent against the European currencies. This, along with the increase in foreign prices and the raising of export incentives, added 22 percent to export proceeds. The weighted index of input prices went up 16 percent; in other words, export earnings outran input prices.

In the second half of the year reviewed the situation changed. The decline of the dollar was arrested, and it even strengthened appreciably, and along with it the Israeli pound. On the other hand, costs continued to rise rapidly.

Table III-16

INDICATORS OF INDUSTRIAL EXPORT PROFITABILITY, 1966-73*

	1966	1967	1968	1969	1970	1971	1972	1973	1972, quarterly				1973, quarterly			
									I	II	III	IV	I	II	III	IV
1. Prices received by the exporter																
Percent annual change	3.8	11.0	11.7	3.6	11.9	10.9	14.0	23.9		0.3	2.8	6.9	4.1	9.5	7.1	6.3
Index (1965=100)	103.8	115.2	128.7	133.3	149.1	165.4	188.6	233.6	180.6	181.2	186.3	199.1	207.2	226.8	243.0	258.2
2. Prices paid by the importer for imported intermediates^b (in IL)																
Percent annual change	1.0	-0.4	9.1	4.5	9.2	22.8	18.5	30.3		2.8	0.2	5.2	3.1	10.5	16.7	12.4
Index (1965=100)	101.0	100.6	109.8	114.7	125.3	153.9	182.3	237.5	177.1	182.1	182.4	191.9	197.9	218.6	255.0	286.7
3. Domestic market prices																
Percent annual change	4.8	1.1	2.4	1.9	6.7	9.2	11.6	19.0		1.6	2.1	3.5	4.4	7.1	3.6	8.2
Index (1965=100)	104.8	106.0	108.5	110.6	118.0	128.9	143.9	171.3	139.4	141.7	144.7	149.8	156.4	167.6	173.6	187.8
4. Wages per unit of output																
Percent annual change	11.0	-0.1	-4.7	-0.1	10.0	3.7	10.9	14.8		4.1	-0.3	-0.6	9.9	2.2	5.5	—
Index (1965=100)	111.0	110.9	105.7	105.6	116.2	120.5	133.6	153.4	129.7	135.0	134.6	133.8	147.0	150.2	158.4	158.4

5. Price of capital per unit of output																
Percent annual change	5.3	7.6	-14.0	-1.6	9.2	17.4	14.5	22.4		0.5	4.9	-0.9	4.6	9.5	12.7	2.1
Index (1965=100)	105.3	113.3	97.4	95.8	104.6	122.8	140.6	172.1	137.1	137.8	144.6	143.3	149.9	164.2	185.1	189.0
6. Weighted index of input prices (indexes 2-5) ^c																
Percent annual change	5.4	1.5	-0.5	1.8	8.0	12.3	13.5	21.6		2.3	1.6	2.5	5.1	7.3	8.7	7.1
Index (1965=100)	105.4	107.0	106.5	108.4	117.1	131.5	149.3	181.6	144.9	148.2	150.5	154.3	162.2	174.1	189.2	202.6
7. Prices received by the exporter/weighted index of input prices (1 ÷ 6)																
Percent annual change	-1.5	9.3	12.2	1.8	3.5	-1.2	0.4	1.8		-1.9	1.2	4.2	-1.0	2.0	-1.5	-0.8
Index (1965=100)	98.5	107.7	120.8	123.0	127.3	125.8	126.3	128.6	124.6	122.3	123.8	129.0	127.7	130.3	128.4	127.4
8. Prices received by the exporter/domestic market prices (1 ÷ 3)																
Percent annual change	-1.0	9.8	9.1	1.6	4.9	1.5	2.2	4.0		-1.3	0.7	3.2	-0.3	2.1	3.5	-1.8
Index (1965=100)	99.0	108.7	118.6	120.5	126.4	128.3	131.1	136.9	129.6	127.9	128.8	132.9	132.5	135.3	140.0	137.5

^a Excluding diamonds, textiles, and minerals.

^b Imports-for-exports.

^c Weighted according to the composition of inputs to industry, excluding diamonds, according to the 1968/69 input-output table.

Table III-17
CHANGES IN THE EFFECTIVE EXCHANGE RATE FOR INDUSTRIAL EXPORTS, 1966-74^a

Value-added group	1966		1967		1970		1971		1972	1973		1974
	April	Nov.	March	Nov. ^b	Feb.	Aug.	Jan.	Aug.	Aug.	Jan.	Aug. ^c	Jan.
A. IL/\$ above beginning-of-period official rate^d												
1. (up to 25 percent)												
	(26-35)	1.0	1.8		50	60	120	120	120	120	120	120
2. (26-45 percent)		3.5	10.5		60	70	130	133 140	205	215	222	225
	(36-45)								206	216	225	229	246
	(46-55)											250
3. (46-65 percent)		7.5	18.0	34.5 ^e	70	85	140	145 150	207	217	228	233
	(56-65)								208	218	231	237	254
4. (66 percent +)		10.5	25.5	45.0 ^e	85	105	155	162	209	219	234	241
								162	209	219	234	241
												262
B. Percent above beginning-of-period official rate												
1.		0.3	0.6		16.7	17.1	40.0	40.0	40.0	40.0	40.0	40.0
2.		1.2	3.5		20.0	23.2	43.3	44.3 46.7	68.3	71.7	74.0	75.0
									68.7	72.9	75.0	76.3	82.0
3.		2.5	6.0	11.0 ^e	23.3	28.3	46.7	48.3 50.0	69.0	72.3	76.0	77.7
									69.3	72.7	77.0	79.0	84.7
4.		3.5	8.5	15.0 ^e	28.3	35.0	51.7	54.0	69.7	73.0	78.0	80.3
												87.3
C. Exchange rate for import component (percent above beginning-of-period official rate)												
		—	—	—	16.7	16.7	40.0 ^f	40.0	68.0	68.0	68.0	68.0
												75.0

^a The computation includes only changes in the official rate and direct incentive payments.

^b IL 0.5 (16.7 percentage points) was due to devaluation.

^c IL 0.7 (23.3 percentage points) was due to devaluation.

^d IL 3/\$ 1.

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

^f On the reservations concerning this datum see Bank of Israel, *Annual Report 1971*, Table III-12, note ¹.

Whereas export returns advanced 14 percent in the second half of 1973, the weighted index of input prices went up by more than 16 percent¹⁷—a trend which apparently carried over through early 1974.

An examination of the relative price of exports and of output marketed domestically reveals a similar picture. Domestic output prices moved up about 20 percent from the final quarter of 1972 through the first nine months of 1973, and jumped 8 percent in the last quarter. Export returns advanced 30 percent during the 12 months between October 1972 and September 1973, but in the final quarter it went up only 6 percent—a trend which apparently also carried over through the first part of 1974.

It is important to note that the upswing in profitability in the first half of 1973 accompanied the expansion of Israel's export markets in the wake of the boom in the industrial nations (see Table III-35). At the end of the year, however, business apparently fell off abroad, so that the decline in profitability may be expected to be accompanied by a slacker expansion of world demand.

Table III-18
HOURLY INDUSTRIAL WAGES IN ISRAEL AND ELEVEN DEVELOPED
INDUSTRIAL COUNTRIES, 1965-73^a

	Hourly wages in Israel		Hourly wages in industrial countries ^b		Wage ratio between Israel and industrial countries
	Index	Percent increase	Index	Percent increase	
1965	100.0		100.0		100.0
1966	116.7	16.7	106.9	6.9	109.2
1967	128.2	9.9	113.2	5.9	113.3
1968	126.7	-1.2	121.6	7.4	104.2
1969	129.1	1.9	131.7	8.3	98.0
1970	146.0	13.1	146.2	11.0	99.9
1971	164.2	12.5	161.7	10.6	101.5
1972	181.7	10.7	180.9	11.9	100.4
1973 ^a	219.4	20.7	201.7	11.5	108.8

^a January-September.

^b The data pertain to the eleven largest industrial countries, with the weighting based on the share of each country in the total exports of the group.

Another indicator suggesting that the Israeli exporter began to fare worse than his competitor abroad is the ratio between the domestic and foreign price increases. Thus, for example, during the first months of 1973 wages per man-

¹⁷ For lack of data we have assumed that the index of wages per unit of output remained unchanged in the final quarter of the year. It apparently resumed its advance in early 1974.

Table III-19
EXPORTS AND IMPORTS, BY COUNTRY, 1973^a

(percentages)

	Total	Italy	Bel- gium	W. Ger- many	Nether- lands	France	U.K.	Den- mark	Nor- way	Swe- den	Switzer- land	Japan	U.S.A.	Can- ada	Others
Exports															
Actual distribution	100.0	4.1	1.9	13.3	3.4	6.2	16.0	0.9	0.8	1.1	2.9	1.4	14.8	1.5	31.6
Expected distribution ^b	100.0	3.8	1.8	12.2	3.9	6.4	13.8	2.0	0.6	1.0	2.5	1.0	15.8	1.5	33.6
Imports															
Actual distribution	100.0	7.2	2.2	17.1	2.9	6.5	9.5	0.5	0.4	2.5	3.5	2.5	19.8	1.7	23.5
Expected distribution ^b	100.0	6.9	2.8	14.7	3.1	6.0	11.2	—	—	2.4	3.9	2.8	21.0	2.0	20.4

^a January-September.

^b The calculation of the expected distribution takes into account the change in the branch structure of exports and imports in January-September, 1973 compared with the same period the year before, but assumes that the intrabranched distribution by country of destination or origin remained unchanged.

hour went up 21 percent in Israel as contrasted with 12 percent in the industrialized nations (see Table III-18). It seems, therefore, that the rate of inflation in Israel was almost twice as fast as in these countries, and this naturally made it harder for Israeli goods to compete in the overseas markets.

The various exchange rate changes did not significantly affect the distribution of Israel's exports by country of destination. The actual breakdown of non-diamond exports during the first nine months of 1973 is not significantly different from that obtained on the assumption of a change in the branch composition of exports and the same distribution of each branch by country of destination as in the corresponding period of 1972 (see Table III-19). The reason for this may lie in the uncertainty as to how the exchange markets would continue to develop, as well as the tendency to maintain commercial links formed and nurtured over the years. It is likely that some of the sales contracts included a clause compensating for the effect of a change in the exchange rates, and that this was reflected in the prices themselves.

Commodity exports in the final quarter of 1973

In the last three months of 1973 net exports of commodities other than ships and aircraft amounted to \$ 302 million, or an average of \$ 102 million a month; this compares with \$ 132 million a month in the first half of the year (seasonally adjusted data) and represents a real drop of 19 percent from the corresponding period in 1972.

Agricultural sales totalled \$ 39 million—roughly the same as in the final quarter of 1972. In October and November citrus exports retreated below the previous season's level. This can be attributed to the war, for in October the picking of early-ripening grapefruit for export was hit by the failure of Arab workers to turn up for work, while in November difficulties were encountered in trucking the fruit to the ports and there were problems in the ports themselves. In December and January growers overcame the hardships caused by the war, but during these months the crop was damaged by hail, with the result that sorting in the packing houses slowed down and exports failed to achieve the targets projected at the beginning of the season.

Industrial exports came to \$ 284 million, compared with an average of some \$ 350 million in the previous two quarters.

Diamonds lost considerable ground, amounting to \$ 100 million, or \$ 33 million a month, compared with a monthly average of \$ 57 million in the preceding half year. At the beginning of 1974 sales perked up a little. The main cause of the market reversal was the weakening of overseas demand, with the crisis being compounded by a manpower shortage due to the war and extended mobilization.

Exclusive of diamonds and the ships and aircraft item, overseas sales of manufactures totalled \$ 160 million, roughly the same as in the final quarter of 1972;

this represents a seasonally adjusted monthly average of \$ 49 million, and compares with \$ 58 million in April-September 1973. Sales slipped most in October. At the beginning of 1974 there were signs of pickup, the monthly average for the first quarter of the year reaching \$ 71 million. The setback during the war period apparently stemmed, as in the case of citrus, from the manpower shortage, transport difficulties, and congestion in the ports. The drop during this quarter was most pronounced in minerals, which had to contend with serious transportation problems; however, these were apparently overcome toward the end of the year, and in December exports rebounded to their prewar level.

4. EXPORTS AND IMPORTS OF SERVICES

In Israel's services account, excluding defense imports and transactions with the administered areas, the surplus rose from \$ 142 million in the first nine months of 1972 to \$ 174 million during the corresponding period in 1973. This was the third consecutive large surplus; in earlier years this account was roughly in balance, with slight fluctuations in either direction. The first three quarters of 1973 saw a faster rise in exports—26 percent over the first nine months of the previous year, compared with a 15 percent rise in 1972—and also in imports—27 vs. 10 percent.

The transportation item showed a big increase in income during the first nine months of 1973 (\$ 69 million) and a much smaller one in expenditures (\$ 23 million). Exports of such services were up 24 percent during this period, and imports by only 13 percent. The subitem which rose fastest, and contributed most to the income growth, is cargo transport; here the figure was up 40 percent from the first nine months of 1972. Advancing prices accounted for about 10 percent, with the balance representing the real growth. This strong upswing reflects the expansion of the merchant fleet during the first three quarters of 1973. Income from passenger fares went up more slowly during the first three quarters of 1973—by 8 percent compared with the same period the year before, as against 26 percent in 1972. The deceleration is explained by the smaller percentage increase in tourist arrivals during this period. The third component of the shipping industry's revenue is "other income", which includes fees from the chartering of ships and aircraft and outlays of foreign shipping and air companies in Israel. Most of the growth here was in charter hire, while the amount spent by foreign shipping and air companies fell off.

On the expenditure side there was an increase in passenger transport, which includes fares paid to foreign carriers. This is explained by the larger number of Israelis using such carriers and the hiking of passenger fares.

Trends in other transportation outlays were mixed: charter hire inched up a little, the bill for bunkers and stores supplied in foreign sea- and airports was

Table III-20
IMPORTS AND EXPORTS OF SERVICES,^a 1968-73
(\$ million)

	1968	1969	1970	1971	1972		1973	
					Jan.- Sept.	Entire year	Jan.- Sept.	Entire year
A. Excl. administered areas and defense								
Transportation								
Credit	200	214	257	328	290	396	358	465
Debit	129	137	174	205	171	221	194	251
Net	71	77	83	123	119	175	164	214
Tourism								
Credit	96	86	103	178	159	212	195	231
Debit	52	66	54	60	56	70	90	105
Net	44	20	49	118	103	142	105	126
Freight insurance								
Net	7	8	10	11	7	10	10	13
Other insurance								
Net	-11	—	-12	-11	-12	-18	-17	-25
Capital services								
Credit	65	73	65	120	93	127	162	240
Debit	136	151	183	207	160	226	213	315
Net	-71	-78	-118	-87	-67	-99	-51	-75
Other services								
Credit	69	81	81	117	101	137	116	146
Debit	69	79	74	98	87	121	100	134
Net	—	2	7	19	14	16	16	12
Government, n.e.s.								
Credit	33	33	28	34	21	27	14	19
Debit	46	71	54	60	43	55	67	95
Net	-13	-38	-26	-26	-22	-28	-53	-76
Net total, excl. defense imports	27	-9	-7	147	142	198	174	189
B. Defense imports	-249	-334	-624	-555	-358	-490	-353	-1,255
Net total, incl. defense imports	-222	-343	-631	-408	-216	-292	-179	-1,064
C. Net transactions with administered areas								
Total balance on services account	-6	-1	-10	-25	-46	-61	-83	-103
	-228	-344	-641	-433	-262	-353	-262	-1,167

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

Table III-21
 EXPORTS OF SERVICES,* 1969-73
 (\$ million)

	1969	1970	1971	1972		1973		Annual increase or decrease (-)							
								\$ million			Percent				
								1973		1972	1970	1971	1972	1973	
				Jan.- Sept.	Entire year	Jan.- Sept.	Entire year	Jan.- Sept.	Entire year					Jan.- Sept.	Entire year
Transportation	214.4	257.2	328.0	289.7	396.2	358.3	464.8	68.2	68.6	68.6	20.0	27.5	20.8	23.7	17.3
Passenger	50.7	54.1	68.6	68.2	86.5	73.6	89.7	17.9	5.4	3.2	6.7	26.8	26.1	7.9	3.6
Freight	128.2	157.6	186.4	167.3	239.5	233.3	307.0	53.1	66.0	67.5	22.9	18.3	28.5	39.5	28.2
Other income	35.5	45.5	73.0	54.2	70.2	51.4	68.1	-2.8	-2.8	-2.1	28.2	52.1	-3.8	-5.2	-3.0
Travel	85.8	103.0	178.3	158.7	212.2	195.1	230.6	33.9	36.4	18.4	20.0	73.1	19.0	22.9	8.7
Insurance	98.8	111.3	137.2	111.4	148.1	128.1	171.5	10.9	16.7	23.4	12.7	23.3	7.9	15.0	15.8
Capital services	72.9	64.8	119.8	92.7	127.0	161.5	239.7	7.2	68.8	112.7	-11.1	84.9	6.0	74.2	88.7
Government, n.e.s.	33.2	28.0	33.7	21.0	27.0	14.0	19.0	-6.7	-7.0	-8.0	-15.7	20.4	-19.9	-33.3	-29.6
Other services	81.3	81.2	117.0	101.0	137.0	115.7	146.0	20.0	14.7	9.0	-0.1	44.1	17.1	14.6	6.6
Total	586.4	645.5	914.0	774.5	1,047.5	972.7	1,271.6	133.5	198.2	224.1	10.1	41.0	14.6	25.6	21.4
Exports to the administered areas	16.4	23.6	35.1	32.0	44.0	39.0	51.0	8.9	7.0	7.0	43.9	48.7	25.4	21.9	15.9
Grand total	602.8	669.1	949.1	806.5	1,091.5	1,011.7	1,322.4	142.4	205.2	230.9	11.0	41.3	15.0	25.4	21.6

* On the basis of c.i.f. recording of commodity imports.

SOURCE: Central Bureau of Statistics.

higher, while other foreign currency outlays of Israeli shipping and air companies held steady.

Income from tourism was, at \$ 36 million, up 23 percent, compared with 19 percent in 1972. Most of the gain was recorded in the second and third quarters of the year, when the figure ran about 30 percent higher than in the same period the year before. The number of tourists in the first nine months of 1973 was not significantly greater than in the same period in 1972; the growth of income from this source apparently derived from a larger expenditure per tourist, reflecting primarily the increase in domestic prices.

Israeli tourists spent 60 percent more abroad during the first nine months of 1973; this compares with a 17 percent rise in 1972. The steep jump can apparently be attributed to the boosting of the travel allowance from \$ 250 to \$ 450 in December 1972 and the larger number of Israelis going abroad.

Capital services showed a big increase on both the debit and credit sides. Exports soared 74 percent during the first nine months of 1973, after moving up only 6 percent in 1972, while imports were up 33 percent as against 9 percent respectively. Israel's foreign currency assets expanded during the first nine months of 1973, the balance at the end of September 1973 being 57 percent higher than at the end of the previous September. This probably accounts for the larger income from capital services, although it should be noted that these two magnitudes do not always display similar trends.

Profit and dividend withdrawals by foreign investors edged up a notch during the period reviewed. This relative stability reflects the continued operation of those factors that dampened the uptrend in this item in 1972: the widening of the local-foreign financial yield differential and the absence of early devaluation expectations. Most of the incremental outlay on capital services was in the second component—interest payments. These soared 40 percent during the period reviewed, reflecting the appreciable 25 percent rise in the country's external debt due to the growth of foreign liabilities, and especially the steep rise in foreign-held deposits in Israeli banks.

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

In the very heterogeneous "other services" item both the debit and credit sides expanded by 15 percent, after a 23 percent rise in imports and a 17 percent rise in exports in 1972. On the credit side there was an increase in agents' fees (foreign exporters' commissions paid to their agents in Israel), which accompanied the growth of imports, while other subitems moved up sluggishly. The main items on the debit side are related to the operations of Israeli companies abroad—notably the payment by Israeli exporters of commissions to their overseas agents, which rose with the expansion of exports. There was also a sharp

Table III-22
IMPORTS OF SERVICES,^a 1969-73
(\$ million)

	1969	1970	1971	1972		1973		Annual increase or decrease (-)							
								\$ million				Percent			
								1973						1973	
				Jan.- Sept.	Entire year	Jan.- Sept.	Entire year	1972	Jan.- Sept.	Entire year	1970	1971	1972	Jan.- Sept.	Entire year
Transportation	137.1	174.5	205.3	171.0	221.5	193.6	251.1	16.1	22.6	29.7	27.3	17.7	7.8	13.2	13.4
Passenger	17.5	17.7	20.2	18.7	22.7	23.5	26.9	2.5	4.8	4.7	1.1	14.1	12.4	25.7	18.5
Other	119.6	156.8	185.1	152.3	198.7	170.1	224.2	13.6	17.8	25.5	31.1	18.0	7.4	11.7	12.8
Travel	65.9	53.8	60.1	56.2	70.2	89.8	105.0	10.1	33.6	34.8	-18.4	11.7	16.8	59.7	49.6
Insurance	91.5	114.5	137.6	116.2	157.1	137.3	183.2	19.5	21.1	26.1	25.1	20.2	14.2	18.2	16.6
Capital services	150.8	183.1	206.9	160.3	225.8	212.5	314.9	18.9	52.2	89.1	21.4	13.0	9.1	32.6	39.5
Government, n.e.s. ^b	71.0	53.8	60.3	43.0	55.0	67.0	95.0	-5.3	24.0	40.0	-24.2	12.1	-8.8	55.8	72.7
Miscellaneous	78.6	74.1	97.7	86.9	120.6	100.1	133.8	22.9	13.2	13.2	-5.7	32.0	23.4	15.2	10.9
Total, excl. defense imports	594.9	653.7	767.9	632.7	850.1	800.3	1,083.4	82.2	167.6	232.9	9.9	17.5	10.4	26.5	27.4
Defense imports	333.7	624.4	554.6	358.0	490.0	353.0	1,253.0	-64.0	-5.0	763.0	87.1	-11.2	11.7	-1.4	155.7
Imports from the administered areas	17.0	33.7	60.4	78.0	105.0	122.0	154.0	44.6	44.0	49.0	98.2	79.2	73.8	56.4	46.7
Grand total	945.6	1,311.8	1,382.9	1,068.7	1,445.1	1,275.3	2,490.0	62.2	206.6	1,044.9	38.7	5.4	4.5	19.3	72.3

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

^b Excluding defense imports.

SOURCE: Central Bureau of Statistics.

increase in transfers of investment income abroad. The other subitems—advertising outlays abroad and royalty and rent payments—advanced only fractionally.

In transactions with the administered areas the growth of imports slowed from 74 percent in 1972 to 56 percent during the first three quarters of 1973, while exports advanced by 22 as against 25 percent respectively. Nearly 98 percent of the imports during the period reviewed consisted of wage payments to workers from the areas, which rose from \$ 74 million during the first three quarters of 1972 to \$ 120 million.

Service imports and exports in the fourth quarter

Imports of services, excluding defense items and the administered areas, added up to \$ 283 million in the last three months of 1973, compared with \$ 310 million in the previous quarter. The sharpest drop was in the travel item, owing to the smaller number of Israelis going abroad in the final quarter because of the war and extended mobilization.

Excluding the administered areas, exports of invisibles fell from \$ 346 million in the months of July-September to \$ 298 million in the final quarter of 1973, with transportation and tourism accounting for the decline.

5. THE CAPITAL ACCOUNT AND THE EXTERNAL DEBT

(a) *Main developments*

From the aspect of capital import developments, the year reviewed falls into two subperiods with completely different trends. In the final quarter of the year there was a sharply higher capital inflow to Israel as a result of the large-scale mobilization of funds among world Jewry and sizable U.S. Government loans. During the first three quarters of the year the curve sloped mildly upward in nominal terms, following a sharp ascent in the two preceding years. But it is important to note that when account is taken of the upward revaluation of various European currencies and the intensification of the global inflation, the small percentage nominal increase turns into a fairly steep decline in real terms.

Israel's balance of payments position deteriorated progressively during the first three quarters of the year. The current deficit widened faster than the inflow of capital to the economy, thereby aggravating the problem of financing the deficit. The proportion of the deficit covered by unilateral transfers shrank steadily during this period and fell more than \$ 500 million short of the deficit, whereas in 1972 they had covered the entire sum. Nevertheless the economy's net foreign liabilities increased by only \$ 249 million during these nine months, with incremental obligations amounting to \$ 662 million and foreign exchange

Table III-23

CAPITAL IMPORTS, BY ORIGIN AND RECIPIENT, 1970-73

(\$ million)

	1970	1971	1972	1973	1972, quarterly				1973, quarterly				
					I	II	III	IV	I	II	III	IV	
To the private sector													
Unilateral transfers	443	612	784.2	777.9	211.8	210.7	174.0	187.9	168.6	195.8	204.3	209.2	
Personal restitution	204	231	291.5	264.3	96.1	83.3	54.0	58.1	57.0	67.4	69.0	70.9	
Other private transfers, net	172	306	392.1	378.1	95.3	103.5	95.7	97.6	82.4	98.5	110.7	86.5	
Nonprofit institutions	67	75	100.6	135.5	20.4	23.9	24.3	32.2	29.2	29.9	24.6	51.8	
Net investment from abroad	22	75	143.0	171.6	21.0	47.7	32.7	41.6	45.1	49.9	58.8	17.8	
Long-term loans	45	166	170.0	177.0	50.0	42.0	36.0	42.0	32.0	45.0	79.0	21.0	
Total private sector	510	853	1,097.4	1,126.5	282.8	300.4	242.7	271.5	245.7	290.7	342.1	248.0	
To the public sector													
Unilateral transfers	206	151	267.6	1,411.8	62.0	48.8	47.0	109.8	77.7	77.4	53.4	1,203.3	
National Institutions	223	156	209.6	606.8	63.0	43.8	37.0	65.8	49.7	47.4	29.4	480.3	
Intergovernmental transfers	-17	-5	58.0	805.0	-1.0	5.0	10.0	44.0	28.0	30.0	24.0	723.0	
Long-term loans	515	477	410.0	635.0	135.0	52.0	94.0	129.0	94.0	81.0	88.0	372.0	
Independence and Development Loans, net	136	180	184.0	359.0	49.0	47.0	23.0	65.0	51.0	42.0	11.0	255.0	
U.S. Govt. loans	339	247	191.4	238.0	33.7	40.0	74.5	43.2	47.0	35.0	77.0	79.0	
Other loans	40	50	34.6	38.0	52.3	-35.0	-3.5	20.8	-4.0	4.0	—	38.0	
Total public sector	721	628	677.6	2,046.8	197.0	100.8	141.0	238.8	171.7	158.4	141.4	1,575.3	
Total capital imports	1,231	1,481	1,775.0	3,173.3	479.8	401.2	383.7	510.2	417.4	449.1	483.5	1,823.3	
Less: Israeli investment abroad ^a			0.6	12.3	2.0	0.6	-1.8	-0.2	6.3	2.7	2.6	0.7	
Total, excl. Israeli investment abroad			1,774.4	3,161.0	477.8	400.6	385.5	510.4	411.1	446.4	480.9	1,822.6	

^a Excluding investments in the administered areas.

SOURCE: Central Bureau of Statistics.

reserves expanding by \$ 413 million.¹⁸ The final quarter of the year saw a reversal of trend: the capital inflow outstripped the growth of the current deficit, and unilateral transfers, after nearly doubling, exceeded the deficit. However, the economy's external debt increased by \$ 135 million, as liabilities went up by \$ 350 million and foreign exchange reserves by \$ 215 million. The small accumulation of reserves relative to the steep rise in capital imports compared with the deficit is explained primarily by the fact that in the second half of the year those European currencies in which most of the country's reserves were held declined against the dollar.

During the first nine months of 1973 the majority of the capital items held steady in nominal terms, following a formidable rise in the three preceding years. Unilateral transfers remained virtually unchanged, while some types of private sector transfers contracted. Foreign investment in Israel continued strongly upward, whereas long-term loans from abroad ran about the same as during the first nine months of 1972. The acceleration of inflation in this country and the events in the world and Israel's money and exchange markets during the year had contrasting effects on Israel's capital imports, and on balance slowed their growth.

The public sector's share of total capital imports went up during the first three quarters of the year, following an increase in intergovernmental transfers, consisting chiefly of U.S. Government grants. Transfer receipts of the private sector, whose share in the capital inflow decreased, fell off relatively while its loan receipts rose relatively.

For the year as a whole unilateral transfers covered the bulk of the current deficit, which widened considerably. Nevertheless the country's external indebtedness mounted noticeably, accompanied by the expansion of foreign exchange reserves with the Bank of Israel. After the Yom Kippur War Israel again demonstrated its ability to quickly raise huge sums abroad through an emergency campaign. In the final quarter of the year the capital inflow was greater than during the rest of the year, amounting to \$ 1,800 million, of which 80 percent consisted of unilateral transfers. The bulk of the funds raised during this period can be attributed to emotional and political motives, while those items that are influenced primarily by economic factors fell off.

In 1973 as a whole foreign exchange reserves expanded by over \$ 750 million to reach \$ 1,700 million. The economy's external debt grew by an unparalleled \$ 1,000 million to stand at \$ 5,100 million. The average rate of interest on these liabilities edged up from 4.9 percent in 1972 to 5.1 percent, and there was some worsening of the maturity schedule of the debt, with a rise in the weight of obligations falling due within the next few years.

¹⁸ Most of the increase in the country's foreign exchange reserves during this period did not stem from current economic activity but represented revaluation increments arising from the slump of the dollar in the first half of the year.

Table
DEFICIT, TRANSFERS, AND THE
 (\$

	1970	1971	1972	1973
A. Current account and long-term capital movements				
Balance on current account				
Excl. administered areas	-1,282.2	-1,267.2	-1,112.0	-2,564.0
Administered areas	48.6	40.2	31.0	4.0
Unilateral transfers	649.4	765.3	1,051.8	2,189.7
Balance on current account plus transfers	-584.2	-461.8	-29.2	-370.3
Long-term capital movements				
Investment from abroad, net	21.8	74.7	143.0	171.6
Independence and Development Loans, net	135.6	179.5	184.0	359.0
U.S. Govt. loans	343.5	262.1	205.3	251.5
Other loans	80.2	200.2	191.0	201.0
Total long-term capital movements	581.1	716.5	723.3	983.1
Total capital imports	1,230.5	1,481.8	1,775.1	3,173.8
Total (A)—Surplus of capital imports over deficit on current account	-3.1	254.8	694.1	612.8
B. Israeli investment abroad, net	-23.6	-11.2	-0.6	-12.3
C. Nonfinancial sectors				
Short-term credit from rest of the world	23.2	9.0	-36.0	8.0
Short-term credit to rest of the world	-59.3	-63.0	-38.8	34.8
Trade credit	-0.4	-22.0	-30.0	-30.0
Other short-term assets	-58.9	-41.0	-8.8	64.8
Total	-36.1	-54.0	-74.8	42.8
D. Financial sectors				
Foreign deposits	120.5	326.1	323.1	346.1
With commercial banks	117.8	355.8	363.3	351.1
With Bank of Israel	2.7	-29.7	-40.2	-5.0
Loans to foreigners	64.6	-35.4	-24.0	-288.0
Commercial banks	63.3	-30.0	6.0	-270.0
Bank of Israel (incl. clearing accounts)	1.3	-5.4	-30.0	-18.0
Foreign currency balances				
Change in reserves ^b	-119.6	-593.4	-975.2	-885.7
Central monetary institutions	-21.1	-284.9	-518.7	-691.7
Other monetary institutions	-98.5	-308.5	-456.5	-194.0
Less: Adjustments				
Foreign currency valuation adjustments		-53.3	-19.1	-223.8
Special Drawing Rights	-15.1	-13.9	-14.0	—
Total changes in reserves due to economic transactions	-104.5	-526.2	-942.1	-661.9
E. Errors and omissions	-17.8	45.9	24.3	39.5

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

^a Excluding investments in the administered areas.

III-24

CAPITAL ACCOUNT, 1970-73

million)

1972, quarterly				1973, quarterly			
I	II	III	IV	I	II	III	IV
-214.0	-289.0	-295.0	-314.0	-284.0	-465.0	-542.0	-1,273.0
3.0	9.0	8.0	11.0	7.0	-7.0	3.0	1.0
272.8	259.5	221.0	298.5	246.3	273.2	257.7	1,412.5
61.8	-20.5	-66.0	-4.5	-30.7	-198.8	-281.3	140.5
21.0	47.7	32.7	41.6	45.1	49.9	58.8	17.8
49.0	47.0	23.0	65.0	51.0	42.0	11.0	255.0
31.5	58.3	76.6	38.9	51.5	47.8	75.8	76.4
104.0	-10.0	30.0	67.0	23.0	36.0	79.0	63.0
205.5	143.0	162.3	212.5	170.6	175.7	224.6	412.2
478.3	402.5	383.3	511.0	416.9	448.9	482.3	1,824.7
267.3	122.5	96.3	208.0	139.9	-23.1	-56.7	552.7
-2.0	-0.6	1.8	0.2	-6.3	-2.7	-2.6	-0.7
-64.2	39.1	-22.4	-27.3	-0.7	69.5	-40.9	14.9
46.3	-117.2	133.0	261.0	-21.0	117.3	322.7	-72.9
52.7	-123.4	133.3	300.7	-20.0	116.3	320.7	-65.9
-6.4	6.2	-0.3	-39.7	-1.0	1.0	2.0	-7.0
-23.0	-87.0	31.0	55.0	-89.0	-107.0	-166.0	74.0
-16.0	-9.0	23.0	8.0	-52.0	-98.0	-181.0	61.0
-7.0	-78.0	8.0	47.0	-37.0	-9.0	15.0	13.0
-334.8	20.3	-198.9	-461.8	-262.8	-202.9	-211.9	-208.1
-293.1	-61.9	-17.9	-145.8	-234.9	-141.8	-87.4	-227.6
-41.7	82.2	-181.0	-316.0	-27.9	-61.1	-124.5	19.5
19.2	7.4	-8.9	1.4	141.5	165.1	47.8	-130.6
14.0	—	—	—	—	—	—	—
-301.6	27.7	-207.8	-460.4	-121.3	-37.8	-164.1	-338.7
77.2	15.5	-31.9	-36.5	98.4	-16.2	107.6	-229.3

^b A minus sign denotes an increase in reserves.

(b) *Background to the capital market developments*

Between the second half of 1970 and the middle of 1972 there was a big surge of capital imports to Israel, particularly private sector transfers. In the middle of 1972 signs began to appear of an abating of the rapid upswing in most of the capital import items. The deceleration persisted through the first three quarters of 1973, with some types of private sector transfers even turning downward. The slow capital import rise in nominal dollar terms actually becomes a decline when the figures are adjusted for the appreciation of various currencies against the dollar and allowance is made for the global inflation prevailing during this period.¹⁹

The enormous inflow of capital transfers in the previous period, especially to the private sector, is partly attributable to long-term economic and other factors, such as the vigorous level of business activity, high profits, the improved security situation (which allayed the apprehension of foreign investors), tax concessions to various investors, and increased immigration from the affluent countries after 1967. In addition, the liberalization of foreign currency control in the second half of 1968 guaranteed the right to repatriate most types of foreign investment and to reconvert immigrant transfers. This removed a number of barriers which had isolated the Israeli economy from the international money markets and enabled the market forces to operate more freely. Against this backdrop, the developments in the international money and exchange markets also gave a strong fillip to the flow of capital to Israel. Among the major factors at work during this period were the waning expectations of a devaluation of the IL, the increase in financial yields and the buoyant state of Israel's stock market in 1972, the rapid mounting of prices, the tightening of monetary restraints, the drop in interest rates abroad, the boom in the property market, which attracted much of the incremental funds from overseas, and the weakening of speculation against the dollar following the international monetary arrangements of December 1971, which reduced the risk of an automatic devaluation of the Israeli pound because of the revaluation of other currencies in relation to the dollar.

In the preceding period most of the factors stimulating the flow of capital to Israel had become more pronounced, whereas during the period reviewed some of them operated in the opposite direction. In September 1971 and April 1972 restrictions were placed on the reconversion of funds originating in property transactions, and this had a moderating effect on the import of private capital. A similar influence was exerted by the big drop in immigration from affluent countries, the weakening of the property boom, the slipping of share prices on the Tel Aviv Stock Exchange during the year, the jump in interest

¹⁹ In view of sharpening of the inflation and the consequent appreciation of incomes and assets abroad during the year reviewed, a constant capital import in nominal terms actually implies a real decline.

rates abroad, and the volatility of foreign exchange rates. At the same time, other factors stimulating the inflow of capital grew stronger. Among these were rising industrial profits; the introduction of stringent monetary measures, which made it harder to mobilize funds domestically; and demand pressure in the home market, which pushed up prices sharply. The intensification of inflation resulted in a much higher overall yield on index-linked bonds and widened the differential between it and the international interest rates²⁰—a development that probably gave a further incentive to transfer capital to Israel.

The impact of each of these factors on the capital inflow cannot be quantified, but it would seem that the much more sluggish growth in 1973 was chiefly the net result of the various contrasting developments described above. But apart from this, there was no reason to expect the high growth rates to be sustained. Drastic changes in the basic determinants of capital movements prompt foreign investors to reshuffle their asset portfolios; presumably this is completed within a relatively short period, after which the flows decline in scope even if the determining variables do not change.

(c) *Unilateral transfers*

Unilateral transfers doubled in 1973 to reach \$ 2,190 million. This can be entirely credited to the unparalleled surge of public sector transfers in the final quarter of the year in the wake of the Yom Kippur War. Those to the private sector held steady, after an unbroken rapid rise begun in 1966.

During the first three quarters of 1973 total receipts of this type amounted to only \$ 23 million more than in the corresponding period the year before. Given the aggravation of the global inflation and the appreciation of the major European currencies, this nominal rise actually represented a decline in real terms. Developments in the fourth quarter of 1973 were similar to those in 1967, which was also a war year. In both years the country succeeded in mobilizing huge sums abroad, which covered the current deficit, with most of the incremental receipts going to the public sector while private sector transfers more or less held steady.

Public sector transfers, which, as already mentioned, are largely determined by emotional and political motives, expanded modestly during the first three quarters of the year, with proceeds from overseas fund-raising campaigns declining and U.S. Government grants rising. In the final quarter both items moved up strongly: the former soared from \$ 127 million in the preceding three quarters to approximately \$ 500 million, while intergovernmental transfers totalled \$ 723 million, with the bulk of the sum connected with the special emergency grant made available by the U.S. Government in 1973.²¹

²⁰ The increase in the Israel-foreign financial yield differential can be seen in Table III-26. The changes were greatest in the final quarter of 1972 and the second and final quarters of 1973.

²¹ Because of the emergency situation in Israel, the U.S. approved \$ 2,200 million in aid to this country. Part of the sum was received in the latter part of 1973 in the form of a grant.

Table III-25

**INCREASE IN FOREIGN CURRENCY ASSETS AND LIABILITIES,
BY MAJOR CATEGORY, 1970-73**

(\$ million)

	1970	1971	1972	1973		
				Entire year	Jan.-Sept.	Oct.-Dec.
A. Assets						
Net foreign exchange reserves at the Bank of Israel	23	214	495	628	413	215
Foreign currency valuation adjustments	—	50	19	165	273	-108
Change due to economic transactions	23	164	476	463	140	323
Other liquid assets	73	320	478	305	300	5
Foreign currency valuation adjustments	—	3	—	58	81	-23
Change due to economic transactions	73	317	478	247	219	28
B. Liabilities						
Foreign currency debts	498	808	651	1,012	661	350
Foreign currency valuation adjustments	..	..	..	136	198	-61
Change due to economic transactions	..	..	..	876	463	411
Liquid foreign currency liabilities of commercial banks	118	355	356	399	512	-113
Foreign currency valuation adjustments	—	-2	—	43	89	-47
Change due to economic transactions	118	357	356	356	423	-66
C. Other short-term capital	-29	89	99	245	334	-89

Private sector transfers, which are influenced more by economic considerations, remained virtually unchanged at \$ 778 million, arresting the rapid up-trend of the three preceding years. This is apparently explained by the weakening of some of those factors which spurred such receipts in the previous period, including the reduced immigration from the Western countries and the sharp fluctuations in foreign exchange rates, which have a moderating effect on transfers to Israel. In the last quarter of the year the amount transferred by immigrants and Israelis fell off, apparently because of the emergency situation, which created a feeling of insecurity on the one hand and caused technical hitches in transferring funds to Israel on the other.

Personal restitution added up to \$ 264 million, compared with \$ 292 million in 1972. All the decline was in nonrecurring payments, which were down \$ 70 million, whereas pension payments continued upward, from \$ 123 million in 1972 to \$ 165 million, or by 34 percent. The growth of the latter stemmed from

Table III-26
QUARTERLY MOVEMENT OF BOND YIELDS IN ISRAEL, U.S.A.,
W. GERMANY, AND U.K., 1972-73
(percentages)

	1972				1973			
	I	II	III	IV	I	II	III	IV
Yields (annual rates)								
Israel								
Bonds linked to								
consumer price index	13.90	13.40	4.10	24.80	9.90	29.10	16.10	44.30
U.S.A.								
Treasury notes	3.85	4.14	4.60	5.16	6.53	7.99	7.15	7.41
Long-term Govt. bonds	5.69	5.61	5.75	5.70	6.29	6.36	6.28	6.40
Germany								
Treasury notes	2.75	2.75	2.75	4.25	4.75	6.75	7.00	7.00
Long-term Govt. bonds	7.40	7.90	7.90	8.60	8.50	9.90	9.60	9.60
U.K.								
Treasury notes	4.31	5.64	6.63	8.31	7.94	6.96	10.94	12.42
Long-term Govt. bonds	8.77	9.39	9.52	9.85	10.25	10.47	11.47	12.26
Absolute differentials (percentage points)								
Israel-U.S.A.								
Treasury notes	10.1	9.3	-0.5	19.6	3.4	21.1	9.0	36.9
Long-term Govt. bonds	8.2	7.8	-1.7	19.1	3.6	22.7	9.8	37.9
Israel-Germany								
Treasury notes	11.1	10.7	1.4	20.6	5.2	22.4	9.1	37.3
Long-term Govt. bonds	6.5	5.5	-3.8	16.2	1.4	19.2	6.5	34.7
Israel-U.K.								
Treasury notes	9.6	7.8	-2.5	16.5	2.0	22.1	5.2	31.9
Long-term Govt. bonds	5.1	4.0	-5.4	14.9	-3.5	18.6	4.6	32.0

Table III-27
UNILATERAL TRANSFERS, 1970-73

(\$ million)

	1970	1971	1972	1973	1972, quarterly				1973, quarterly			
					I	II	III	IV	I	II	III	IV
Personal restitution from West Germany	203.6	230.7	291.5	264.3	96.1	83.3	54.0	58.1	57.0	67.4	69.0	70.9
Lump-sum	119.9	135.3	169.3	98.0	69.8	50.7	25.3	23.5	25.1	25.1	25.9	21.9
Pensions	83.7	95.4	122.2	166.3	26.3	32.6	28.7	34.6	31.9	42.3	43.1	49.0
Personal transfers in cash	175.2	303.4	386.0	370.1	93.3	102.2	94.5	96.0	80.4	96.5	108.7	84.5
Immigrants	55.1	112.8	166.7	147.5	39.4	40.4	41.2	45.7	35.8	42.5	43.9	25.3
Others	120.1	190.6	219.3	222.6	53.9	61.8	53.3	50.3	44.6	54.0	64.8	59.2
Personal transfers in kind	4.6	13.3	13.1	16.0	3.0	3.3	3.2	3.6	4.0	4.0	4.0	4.0
Total personal transfers from the rest of the world	383.4	547.4	690.6	650.4	192.4	188.8	151.7	157.7	141.4	167.9	181.7	159.4
Personal transfers to the rest of the world	7.5	11.1	7.0	8.0	2.0	2.0	2.0	1.0	2.0	2.0	2.0	2.0
Total net personal transfer receipts	375.9	536.3	683.6	642.4	190.4	186.8	149.7	156.7	139.4	165.9	179.7	157.4
Institutional transfers												
In cash	287.4	230.7	305.5	737.5	82.2	66.5	60.1	96.7	77.7	76.1	52.8	530.9
In kind	2.8	3.6	4.7	4.8	1.2	1.2	1.2	1.1	1.2	1.2	1.2	1.2
Total institutional transfers	290.2	234.3	310.2	742.3	83.4	67.7	61.3	97.8	78.9	77.3	54.0	532.1
Net transfers to the Government	-16.7	-5.3	58.0	805.0	-1.0	5.0	10.0	44.0	28.0	30.0	24.0	723.0
Total unilateral transfers	649.4	765.3	1,051.8	2,189.7	272.8	259.5	221.0	298.5	246.3	273.2	257.7	1,412.5

SOURCE: Central Bureau of Statistics.

the rise of the DM against the dollar, the larger number of persons eligible for pensions in 1973, and the adjustment of such payments for the cost-of-living increase in Germany. The volume of nonrecurring receipts, which included accumulated pension payments and other payments by the W. German Government, fell off during the year.

Nonprofit institution transfers reached \$ 135 million, as against \$ 100 million in 1972 and \$ 75 million in 1971. During the first three quarters of 1973 the volume rose to about the same extent as in recent years, but in the final quarter it jumped to \$ 52 million, compared with \$ 84 million in the preceding nine months. The fourth-quarter figure was connected with the strenuous effort made to raise capital abroad by the institutions on the one hand and the generous response of world Jewry to Israel's emergency needs on the other.

Transfers by Israelis from abroad²² were, at \$ 223 million, about the same as in 1972. Those by immigrants amounted to \$ 148 million, as against \$ 167 million in 1972, with the level falling sharply in the fourth quarter because of the emergency situation. The volume of such transfers was apparently influenced by several contrasting developments: a drop in the number of newcomers from the affluent countries, which began in 1971, depressed the level of such transfers, but the accelerating inflation in Israel resulted in immigrants spending larger sums for the acquisition of a home and for getting settled, while price rise expectations presumably induced many to convert their funds into Israeli currency sooner than usual.²³

(d) *Foreign investment*

Foreign investment in Israel continued to expand in 1973, but more slowly than in the two preceding years—\$ 171 million as against \$ 143 million in 1972. Israeli investments abroad, after declining in the two preceding years, reversed their trend in the year reviewed. The net increase in foreign investment amounted to \$ 17 million, or 12 percent, compared with a doubling of the growth rate in 1972.

Foreign purchases of Israeli securities listed on the Tel Aviv Stock Exchange sagged steadily during 1973 and totalled \$ 37 million at year's end; this was apparently connected with the slump on the domestic share market. Direct investments, including the purchase of unlisted securities, were up impressively, from \$ 118 million in 1972 to \$ 190 million. Investment in approved enterprises²⁴ fell to \$ 8 million, about half the 1972 sum; this can apparently be attributed to the smaller foreign investment in Israeli hotels. The much greater

²² In the balance of payments this item is defined as pensions, gifts, and legacies from abroad.

²³ Immigrant transfers are recorded in the official statistics only after conversion into local currency.

²⁴ Approved enterprises are entitled to various concessions under the Law for the Encouragement of Capital Investments.

Table III-28
FOREIGN INVESTMENT IN ISRAEL, 1970-73
(\$ million)

	1970	1971	1972	1973	1972, quarterly				1973, quarterly			
					I	II	III	IV	I	II	III	IV
Investment in Israel by nonresidents												
In foreign currency	11.7	62.5	124.3	157.5	18.2	41.7	28.0	36.4	40.3	44.1	54.2	18.9
Investments	39.5	85.9	171.8	234.9	30.2	52.8	40.6	48.2	60.6	62.2	71.6	40.5
Investments repatriated	-27.8	-23.4	-47.5	-77.4	-12.0	-11.1	-12.6	-11.8	-20.3	-18.1	-17.4	-21.6
In Israeli currency (from blocked accounts)	-1.4	-0.7	3.0	-7.8	-0.5	1.9	0.6	1.0	-3.4	0.6	0.2	-5.2
In Development Bonds	4.8	5.3	7.3	12.5	1.3	2.0	2.0	2.0	5.9	2.8	2.1	1.7
In kind	1.5	2.0	1.0	1.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3
Total	16.6	69.1	135.6	163.4	19.2	45.8	30.9	39.7	43.1	47.8	56.8	15.7
Reinvestment of profits	5.2	5.6	7.4	8.2	1.8	1.9	1.8	1.9	2.0	2.1	2.0	2.1
Total, net	21.8	74.7	143.0	171.6	21.0	47.7	32.7	41.6	45.1	49.9	58.8	17.8
Israeli investment abroad												
Direct*			-0.5	-0.7	—	-0.4	-0.3	0.2	—	-0.1	-0.3	-0.3
Portfolio												
Private individuals	12.4	9.9	2.5	6.4	1.0	1.4	-1.0	1.1	2.5	2.2	1.4	0.3
Banks	2.4	-2.9	-1.4	6.6	1.0	-0.4	-0.5	-1.5	3.8	0.6	1.5	0.7
Total			0.6	12.3	2.0	0.6	-1.8	-0.2	6.3	2.7	2.6	0.7
Net foreign investment in Israel			142.4	159.3	19.0	47.1	34.5	41.8	38.8	47.2	56.2	17.1

* Excluding investments in the administered areas.
SOURCE: Central Bureau of Statistics.

Israeli investment abroad during this period, despite the drop in other capital items which are influenced by economic factors, is explained *inter alia* by the time-lag between an investment decision and its implementation. The projects carried out in 1973 were apparently decided upon in the previous year, when the factors stimulating the inflow of investment capital were stronger.

The increased Israeli investment abroad in 1973 ended a two-year downtrend. Purchases of foreign securities by commercial banks totalled \$ 7 million, compared with a net sale in the two preceding years. Individual investors added \$ 6 million worth of foreign securities to their portfolio, after a smaller investment in 1972.

(e) *Long-term loans*

Net foreign loan receipts were up 40 percent, after dipping 10 percent in 1972. Most of the increase took place in the last three months of the year, when the figure was equal to that of the preceding three quarters. Gross receipts from this source went up from \$ 1,012 million in 1972 to \$ 1,232 million, with repayments amounting to a little more than \$ 400 million each year.

The much heavier foreign borrowing can be attributed to two factors: first, credits to Israeli shipping companies and airlines rose from \$ 55 million in 1972 to \$ 264 million as a result of the large import of ships and aircraft in the year reviewed, after a drop in 1972. Secondly, public sector borrowing was, at \$ 822 million, much greater than in 1972; half this sum was received in the fourth quarter alone, due to the soaring finance needs of the Government because of heavier defense imports.

Foreign loans to the private sector,²⁵ excluding ships and aircraft, were down sharply, from \$ 250 million in 1972 to \$ 160 million. Financial institutions likewise recorded a steep drop in loan proceeds, from \$ 109 million to \$ 54 million. In the last quarter they stepped up their foreign borrowing, the sum amounting to nearly half that for the year as a whole. Since most of the loans were raised on the initiative of the Government, with the institutions serving merely as intermediaries between the foreign sector and the Treasury, it may be assumed that the spurt in their loan receipts, most of which were obtained in the final quarter of the year, was due primarily to the Government's larger financing requirements because of the emergency situation. The tumbling of the private sector's borrowed receipts, exclusive of shipping and air company credits, following two years of rapid growth can apparently be ascribed to two main factors. First was the exacerbation of inflation in Israel and the consequent

²⁵ The distribution of long-term loans by recipient sector, which is based on reports of the Treasury's Foreign Exchange Department, does not correspond with balance of payments data or with those presented in the chapters on the public sector and the financial institutions, since in these chapters loans procured through the intermediation of financial institutions for the Treasury are treated as public sector and not financial institution loans.

Table III-29
FOREIGN INVESTMENT IN ISRAEL, QUARTERLY, 1968-73
(\$ million)

	Securities listed on the Tel Aviv Stock Exchange	Direct investment and unlisted securities	Investment in approved enterprises	Total
1968 I	3.6	2.6	0.8	7.0
II	1.3	1.6	1.2	4.1
III	2.0	1.9	2.3	6.2
IV	3.7	5.4	1.4	10.5
1969 I	3.0	13.3	1.2	17.5
II	4.3	5.7	2.2	12.2
III	3.3	5.3	0.8	9.4
IV	2.9	2.8	3.0	8.7
1970 I	5.4	5.3	0.8	11.5
II	0.8	6.8	0.9	8.5
III	2.3	8.4	0.8	11.5
IV	2.7	6.0	0.8	9.5
1971 I	3.4	14.2	1.0	18.6
II	4.4	13.6	2.7	20.7
III	4.7	15.1	1.0	20.8
IV	6.1	19.4	7.3	32.8
1972 I	4.0	22.4	3.0	29.4
II	18.0	30.0	4.9	52.9
III	8.0	31.6	1.9	41.5
IV	9.4	33.8	6.1	49.3
1973 I	13.3	45.2	2.8	61.3
II	11.5	48.3	2.0	61.8
III	7.0	62.6	1.9	71.5
IV	4.7	34.2	1.5	40.4

SOURCE: Foreign Exchange Department, Ministry of Finance.

decline in the real rate of interest charged on domestic loans, which generally causes borrowers to prefer credit from domestic sources.²⁶ The second factor was the policy adopted by the Treasury of restraining private borrowing abroad: on the one hand, the interest ceiling on such loans was not raised, and with international interest rates advancing, this diminished the possibilities of mobilizing loan capital; on the other hand, the Treasury granted fewer foreign loan permits.

The total value of loan permits in 1973 was \$ 167 million, as contrasted with \$ 546 million the year before. The level fell steadily from the beginning of 1972 until the second quarter of 1973, reflecting the Government's tight foreign credit policy introduced at the beginning of 1972. The rise in the final quarter of 1973 was probably connected with the Government's attempt to "open the taps" at a time when bottlenecks appeared in the economy because of the mobilization of manpower and equipment, which led to distortions in production.

Table III-30
FOREIGN LOAN PERMITS, 1972-73

(\$ million)

Quarter	1972		1973	
	Value	No.	Value	No.
I	179	154	69	60
II	131	97	9	49
III	125	95	38	80
IV	111	78	51	36
Total	546	424	167	225

SOURCE: Ministry of Finance.

(f) *Foreign exchange reserves*

The year reviewed witnessed a further substantial buildup of foreign exchange reserves at the Bank of Israel, which began in 1971. The Bank's net reserve assets expanded by \$ 628 million, as against some \$ 500 million in 1972, bringing the level up to \$ 1,697 million, sufficient for financing a third of the 1973 import bill. During the first three quarters of the year holdings ran at 45 percent

²⁶ In 1973 the public apparently did not anticipate an official devaluation of the IL, as evidenced by the stability of the Natad and free-market dollar rates. This factor enhanced the desire to borrow from foreign sources. However, its influence was apparently offset somewhat by the fluctuations in foreign exchange rates during the year, which increased the risk of the average rate of the IL automatically following the dollar downward.

of imports, compared with an average of 43 percent in 1963–66 and a lower ratio in 1968–72.

The bulk of the foreign exchange reserves at the Bank of Israel are in European currencies; consequently the jump in these currencies against the dollar during the year appreciated the reserves in dollar terms. This accounted for \$ 165 million, or 26 percent, of their overall growth. During the first three quarters of the year the real increment to the reserves amounted to only \$ 139 million, whereas that due to the currency revaluations came to \$ 273 million. In the final quarter the real increase was \$ 323 million, while the currency valuations shaved off \$ 108 million. The huge fourth-quarter increase stemmed from the heavier flow of capital to Israel because of the emergency situation.

Nonresident deposits, which constitute a liquid foreign currency liability, grew by \$ 230 million to reach \$ 900 million; this is a rise of 34 percent, and compares with 27 percent in 1972. Since over 80 percent of these deposits were in dollars, the exchange rate fluctuations did not lead to any significant change in their volume in dollar terms; hence the growth of these deposits may be regarded as continuing the upward trend that has persisted over the past several years. Despite the emergency situation, there was a further expansion of deposits in the final quarter of the year, a development which casts doubts on the assumption about their high liquidity.

(g) *Foreign currency liabilities*²⁷

The rising trend in the country's foreign currency liabilities, a perennial feature of the economy, carried over through the year reviewed, when the level jumped by a record \$ 1,000 million approximately to stand at \$ 5,093 million.²⁸ As in 1972, most of the adverse balance on goods and services was covered by unilateral transfers, and consequently the increase in liabilities was accompanied by the expansion of foreign exchange reserves. The increase in net foreign currency indebtedness (i.e. liabilities less incremental reserves) came to \$ 467 million, as opposed to \$ 158 million in 1972.

The Government's direct foreign currency obligations totalled \$ 3,865 million, after rising by \$ 738 million, compared with \$ 450 million in 1972 and \$ 622 million in 1971. Nongovernmental liabilities were up \$ 273 million to \$ 1,228 million, with loans to shipping and air companies accounting for most of the increase. The relatively big rise in such debts reduced the proportion of direct

²⁷ The economy's foreign currency liabilities are not identical with its external debt, which also includes Israeli currency liabilities abroad, balances in clearing accounts, foreign investment in Israel, and deposits of foreign nationals in Israeli banks.

²⁸ The increase in foreign currency liabilities includes currency revaluations but not some of the other adjustments; hence it does not completely correspond to the change in loans as shown in the balance of payments.

Government liabilities to 76 percent of the total, as against 77 percent in 1972 and 78 percent in 1971 and 1970.

A breakdown by major item does not show any notable changes. Outstanding liabilities on account of the Defense Loans accounted for 18 percent of the total, about the same as in 1972; in 1971 the figure was only 12 percent. Development Bonds held steady at 34 percent. The share of this loan has been on the decline since the 1960s, and its stability in the year reviewed was apparently connected *inter alia* with the emergency situation, which sparked a lively sale of this security abroad.

The country's foreign currency indebtedness has been mounting at an unprecedented pace since 1967, and this has imposed a heavy debt servicing burden on the economy—both current interest payments and future payments on account of principal and interest. One way of measuring the increase in the debt servicing burden is to compare it with growth of the gross national product. In 1955–66 both aggregates moved up to roughly the same extent—about 9.5 percent; but in 1967–73, whereas GNP continued to advance at approximately the same rate, foreign liabilities went up by an average of 20 percent p.a. Nevertheless, until 1972 there was an improvement in the maturity schedule of such indebtedness, with a decline in the proportion of short-term repayments.

There was a slightly adverse change in the maturity schedule in the year reviewed. A classification of the loans by repayment period shows that the proportion falling due within five years was greater than in 1971–72—38 vs. 35 percent in 1972. The proportion of loans with shorter maturities was also higher than in 1972. The percentage of long-term loans obtained abroad rose in 1973, which suggests that the appreciation of the world's leading currencies against the dollar was one of the main reasons for the changes in the maturity schedule. The share of loans repayable in dollars is higher the longer the maturity. Therefore the decline of the dollar, by appreciating the debts in other currencies, resulted in a steeper rise in liabilities with short maturities.

The currency distribution of the debt has not changed very much during the past three years—about 82 percent in dollars, 2 percent in sterling, and the rest in other currencies. Any change in the currency distribution in 1973 could only be marginal, since it depended on the composition of the debt in the previous year, which consisted mainly of long-term obligations which cannot be readily converted into other currencies and on new borrowings in the year reviewed, which were mainly from sources providing dollar loans. Nevertheless, after deducting foreign currency revaluations, the proportion of dollar indebtedness rises to 84 percent, while that in other currencies declines to 16 percent. This situation applies to both direct Government debts and other liabilities. It therefore seems that, despite the limited possibilities, there was some tendency to alter the composition of the loans from those currencies which appreciated in value in favor of those which declined.

FOREIGN CURRENCY

(\$)

	1970	1971	1972
A. Net balances with Bank of Israel			
1. Foreign currency assets with Bank of Israel	458.6	732.0	1,229.5
Change from previous year due to:			
Foreign currency valuation adjustments	—	50.2	18.9
Transactions and transfers	13.4	223.3	478.6
2. Foreign deposits with Bank of Israel	97.4	156.9	159.9
3. Net balances with Bank of Israel (1-2)	361.2	575.1	1,069.6
B. Other foreign currency balances			
4. Gross foreign currency balances	393.0	713.0	1,190.7
Government deposits abroad	24.4	35.9	57.1
Bank deposits abroad	368.6	677.1	1,133.6
Change in gross foreign currency balances due to:			
Foreign currency valuation adjustments	—	3.1	0.2
Transactions and transfers	—	316.9	477.5
5. Foreign-held deposits with commercial banks	631.1	986.2	1,342.6
6. Other foreign currency balances, net (4-5)	-238.1	-273.2	-151.9
C. Net foreign currency assets			
7. Total foreign currency assets (1+4)	851.6	1,445.0	2,420.2
Change from previous year due to:			
Foreign currency valuation adjustments	—	53.3	19.1
Transactions and transfers	—	540.1	956.1
8. Total foreign-held deposits ^a	668.6	996.9	1,346.1
9. Net foreign currency assets (7-8)	183.0	448.1	1,074.1
D. Change in foreign-held deposits (8)			
Due to foreign currency valuation adjustments		-1.5	—
Due to transactions and transfers		329.8	349.2

^a Line (2) plus line (5), excluding that part of the Patach deposits redeposited by the commercial banks with the Bank of Israel, which has already been deducted in the calculation

RESERVES, 1970-73

million)

1973	1972, quarterly				1973, quarterly			
	I	II	III	IV	I	II	III	IV
1,809.8	1,020.8	1,085.3	1,107.9	1,229.5	1,449.2	1,518.5	1,607.1	1,809.8
165.4	17.2	7.2	-7.4	1.9	117.9	113.7	41.8	-108.0
414.9	271.6	57.3	30.0	119.7	101.8	-44.4	46.8	310.7
112.7	170.8	160.0	157.4	159.9	171.2	168.8	124.7	112.7
1,697.1	850.0	925.3	950.5	1,069.7	1,278.0	1,349.7	1,482.4	1,697.1
1,496.1	759.0	677.9	854.0	1,190.7	1,238.3	1,367.4	1,490.7	1,496.1
168.5	40.2	41.3	36.4	57.1	76.8	144.8	143.6	168.5
1,327.6	718.8	636.6	817.6	1,133.6	1,161.5	1,222.6	1,347.1	1,327.6
58.4	2.0	0.2	-1.5	-0.5	23.6	51.4	6.0	-22.6
247.0	44.0	-81.3	177.6	337.2	24.0	77.7	117.3	28.0
1,741.9	1,038.8	912.4	1,044.8	1,342.6	1,358.9	1,536.4	1,854.5	1,741.9
-245.8	-279.8	-234.5	-190.8	-151.9	-120.6	-169.0	-363.8	-245.8
3,305.9	1,779.8	1,763.2	1,961.9	2,420.2	2,687.5	2,885.9	3,097.8	3,305.9
223.8	19.2	7.4	-8.9	1.4	141.5	165.1	47.8	-130.6
661.9	316.6	-24.0	207.6	456.9	125.8	33.3	164.1	338.7
1,741.9	1,043.2	916.9	1,049.4	1,346.1	1,362.4	1,539.9	1,861.3	1,741.9
1,564.0	736.6	846.3	912.5	1,074.1	1,325.1	1,346.0	1,236.5	1,564.0
395.8	46.3	-126.3	132.5	296.7	16.3	177.5	321.4	-119.4
42.6	—	—	—	—	37.2	54.8	-2.7	-46.7
353.2	46.3	-126.3	132.5	296.7	-20.9	122.7	324.1	-72.7

of the Bank of Israel's net foreign currency assets.
SOURCE: Central Bureau of Statistics.

Table III-32

ISRAEL'S FOREIGN CURRENCY LIABILITIES, BY REPAYMENT DATE, 1966-73

(\$ million)

	1966	1967	1968	1969	1970	1971	1972	1973
Repayment date								
Up to one year	198	198	301	244	398	475	434	549
One to two years	87	141	135	195	195	224	263	329
Two to three years	131	82	114	135	174	202	241	351
Three to four years	75	87	112	122	136	159	268	327
Four to five years	79	85	110	109	117	192	238	369
Five years or more	750	963	1,130	1,319	1,602	2,178	2,637	3,168
Total	1,320	1,556	1,902	2,124	2,622	3,430	4,081	5,093
Percentage distribution by repayment date								
Up to one year	15.0	12.7	15.8	11.5	15.2	13.9	10.6	10.8
One to two years	6.6	9.0	7.1	9.2	7.4	6.5	6.4	6.5
Two to three years	9.9	5.3	6.0	6.4	6.6	5.9	5.9	6.9
Three to four years	5.7	5.6	5.9	5.7	5.2	4.6	6.6	6.4
Four to five years	6.0	5.5	5.8	5.1	4.5	5.6	5.8	7.3
Five years or more	56.8	61.9	59.3	62.0	61.1	63.5	64.6	62.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Cumulative percentage distribution								
Up to one year	15.0	12.7	15.8	11.5	15.2	13.9	10.6	10.8
Up to two years	21.6	21.7	22.9	20.7	22.6	20.4	17.0	17.3
Up to three years	31.5	27.0	28.9	27.1	29.2	26.3	22.9	24.2
Up to four years	37.2	32.6	34.8	32.8	34.4	30.9	29.5	30.6
Up to five years	43.2	38.1	40.6	37.9	38.9	36.5	35.3	37.9
Five years or more	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

SOURCE: Ministry of Finance.

Table III-33

ISRAEL'S FOREIGN LIABILITIES, BY CURRENCY, 1971-73*

(\$ million)

	1971		1972		1973		
	\$ m.	Percent of total	\$ m.	Percent of total	\$ m.	Percent of total	
						Incl. currency revaluations	Excl. currency revaluations
Total liabilities	3,341	100.0	3,985	100.0	4,995	100.0	100.0
In dollars	2,726	81.6	3,291	82.6	4,074	81.6	84.2
In sterling	70	2.1	78	2.0	85	1.7	1.8
In other currencies	545	16.3	616	15.5	836	16.7	14.1
Direct Government liabilities	2,619	100.0	3,092	100.0	3,831	100.0	100.0
In dollars	2,185	83.4	2,608	84.3	3,176	82.9	85.6
In sterling	5	0.2	7	0.2	5	0.1	0.1
In other currencies	429	16.4	477	15.4	650	17.0	14.2
Nongovernmental liabilities	722	100.0	893	100.0	1,164	100.0	100.0
In dollars	541	74.9	683	76.5	89	77.1	79.3
In sterling	65	9.0	71	8.0	80	6.9	7.1
In other currencies	116	16.1	139	16.1	186	16.0	13.6

The average rate of interest on medium- and long-term foreign currency loans edged up from 4.6 percent in 1971 and 4.9 percent in 1972 to 5.1 percent in the year surveyed. This can apparently be attributed primarily to the rise in international interest rates.²⁹

6. ISRAEL IN THE WORLD ECONOMY

Among the numerous unusual developments that took place in the world economy during 1973, the following had a strong impact upon the Israeli economy:

(a) The breakdown of the fixed exchange rate system. This led to the de facto floating of the IL—which has remained pegged to the dollar—against the

²⁹ In 1972, when international interest rates declined, the rise in the average rate paid on Israel's foreign currency liabilities was probably connected with their changed composition.

major currencies. This float reflects the market forces that affected the dollar rather than developments in the Israeli economy. Along with the U.S. dollar, the IL first moved sharply downward until the middle of the year, after which it rebounded to almost regain its level at the beginning of the year.

(b) The boom in commodity prices (food, industrial raw materials), which began in 1972 and continued through 1973. In common with many other countries, Israel suffered a very steep rise in import prices. The result was strong pressure on the level of domestic prices and some deterioration in both the trade balance and the terms of trade—and hence some loss in real national income.

(c) An extraordinary harmony in the business cycle “booms” of the world’s major industrial economies in the first half of 1973. It was this factor which resulted in an exceptionally notable growth of world output and demand for raw materials and, together with the poor harvests in numerous countries (especially in 1972) and virtual absence of unutilized capacity in many raw material industries, produced the “take off” in commodity prices. This boom also stimulated Israel’s exports, but the subsequent sharp reaction in the second half of 1973 depressed the growth rate, particularly in cyclically sensitive sectors.

Table III-34

INCREASE IN REAL GNP IN SEVEN MAJOR OECD COUNTRIES, 1959-73

(percentages)

	Average 1959/60 to 1970/71	Annual increase		Half-yearly increase		
		1972	1973	1972	1973	
				II	I	II
U.S.A.	3.9	6.1	6.0	7.3	6.9	3.0
Canada	4.9	5.8	7.2	5.3	9.4	4.1
Japan	11.1	9.6	11.0	13.8	11.6	7.0
France	5.8	5.5	6.2	5.6	6.5	6.0
W. Germany	4.9	3.0	6.2	1.3	11.2	1.5
Italy	5.5	3.5	5.2	4.7	3.0	10.0
U.K. ^a	2.9	3.0	6.7	7.5	8.4	3.0
Total, seven countries ^b	4.8	5.8	6.7	7.1	8.0	4.0
Total OECD countries ^c	4.8	5.7	6.7			

NOTE: The figures for the second half of 1973 are preliminary estimates.

^a Gross domestic product.

^b 1972 weights and exchange rates.

^c 24 countries.

SOURCE: Organization for Economic Cooperation and Development (OECD).

(d) Last, but hardly of less importance, the OPEC oil price “revolution” of October and December 1973, which cast a further shadow over Israel’s prospective terms of trade and payments problems (again in common with most other nations).

Following we take up these topics in the order suggested by their interrelation within the world economy.

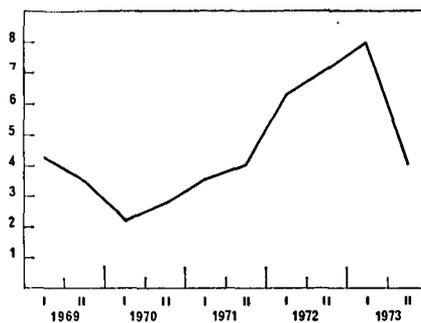
(a) *The business cycle boom and commodity prices*

Perhaps the prime mover among the many unusual developments in 1973 was the degree of coincidence, unprecedented since the Second World War, in the business cycles of the world’s major industrial economies (North America, Western Europe, and Japan). While these cycles were not perfectly juxtaposed (that of the U.S. was somewhat further advanced than that of Europe), they were sufficiently in step to create a very rapid expansion in total world demand and resource use, which rose throughout 1972 and peaked in the first half of 1973.³⁰

The overall rate of increase in real GNP in the major OECD countries rose from 7.1 percent in the second half of 1972 to an appreciable 8 percent in the first half of 1973 (as against a long-run average of only 4.8 percent), and then slowed sharply to 4 percent in the second half of the year. This development, together with the short-run inelasticity of supply of most raw material industries (in which capacity utilization had been high even before the boom, due to a lengthy period of low prices and low investment), underlay the precipitate advance through most of 1972 and 1973 in commodity prices (food and industrial raw materials). Together with the more important circumstance of poor harvests in many countries in 1972, it helped to generate the explosion in food prices. In the event, commodity prices more than doubled from mid-1972 to the fall of 1973 (before the oil crisis). The Reuters index of 17 basic commodities, for example, rose from 550 in mid-1972 to 1,200 in September 1973, while the Economist index exhibited a quite similar movement (see Figure III-5).

³⁰ See Figure III-4 and Table III-34. The related, but not identical, changes in Israel’s export markets (i.e. the changes in the total imports of Israel’s trading partners weighted by their shares of Israeli exports) are shown in Table III-35.

Figure III-4
GROWTH OF GNP IN SEVEN MAJOR
OECD COUNTRIES—TOTAL, 1969-73
(percent change from previous half-year,
at annual rates)



The pressure which developed in the commodity or raw material industries is suggested not only by the actual price increases but by figures on capacity utilization in these industries in the United States (which is a major supplier as well as consumer of such raw materials). The highest levels on record were reached in 1973, even eclipsing those prevailing during the Korean War in 1950-51.³¹

For Israel, the commodity price boom meant a 2.6 percent decrease in its terms of trade. Up to the oil price explosion, there was a relatively moderate rise in import prices relative to export prices,³² since the country's exports, particularly food, also benefited considerably from this development. On an average,³³ export prices rose 24.9 percent and import prices by 28.2 percent in 1973.

But the averages do not give a complete picture. In the final quarter of 1973 the deterioration in the terms of trade became much more severe, mainly because of the initial hiking of oil prices in October.³⁴ During this quarter there

Table III-35
GROWTH OF ISRAEL'S EXPORT MARKETS,^a 1966-73^b
(percentages)

	Developed countries	Others	Total
1966	7.7	7.5	7.7
1967	5.3	4.6	5.2
1968	13.8	12.2	13.6
1969	10.7	10.4	10.7
1970	7.9	10.3	8.3
1971	6.3	9.9	6.8
1972	10.6		
1973 ^b	10.1		

^a The measure of market expansion is the rate of quantitative increase in the total imports of the countries of destination, weighted by each country's share in Israel's exports (excluding diamonds).

^b January-September.

³¹ See Table III-9 above for the detailed price indexes of imports and exports.

³² With respect to these commodities it should be noted that the changes in the average import prices of every country, including Israel, differ from those indicated by these indexes because of the existence of long-term contracts, forward purchasing, and the disparate weights of the various import commodities.

³³ The upward pressure on commodity prices undoubtedly increased as a result of a wave of speculative demand, which was also stimulated by the general lag of nominal interest rates on financial assets behind the growing rate of inflation.

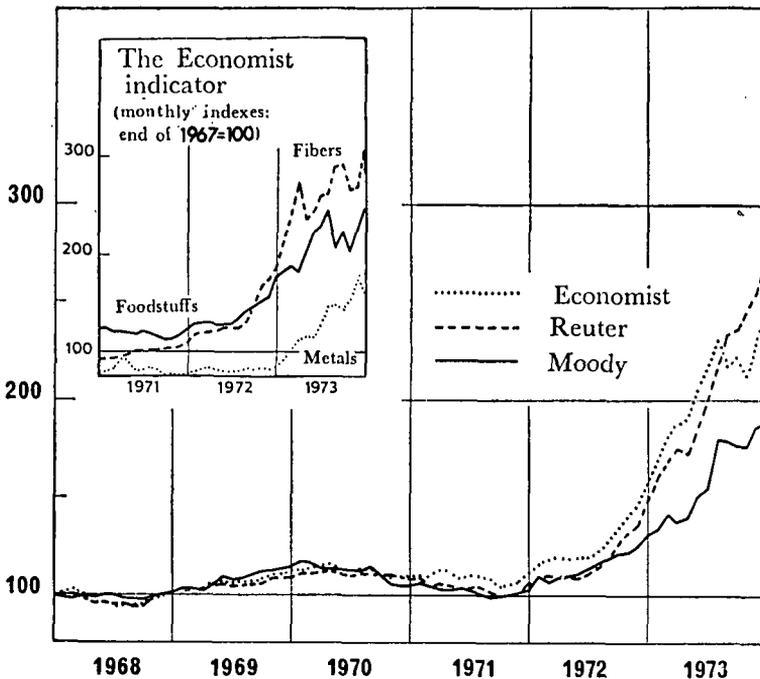
³⁴ The rise at the end of December was not reflected in the index of import prices for the final quarter of 1973. It is estimated that the higher cost of crude petroleum may add an estimated \$ 300 million to the 1974 import bill for this item.

was a 13.5 percent decrease from the average for 1972. The worsening of the terms of trade has several important implications. First of all, it makes it imperative for the economy to step up exports in order to finance a given volume of imports, with the increase being equivalent to the deterioration in the terms of trade—2.6 percent if the comparison is made between the average for 1973 and that for 1972, and 13.5 percent if it is made between the fourth quarter of 1973 and the average for 1972. Secondly, to finance a given real import surplus will necessitate a big increase in capital imports or in real exports.

The adverse swing in the terms of trade means, in effect, a decline in the purchasing power of national income measured in relation to a given basket of resources (domestic output and imports). In 1973 real national income inched down 0.65 percent. Calculated on the basis of the terms of trade in the final quarter of 1973, the level fell 3.4 percent below the average for 1972, offsetting much of the growth in real GNP.

The potential effect on Israel's prices has also been substantial. However, the evidence suggests that the cost-push element of import prices was in the main swamped by powerful demand-inflationary pressures within the Israeli economy (see Chapter VI, "Prices"). If the latter had not been present, import

Figure III-5
WORLD MARKET COMMODITY PRICE INDEXES, 1968-73
(1967=100)



prices would still have pushed up the general level of prices, but taking lags into account, by less than 10 percent on an average for the year as a whole, and possibly by as little as 5 percent for the consumer price index in the first nine months. But in fact the demand growth not only made it possible to absorb increases of this scale, but even to compound them. In this respect the Israeli development differed fundamentally from that in most of the developed economies in the world, in which real growth appears to have suffered from the inability of domestic demand to absorb all elements of both imported and domestic cost-push price inflation.

(b) *Inflation in Israel and abroad*

The slowdown in the world economy in the second half of 1973 partly explains the sluggish growth of Israel's exports (especially diamonds) in 1973, and is liable to depress them further in the course of 1974. However, it should be emphasized that most of the country's exports are influenced more by other factors, primarily the ability of Israeli-made goods to compete abroad and the relative profitability of sales abroad compared with those on the local market. This declined in 1973, partly because the price inflation in Israel was much

Table III-36

PRICE AND COST PERFORMANCE OF SEVEN MAJOR OECD COUNTRIES, 1972-73

(percent increase over previous year; in local currency terms)

	1972				1973			
	Consumer prices ^a	GNP prices ^b	Unit labor costs	Export prices ^c	Consumer prices	GNP prices	Unit labor costs	Export prices ^c
Canada	3.5	4.6	4.7	2.9	5.5	6.5	5.1	12.0
U.S.A.	2.6	3.2	3.5	3.3	5.0	5.25	4.7	12.7
Japan	4.5	4.6	5.6	1.8	11.5	10.5	12.1	4.2
France	6.2	5.7	6.2	1.0	7.5	7.0	9.0	7.0
W. Germany	5.7	6.1	6.5	0.9	7.0	6.25	7.5	0.9
Italy	5.7	6.0	7.4	0.8	10.75	11.0	13.4	10.7
U.K.	5.8	6.7	8.2	8.7	7.5	5.75	5.2	9.5

^a The implicit price deflator of the private consumption expenditure series.

^b GNP prices increase faster than consumer prices when export prices rise relative to import prices, while consumer prices increase faster in the opposite case (reflecting a deterioration in the terms of trade).

^c The implicit deflator of commodity and service export prices. The changes are presented in terms of local currencies, and hence they largely reflect demand-induced rises in commodity export prices (as in the U.S. and Canada), as well as supply-induced price changes, which are more dominant for industrial exports (as in Germany and the U.K.).

^d The first three quarters of 1973 compared with the corresponding period the year before.

SOURCE: OECD, *Economic Outlook*, December 1973.

higher than in its major export markets in Europe and America. For example, from 1972 to 1973 consumer prices went up by an average of only 7.75 percent in the Common Market and 5.5 percent in the U.S., but by 20 percent in Israel. The difference is not offset by the fact the price inflation abroad accelerated in the last two quarters of the year.

Table III-36 shows that the inflation in Israel in 1972 and 1973, whether measured by the consumer or the GNP price index, was about triple the (weighted) average for the major industrial countries. Unit wage costs rose 2-2.5 times the rate abroad, and export prices in local currency terms exhibited a similar performance. The impact of these internal price and cost developments on export profitability was offset to some extent by the decline in the average exchange rate of the IL, which came to 7 percent for 1973 as a whole.

The net effect of both factors (internal price changes and exchange rate changes) is reflected in the export price series presented in terms of a common currency (the dollar), set forth in Table III-37, which therefore provides one of the better indicators of the changes in relative price competitiveness among the various nations. This shows that even when the average value of the IL depreciated, Israel, like the U.K., almost kept up with the industrial export price rise of the revaluing countries. The U.S., by contrast, enjoyed a sharp

Table III-37
EXPORT UNIT VALUES OF MANUFACTURES, 1969-73
(in dollars; 1970=100)

	U.S.A.	U.K.	W. Ger- many	France	Italy	Japan	Total, six countries ^a	Israel	Israel/ the Six
1969	95	93	92	97	95	95	94	98.6	1.05
1970	100	100	100	100	100	100	100	100.0	1.00
1971	102	110	108	106	108	105	105	100.0	95
1972	105	122	119	116	115	118	113	105.5	93
1972 I	104	123	118	114	114	113	111	103.7	93
II	105	125	118	114	114	118	113	103.5	92
III	104	121	122	116	116	120	113	104.1	92
IV	106	117	119	118	116	122	112	110.2	98
1973 I	107	122	132	127	121	130	118	112.2	95
II	110	131	148	141	127	142	126	124.8	99
III	114	133						133.2	

NOTE: The industrial export price changes are more nearly cost determined than, for example, agricultural or raw material exports, but demand or market price shifts still play a role (especially for small countries). For this as well as statistical reasons, these series can only be regarded as a rough indication (rather than an accurate measure) of true changes in cost or supply price (the ideal measure of competitiveness).

^a Weighted by the share of Israeli industrial exports, excluding diamonds, in 1972. The six countries took 47 percent of such exports.

SOURCE: Data on the Six: *National Institute Economic Review*, No. 67, February 1974 (London); data on Israel: Central Bureau of Statistics and Bank of Israel.

relative price reduction (the difference, of course, reflects the disparate rates of inflation). The very high German index, on the other hand, is essentially a reflection of the persistent upvaluation of the DM.³⁶

(c) *Reaction to the price boom—a world slump*

The policy reactions of several of the most important industrial nations (especially the U.S. and West Germany) to the great inflation of commodity prices (including fuel and food) have created the prospect of a more or less simultaneous cyclical slowdown in 1974. This slowdown was well under way in the year reviewed (see Figure III-4 and Table III-34). In the U.S. the real growth rate in the last three quarters apparently dropped below the full-employment trend level of about 4 percent, after peaking sharply at 8.5 percent in the first quarter of the year. The rate, in fact, fell from about 3 percent during the second and third quarters to only 1.3 percent in the fourth quarter and to -5.8 percent in the first quarter of 1974.³⁷ Both the U.S. Government and the OECD forecast little or no growth in early 1974, followed by a recovery in the second half, with the increase for the year as a whole amounting to only 1-2 percent.

The German GNP growth rate plunged from 11.2 percent in the first half to 1.5 percent in the second. In Japan, the U.K., and Canada it fell by a third to two-thirds. On the other hand, in France, which has an outstanding record in moderating cyclical fluctuations in recent years, the growth rate declined gently, from 6.5 to 6 percent, while in Italy it actually advanced quite smartly.

In the U.S. (and in varying degrees in other countries, particularly West Germany), the policy response which contributed most, if not entirely, to the slowdown consisted primarily in the employment of deflationary monetary and fiscal policy weapons to combat a general price index rise which was dominated by the upward push of commodity prices. (In the U.S. food and fuel accounted for more than 60 percent of the price index rise, and a much higher proportion still of the acceleration of the price rise.³⁸)

However, fiscal and monetary policies, together with the incomes policies which helped to hold back wage increases, were geared to combating demand inflation rather than the cost-push on prices. For example, in both the U.S. and

³⁶ In contrast to Israel, where prices to the exporter moved up roughly in step with unit wage costs, Germany did not experience such a development because exporters there endeavored to maintain their competitive edge. This is reflected in the exceptionally low rise in DM export prices—0.9 percent, as against a 7.5 percent rise in unit wage costs (see Table III-36).

³⁷ The extent of the slowdown, especially in the first quarter of 1974, was undoubtedly greatly accentuated by a fuel shortage and a resulting fall in demand for automobiles and related goods and services.

³⁸ It appears that the very sharp increases in commodity prices could not be partially offset by actual decreases in prices of other goods and services (and wages) due to downward price and wage rigidity. As a result, the sharp relative price increase in the commodity sector necessarily led to a significant acceleration of the general price index rise.

Germany money supply growth slowed (in the latter country to negative rates by mid-1973), and fiscal policy moved in a parallel direction. This made it impossible for the steep increases in commodity prices (which enter as costs into most of industry) to be passed on to the consumers of final products without generating pressure on real disposable income and/or profitability. In addition, the overall rate of saving increased, as real income was shifted from wage earners to profits in the commodity sectors.³⁹

(d) *The oil crisis*

The origins of the oil crisis which burst upon the world in late 1973 lie much deeper than the pressure of the worldwide boom, and they have little to do with the Arab-Israel dispute (apart from the employment of the oil embargo by the Arab oil producing states as a pretext to cut supplies and boost prices). They reflect both the gradual adaptation of the industrialized world to reliance upon low-cost Persian Gulf oil and the growing affluence and self-confidence of the largest oil exporting countries. In essence, the radical price increases (totalling about 270 percent) announced by OPEC in October and December 1973 constituted a new and serious attempt to exploit potential monopoly (or cartel) power. The culminating stimulus to this attempt was provided by the lowering of the traditional U.S. quota barriers against the import of cheaper OPEC oil, a decisive change of policy which has only begun to be reflected in imports from the Gulf area—a sharp increase in 1973 and even larger increases anticipated in 1974.

³⁹ Prevention of the slowdown, given the wage and price rigidity, would have necessitated a somewhat higher rate of general inflation than actually occurred in 1973 in order to permit the passing on of the higher costs. The extent of the general slowing of money supply growth despite the commodity cost-push is suggested by the following table, which shows the percentage change from the same quarter in the previous year for seven major OECD countries and Israel. It will be noted that the U.S., Canada, France, Germany, and U.K. all follow this trend, while Japan, Italy, and Israel do not.

Percent Increase in Money Supply Over Same Period
in Previous Year, 1972-73

	1972	1973	
	IV	III	IV
U.S.A.	7.7	7.3 ^a	6.1 ^a
Canada	26.5	9.0	
Japan	23.1	31.2	13.0
France	15.2	8.7	6.4
Germany	13.0	1.2	0.6
Italy	22.5	24.8	
U.K.	14.4	7.7	
Israel	28.3	24.3	32.0

^a IMF and OECD data show a much slower growth in these quarters. The reason for these large discrepancies is as yet unclear. SOURCE: OECD countries —Federal Reserve Bank of St. Louis; Israel — Central Bureau of Statistics.

Table III-38

CHANGES IN AVERAGE^a U.S. DOLLAR AND IL RATES FROM "SMITHSONIAN"
PARITIES (DECEMBER 1971), 1973-74

(percentages)

	Dollar ^b	IL		Increase in import tax (percent of previous effective rate ^d)	Increase in export premiums
		Weighted by imports ^c	Weighted by exports ^c		
1973					
January	-0.5	1.6	0.6		
February	-10.4	-2.3	-3.9		
March	-10.2	-5.4	-7.4		
April	-10.0	-4.4	-6.4		
May	-13.1	-5.6	-7.6		
June	-17.5	-8.7	-10.8		
July (3) ^e	-22.3				
July	-18.3	-12.5	-15.0		
August	-15.6	-10.1	-12.4		1.2
September	-16.7	-9.7	-12.1		
October	-16.1	-10.2	-12.6	3.9	
November	-9.7	-6.1	-8.6		
December	-7.9	-3.9	-6.5		
1974					
January	-2.7	0.3	-2.4		3.7
February	-6.7	-1.8	-4.7		
March	-10.2	-4.0	-7.0		
April	-12.3	-6.8	-8.6		

^a Trade-weighted.^b End-of-month position against trade-weighted average rate of the 11 leading foreign currencies (Japan, Germany, France, Switzerland, Belgium, Netherlands, Italy, U.K., Sweden, Denmark, and Norway).^c Average monthly trade-weighted rate. The effective rate of the IL (including premiums and import taxes) would show the same percentage changes except where taxes or premiums are raised. In this case the change in the effective rate would equal that in the formal rate minus the increase in taxes or premiums. For example, in January 1974 the 3.7 percent rise in premiums increases the small remaining average decline of the IL (export weights) of 1.5 to 5.2. This, of course, is still well above its position in July or August.^d 5.41 for imports and 5.33 for exports other than diamonds at the end of 1972.^e The 1973 trough.

The entrance of the U.S. into the market for OPEC oil is, of course, explained by a combination of factors. The growth of domestic U.S. energy supplies slowed under the influence of both consumer-oriented price restriction of natural gas, and the rising resistance to pollution (which delayed the Alaska pipeline, offshore oil, and other energy-related investments as well). Fundamentally, however, the behavior of the U.S. in this respect followed the prin-

ciples of efficient international specialization. It did not appear economically rational to insist on the exploitation of higher-cost local energy resources as long as much cheaper oil imports were available. The dramatic change in relative prices brought about by the OPEC countries' action may rebound to their disadvantage in the not-too-distant future, for the U.S. has been induced to turn inward in its future energy policy. More important, both the U.S. and Europe possess the alternative resources and the technology needed to reduce their dependence on outside oil and to undercut and bring down the excessive OPEC prices within a relatively short period.⁴⁰

The large negative impact of the oil price rise on prospective trade balances of oil importing countries has a twofold aspect: the direct deflationary effect of transferring purchasing power from the domestic market to the oil exporting states and the danger of further deflationary policy responses. The first problem stems from the fact that part of the disposable income that would have been used for purchasing domestic output now has to be diverted to paying for the import of oil. The effect of this on the demand for domestic output is similar to that of an increase in saving, and it has to be balanced by a corresponding growth of investment if total demand for domestic output is not to be reduced with a consequent growth of unemployment.

The danger of a deflationary policy arises mainly from the tendency of nations to concentrate primarily upon current account or trade balances (as opposed to the balance of payments as a whole), and to habitually restrict domestic demand upon the appearance or growth of a deficit in these accounts. Fundamentally, however, much larger trade deficits for the oil importing countries imply that the oil exporters, as a group, are unable to expand their local consumption and investment in proportion to the increase in their national income (swollen by their increased export earnings). Thus, they will necessarily increase their national financial saving sharply, which means additional foreign investment in the rest of the world. It is both possible and feasible for the capital markets of the world to absorb and to redistribute these additional funds among both the industrialized and the developing economies. The main difficulty in this process lies in the fact that some nations may be unable (because of lower rates of return or political factors) to attract a sum equivalent to their increased oil deficit. As a result, some degree of exchange rate and current account readjustment will be called for.⁴¹

⁴⁰ Output of traditional fuels, such as coal, can be expanded in the U.S. for much less than the present OPEC prices, even if allowance is made for the extra costs bound up with environment-preservation considerations.

⁴¹ The inability of the world economy to achieve full equilibrium in the matter of large capital movements in the past was primarily due to the system of fixed exchange rates (see, e.g., the discussion of the U.S. case below). The shift to a much greater flexibility in rates will help to avoid similar imbalances in the flow of trade and capital.

(e) *Exchange rate developments*

The year 1973 witnessed the culmination of a historic change in the international exchange rate regime, namely the breakdown of the Bretton Woods system of fixed rates linked to the U.S. dollar and the emergence of floating rates for the major currencies, albeit subject to varying degrees of official intervention. The switch to floating rates was accompanied by the placing of new restrictions on short-term capital movements; however, these restrictions were reduced in the course of the year, and their effect on future developments cannot be determined.

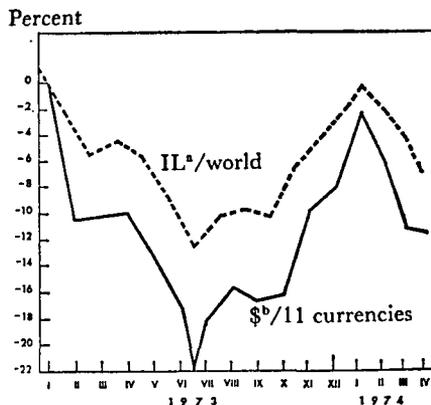
The primary cause of this transformation, which took place not as an intentional reform, but despite institutional resistance and anxiety, was undoubtedly the rapidly increasing intensity and frequency of exchange market crises (i.e. massive speculative shifts of capital from one currency to another) under the previous arrangements.⁴²

The consequences of this change for the Israeli economy are very important. Although the IL remains pegged to the dollar, it is in fact floating relative to the average of the other leading currencies. However, it is floating with the dollar rather than independently, which means that there is only an accidental, if any, correspondence between the direction of the float and Israel's own balance of payments requirements.

In the event, Israel's higher rate of inflation was approximately offset, until July, by the falling trend of the U.S. dollar, which drew the IL down with it in relation to the average of the other currencies. This constituted an effective gradual devaluation of the IL, which maintained (or even slightly improved) the relative prices and hence the relative profitability of Israel's exports and import substitutes. However, the dollar reversed direction in July, and by year's

Figure III-6

CHANGE IN IL AND DOLLAR RATES
FROM SMITHSONIAN PARITIES
(DEC. 1971), 1973-74



^a IL import-weighted exchange rate from Table III-38.

^b From Table III-38.

⁴² Under the fixed rate system the speculation that the formal rate of a given currency would be changed could, at worst, be disappointed by the maintenance of the old rate; at best, it would be rewarded by a change in the expected direction. A one-way option thus existed which greatly encouraged speculative flows. This potential for massive instability was increasingly realized as restrictions on convertibility were eliminated, experience accumulated, and the resistance of government to exchange rate adjustments weakened.

end most of the decline in the first half of 1973 had been erased. From the standpoint of the IL this meant that, instead of continuing to offset Israel's relatively higher rate of internal inflation, the upward movement of the average exchange rate of the IL actually further eroded the price competitiveness of exports. The deterioration caused by the *de facto* upvaluing of the IL (by an average of 8 percent between July and December) and by the much more rapid inflation in Israel compared with the average for the developed countries was only slightly offset by increases in import taxes and export premiums.⁴³ Failure to check and even to reverse this slide in Israel's price competitiveness seriously jeopardizes its trade balance.

Table III-39
INCREASE IN ISRAELI IMPORT PRICES, BY SOURCE, 1973

	Import prices (c.i.f.)		Source of increase in import prices	
	Index 1968=100	Percent increase	Change in average IL exchange rate	Price rise abroad
1972 IV	119.4	3.8		
1973 I	125.1	4.8	3.6	1.2
II	139.6	11.2	4.1	6.8
III	158.6	13.6	4.2	9.0
IV	175.9	10.9	-3.6	14.9
Average 1972	115.8			
Average 1972 to average 1973	148.4	28.2	6.7	20.1
IV 1972 to IV 1973	175.9	47.3	8.4	35.9

Although by January 1974 the average rate of the IL had almost returned to its January 1973 level (see Table III-38), its average value for the year as a whole was down about 7 percent. However, this accounted for only a small

⁴³ Export premiums were raised by 1.2 percent in August 1973 and by 3.7 percent in January 1974; import taxes were upped by 3.9 percent in October. The effect of these was to offset roughly one-third of the deterioration from July 1973 to the end of the year.

part of the overall rise in the country's import prices. In the main it reflects price increases abroad (see Table III-39).

The reversal of the dollar trend in mid-1973 was itself one of the notable developments in the world economy that year. It reflected the steady improvement in the U.S. trade balance and current account over several preceding quarters, in response to the several effective devaluations of the dollar since 1971 (the Smithsonian arrangement of December 1971, which formalized the "devaluation" of the dollar that year, the devaluation of February 1973, and the "floating" devaluation from March to July). An additional factor was the extraordinarily heavy demand for U.S. food exports.⁴⁴

An unprecedented shift in the U.S. current account from a deficit of about \$ 6,000 million in 1972 to a surplus of about \$ 1,000 million in 1973 directly strengthened the exchange market position of the dollar. Together with a smaller shift in long-term capital flows, it also changed the speculative climate and induced some reconversions of private liquid assets into dollars. Governments and central banks outside the U.S. (especially Japan) were willing to sell part of their swollen accumulation of dollar reserves, thus slowing the rise of the dollar and generating a surplus in the "official reserve balance" of the U.S. balance of payments.⁴⁵

The system of floating rates was still in its infancy in 1973. It had inherited the accumulated disequilibria of the previous system, particularly as regards the U.S. dollar and the Japanese yen in relation to West European currencies. Participants in the exchange markets still have to gain experience in following the market trend. With the acquisition of such experience, the fluctuations in rates presumably will be smaller, as a rule, than in 1973. Even in its first hectic year the new system succeeded in eliminating the exchange market crises and the temporary breakdowns in convertibility which had appeared with increasing frequency before. In addition, it did not prevent the continued vigorous expansion of international trade and investment (the foreign trade of the OECD area, for example, increased by 14 percent in volume in 1973, as against 9.6 percent in 1972). Efforts to reestablish a greater degree of stability in the exchange rate system—presently under consideration by the member-states of the IMF—will have to take account of these facts if a return to the characteristic faults of the old system is to be avoided.

⁴⁴ Since January 1974 the trend has changed, and the dollar again dipped by 10 percent. This can apparently be attributed on the one hand to the lifting, at the end of the month, of the restrictions on U.S. capital exports which had been in force for 11 years, and on the other hand to the market's reassessment of the gravity of the effects of the oil price rise on the balance of payments of Western Europe and Japan.

⁴⁵ The improvement in the current account of the U.S. was almost matched by an opposite shift in that of Japan, which had been in massive surplus. The German current balance continued to rise despite revaluations; this undoubtedly reflects in part the sharp slowdown in the German economy in mid-1973.

(f) *Capital market developments*

The pursuance of increasingly tight monetary policies in most of the major countries was noted earlier. This policy response, together with the persistence of accelerating price inflation, made 1973 a year of rising nominal interest rates. Short-term rates rose steeply almost everywhere; long-term rates, reflecting more stable expectations about price inflation in the long run, rose quite moderately. (Certain deviations from this trend, such as the much sharper rise in German rates than those in the U.S. or Eurodollar markets, may be explained by the stiffer restrictions placed on capital flows by Germany, as well as by the particularly tight monetary policy introduced in that country.)

It might be thought that the upward movement of interest rates abroad would tend to reduce capital flows to Israel. It is true that the rise in rates abroad exceeded that in nominal (unlinked) rates in Israel (e.g. on bank loans or unlinked Government credits) and certainly pushed against the limits specified for foreign borrowing by the Treasury. Nevertheless, the major event of 1973 was the emergence of Government bonds linked to the c-o-l index as the preeminent financial investment instrument in Israel. The rise in the rate of return on such bonds, including the linkage element, far exceeded the rise in long-term interest rates abroad. Thus the relative Israeli rate rose from 2.5:1 in 1972 to 3.4:1 in 1973 against the German Government bond rate, and from 2.6:1 to 4.4:1 against the rate on prime U.S. corporate bonds.⁴⁶ Obviously, however, some foresight was required to take advantage of these changes.

Restrictions on foreign transactions

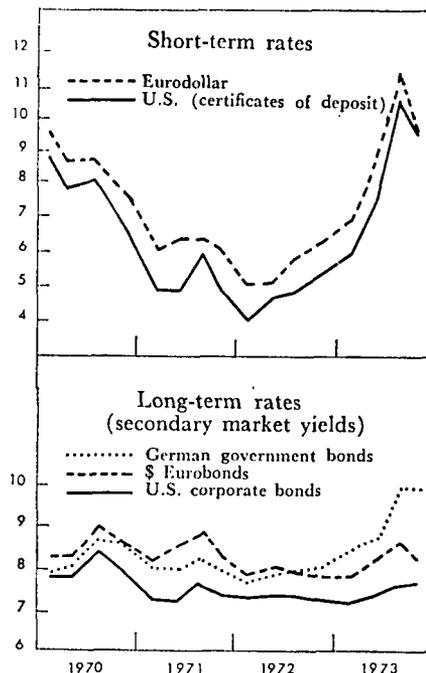
The introduction of the floating rate system abroad was hemmed about by a multitude of new restrictions (e.g. zero or negative interest for foreign depositors), particularly on short-term capital flows. Most of these restrictions were imposed by European governments and Japan in 1972 and early 1973 in an attempt to resist speculative inflows, both before and immediately following the abandonment of a fixed peg of their currencies to the dollar. They were intended initially to prevent the breakdown of the fixed peg, and subsequently to dampen changes in rates of exchange.⁴⁷

⁴⁶ So long as a devaluation was not regarded as imminent, it was advantageous to those possessing the right of reconvertibility to move capital to Israel in order to exploit this widening rate differential. High and still rising foreign currency reserves in 1973 precluded expectations of an imminent devaluation.

⁴⁷ To some extent the restrictions were intended to insulate domestic monetary policy from the offsetting effects of capital flows. The opportunity for an independent monetary, as opposed to fiscal, policy narrows as capital mobility increases, particularly under a fixed rate system. Under flexible rates a tighter money policy will lead to a capital inflow (but no increase in the money supply), upward pressure on the exchange rate, and hence a reduction in aggregate demand through a negative shift in the trade balance (a higher exchange rate will also tend to curb capital inflows).

To some extent these restrictions tended to divert capital flows from domestic banks and financial markets into the Eurocurrency market, where they could be partially avoided. This negative development in the capital field, however, was followed by an important positive step which came about as a direct result of the strengthening of the dollar—namely the elimination of the entire U.S. program of restrictions on foreign investment by banks, corporations, and individuals (including the interest equalization tax). At the same time there was a reduction of the new inflow restrictions in Europe (motivated in part by the prospect of trade deficits due to the oil price rise). The U.S. restrictions had grown piecemeal in the course of the 1960s in an effort to improve the country's balance of payments, and there is evidence that they did significantly reduce the real capital flow from the U.S. Their removal, therefore, bodes well for the cause of world economic development in general.⁴⁸

Figure III-7
REPRESENTATIVE INTEREST RATES, 1970-73
 (middle of quarter)



⁴⁸ The long persistence of dollar exchange rate disequilibrium under the old system frustrated to a considerable extent the real transfer of capital from the U.S. to the rest of the world. Either a large fraction of the long-term capital outflow ended up as swollen liquid reserves in the hands of European or Japanese governments, instead of financing larger U.S. real exports, or restrictions were imposed which prevented much of the financial outflow in the first place. With the elimination of this disequilibrium, the financial outflow can once again be realized in the form of a larger U.S. export surplus.