

## CHAPTER II

### RESOURCES, USES, AND INCOME

#### 1. MAIN DEVELOPMENTS

The gross national product expanded by 5 percent in 1979, about the same rate as in the previous year. This reflected the acceleration of activity at the beginning of the year, followed by a slowdown later on. There were two main reasons for this: First, demands grew stronger in the year reviewed, especially for imports: domestic uses were up 8 percent, compared with 6 percent in 1978, while nondiamond civilian imports rose 14 percent. At the same time the central problems confronting the economy became more acute: Israel's terms of trade deteriorated, causing a further widening of the balance of payments deficit, while inflation soared to an all time high, from 50 percent last year to more than 100 percent. These developments were reflected in the labor market by a substantial growth of the business sector's labor input, in excess of what was warranted by the level of activity; productivity was thus only a notch higher this year.

As the year opened the economy braced itself for a further pickup in activity begun in the previous year, which was spearheaded by residential building. It seemed that in 1979 too the construction industry would play a leading role in the expansion of domestic demands because of a sustained housing boom and the military redeployment in the Negev. These expectations stimulated private investment and imports of raw materials in 1979, particularly in the early part of the year.

The public sector again contributed to the bulging of demands. There was a heavier real demand for resources: public consumption, excluding direct defense imports, rose 3.5 percent, after inching up 1 percent in 1978, and the sector awarded a 10 percent real pay hike to its staff.<sup>1</sup> Besides these direct influences, the sector stimulated demand through the subsidization of capital—the granting to the business sector of nonindexed loans carrying interest at below-market rates. The

<sup>1</sup> Under the system of national accounts a change in real wages and salaries in the public sector is not recorded as a quantitative change, but an increase in the income of about one-third of the economy's employed unquestionably has a strong indirect effect.

**Table II-1**  
**RESOURCES AND USES, 1976-79**  
 (IL million, at current prices)

	1976	1977	1978	1979	Percent annual increase						
					Average		Quantity		Price		
					1968-72	1974-77	1978	1979	1977	1978	1979
<b>Resources</b>											
Gross national product	96,772	140,206	225,643	418,920	10.9	2.1	4.8	4.8	42.7	53.6	77.2
Imports <sup>a</sup>	73,597	101,624	195,319	342,778	11.7	-0.3	10.3	2.4	41.4	74.3	71.3
Thereof: Civilian	59,240	88,362	164,819	310,940	11.3	1.7	6.1	9.5	41.3	75.8	72.3
<b>Total resources</b>	<b>170,369</b>	<b>241,830</b>	<b>420,962</b>	<b>761,698</b>	<b>11.2</b>	<b>1.1</b>	<b>7.0</b>	<b>3.8</b>	<b>42.1</b>	<b>62.6</b>	<b>74.4</b>
<b>Uses</b>											
Private consumption	62,078	88,110	147,010	278,990	7.2	2.9	8.6	6.1	36.2	53.7	78.9
Public consumption	40,936	52,020	90,797	150,898	10.0	-4.6	10.9	-8.8	46.2	57.4	82.3
Public consumption, excl. direct defense imports	26,579	38,758	60,297	119,060	8.8	-1.7	1.2	3.4	47.6	53.8	90.9
Gross domestic investment	26,897	34,371	62,802	121,903	18.4	-5.8	3.1	15.8	39.6	77.2	67.6
Investment in dwellings	9,306	9,721	16,810	38,400	33.8	-10.7	-2.3	11.5	32.6	77.0	104.9
Total domestic uses, excl. defense imports	<b>115,554</b>	<b>161,239</b>	<b>270,109</b>	<b>519,953</b>	<b>10.2</b>	<b>-0.3</b>	<b>5.7</b>	<b>7.6</b>	<b>39.6</b>	<b>58.5</b>	<b>78.9</b>
Exports <sup>b</sup>	40,458	67,329	120,353	209,907	14.0	9.3	4.1	4.0	48.9	71.7	67.7
<b>Total uses</b>											
Excl. direct defense imports	<b>156,012</b>	<b>228,568</b>	<b>390,462</b>	<b>729,860</b>	<b>11.1</b>	<b>2.0</b>	<b>5.3</b>	<b>6.6</b>	<b>42.3</b>	<b>62.3</b>	<b>75.4</b>

Incl. direct defense imports	<b>170,369</b>	<b>241,830</b>	<b>420,962</b>	<b>761,698</b>	<b>11.2</b>	<b>1.1</b>	<b>7.0</b>	<b>3.8</b>	<b>42.1</b>	<b>62.6</b>	<b>74.4</b>
Net factor payments abroad	3,494	3,780	7,361	18,261	11.4	-0.2	11.8	25.3	33.4	74.1	98.1
Gross domestic product, at market prices	100,266	143,986	233,004	437,181	10.9	2.0	5.0	5.4	42.5	54.2	78.0
Gross domestic product of the business sector, excl. ownership of dwellings, at market prices	72,841	103,231	168,166	298,155	12.2	1.2	5.3	5.9	42.2	54.7	67.3

<sup>a</sup> Valued at c.i.f. prices and at the effective rate of exchange. Includes imports from the administered areas; excludes interest paid by the public sector.

<sup>b</sup> Valued at f.o.b. prices and at the effective rate of exchange. Includes exports to the administered areas; excludes interest received by the public sector.

Source: Central Bureau of Statistics.

escalation of inflation increases the subsidy component of these loans, and with inflation running at a record high in 1979, this greatly augmented private income.<sup>2</sup>

The combined impact of these factors may be seen in the faster growth of the private sector's domestic demands this year: private consumption and investment were up 9.5 percent, after advancing 7 percent last year. Most of the extra investment was in imported capital goods, a result of the expectations that economic growth would be sustained, especially in construction activity. However, the economy's actual performance did not measure up to expectations. The demand for domestic factors of production generated by the military redeployment was smaller than anticipated and did not justify the outlays on earthmoving machinery and equipment and trucks, nor the much larger labor input. In addition, the housing boom began to lose steam in the middle of the year. This is probably explained by the influence of the high inflation on both building contractors and buyers ability to finance the purchase of homes.

Private consumption was up 6 percent this year (compared with 9 percent in 1978), with purchases of durables accelerating at an especially steep rate (from 23 percent in 1978 to 34 percent), mainly because of the replacement of black-and-white by color television sets. The rise in other current consumption items slowed this year along with the more sluggish growth of private incomes because of a greatly increased direct tax collection.

The export gain, which was similar to that in 1978 (8 percent excluding diamonds) contributed about the same as last year to the growth of GNP. This headway was made even though the revolution in Iran deprived Israel of one of its important markets.

To sum up, most of the incremental domestic demand was channeled to imported goods, while demand for domestic production sagged. The latter development was not accompanied by a notable advance in exports, and the anticipated surge in production failed to take place; instead, there was apparently an unplanned buildup of finished goods inventories by the business sector.

As stated, the expectations formed at the beginning of the year did not materialize, and as the year wore on the expansion of imported raw materials and capital goods ground to a halt. Private sector demand flagged a bit in the second half, when the uptrend in commodity imports flattened noticeably and sales of domestically produced goods perked up. At the end of the year the sector's demand shrank as a result of the stringent monetary measures introduced and the lagged effect of the slumping of demand for domestic production in the first six

<sup>2</sup> A rough estimate of the contribution of this factor appears in section 4 below.

Table II-2

**EFFECT OF FINAL USES ON THE BUSINESS SECTOR PRODUCT,<sup>a</sup>  
1976-79**  
(Percentages, at 1972/73 prices)

	Distribution of the product by final use					Contribution of uses to growth of the product			
	1972	1976	1977	1978	1979	1976	1977	1978	1979
Private consumption	38.5	39.0	39.1	39.7	38.9	0.9	1.1	2.7	0.7
Public consumption	9.6	9.8	9.1	8.4	8.4	-1.1	-0.5	-0.2	0.3
Gross domestic investment <sup>b</sup>	24.7	20.2	17.1	16.4	16.3	-3.1	-2.7	0.2	0.6
Total domestic uses	<b>72.8</b>	<b>69.0</b>	<b>65.3</b>	<b>64.5</b>	<b>63.6</b>	<b>-3.3</b>	<b>-2.1</b>	<b>2.7</b>	<b>1.6</b>
Exports	27.1	31.0	34.7	35.4	36.5	3.4	4.6	2.5	2.5
Total product	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>0.2</b>	<b>2.5</b>	<b>5.2</b>	<b>4.0</b>

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

<sup>a</sup> Gross domestic product at factor cost, excluding the product originating in public sector and nonprofit institution services.

<sup>b</sup> Excludes changes in inventories. Because of this and the different definition and estimating methods used, the change in the business sector product in this table does not correspond to that shown in Table II-1.

Source: Central Bureau of Statistics data adjusted according to input-output data for 1972/73.

months.<sup>3</sup> Exports revealed an opposite development during the year, gathering speed in the second half. One reason for this was the dampening of demand for domestic production, notably clothing and footwear.<sup>4</sup>

The diversion of demands to import, one of the factors in the dragging of economic activity in the final part of the year, also led to a marked erosion in the balance of payments: the import surplus increased by more than 14 percent. To some extent this was of a one-time nature and not indicative of any trend. The civilian current account deficit shot up by about \$1 billion to reach \$2.8 billion. This reflected a significant worsening of the country's terms of trade due to the jump in oil prices (at an annual average rate of over 60 percent in dollar terms). This unfavorable turn in the terms of trade might persist, impairing real national income and necessitating adequate countermeasures by the government.

<sup>3</sup> The subsiding of demand for domestic goods and services affects the economy's performance through the income effect. For a precise analysis in the course of the year we have to examine how the public sector influenced aggregate domestic demand, but because of the large margin of error in the quarterly estimate of public consumption, we only analysed the endogenous demand variables, namely private consumption and investment.

<sup>4</sup> For a detailed discussion see Chapter V.

Disposable private income, as measured in the national accounts, inched down 1 percent in real terms. This was due to a much larger income tax collection (up 15 percent in real terms), mainly from wage and salary earners, and a real 8 percent drop in transfer payments. These two developments can be ascribed to the failure to adjust the tax structure for the mounting rate of inflation. The advance of prices, by eroding the real debt owed by the private sector to the government, also increases the wealth of individuals, but this is not caught in the national accounts. A rough estimate places this unexpected increment at around 4 percent in 1979. It thus turned out that the marked aggravation of inflation affected not only demand but also income distribution. It is important to note that the escalation of inflation was due not so much to real developments as to the special structure of Israel's monetary system which, besides indexed liquid assets and a perennially large public sector demand surplus, is characterized by various price adjustment arrangements (for a detailed description see the chapter on prices).

The year reviewed was one of full employment. The jobless rate was one of the lowest ever recorded (2.9 percent on an annual average). The business sector took on additional staff, and its labor input rose 5 percent. But this did not seem to be justified by the actual development of production, for product per manhour did not rise this year and factor productivity edged up only fractionally. In some segments of the business sector employment slowed in the final part of the year, apparently in a lagged response to the production situation.

## 2. USES<sup>5</sup>

### (a) Private Consumption

Total private consumption was up 6 percent in 1979, continuing the sharply rising trend begun in the previous year (9 percent). This followed three years of stability in private consumption per capita, which was accompanied by a zero or only a niggardly growth of incomes. The upswing in consumption was sparked by the expansion of the economy, and in fact it even paced the expansion, spurred by the unexpected capital gains enjoyed by the private sector.<sup>6</sup> In 1978 private consumption rose at about the same rate as disposable income, but in the year reviewed it expanded despite the slacker growth of disposable income, i.e. at the expense of a decline in the saving rate.<sup>7</sup>

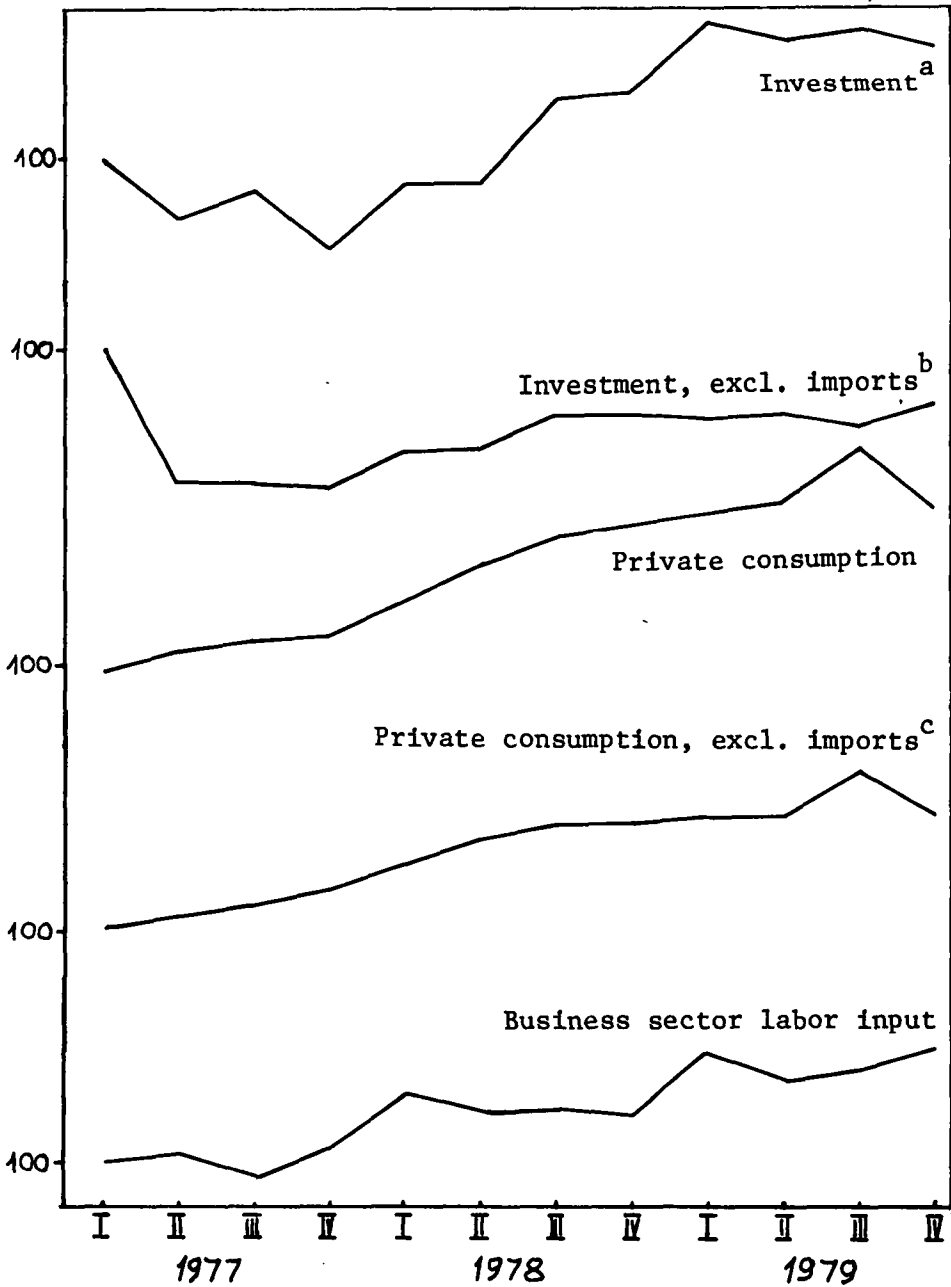
<sup>5</sup> Private consumption is discussed here rather extensively since, in contrast to previous years, a special chapter is not devoted to this subject. Other uses will be discussed only briefly (for fuller details see the relevant chapters on investment, exports, and the public sector).

<sup>6</sup> These were the earned stock of nonindexed government loans to the private sector under conditions of mounting inflation.

<sup>7</sup> The rate of saving as conventionally defined (without imputing capital gains to income—see section 4 below).

Figure II-1

MAIN ECONOMIC INDICATORS, 1977-79  
 (Quantity indexes, seasonally adjusted: 1977I = 100)



<sup>a</sup> Fixed investment, excluding ships and aircraft.

<sup>b</sup> Fixed investment, excluding imported machinery and equipment and transport equipment.

<sup>c</sup> Private domestic consumption, less household equipment and motor vehicles.

**Table II-3**

**CONTRIBUTION OF FINAL USES TO THE GROWTH OF TOTAL USES,<sup>a</sup> 1976-79**  
(Percent real change, at 1975 prices)

	1976	1977	1978	1979
Private consumption	1.5	1.7	3.4	2.5
Public consumption <sup>a</sup>	-0.5	-0.3	0.2	0.5
Civilian	0.4	0.2	0.4	0.2
Noncivilian <sup>a</sup>	-0.9	-0.4	-0.2	0.3
Gross domestic investment	-2.5	-1.5	0.5	2.4
Thereof: Dwelling investment	-0.9	-1.5	-0.1	0.5
Inventories	-0.3	-0.5	-0.3	0.9
Exports	3.5	3.1	1.1	1.1
Excl. diamonds	2.8	2.9	1.7	1.5
Total uses <sup>a</sup>	1.9	3.1	5.3	6.6

<sup>a</sup> Excludes direct defense imports.  
Source: Central Bureau of Statistics.

In 1978 all private consumption items moved up more rapidly, led by durable goods. In 1979 the latter posted an exceptionally steep 34 percent rise (compared with 23 percent the year before), but the other items showed paltry increases. Excluding durables, private consumption spending was up less than 3 percent (as against 7 percent in 1978); this laggard growth was consistent with the insignificant change in real disposable income.

Purchases of consumer durables display a cyclical pattern over the years, in line with business activity in general. During a boom, when liquidity and incomes are expanding strongly, individuals tend to advance the acquisition of durables without drastically altering their spending on other goods; when the economy slides into a recession the tendency is to cut back on purchases of durables (see the table below). This adjustment of durables purchases to the business cycle is made possible by drawing on past savings or by current dissaving.

**Average Annual Real Change in Purchases of  
Durables and Other Private Consumption Goods, 1960-79**  
(Percentages)

	1960-65	1966-67	1968-72	1975-77	1978	1979
Durable goods	20	-13	10	-7	23	34
Other private consumption	8	3	6	4	7	3



Table II-4

**PRIVATE CONSUMPTION OF GOODS AND SERVICES BY MAJOR  
COMPONENTS, 1976-79**  
(IL million, at current prices)

	1976	1977	1978	1979	Percent annual increase								
					Quantity				Price				
					1976	1977	1978	1979	1976	1977	1978	1979	
<b>Goods</b>													
Food, beverages, tobacco	17,158	25,217	39,586	70,977	5.7	4.5	6.2	2.2	26.2	40.6	47.8	75.4	
Other current consumption	10,491	14,638	24,882	42,242	6.9	4.7	11.1	0.1	33.6	33.3	53.0	69.6	
Durables	6,056	8,289	16,114	32,237	-2.5	-0.6	22.7	34.2	32.4	37.7	58.4	49.1	
<b>Total goods</b>	<b>33,705</b>	<b>48,144</b>	<b>80,582</b>	<b>145,456</b>	<b>4.5</b>	<b>3.7</b>	<b>10.5</b>	<b>7.6</b>	<b>29.6</b>	<b>37.8</b>	<b>51.5</b>	<b>67.8</b>	
<b>Services</b>													
Nonprofit institutions	6,087	9,623	14,998	30,071	1.4	3.6	2.2	3.1	33.0	52.6	52.4	94.4	
Housing	11,887	15,231	25,180	56,937	8.3	6.1	4.8	4.1	18.7	20.8	57.7	117.1	
Other services and misc.	12,208	18,464	31,101	56,322	6.4	6.8	8.4	6.0	33.4	41.6	55.4	70.8	
<b>Total services</b>	<b>30,182</b>	<b>43,318</b>	<b>71,279</b>	<b>143,330</b>	<b>6.2</b>	<b>5.9</b>	<b>5.7</b>	<b>4.7</b>	<b>27.1</b>	<b>35.6</b>	<b>55.7</b>	<b>92.1</b>	
Consumption of Israelis abroad	1,962	3,327	6,852	11,202	-3.1	19.2	25.7	2.7	56.2	42.3	63.9	59.2	
Less consumption of foreign nationals in Israel	3,771	6,679	11,703	20,998	31.9	20.4	10.4	6.5	34.0	47.2	58.6	68.5	
<b>Total private consumption</b>													
Excluding durables	<b>56,022</b>	<b>79,821</b>	<b>130,896</b>	<b>246,753</b>	<b>4.6</b>	<b>4.7</b>	<b>7.1</b>	<b>2.9</b>	<b>28.4</b>	<b>36.1</b>	<b>53.1</b>	<b>83.3</b>	
Including durables	<b>62,078</b>	<b>88,110</b>	<b>147,010</b>	<b>278,990</b>	<b>3.9</b>	<b>4.2</b>	<b>8.6</b>	<b>6.1</b>	<b>28.8</b>	<b>36.2</b>	<b>53.7</b>	<b>78.9</b>	

Source: Central Bureau of Statistics.

The emergence of the economy from the slump, which began in 1978, was also reflected by a turnabout in acquisitions of durables: following a contraction in the three preceding years, the public began to step up its purchases. This trend gathered momentum in 1979, for three principal reasons. The most salient one was the appearance of a new item on the market—color television.<sup>8</sup> TV sets, which accounted for 6 percent of total purchases of durables in 1978, were responsible for over half the increment in 1979 (19 percent out of a total of 34 percent). Another reason was the relative price of durables compared with that of other private consumption items. The foreign currency reform drove up the relative price of imports in 1978, depressing acquisitions of durables, most of which are foreign brands; in 1979, on the other hand, imports became relatively cheaper, and their price at the

<sup>8</sup> The inauguration of color transmission in Israel generated a demand for color TV sets. This coincided with the obsolescence of the sets bought in the first big wave of purchases in 1969, when black-and-white transmission was introduced in Israel.

end of the year almost stood at their level during the prereform period. Another factor was the significantly larger immigration in 1979: newcomers generally buy most of their durable goods during their first years in the country.

In 1978 the acquisition of durables was not accompanied by any decline in the rate of saving; in fact it even rose. By contrast, this year the private saving rate was drawn down in order to finance the extraordinarily large volume of such purchases.

Private consumption did not trace an even path during the year. The weakening of certain markets toward the end of 1978 caused some uncertainty as to what turn the business cycle would take in the year reviewed. It was not clear whether the economy was heading for vigorous growth with a slight breathing spell, or whether the cycle had run its course and the economy was about to recede.

One segment which responded quickly, as in the past, was the durable goods market. Here sales (especially of cars) slumped in the latter part of the year. Other private consumption items, such as industrial goods and control-free services, also tumbled in the final quarter.

The development of food consumption is worthy of note. In the final quarter of the year food prices went up steeply after the abolition of government subsidies. The result was an immediate plummeting of sales (a similar development followed the abolition of subsidies in 1974). Food consumption per capita has a relatively low income and price elasticity, and so fluctuations during the year tend to be small. Presumably the initial sharp response to the hiking of prices will be followed by the plateauing of this item at a higher level.

#### **(b) Public Consumption**

Public domestic consumption<sup>9</sup> was up 5 percent this year in real terms, after rising marginally in 1978. The flattening of public consumption in 1975-77 was caused by the cutting back of noncivilian purchases. In 1979, for the first time in several years, there was an increase in this component, which was only partly due to the defense construction program in the Negev. In contrast, civilian consumption, which rose at a more or less uniform pace of 4-5 percent even in years of fiscal restraint after the Yom Kippur War, did not deviate from this trend in 1979 (domestic civilian consumption expanded by 5 percent). To the direct impact of civilian consumption on real demands was added this year the indirect effect of the steep 10 percent real wage and salary hikes granted to public sector employees,<sup>10</sup> which was equal to 3 percent of total public domestic consumption.

<sup>9</sup> Excluding defense imports and government imports n.e.s.

<sup>10</sup> In the national accounts a real increase in wages and salaries is treated as a price rather than a quantity change.

The protracted uptrend in civilian consumption, which for the most part has been due to the expansion of personnel, has brought up the share of the public sector in the country's employed civilian workforce. Since 1972, for example, the labor input in this sector has risen by 32 percent, compared with only 11 percent in the business sector. The absorption of workers by the public sector has prevented the creation of unemployment during slack periods, but when the economy is on the rebound, as in the past two years, it leads to a shortage of labor in the business sector. It follows that over time the percentage of the economy's resources available to the business sector diminishes, an especially disturbing development in view of the balance of payments strain and the heavy defense burden which Israel is trying to shoulder.

(c) **Investment**

Gross domestic investment expanded by a formidable 16 percent this year, as contrasted with only 3 percent in 1978. Spearheading the advance were housing construction (up 12 percent), imports of machinery, equipment, and transport equipment (30 percent), and the buildup of inventories (90 percent). Nonresidential construction, on the other hand, slumped by a steep 10 percent.

The acceleration of housing construction continued the upswing begun at the end of 1977. But the cyclical rise was cut short in the middle of the year, when the housing market began to soften, leading to the faltering of private housing starts as well. The latter development was not reflected in the data for 1979, but will affect the level of activity in the next two years. The slackening of demand for homes can apparently be ascribed to financing difficulties, which were especially acute at the beginning of the year when the housing credit arrangements had not yet been adjusted for the rocketing of dwelling prices.<sup>11</sup> At the same time private contractors cut back on their housing starts, both in response to the downturn in sales and primarily because their profits were squeezed by inflationary taxation, which hit them particularly hard in view of the long construction period.

In contrast to the more sluggish pace of private construction, the public sector stepped up its volume of starts and thus captured a larger share of the market. This represents a reversal of the declining trend, which set in at the end of 1974, in the government's direct intervention in home construction. The diminution of such intervention is in itself a desirable development because of the red tape connected with public construction, which results *inter alia* in a belated response to the cyclical fluctuation characteristic of this industry.

Nondwelling investment was up 10 percent this year, about the same rate as in 1978. This was the resultant of contrasting trends in machinery and equipment on the one hand and structures on the other: capital spending on machinery, plant,

<sup>11</sup> The influence of the financing problem on the demand for homes is discussed in Chapter VIII.

and transport equipment rose 20 percent or more, while that on structures dipped 10 percent. The hefty increase in imported machinery, equipment, and vehicles in particular partly reflected the preparations made by various concerns in anticipation of the large construction projects scheduled in the Negev and the expectation of a strong rebounding of economic activity which prevailed at the beginning of the year. Another factor in the differential development of investment may have been the system of taxation: this discriminates in favor of existing enterprises, making it more worthwhile to invest in the renewal of equipment, since nominal interest outlays can be charged against profits even before the investment begins to bear fruit.

Under the system of providing government loans on nonindexed terms the acceleration of inflation depresses their price to the investor far below their price to the economy, thus giving a powerful spur to investment. This year the government decided to index investment loans, thereby greatly decreasing the hidden subsidization of investment in the future. In 1979 such loans were still heavily subsidized, and this goes a long way to explain the high level of investment, which reached a new peak. The indexing of such loans is intended to discourage investments unprofitable to the economy; if the system of taxation is also adjusted for the prevailing inflationary conditions, this will further correct the distortion.<sup>12</sup>

#### (d) Exports

Exports forged ahead only 4 percent this year, about the same rate as in 1978. Diamonds were largely responsible for this niggardly gain. Less this item, the increase came to 8 percent, after a 10 percent advance the year before. In 1979 too the export share of the business sector product continued upward, accounting for more than half the increment.

The share of exports in the business sector product has been on the rise for many years. This can be credited to the advantages accruing from a highly specialized production, which enhances the profitability of manufacturing for foreign markets with a large potential demand, as well as to the maturing of investments made in the past, which were heavily oriented toward export enterprises. In addition, two special factors influenced Israel's export performance this year. One was the loss of the Iranian market (which accounted for 5 percent of the country's total foreign sales); this was only partly compensated by the more buoyant demand for Israeli-made goods in other markets (the total trade of these countries expanded by 6 percent, roughly the same as in the previous year). The second factor was the unexpected slackening of domestic demands, which induced producers to turn to foreign markets (this is undoubtedly only a passing phenomenon).

<sup>12</sup> A proposal for such an adjustment is included in the report of the special committee set up to examine the system of taxation under inflationary conditions.

Table II-5

**INDICATORS OF THE GROSS DOMESTIC PRODUCT AT FACTOR COST,<sup>a</sup>  
BY INDUSTRIAL ORIGIN, 1976-79**

	Weight in 1979 at 1975 prices	Average 1969-79	Percent annual real increase			
			1976	1977	1978	1979
Agriculture, forestry, fisheries	6	6.8	8.0	7.3	4.3	2.2
Industry, mining, quarrying	25	11.9	4.7	4.3	7.7	5.4
Transportation and communication	11	13.4	6.3	6.8	7.6	4.4
Electricity and water	2.5	10.0	5.2	6.4	5.2	5.0
Construction	7	18.2	-13.6	-14.3	-0.7	2.7
Finance, trade, services	20	4.5	2.5	4.3	3.0	3.0
Ownership of dwellings	11.5	3.7	8.7	6.0	4.5	4.1
Public and community services	17	6.4	1.1	1.8	3.8	3.9
Gross domestic product						
Total product	100	9.0	2.6	3.1	4.8	4.0
Business sector <sup>a</sup>	71.5	10.0	2.1	2.9	5.1	4.0

<sup>a</sup> Excludes ownership of dwellings.

The profitability of export production, as measured by the index of its price relative to that of domestic uses, rose this year by 7 percent.<sup>13</sup> There was also an increase in the subsidy component of export working capital; if this is included in the calculation, the index went up 12 percent. The directed export credit arrangements are designed to ensure the availability of sufficient finance at a time when a general credit squeeze is clamped on the economy, but the aggravation of inflation caused the subsidy element to mount appreciably because of the belated adjustment of interest rates.

### 3. RESOURCES

#### (a) Product

The domestic product rose 5 percent, about the same as the year before. But whereas in 1978 the product rebounded from the preceding years' depressed level, there was no acceleration of growth in 1979. The business sector product advanced at an annual average 5.5 percent rate, this too similar to last year's figure. Growth did not proceed at an even pace: the uptrend tailed off in the course of the year<sup>14</sup>

<sup>13</sup> This is discussed in detail in Chapter V of this Report.

<sup>14</sup> Quarterly data on the product tend to fluctuate sharply because of the relatively short time-span measured. Since the influence of random factors cannot be eliminated by adjusting for seasonality, this renders problematic an analysis based on quarterly data. It is not surprising that different indicators give different results.

owing to the diversion of demand from local to imported products, but this was not fully reflected in the product. Input-output analysis shows that the concerns continued to produce for stock, apparently on the assumption that the business slowdown was only temporary. At the same time, as stated, the slowdown prompted them to turn to foreign markets.

A sectoral analysis of the product points up the difficulties experienced by agriculture in 1978/79 because of drought. Its product inched up only a notch, and factor productivity fell off. The construction industry did not fare as well as expected, its product advancing only 3 percent. This figure is very surprising, since the industry took on additional workers and the labor input rose 10 percent. We cannot offer a satisfactory explanation of this development. It is not reasonable to assume that the industry increased its workforce and the number of manhours only in anticipation of a possible expansion of activity. Part of the labor was probably employed in renovating existing homes, which in 1979 became highly profitable; such activity is not caught in the statistics.

The business sector continued to enlarge its personnel in 1979, the number of employees rising 3 percent; together with an increase in the number of hours worked, this brought up the labor input by nearly 5 percent. This was not consistent with the slackening of demands for the business sector product, but it strengthens the assumption that the enterprises produced for stock in the belief that the slowdown would be short-lived.

The factor productivity gain in the business sector was very low this year. A glance at Table II-6 shows a sharp deceleration since 1975, which is also reflected in labor productivity<sup>15</sup> despite an increase in the capital stock per worker. The slowdown even grew more pronounced in the last two years despite the rebounding of activity. The paltry advance in factor productivity in general and in the labor input in particular is very disturbing because of its effect on the prospects of sustained economic growth. We cannot fully explain this development, but it can apparently be attributed to some extent to the warping influence of the high inflation. This impairs productivity by creating an atmosphere of uncertainty as to possible future price changes, causing firms to make decisions which fall short of actual developments; in addition, together with the system of subsidized credit, it creates interfirm price differentials.

#### **(b) Imports**

The civilian import growth surplus rose 9 percent or more in quantitative terms; less diamonds the increase was 14 percent, which eclipsed last year's figure of 10 percent. On the one hand this reflected a steep jump in imports in dollar terms, which directly worsened the current account deficit; on the other hand there was a

<sup>15</sup> The change in the product-labor input ratio.

Table II-6

**CHANGES IN GROSS DOMESTIC PRODUCT,<sup>a</sup> FACTOR INPUT, AND  
PRODUCTIVITY OF THE BUSINESS SECTOR, 1975-79**  
(Percent annual increase)

	Average			1975	1976	1977	1978	1979
	1960-72	1968-72	1972-79					
Gross domestic product <sup>a</sup>	9.7	13.2	3.0	3.1	1.0	-0.3	5.3	5.9
Labor input	3.6	6.9	1.4	3.8	0.1	0.6	3.9	4.7
Stock of fixed nondwelling capital	8.9	7.8	6.5	7.7	6.3	5.2	4.0	4.4
GDP/labor input	5.9	5.9	1.6	-0.7	0.9	-0.9	1.3	1.1
GDP/capital stock	0.7	5.0	-3.3	-4.3	-5.0	-5.2	1.0	1.4
Productivity								
Labor weighted 2/3	4.3	6.0	1.0	-2.0	-2.1	-2.4	1.4	1.3
Labor weighted 1/2	3.5	5.9	-1.0	-2.7	-2.2	-3.2	1.4	1.4

<sup>a</sup> Measured according to uses.

Table II-7

**NATIONAL PRODUCT AND INCOME, 1976-79**  
(IL million, at current prices)

	1976	1977	1978	1979	Percent annual increase		
					1977	1978	1979
1. Gross national product, at market prices	96,772	140,206	225,643	418,920	44.9	60.9	85.7
2. Indirect taxes on domestic production	13,527	18,789	30,169	57,155	38.9	60.6	89.4
3. Subsidies on domestic production	3,300	4,580	8,072	14,936	38.8	76.2	85.0
4. Net indirect taxes (2-3)	10,227	14,209	22,097	42,219	38.9	55.5	91.1
5. Gross national product, at factor cost	86,545	125,997	203,546	376,701	45.6	61.5	85.1
6. Depreciation	12,835	19,752	35,783	67,233	53.9	81.2	87.9
7. National income (5-6)	73,710	106,245	167,763	309,468	44.1	57.9	84.5

Source: Central Bureau of Statistics and Bank of Israel.

shift to highly taxed imports (consumer goods), which helped to absorb money from the public.

Leading the import were investment goods, which were up 30 percent; consumer goods—40 percent; and production inputs (except fuel and diamonds)—9 percent. The striking increase in consumer and investment goods was connected with the much larger direct import component of uses this year, the causes of which were discussed above in the sections on consumption and investment. In production inputs most of the increment was recorded in the first quarter of the year, when economic activity was expected to perk up and real interest on credit was negative until April. The stockpiling of raw materials, on the other hand, does not seem to be consistent with the liberalization of foreign currency control, under which the public may hold Patam accounts. However, during the last two years there were two factors which worked in the opposite direction: the increase in subsidized credit for imports for export production and the granting of income tax inventory relief to industry, which encouraged the buildup of stocks.

#### 4. INCOME AND SAVING

Private saving, as customarily defined, did not rise at all this year in terms of purchasing power (see Table II-9) because of a steep real increase in the net direct tax burden,<sup>16</sup> after it had eased in the two preceding years. The heavier 1979 burden can be attributed to a real increase in income tax collections, mainly from employees, the growth of national insurance contributions, and a noticeable contraction of transfer payments—a direct consequence of the failure to adjust the rates for the precipitate rise in inflation.

The zero growth of incomes did not prevent the public from stepping up its consumption spending, which expanded nearly 4 percent in per capita terms. This was apparently made possible by the aforementioned inflation-generated wealth increment stemming from the nonindexed private sector debt to the government. In analyzing the influence of the subsidy element in this debt, a distinction must be made between the expected subsidy which borrowers foresee and take into account when they obtain the credit and the unexpected subsidy on outstanding investment loans received in the past, which results from the unforeseen escalation of inflation to a very high level. According to a rough estimate this augmented private incomes by several percent a year (see the table below).

<sup>16</sup> Income tax payments and national insurance contributions, less transfer payments.



**DISPOSABLE INCOME INCLUDING THE CREDIT SUBSIDY,<sup>a</sup> 1976-79**  
(IL million, at current prices)

	1976	1977	1978	1979	Percent real increase			
					1976	1977	1978	1979
Disposable private saving from domestic sources	78,634	115,242	191,506	339,691	-7.5	7.6	8.1	-0.9
Credit subsidy	8,512	12,359	18,187	59,976	54.4	6.6	-4.3	84.3
Disposable income plus ¼ of credit subsidy					-6.5	7.6	7.8	1.1
Disposable income plus ½ of credit subsidy					-5.5	7.6	7.5	3.0
Disposable income plus total credit subsidy					-3.7	7.5	6.9	6.5

<sup>a</sup> The subsidy on loans granted to the business sector but not to households (mainly for housing).

The share of wages in national income as conventionally defined continued upward, in line with the trend of the past few years, while nonwage income fell off in real terms. The deduction of taxes<sup>17</sup> moderates this change in income distribution, but the hidden subsidy in nonindexed credit to the business sector should be added to the income data.<sup>18</sup> This alters the distribution of income in 1979 as well as in preceding years: the share of nonwage incomes so defined did not shrink in 1979 but even rose.

The rate of private saving as defined in the national accounts dipped sharply this year, but inclusion of the credit-subsidy increment to private wealth mitigates the downturn (if the total subsidy is included there was even a slight increase). Examination of the public's savings portfolio shows a shift this year from financial assets to the purchase of durables. After the real expansion of financial assets in the wake of the foreign currency reform of October 1977, the public probably began to reshuffle its portfolio; this grew more pronounced in 1979 because of the decline in the relative price of durables compared with financial assets, and was mainly at the expense of noncontractual saving.

<sup>17</sup> Income tax and national insurance contributions, but not the increase in transfer payments.

<sup>18</sup> In discussing the distribution of income it should be noted that wage and salary earners may also receive income other than from labor.

**Table II-8**  
**GROSS DISPOSABLE PRIVATE INCOME, 1976-79**  
(IL million, at current prices)

	1976	1977	1978	1979	Percent annual increase		
					1977	1978	1979
National income	73,710	106,245	167,763	309,468	44.1	57.9	84.5
Public sector property and entrepreneurial income	2,556	4,573	4,920	7,688	78.9	7.6	56.3
Depreciation	12,835	19,752	35,783	67,233	53.9	81.2	87.9
Gross private income from economic activity	<b>83,989</b>	<b>121,424</b>	<b>198,626</b>	<b>369,013</b>	<b>44.6</b>	<b>63.6</b>	<b>85.8</b>
Income tax	17,125	23,518	36,538	74,072	37.3	55.4	102.7
National insurance contributions	6,147	9,609	15,752	29,966	56.3	63.9	90.2
Total direct taxes	23,272	33,127	52,290	104,038	42.3	57.8	99.0
Net transfer payments	17,917	26,945	45,170	74,716	50.4	67.6	65.4
Gross disposable income from domestic sources	<b>78,634</b>	<b>115,242</b>	<b>191,506</b>	<b>339,691</b>	<b>46.6</b>	<b>66.2</b>	<b>77.4</b>
Personal transfers from abroad	5,452	8,797	15,893	26,944	61.4	80.7	69.5
Gross disposable private income from all sources	<b>84,086</b>	<b>124,039</b>	<b>207,399</b>	<b>366,635</b>	<b>47.5</b>	<b>67.2</b>	<b>76.8</b>

Source: Central Bureau of Statistics and Bank of Israel.

Table II-9

**PRIVATE INCOME, CONSUMPTION, AND SAVING, 1976-79**  
(IL million, at current prices)

	1976	1977	1978	1979	Percent annual increase						
					Value			Quantity			
					1977	1978	1979	1977	1978	1979	
Disposable private income from domestic sources <sup>a</sup>	78,634	115,242	191,506	339,691	46.6	66.2	77.4	7.6	8.1	-0.9	
Disposable private income from all sources	84,086	124,039	207,399	366,635	47.5	67.2	76.8	8.3	8.8	-1.2	
Private consumption	62,078	88,110	147,010	278,990	41.9	66.8	89.8	4.2	8.6	6.1	
Gross private saving from domestic sources	16,556	27,132	44,496	60,701	63.9	64.0	36.4	20.3	6.7	-23.8	
Gross private saving from all sources	22,008	35,929	60,389	87,645	63.3	68.1	45.1	19.8	9.4	-18.9	
			<b>Percentages</b>								
Rate of gross saving from domestic sources	21.1	23.5	23.2	17.9							
Rate of gross saving from all sources	26.2	29.0	29.1	23.9							

<sup>a</sup> Before deducting compulsory loans.

Source: Central Bureau of Statistics and Bank of Israel.

Table II-A1

**RESOURCES AND USES, INCLUDING DIRECTED EXPORT CREDIT SUBSIDY,  
1978-79**  
(IL million, at current prices)

	1978	1979	Percent annual increase			
			Quantity		Price	
			1978	1979	1978	1979
<b>Resources</b>						
Gross national product	228,929	433,401	4.8	4.8	55.8	80.6
Imports <sup>a</sup>	195,319	342,778	10.3	2.4	74.3	71.3
Thereof: Civilian	164,819	310,940	6.1	9.5	75.8	72.3
Total resources	<b>424,248</b>	<b>776,179</b>	<b>7.0</b>	<b>3.8</b>	<b>64.0</b>	<b>76.3</b>
<b>Uses</b>						
Private consumption	147,010	278,990	8.6	6.1	53.7	78.9
Public consumption	90,797	150,898	10.9	-8.8	57.4	82.3
Public consumption, excl. direct defense imports	60,297	119,060	1.2	3.4	53.8	90.9
Gross domestic investment	62,802	121,903	3.1	15.8	77.2	67.6
Domestic uses, excl. direct defense imports	<b>270,109</b>	<b>519,953</b>	<b>5.7</b>	<b>7.6</b>	<b>58.5</b>	<b>78.9</b>
Exports <sup>b</sup>	123,639	224,388	4.1	4.0	76.4	74.5
Total uses						
Excl. direct defense imports	<b>393,748</b>	<b>744,341</b>	<b>5.3</b>	<b>6.6</b>	<b>63.6</b>	<b>77.3</b>
Incl. direct defense imports	<b>424,248</b>	<b>776,179</b>	<b>7.0</b>	<b>3.8</b>	<b>64.0</b>	<b>76.3</b>
Net factor payments	7,361	18,261	11.8	25.3	74.1	98.1
Gross domestic product, at market prices	236,290	451,662	5.0	5.4	56.3	81.3
Gross domestic product of business sector, excl. ownership of dwellings, at market prices	171,452	312,636	5.3	5.9	57.7	72.1

<sup>a</sup> See note a to Table II-1.

<sup>b</sup> See note b to Table II-1.

Source: Central Bureau of Statistics.

Table II-A2

**RESOURCES AND USES AT CURRENT PRICES, 1968-79**  
(IL million)

	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
<b>Resources</b>												
Gross national product	13,752	15,865	18,513	23,163	29,735	37,430	52,847	74,870	96,772	140,206	225,643	418,920
Imports <sup>a</sup>	6,990	8,593	10,448	13,600	16,809	26,964	38,473	56,876	73,597	101,624	195,319	342,778
Civilian imports <sup>a</sup>	6,128	7,387	8,267	11,493	14,296	20,374	31,650	43,917	59,240	88,362	164,819	310,940
<b>Total resources</b>	<b>20,742</b>	<b>24,458</b>	<b>28,961</b>	<b>36,763</b>	<b>46,544</b>	<b>64,394</b>	<b>91,320</b>	<b>131,746</b>	<b>170,369</b>	<b>241,830</b>	<b>420,962</b>	<b>761,698</b>
<b>Uses</b>												
Private consumption	9,116	10,343	11,339	13,414	17,055	22,122	32,877	46,408	62,078	88,110	147,010	278,990
Public consumption	4,093	4,919	6,728	7,940	9,242	16,396	22,073	33,935	40,936	52,020	90,797	150,898
Public consumption, excl. direct defense imports	3,231	3,713	4,547	5,833	6,729	9,806	15,250	20,976	26,579	38,758	60,297	119,060
Gross domestic investment	3,238	4,308	5,373	7,429	9,778	12,930	17,558	24,382	26,897	34,371	62,802	121,903
Exports <sup>b</sup>	4,295	4,888	5,521	7,980	10,469	12,946	18,812	27,021	40,058	67,329	120,353	209,907
<b>Total uses</b>												
Excl. direct defense imports	19,880	23,252	26,780	34,656	44,031	57,804	84,497	118,787	156,012	228,568	390,462	729,860
Incl. direct defense imports	20,742	24,458	28,961	36,763	46,544	64,394	91,320	131,746	170,369	241,830	420,962	761,698
Net factor payments abroad	240	280	352	428	572	1,112	1,577	2,753	3,494	3,780	7,361	18,261
Gross domestic product	13,992	16,145	18,865	23,591	30,307	38,542	54,424	77,623	100,266	143,986	233,004	437,181
Gross domestic product of the business sector	10,543	12,302	14,228	17,844	22,949	27,837	39,185	56,514	72,841	103,231	168,166	298,155

<sup>a</sup> See note a to Table II-1.

<sup>b</sup> See note b to Table II-1.

Source: Central Bureau of Statistics.

**Table II-A3**  
**QUANTITATIVE CHANGE IN RESOURCES AND USES, 1969-79**  
 (Percentages)

	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
<b>Resources</b>											
Gross national product	12.6	7.9	11.0	12.3	4.1	4.6	3.2	1.8	1.5	4.8	4.8
Imports <sup>a</sup>	16.1	16.6	12.1	2.6	33.1	2.6	4.3	-2.6	-2.4	10.3	2.4
Civilian imports <sup>a</sup>	13.8	7.1	20.0	4.9	17.8	8.6	-2.6	2.2	5.5	6.1	9.5
<b>Total resources</b>	<b>13.8</b>	<b>10.9</b>	<b>11.4</b>	<b>8.8</b>	<b>14.0</b>	<b>3.8</b>	<b>3.6</b>	<b>-0.1</b>	<b>-0.1</b>	<b>7.0</b>	<b>3.8</b>
<b>Uses</b>											
Private consumption	10.2	3.0	5.8	9.9	8.2	7.6	0.6	3.9	4.2	8.6	6.1
Public consumption	16.6	26.3	1.3	-1.9	46.4	2.1	10.0	-9.1	-13.1	10.9	-8.8
Public consumption, excl. direct defense imports	12.5	11.3	10.5	1.1	19.0	14.1	-0.8	-3.1	-1.2	1.2	3.4
Gross domestic investment	26.2	13.4	21.8	12.8	5.2	-4.2	4.1	-12.2	-8.5	3.1	15.8
Exports <sup>b</sup>	8.9	9.4	25.2	13.3	4.6	6.8	1.3	15.2	11.7	4.1	4.0
<b>Total uses</b>											
Excl. direct defense imports	<b>13.0</b>	<b>7.6</b>	<b>13.8</b>	<b>9.9</b>	<b>8.3</b>	<b>6.0</b>	<b>1.2</b>	<b>1.9</b>	<b>3.0</b>	<b>5.3</b>	<b>6.6</b>
Incl. direct defense imports	<b>13.8</b>	<b>10.9</b>	<b>11.4</b>	<b>8.8</b>	<b>14.0</b>	<b>3.8</b>	<b>3.6</b>	<b>-0.1</b>	<b>-0.1</b>	<b>7.0</b>	<b>3.8</b>
Net factor payments abroad	11.7	18.9	11.1	4.3	56.1	-6.0	18.7	3.2	-18.9	11.8	25.3
Gross domestic product	12.6	8.1	11.0	12.1	5.0	4.4	3.5	1.8	0.8	5.0	5.4
Gross domestic product of the business sector	14.5	8.3	12.4	13.9	2.1	3.7	3.1	1.0	-0.3	5.3	5.9

<sup>a</sup> See note a to Table II-1.

<sup>b</sup> See note b to Table II-1.

Source: Central Bureau of Statistics.

Table II-A4

**CHANGES IN PRICES OF RESOURCES AND USES, 1969-79**  
(Percentages)

	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
<b>Resources</b>											
Gross national product	2.4	8.2	12.7	14.4	21.0	34.9	37.3	27.0	42.7	53.6	77.2
Imports <sup>a</sup>	5.8	4.3	16.1	20.5	20.5	39.1	41.7	32.9	41.4	74.3	71.3
Civilian imports <sup>a</sup>	5.9	4.5	15.9	18.5	21.0	43.1	42.4	32.0	41.3	75.8	72.3
Total resources	<b>3.6</b>	<b>6.8</b>	<b>13.9</b>	<b>16.4</b>	<b>21.3</b>	<b>36.6</b>	<b>39.2</b>	<b>29.5</b>	<b>42.1</b>	<b>62.6</b>	<b>74.4</b>
<b>Uses</b>											
Private consumption	3.0	6.5	11.8	15.7	19.9	38.1	40.4	28.8	36.2	53.7	78.9
Public consumption	3.0	8.3	16.5	18.6	21.2	31.8	39.8	32.7	46.2	57.4	82.3
Public consumption, excl. direct defense imports	2.2	10.0	16.1	14.1	22.4	36.3	38.6	30.7	47.6	53.8	90.9
Gross domestic investment	5.4	10.0	13.6	16.6	25.7	41.7	33.5	25.6	39.6	77.2	67.6
Exports <sup>b</sup>	4.5	3.3	15.4	15.8	18.2	36.1	41.8	30.0	48.9	71.7	67.7
Total uses											
Excl. direct defense imports	<b>3.5</b>	<b>7.0</b>	<b>13.7</b>	<b>15.6</b>	<b>21.2</b>	<b>37.9</b>	<b>39.0</b>	<b>28.9</b>	<b>42.3</b>	<b>62.3</b>	<b>75.4</b>
Incl. direct defense imports	<b>3.6</b>	<b>6.8</b>	<b>13.9</b>	<b>16.4</b>	<b>21.3</b>	<b>36.6</b>	<b>39.2</b>	<b>29.5</b>	<b>42.1</b>	<b>62.6</b>	<b>74.4</b>
Net factor payments abroad	4.4	5.7	9.5	28.1	24.5	50.8	47.1	22.9	33.4	74.1	98.1
Gross domestic product	2.4	8.1	12.6	14.6	21.1	35.3	37.8	26.9	42.5	54.2	78.0
Gross domestic product of the business sector	1.9	6.8	11.6	12.9	18.9	35.8	39.9	27.6	42.2	54.7	67.3

<sup>a</sup> See note a to Table II-1.

<sup>b</sup> See note b to Table II-1.

Source: Central Bureau of Statistics.