CHAPTER II

THE PRODUCT AND DOMESTIC DEMANDS

1. MAIN DEVELOPMENTS

Economic activity accelerated in 1981, and the business sector product expanded 5 percent, following a small gain in 1980.[1] After declining last year, domestic uses turned up (by over 6 percent), with the steepest rise recorded in private consumption. Exports continued to advance, increasing their weight in the business sector product. Imports also grew after contracting the year before, but still fell short of what was warranted by the level of domestic activity. The labor market remained weak, and there was no improvement in the unemployment rate. The better performance of the economy in 1981 is explained by two main factors: the reaction to the previous year's slump, and the effect of the new policy introduced by the government at the beginning of the year, particularly in the sphere of taxation. This terminated the cyclical fluctuation in business activity evident in the two preceding years, which was shorter than usual and marked by exceptional changes in private consumption.

The economic slowdown, which was largely confined to the early part of 1980, was felt in domestic uses and private sector imports. Its source lay in the adjustment process which the economy underwent at the end of 1979 and beginning of 1980. Private sector demands expanded strongly at the beginning of 1979 in the expectation that the previous year's growth trends would continue and intensify with the realization of the peace process (the Camp David accords) and the start of the military redeployment in the Negev. But these

[1] There has been a substantial difference between the alternative estimates of the business sector product in recent years, especially in 1980. A measurement based on sectoral origin showed a 1 percent decline this year, whereas according to the measurement from the uses side there was a 3 percent increase. A priori it is hard to judge which calculation is more reliable. Nevertheless, it seems that in 1980 most economic indicators favored the sectoral measurement. The calculation from the uses side has an upward bias because of the estimated investment in inventories, which is frequently revised retroactively. In 1979 and 1980 the data on such investment were not consistent with input-output analysis, nor in 1980 with the effect which the rise in real interest rates should have had that year. For analytical purposes we therefore preferred to use an average of these two measurements. The rates of real change in the past few years will then be as follows: 1977—1.2 percent; 1978—5.8 percent; 1979—4.2 percent; 1980—0.8 percent; and 1981—5.1 percent.

expectations proved to be exaggerated, and the investment in inventories, equipment, and transport vehicles was unnecessary. Also contributing to the change in expectations was the marked deterioration in Israel's terms of trade at the end of the year. The adjustment to these developments affected several segments of the economy. Subsequently the government announced a change in policy: general budgetary restraint, the slashing of subsidies, and the restraining of real wages in the public sector. In addition, the Bank of Israel pursued a tight monetary policy, which drove up real interest rates and drastically reduced credit, in particular for financing production for the domestic market.

The private sector responded by cutting consumption and investment, which in turn pulled down imports, slowed production, and increased unemployment. A decline in investment[2] or the running down of stocks of imported goods in a particular year is typical of the economic adjustment process. But in 1980 this was marked by an unprecedented contraction of private consumption, which occurred in all current consumption components and was greater than warranted by the actual decline in income and wages. Even today, one year later, there is no satisfactory explanation of this unusual development; we are inclined to attribute it to an incorrect assessment by the public of the impact of the economic policy measures adopted.

In the second half of 1980, in particular toward the end of the year, the economy began to move out of recession, bringing up the low levels of private consumption, investment, and imports. This occurred even though there was no change in economic policy, and it can probably be ascribed to the nonrealization of the expectations of a severe restraining of government demand. Thus in the second part of the year private consumption regained its preslump level, and capital outlays on machinery and equipment began to rise in the final quarter of 1980.

At the beginning of 1981 fiscal policy was again altered. There was an about-face in tax policy, along with a continued restrained growth of the government's direct real demand (although not to the same extent as in the previous year).

The new policy covered indirect taxes, subsidies on basic consumption items, and direct taxes. Inordinately high indirect tax rates were axed on a wide range of products, notably durable consumer goods—a step compatible with long-term considerations. Subsidies swelled due to the nonadjustment of the prices of basic consumption items for the rise in the general price level, and income tax rates dropped following the adjustment of tax brackets (by more than their current erosion).

While this policy, which was designed first and foremost to cool inflation,

[2] Including purchases of durable goods, which can be treated as investment.

Table II-1
RESOURCES AND USES, 1979-81
(IS million, at current prices)

	1979	1980	1981	Percent annual increase							
				Quantity						Price	
				1968-1972	1974-1977	1978	1979	1980	1981	1980	1981
Resources											
Gross domestic product	44,422	104,327	245,614	11.0	1.9	4.4	3.7	2.7	4.2	128.8	125.9
Imports of goods and services [a]	31,813	69,838	166,980	11.2	-0.3	10.6	3.5	-6.6	9.8	135.0	117.8
Thereof: Civilian	28,412	59,626	139,173	10.6	1.8	6.0	10.6	-10.8	7.9	135.2	116.3
Total resources	**76,235**	**174,165**	**412,594**	**11.0**	**1.0**	**6.8**	**3.6**	**-1.0**	**6.4**	**130.9**	**122.6**
Uses											
Private consumption	27,956	62,037	149,750	7.2	3.0	7.4	7.1	-3.2	10.5	129.3	118.4
Public consumption	15,187	37,162	92,691	10.0	-5.2	12.1	-8.7	7.6	7.7	127.4	131.6
Public consumption, excl. direct defense imports	11,786	26,950	64,884	8.7	-2.6	2.5	1.9	1.7	2.8	124.9	134.2
Gross domestic investment	11,988	23,539	51,496	18.4	-5.5	1.1	12.8	-17.4	-1.0	137.8	121.0
Thereof: Excl. change in inventories	11,598	24,326	57,068	19.4	-7.9	5.1	13.9	-9.6	2.1	132.1	129.8
Total domestic uses, excl. defense imports	**51,730**	**112,526**	**266,130**	**10.2**	**-0.4**	**4.9**	**7.2**	**-5.4**	**6.5**	**130.0**	**122.0**
Exports, at market prices [b]	21,104	51,427	118,657	13.2	9.8	5.2	3.3	6.3	3.9	129.3	122.1
Total uses											
Excl. direct defense imports	**72,834**	**163,953**	**384,787**	**10.9**	**2.0**	**5.0**	**6.2**	**-2.3**	**5.8**	**130.5**	**121.9**
Incl. direct defense imports	**76,235**	**174,165**	**412,594**	**11.0**	**1.1**	**6.8**	**3.6**	**-1.0**	**6.4**	**130.9**	**122.6**
Net factor payments abroad	1,758	4,242	8,516	11.0	-2.1	14.7	14.8	2.6	-7.5	135.3	117.0
Gross national product, at market prices	42,664	110,085	237,098	10.9	2.1	4.1	3.0	2.7	4.6	128.5	126.5
Gross domestic product of the business sector, excl. ownership of dwellings, at market prices [c]	30,248	74,038	171,999	12.2	1.1	4.5	3.5	3.0	5.3	137.7	120.7

[a] Valued at c.i.f. prices. Excludes factor payments abroad and interest paid by the public sector.
[b] Valued at f.o.b. prices. Excludes factor receipts from abroad and interest received by the public sector.
[c] The gross domestic product, less ownership of dwellings and public and nonprofit institution services.
SOURCE: Central Bureau of Statistics.

retarded the spiraling of prices, especially in the second quarter of the year,[3] it inevitably had other repercussions. The government demand surplus bulged, generating an unprecedented liquidity injection in the second half of the year (see Figure VIII-1). The growth of the demand surplus stemmed primarily from the increase in subsidies, whereas the reduction of indirect taxes produced a larger revenue from this source. Disposable private income rose (about 14 percent in terms of purchasing power), and along with it private consumption and saving. The growth of private saving (over 20 percent in real terms), which reflected the public's attitude toward temporary fluctuations in its current income, sterilized part of the injection. However, the government improved the terms of institutional saving, thereby increasing the share of private saving that flowed back to it; this was used for financing its own consumption, thus depressing national saving. Another part of the injection was siphoned out through purchases of foreign currency following the large-scale acquisition of imported consumer goods (notably durables), which was directly stimulated by the government's lowering of taxes on these items.

In summary, it can be said that the government's tax policy contributed to the acceleration of domestic demands, which began at end of the previous year, and led to a further expansion of activity and particularly of imports. There was a striking increase in total private consumption, and apparently also some advancing of consumer goods purchases. Nevertheless, at the end of 1981 the level of private consumption was not far off its long-run trend.[4] In investment, this year's growth (5 percent in nondwelling capital spending) did not compensate for the previous year's decline (18 percent),[5] and the 5 percent increase in business sector activity was to some extent a compensatory response to last year's stagnation.

Along with the more buoyant domestic demands, exports (excluding diamonds, which were hit by the worldwide depression in this industry) chalked up an 8 percent gain, after advancing 6 percent or more in 1980, and the proportion of export value added in the business sector product continued to move up. This impressive export performance stands out all the more when viewed against the acceleration of domestic uses, which sometimes puts a damper on export growth (as happened in 1978, for instance), and even more, against the slumping of international trade in the past two years.

In contrast to the rebounding of economic activity, there was no significant recovery in the labor market, which continued to be weak (a trend begun at the end of 1979). The expansion of GNP was not accompanied by a heavier demand for workers (business sector employment inched up only 1 percent),

[3] A detailed analysis of the influence of this policy on the rise of prices is presented in Chapter III, "Prices".

[4] This is discussed in section 4.

[5] This is discussed in section 3.

and unemployment continued to run at a fairly high rate for the Israeli economy (5.1 percent). It follows that the supply of labor did not constitute an effective constraint on the growth of product.

The composition of the private sector's demands and the level of domestic activity were influenced by the restrictive policy followed by the central bank in the last two years. The main object of this policy was to cool inflation by reducing demands, but because of the large financial holdings of the public, its effectiveness was limited to investment in general and that in inventories in particular, rather than private consumption. Business sector demand for credit nevertheless rose strongly in recent years because of the profitability of financial activity; this has been enhanced under the present system of taxation, which is unsuitable for inflationary conditions. The quantitative restriction of credit led to an even more drastic reduction of the amount provided for financing productive activity, and so it had a negative effect on economic growth.

Despite the rebounding of economic activity this year, the growth rate fell short of the levels attained in the past. The more sluggish expansion can undoubtedly be attributed in part to external factors: the global oil crisis and the increasing uncertainty in the world economy created in its wake, Israel's mounting defense burden, and the drop in immigration to this country. To these influences were added the effects of the economic policy pursued: The growing intervention of the government in income distribution led to the upping of gross tax rates on production without any change in the net rates—a development which constituted a production disincentive. On the other hand, the frequent changes in economic policy during this period (e.g. with respect to the exchange rate) heightened the prevailing uncertainty.

The huge increase in the government's demand surplus (due to heavier defense spending and the expansion of civilian consumption), which was not accompanied by a commensurate growth of net taxes (their weight in the product remained unchanged), led to both a higher rate of inflation and a larger public sector dissaving. The government's intervention in the capital market—a result of its being the sole borrower of household savings and the principal borrower of foreign funds—has made it the dominant factor in the channeling of the bulk of private saving to investment. Over the years the government has used much of this saving for public consumption instead of investment, with the consequence that even though the rate of private saving is relatively high in Israel, the rate of domestic investment is not. However, it is hard to know whether or not this is a fair rate. The absence of an efficient capital market and the government's domination in this sphere has led to a distorted allocation of investment financing: some segments of the economy (notably enterprises in development areas producing for export) enjoy a large subsidy in the form of grants and loans on preferential terms, with the result that the stock of such capital exceeds the optimal from the standpoint of the national economy. On the other hand, in other segments of the economy investment has been very low, owing to the chronic absence of any possibility of raising long-term capital, and in the last two years also to the monetary restraint, which pushed up the market interest rate, thus inhibiting investment still more.

2. PUBLIC CONSUMPTION[6]

Public domestic consumption was up 3 percent in real terms this year, with civilian consumption rising 1 percent and defense spending by 4 percent. Defense imports expanded quantitatively by 20 percent, due primarily to the completion of the military redeployment in the Negev.

Fiscal restraint was again announced as one of the major ingredients of economic policy in 1981, but again this proved difficult to realize. A reduction in public spending was achieved primarily in investment. In 1980 as well the stress had been put on investment, but the government also had some success in curbing civilian consumption, restricting new hires in the civil service and cutting down on civilian purchases. The year reviewed, however, witnessed a slight expansion of personnel, an increase in real wages, and a 2 percent growth of civilian purchases.[7] It therefore seems that the hoped-for continued easing of the pressure of public civilian consumption on the economy's resources was stalled this year.

Domestic defense outlays remained high in 1981, and their weight (at current prices) in GNP edged up from 14 percent in 1980 to 15 percent. The growth of noncivilian consumption was the net result of an 8 percent increase in domestic procurements and a similar rise in defense construction on the one hand, and a 4 percent decline in defense establishment employment on the other. The completion of the withdrawal from Sinai and construction of the Negev airfields partly accounted for the apparently exceptional increase in purchases and construction expenditures. The trimming of the defense establishment workforce can be attributed to the government's policy of reducing public sector employment, which is a step in the right direction.

To sum up, while the share of the economy's resources flowing to public consumption did not increase this year, neither was there any sign of a solution of the economy's basic problems; there was no easing of the public sector's real pressure on GNP, which would permit a lightening of the tax burden in the future and stimulate the growth of the business sector.

[6] Public consumption is discussed here very briefly; for a more detailed presentation see Chapter V.

[7] National accounts estimates show that the number of employees in the public sector rose only slightly this year, but labor force survey data point to an increase of close to 4 percent and a rise in the weight of this sector in total employed.

3. INVESTMENT[8]

Fixed investment edged up 2 percent in 1981, after slumping 10 percent the year before. This slight increase reflected a 5 percent expansion in the business sector, stability in the public sector, and a mild drop in residential construction. The last two years witnessed a sharp inventory disinvestment, especially in diamonds. The growth of business sector investment reflected mixed trends in the two main components. Outlays on machinery and equipment rose 8 percent in real terms, which was consistent with the long-run uptrend in their share of the economy's capital stock. As against this, nonresidential construction continued to sag, with this year's 7 percent drop being concentrated in the public sector.

The level of investment is a function of the firms' decisions to adjust their capital stock and production to expected demand, and so it also reflects the need to replace obsolescent assets. The expansion of the capital stock in the business sector (excluding public transportation, which is subject to sharp fluctuations) tailed off a bit in all components: the total stock moved up 3.7 percent, compared with 4.1 percent the year before, while structures and equipment rose 3 and 4.6 percent respectively, as against 3.3 and 5 percent in 1980. Investment in machinery and equipment is affected by changes in production levels in preceding years. Thus, the stagnation of production in 1975-76 and 1979 found expression in the volume of capital expenditure after a year's lag, i.e. it depressed investment in 1976-77 and 1980; on the other hand, the 1979 upswing in investment followed the recovery of production in the previous year. This pattern explains the trend in 1981: the 8 percent expansion of machinery and equipment spending (which occurred mainly in the second half of the year) was in part a response to the previous year's slump.

Nondwelling Investment and Capital Stock

Recent developments in nondwelling investment and the capital stock should be examined in the light of the sharply decelerated growth of the business sector product during the past decade. Whereas in 1965-72 the average annual gain came to 9 percent, during the ten years 1972-81 it fell to 4 percent or less. Although the uptrend in the total capital stock and investment in structures gradually tapered off during the past ten years, it still exceeded the growth of the product, and the stock of machinery and equipment even expanded at an accelerated rate. This was reflected by a 28 percent growth of capital per unit of output in the business sector, with most of the

This section focuses on nondwelling investment. For a more detailed description of investment in housing construction see the relevant section in Chapter VI.

Table II-2

GROSS FIXED INVESTMENT BY TYPE OF ASSET, 1979-81

(IS million, at current prices)

				Percent annual increase					
				Quantity			Price		
	1979	1980	1981	1979	1980	1981	1979	1980	1981
1. Residential construction	3,738	10,406	23,994	15.6	8.5	-1.2	106.0	156.6	133.3
Private	2,996	7,553	17,452	13.1	-1.7	-1.0	103.6	156.3	133.4
Public	742	2,853	6,542	26.6	48.6	-1.6	117.9	158.8	133.1
2. Nonresidential construction	2,473	4,861	10,803	-6.7	-12.2	-6.9	87.5	123.8	138.8
Structures	1,444	2,764	5,792	-3.1	-14.0	-10.8	88.5	122.6	135.0
Earthwork	1,029	2,097	5,011	-11.2	-9.6	-1.8	86.3	125.4	143.3
3. Total construction (1+2)	6,211	15,267	34,797	5.3	0.0	-3.0	97.8	145.8	135.0
4. Machinery and equipment	3,914	7,330	17,416	18.2	-13.3	7.6	66.2	115.9	120.8
Domestic production	1,051	2,386	5,692	7.2	0.8	7.0	73.0	125.1	123.0
Imports	2,863	4,944	11,724	24.0	-19.7	7.9	61.9	115.1	119.7
5. Transport equipment	1,473	1,729	4,855	57.8	-44.0	24.3	61.5	109.7	125.9
Thereof: Ships and aircraft	407	59	777						
6. Total gross fixed investment (3+4+5)	**11,598**	**24,326**	**57,068**	**13.9**	**-9.6**	**2.1**	**83.3**	**132.1**	**129.7**
7. Change in inventories	390	-787	-5,572						
8. Total gross domestic investment	**11,988**	**23,539**	**51,496**	**12.8**	**-17.4**	**-1.0**	**73.0**	**137.8**	**120.9**

SOURCE: Central Bureau of Statistics.

component segments recording impressive increases.[9] This has given rise to the conjecture that there has been an overinvestment in this sector and that the capital is not being efficiently utilized. Support for this view is found in the fact that electricity consumption per unit of capital in industry (which is an indicator of capital utilization) declined 23 percent during the period in question. One of the principal reasons cited to explain this development in the past was the strong support given investment (*inter alia* through the Law for the Encouragement of Capital Investment), which increased with the acceleration of inflation.

GROWTH OF CAPITAL STOCK AND PRODUCT, 1965-81

(Percent average annual increase)

	Business sector[a]				Industry			
Period	Structures	Equipment	Total	Product	Structures	Equipment	Total	Product
1965–72	6.8	6.9	6.9	9.3	7.8	6.7	7.1	10.3
1972–81	4.9	8.0	6.2	3.6	5.5	8.2	7.4	4.0

[a] Excludes transportation equipment.

Another view is based on the combination of a protracted growth of capital per unit of output accompanied by an underutilization of capital stock, and a steadily rising investment in equipment in the production and service sectors and a shrinking investment in structures. According to this view the actual capital stock did not expand rapidly, and the measured changes stemmed partly from a systematic downward bias in the volume of discards, arising from an overestimate of the economic life of machinery and equipment. This conjecture is based on a possible early replacement of high energy-consuming machinery in the wake of the fuel crisis, rapid technological advances, and the encouragement of investment in shorter-term projects (see the section on investment financing). Examination of the influence of a shorter economic lifespan on the industrial capital stock indicates that the actual rate of change in capital per unit of output has been lower than the calculated change. The differential was particularly striking in the last two years—a 1.5 percent yearly rise in the capital stock according to the alternative calculation, as opposed to 5 percent according to the customary measurement.[10]

[9] Approximately 90 percent in construction, 34 percent in industry, 45 percent in industrial equipment, 25 percent in trade, and 11 percent in electricity and water. Agriculture registered a slight drop during this period.

[10] In this examination the economic life of the investment was assumed to be ten years, as opposed to 14 years in the customary calculation.

Table II-3

GROSS FIXED INVESTMENT BY SECTOR, 1978-81

(IS million, at current prices)

			Percent annual increase					
			Quantity				Price	
	1980	1981	1978	1979	1980	1981	1980	1981
1. Agriculture [a]	1,008	2,369	6.2	3.5	-17.4	-5.3	116	148
2. Water	396	1,015	17.9	21.2	17.5	7.8	116	137
3. Industry	3,191	7,358	14.5	4.7	-18.0	2.6	118	126
4. Construction equipment	368	793	28.2	233.3	-32.0	-6.5	107	131
5. Electricity	1,430	2,874	14.0	3.2	15.2	-5.7	120	113
6. Transportation and communications	3,319	8,468	10.7	41.2	-30.6	5.4	111	142
7. Private services [b]	1,481	3,972	-5.1	7.3	-9.0	21.3	119	121
8. Business sector [b] (1 to 7)	11,193	26,850	9.8	18.8	-17.7	5.5	114	127
9. Public services [b]	2,728	6,225	5.3	-5.4	-19.2	0.1	123	128
10. Total fixed nondwelling investment (8+9)	**13,920**	**33,074**	**8.7**	**13.2**	**-18.0**	**4.6**	**116**	**127**
11. Residential construction	10,406	23,994	-2.0	15.6	8.5	-1.2	157	133
Private	7,553	17,452	5.0	13.1	-1.7	-1.0	156	133
Public	2,853	6,542	-24.3	26.6	48.6	-1.6	159	133
12. Total fixed investment (10+11)	**24,326**	**57,068**	**5.1**	**13.9**	**-9.6**	**2.1**	**132**	**130**

[a] Agriculture, forestry, land amelioration, and change in livestock inventories.

[b] For lack of direct data on the distribution of investment in domestically produced equipment among the service subbranches, the distribution here between business and public services is a Bank of Israel estimate which assumes that such investments are distributed similarly to those in imported equipment. Public services comprise the government, local authorities, Jewish Agency, and nonprofit institutions.

SOURCE: Central Bureau of Statistics.

In conclusion, while the existing data point to an overinvestment, if we accept the assumption about a possible shortening of the economic life of the projects, then the idle capital stock was actually much smaller than indicated by the present measurement. This is consistent with the claim that in some areas the level of investment is adversely affected by the high degree of uncertainty facing investors, which has become more pronounced in recent years, as well as by the absence of an efficient free capital market.

Investment in nonresidential structures was cut back 7 percent in 1981, in continuation of the trend evident since 1975. The decline occurred mainly in public services, particularly local authorities, where the level dipped 25 and 21 percent in 1980 and 1981 respectively. Similar decreases were recorded for medical institutions, public buildings, and government services. During the past six years the figure for public service buildings, the chief target of the budget restraint policy in recent years, fell at an average yearly rate of 11 percent. The contraction of such investment was largely made possible by the remarkably rapid growth of capital stock in the public services (10 percent or more in each of the years 1960-76), with the result that even after the reduction of investment in the past few years, the capital stock continued to expand at an average annual 5 percent rate during the period 1976-81.

An analysis of investment by initiating sector (see Table II-A2) shows that public sector investment in structures broadly defined[11] was down 13 percent in 1981. This also reflected a cutback in public sector infrastructure investment, e.g. roads, ports, and airfields. At the same time there was a small percentage increase in building investment by public sector companies,[12] in line with the trend apparent during the past decade. Fixed nondwelling investment (excluding transportation equipment) rose 2 percent in 1981, the net outcome of a 7 percent increase in the private sector and a slight drop in the public sector and public sector companies. Private investment responds more quickly to economic changes than that by the public sector; this explains the sharper fluctuations in the former, although capital outlays of the public sector (including public sector companies) generally move in the same direction (except this year), but at a more laggard pace.

[11] In addition to public service buildings, public, educational, and medical institutions, and construction by local authorities, such investment includes government enterprises (the railway, sea- and airports, and the Post Office), highway construction, afforestation, and land reclamation and amelioration.

[12] Public sector companies are found in electricity and water, industry, transportation, and services.

Table II-4

GROWTH OF CAPITAL STOCK[a] BY SECTOR, 1960-82

	Percent annual quantitative increase						Change in capital stock in 1981, at 1975 prices (IS million)				Discards and capital stock in 1981, at current prices (IS million)	
	Average											
	1960-65	1965-72	1972-82	1980	1981	1982	Stock at beginning of 1981	Gross investment	Discards	Stock at beginning of 1982	Discards	Capital stock
Agriculture	6.0	3.4	4.2	4.1	2.8	2.1	2,088	90	45	2,133	1,137	2,533
Water	9.9	3.0	2.7	3.3	3.9	4.1	899	41	4	936	101	607
Industry	9.9	7.1	7.0	6.2	4.2	3.8	4,512	297	125	4,684	3,104	6,956
Construction equipment	14.2	2.9	4.2	10.0	2.1	0.1	347	31	31	347	786	888
Electricity	7.7	6.2	8.5	9.0	9.8	8.3	1,182	120	22	1,280	544	1,378
Transportation and communications	15.1	11.5	4.7	3.8	0.3	-1.0	5,165	306	359	5,112	10,756	8,441
Private services	16.0	10.3	6.5	5.2	4.0	5.3	1,569	155	71	1,653	1,823	2,912
Total business sector	**10.6**	**7.7**	**5.6**	**5.1**	**3.0**	**2.4**	**15,761**	**1,040**	**657**	**16,144**	**18,251**	**23,715**
Public services	15.8	12.0	7.9	5.2	3.4	3.0	4,670	228	89	4,809	2,292	2,353
Total nondwelling stock	**11.3**	**8.4**	**6.1**	**5.1**	**3.1**	**2.6**	**20,431**	**1,268**	**746**	**20,953**	**20,543**	**26,067**
Dwellings	9.7	7.2	7.7	5.5	5.7	5.3	13,193	731	26	13,897	862	10,826
Total fixed capital stock	**10.7**	**8.0**	**6.7**	**5.3**	**4.1**	**3.6**	**33,624**	**1,999**	**772**	**34,851**	**21,405**	**36,893**

[a] Capital stock at the beginning of the year.

SOURCE: Central Bureau of Statistics and Bank of Israel.

Investment Financing[13]

Total medium- and long-term credit to the business sector hardly changed in the past two years, while its capital spending rose 5 percent or more, after contracting 18 percent in 1980. The relationship between the amount of credit provided to the various subsectors and their investment during the same year is unclear. Thus, for instance, industrial credit shot up 43 percent in real terms this year, while capital expenditures rose only fractionally. The higher volume of industrial credit is explained by the swelling of foreign currency loans from approximately IS100 million to over ten times that amount after investors were permitted for the first time to receive such loans in addition to development loans. Part of this huge increment was probably a substitute for short-term credit, which was more stringently restricted this year. In 1981 the law for encouraging the construction of rental housing and the law for promoting capital investment in agriculture went into effect. The influence of the former on the volume of building cannot yet be assessed owing to the small number of rental units completed, while the agricultural investment law has apparently had only a marginal effect.

Government intervention in investment financing has taken the form *inter alia* of direct budget credits, development loans, and investment grants under the Law for the Encouragement of Capital Investment. During the 1970s, and particularly from 1974 onward, development loans (whose interest rates were not adjusted for changes in the rate of inflation) contained a subsidy element, arising from the differential between the low interest rate paid by the borrower on the one hand and a reasonable market rate of interest plus the expected rate of inflation on the other.[14] Beginning in 1979, with the government's decision to link development loans, this subsidization was reduced.

These direct and indirect grants have influenced the composition and volume of investment. The grants, which are given at a specified rate of the approved investment (according to geographic location), have induced a preference for shorter-term projects, since the rate of return rises the shorter

[13] In discussing investment financing a number of difficulties arise. First is the assumption that all medium- and long-term credit is used to finance investment. This is too strong an assumption, for it is a reasonable inference that a shortage of short-term credit will induce a greater resort to long-term finance, and that the latter will be used for other financial activities besides investment. Moreover, the data on financing and investment are obtained from different sources, and they do not always coincide. Nevertheless, they give an indication of the effects of the various financing methods on the structure and scope of investment.

[14] A comprehensive discussion of the estimated total expected and unexpected direct grants provided under the Law for the Encouragement of Capital Investment, as well as the grant equivalent of related development loans, may be found in U. Litvin and L. Meridor, "The Grant Equivalent of Subsidized Investment in Israel", Bank of Israel *Economic Survey* 54.

the economic lifespan.[15] Thus, investors have preferred equipment over buildings, and in particular equipment with a shorter life. This conclusion is consistent with the rising weight of equipment in total investment (because of the need for more frequent replacement). Of total development loans granted in 1981, only 15 percent were unlinked, evidence that the process of linking such loans has reached completion.[16]

In spite of the rising proportion of linked loans, this source was tapped to the same extent as in the previous year, with the result that its weight in total industrial investment financing remained unchanged. It is reasonable to assume that the linkage of development loans will have a dampening effect on future demand for such credit and on total industrial investment in general, in contrast to the expansionary effect exercised in the past by the availability of such loans on unlinked terms and of direct investment grants. Examination of the effects of grants and development loans on the volume of investment in the past gives grounds for arguing that projects with a relatively long economic lifespan and a negative rate of return from the national economic standpoint[17] should not have been implemented by the investors. The more beneficial the project is to the economy, the greater encouragement it will receive from a grant at a given rate. But with the shortening of their life, projects that were not worthwhile to the national economy become profitable to the investor.

4. PRIVATE CONSUMPTION

Per capita private consumption rose 9 percent in 1981; excluding nonprofit institution and housing services,[18] the increase was 12 percent. This extraordinary upsurge was due to a combination of factors: the growth of per capita disposable income (up 12 percent), a compensatory response to the previous year's unprecedented downswing in consumption, and the government's policy of cutting indirect taxes on durables. Durables accounted for nearly 40

[15] A detailed discussion of the effect of the grants on the economic life of investment projects and on their rate of return appears in H. Levy and M. Sarnat, "Investment Incentives and Resource Allocation", *Economic Quarterly* 87 (in Hebrew).

[16] Nearly 48 percent of such credit was granted on the special terms applicable to loan requests in the pipeline during the changeover, namely 100 percent linkage to the dollar, or 70 percent linkage to the consumer price index plus a maximum of 2 percent interest.

[17] A calculation which assumes that the grant is equal to 42 percent of the value of a project with a 14-year economic lifespan, and ignoring tax considerations (which are complex and work in both directions), shows that a project with a negative rate of return will not begin to earn a positive return that is worthwhile to the investor.

[18] These two items are not actually determined by individuals in the current year: consumption of housing services is essentially an imputation based on changes in the country's dwelling stock, while consumption of nonprofit institution services is determined by the institutions' budgets.

percent of the incremental private consumption; this component, whose weight in total consumption is small, jumped 37 percent per capita in 1981. The amount spent on nondurable goods was 7 percent higher than in 1980, the steepest rise since 1968. Services increased 3 percent per capita, similar to the trend in recent years.[19] Despite the daunting growth of private consumption in 1981, the average annual increase over the past two years was only half of that of disposable income (3.5 vs. 6.4 percent respectively), with the result that the rate of saving moved up two consecutive years.

Private consumption fluctuated sharply in 1980-81. This irregular pattern was unusual, and cannot be explained solely by swings in disposable income. Private consumption is primarily determined by long-term considerations based on the expected future stream of disposable income. Changes in disposable income in the current year are only partly reflected in that year's private consumption, and as a rule fluctuations in private consumption (especially in the case of nondurable goods) are smaller than the changes in disposable income, whether in an upward or particularly in a downward direction. This has been the pattern during the past two decades. 1980, however, was a deviant year in this respect: total private consumption, and that of nondurable goods in particular, slumped much faster than disposable income. Whereas per capita disposable income sagged 3 percent, per capita spending on current consumption goods tumbled 9 percent. In view of the decrease in disposable income in 1979-80, the precipitate drop in the rate of saving in 1979, and the policy of restraint adopted in 1980, it was reasonable to expect a downturn in private consumption (notably durables) that year, although not of such drastic proportions. The abrupt contraction of private consumption in 1980 can apparently be ascribed to the public's exaggerated expectations regarding the future stream of disposable income. These expectations were fed by jitters over a possible deepening of the recession which prevailed in the second half of 1979 and beginning of 1980, and were intensified by the government's attempt to make the public more conscious of the gravity of the economic situation. Against this backdrop it is reasonable to assume that the growth of private consumption in 1981 was to some extent a compensatory response to the steep drop of the previous year.

Private consumption began to turn down sharply in the last quarter of 1979 in all commodity categories, and continued falling until the middle of 1980. In the second half of 1980 it reversed direction, and the upswing gathered momentum toward year's end, with durable goods setting the pace. The rising trend was sustained throughout 1981, and encompassed all component groups with some shift between them in the course of the year: during the first quarter durable goods outraced all other components, but in the next two

[19] Apart from 1980, when per capita consumption held steady.

Table II-5

TOTAL PRIVATE CONSUMPTION, 1978-81

(IS million, at current prices)

					Percent annual increase					
					Quantity				Price	
	1978	1979	1980	1981	1978	1979	1980	1981	1980	1981
Current consumption goods	6,452	11,311	26,800	61,253	7.1	1.0	-6.4	8.6	153.1	110.4
Durables	1,635	3,260	5,498	15,047	22.9	33.5	-11.1	39.0	89.7	96.8
Other services	3,110	5,648	12,999	31,362	8.3	6.1	-1.3	6.8	133.3	125.9
Consumption of Israelis abroad	628	1,217	2,862	7,314	31.8	20.7	2.9	19.3	128.6	114.2
Less: Consumption of foreign nationals in Israel	1,322	2,261	5,089	11,924	24.8	0.5	-2.1	-1.0	130.0	136.5
Total private consumption, excl. housing and non-profit institutions	**10,503**	**19,175**	**43,070**	**103,052**	**8.7**	**8.3**	**-5.8**	**13.8**	**138.5**	**110.3**
Housing services	2,520	5,714	12,339	31,458	4.9	4.3	4.6	3.7	106.5	145.8
Nonprofit institution services	1,553	3,067	6,628	15,240	3.2	4.1	0	2.1	116.1	125.1
Total private consumption										
Incl. durables	**14,576**	**27,956**	**62,073**	**149,750**	**7.4**	**7.1**	**-3.2**	**10.5**	**129.3**	**118.4**
Excl. durables	**12,941**	**24,696**	**56,539**	**134,703**	**5.8**	**4.0**	**-2.1**	**7.8**	**133.7**	**121.1**

quarters they slowed down and current consumption goods moved up. In the last quarter the latter slackened, while the uptrend in durables and "other services" reasserted itself.

Almost half of the decline in current consumption goods in 1980 was due to a steep fall in "food, beverages, and tobacco" (about 7 percent per capita). The severity of the downturn here is explained *inter alia* by a jump in the relative price owing to the government's policy of cutting subsidies on basic goods and services, which depressed the quantity consumed of this item and increased its weight in total household expenditure. In 1981 this item rose somewhat (about 4 percent per capita), which was compatible with its basic characteristic—a low income elasticity of demand. The subsequent heavier subsidization of basic products and services depressed its relative price, stimulating consumption and reducing its weight in total expenditure. In the food subgroup milk and milk products displayed the sharpest fluctuations. In 1980 their relative price soared 50 percent (in relation to the price of total consumption), causing a 16 percent drop in the quantity consumed per capita. In 1981, however, the relative price retreated 30 percent, and per capita consumption rebounded 8 percent quantitywise. This acute swing was a result of the about-face in the government's policy on basic product and service subsidies in the past two years. Per capita spending on beverages rose by a mild 3 percent, which can be ascribed to a relative price rise and a decline in tourism to this country (per capita alcoholic consumption slumped 3 percent). Per capita expenditure on household fuel and light drifted down 1 percent, apparently in a lagged reaction to the sizable 1980 relative price increase. Although the relative price fell in 1981, it remained high. Nearly half of the incremental spending on current consumption goods in 1981 was due to an upsurge in clothing and footwear purchases (21 percent per capita), along with a precipitous rise in their relative price and weight in total consumer expenditures. The increase was in part a compensation for the steady decline of the two preceding years.

After slumping 13 percent in 1980, purchases of durables shot up 37 percent per capita in 1981. Most of the increase came at the beginning of the year, and was concentrated in household equipment and automobiles. Purchases of durables started to pick up in the third quarter of 1980, and grew very buoyant in the next quarter. The government's policy of lowering indirect taxes, which came into effect at the beginning of 1981, contributed both to the growth of disposable income and to the decline in the relative price of durables, thereby giving added impetus to the acquisition of such goods, which have a high income and price elasticity. The buying spree at the beginning of 1981 also had the character of advance purchases, a result of the prevailing uncertainty whether the government would continue to reduce taxes on these products—a policy initially instituted for a limited period only.

Table II-6

CONTRIBUTION OF MAJOR COMPONENTS TO TOTAL PER CAPITA PRIVATE CONSUMPTION, 1979-81

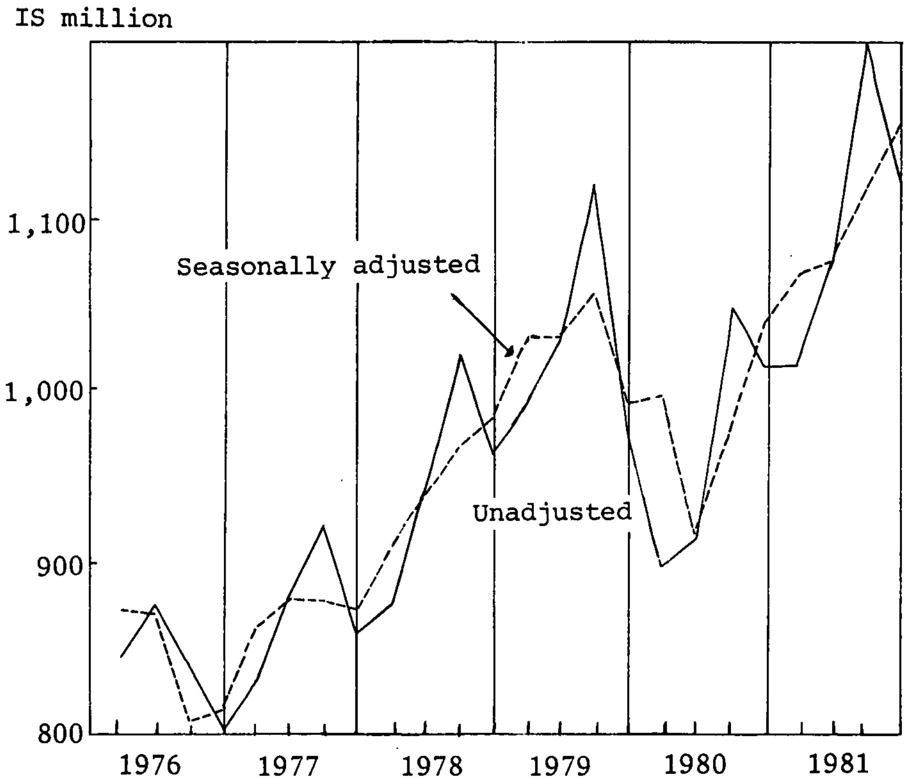
(Percentages)

	1979				1980				1981			
	Per capita quantitative change	Weight in 1978, at 1975 prices	Contribution to change in total	Relative contribution	Per capita quantitative change	Weight in 1979, at 1975 prices	Contribution to change in total	Relative contribution	Per capita quantitative change	Weight in 1980, at 1980 prices	Contribution to change in total	Relative contribution
Current consumption goods	-1.5	0.573	-0.8	-16.3	-8.6	0.539	-4.6	-59.7	6.6	0.557	3.7	36.3
Durables	30.2	0.135	4.1	83.7	-13.2	0.167	-2.2	-28.6	36.5	0.114	4.2	41.2
Other services	3.5	0.251	0.9	18.3	-3.7	0.248	-0.9	-11.7	4.9	0.270	1.3	12.7
Consumption of Israelis abroad	17.7	0.041	0.7	14.3	0.4	0.046	0	0	17.1	0.059	1.0	9.8
Total consumption, excl. housing and nonprofit institutions and incl. foreign nationals	**4.9**	**1.000**	**4.9**	**100.0**	**-7.7**	**1.000**	**-7.7**	**100.0**	**10.2**	**1.000**	**10.2**	**100.0**

This uncertainty was reflected in the fact that the growth of purchases was not evenly spread over all components during the period discussed, and that the lion's share of the 1981 increment was recorded in the first quarter of the year.

The public's wealth remained unchanged in 1980 in real terms,[20] although the ratio between financial and physical assets (excluding durables) rose appreciably (from 30 percent at the end of 1979 to 37 percent at the end of 1980). To some extent the heavier purchase of durables at the end of 1980 and beginning of 1981 may have reflected the adjustment of the public's assets portfolio.[21] The ratio between financial and other assets moved up further in the course of 1981 (from 37 to 40 percent), apparently due to the massive li-

Figure II-1
TOTAL PRIVATE CONSUMPTION (EXCL. NONPROFIT INSTITUTIONS AND HOUSING), 1976-81
(IS million, at 1975 prices)



[20] The reference is to the wealth of the private nonfinancial sector.

[21] There was a similar development in 1978. During 1977 the ratio between financial and other assets rose from 33 to 40 percent, and in 1978-79 purchases of durables soared (at a 25 percent average annual rate per capita), while the ratio between financial and other assets dropped from 40 percent at the end of 1977 to 30 percent at the end of 1979.

quidity injection during the year. Presumably this spurred the acquisition of durables, a trend that may very likely carry over into 1982.

Examination of the weight of the various components of total consumption in 1981 shows no deviation from the long-term pattern, namely a decrease in the proportion of current consumption goods, an increase in durables and in Israeli consumption abroad, and relative stability in "other services".

During the past two years the rate of saving from disposable income rose, but since this followed a sharp drop in 1979, it can be said that essentially there was no departure from the fairly stable trend evident since 1976. The relative flattening of the national saving rate in recent years stands out against its protracted cyclical fluctuation, which began at the end of the 1960s and lasted until the mid-1970s. The fact that in 1980-81 the rate held relatively steady bolsters the assumption that its stabilization in recent years is not of a fortuitous nature but signifies a return to the long-term pattern of a constant saving rate (although at a lower level than during the 1960s).

5. EXPORTS[22]

Exports continued to expand this year, increasing their weight in GNP; excluding diamonds, the gain came to 8 percent, compared with 6 percent in 1980. Diamonds lost considerable ground in 1981 (down 20 percent in quantity), continuing the two-year slump in this industry. This pulled down the growth rate of total exports to only 4 percent (at market prices). Their share of the incremental business sector product in 1981 is estimated at 2.5 percent, roughly the same as last year. The advance was again spearheaded by industrial goods (which account for the bulk of the high-technology and military exports); these posted a 13 percent higher figure in 1981.

In line with the trend apparent for many years, exports again boosted their share of GNP. This impressive performance can be credited to the worthwhileness of producing for foreign markets, which have a much larger potential demand than the relatively small Israeli market. The persistence of this trend in 1981 stands out all the more in view of the developments, both internal and external, which could have harmed Israel's foreign sales. On the one hand, surging domestic demand sharpened competition on the part of the home market for export products, and on the other hand, international trade has been dragging during the past two years, creating unfavorable conditions for the continued expansion of Israel's foreign sales. In addition, the profitability of exports to Europe was hurt by the weakening of the major European currencies against the dollar, with the chief victim being agricultural exports, the bulk of which is destined for Europe. By contrast,

[22] For a fuller description of export developments see Chapter VII.

sales to countries whose currency appreciated (the dollar) became more profitable. This development has created uncertainty among exporters about future trends, and exchange rate policy cannot compensate the economy on this score. If this pattern persists, exporters will find a partial solution to the problem by redirecting their trade to markets with stronger currencies; if there should be an opposite, remedial development, they will automatically be compensated. The retroactive compensation which the government granted to those selling to European markets this year accorded with its long-standing declared commitment to compensate Israeli exporters and to continue to promote exports in one way or another. This policy runs counter to the optimal development of the economy, and in the long run is liable to affect both economic growth and the balance of payments.

6. IMPORTS[23]

The domestic market value of civilian imports rose 8 percent this year, after dipping 10 percent or more in 1980. Last year's decline embraced most component groups, but was most striking in inventories, which were run down to an unprecedented degree because of the dearer cost of credit. The 1981 increase was also spread over most components other than diamonds; the upswing was particularly steep in consumer goods (50 percent), as purchases were stimulated by the government's revised policy of lowering taxes on these products. Withal, the larger purchase of foreign consumer goods had only a marginal effect on the total import bill in dollar terms. Inventories remained at a low level this year, and diamond stocks continued to shrink (by approximately $200 million).

Imports of raw materials (excluding oil and diamonds) expanded 17 percent, after declining at a similar rate the year before; their level apparently fell a little short of what was required for current production.

7. PRODUCT

The gross domestic product expanded more than 4 percent this year, and the business sector product by over 5 percent. These gains partly reflected the rebounding of economic activity, after it had weakened in 1980 and pulled down the product growth rate.

About half of this year's increase in the business sector product—more than 3 percent—was accounted for by private consumption, after it had depressed the level by 2 percent the year before. Exports contributed 2.5 percent, about the same as in 1980; this too was close to half the total increment (see Table II-7).

[23] For a more detailed discussion of import developments see Chapter VII.

Table II-7

BUSINESS SECTOR PRODUCT[a] BY FINAL USES, 1979-81

(Percentages)

	Distribution of the product by final uses				Contribution of uses to the growth of product		
	1972	1979	1980	1981	1979	1980	1981
Private consumption	38.5	39.1	36.9	38.0	0.9	-2.3	3.4
Public consumption	9.6	8.3	8.6	8.8	0	0.3	0.7
Investment[b]	24.7	17.1	16.3	14.9	1.5	-0.8	-0.5
Total domestic uses	**72.8**	**64.5**	**61.8**	**61.7**	**2.4**	**-2.8**	**3.6**
Exports							
To foreign countries	25.1	32.3	34.9	35.1	2.0	2.5	2.3
Thereof: Excl. diamonds	24.0	30.8	33.2	33.9	2.2	2.4	2.6
To the administered areas	2.1	3.2	3.3	3.2	0	0.2	0
Total final uses	**100.0**	**100.0**	**100.0**	**100.0**	**4.5**	**-0.2**	**5.9**

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.

[a] Gross domestic product at factor cost, excluding public sector and nonprofit institution services.

[b] Includes changes in domestically produced inventories in 1979-80.

SOURCE: Central Bureau of Statistics data adjusted in accordance with Bank of Israel input-output data for 1975/76.

The expansion of the product in recent years fell far short of the gains chalked up in the past. The laggard growth coincided with the general recession in the western countries in the wake of the global oil crisis, which threw the world economy out of gear, sharply pushed up prices, and heightened uncertainty over future supply and demand. In Israel the slowing of growth and the escalation of inflation were more acute than elsewhere. The repercussions of the oil crisis were particularly severe for this country because of the magnitude and composition of its balance of payments deficit. Exacerbating the situation was the heavy defense burden, which had grown increasingly onerous since the Yom Kippur War. Against this background the government has focused its efforts on a deliberate policy of slowing economic activity in order to retard the expansion of imports while changing the structure of production. The last few years have witnessed frequent shifts in economic policy, particularly with regard to the exchange rate, and this has increased uncertainty about future developments.

Concurrently, the population growth trend has undergone a drastic change due to the reduction of immigration to this country. It is difficult to determine to what extent this is related to economic developments and to what extent to other factors, but it is clear that it has diminished the economy's growth potential. What is more, over the years a change has taken place in the educational level of the country's incremental manpower: whereas in the past most of the additional labor force was composed largely of unskilled workers with little schooling, in recent years the educational level of those joining the labor force has risen steadily. This has enhanced the comparative advantage enjoyed by Israel, and is therefore likely to change the economy's growth path.

As opposed to this, there has been a significant change in the government's income distribution policy in the wake of its declared social welfare policy. Beginning in the early 1970s the government increasingly stepped up its transfer payments to individuals, with the consequence that it had to raise gross tax rates on production without significantly affecting the net tax burden. Gross tax rates were almost doubled, bringing up the share of revenue from this source to close to 50 percent of GNP, while the share of net taxes remained at only 20-24 percent. The stiffening of direct and indirect taxes was borne mainly by labor, the principal primary factor of production in the economy. This constituted a production disincentive, and it affected domestic economic activity as well as employment opportunities.

During the past two years the level of economic activity was apparently also inhibited by the government's stringent credit policy. This included quantitative restrictions, which for the most part proved quite effective; because of the substantial credit needs of the productive sector, the restrictions put a damper on business sector activity, apart from exports, which suffered less.

Table II-8

CHANGES IN GROSS DOMESTIC PRODUCT,[a] FACTOR INPUT, AND BUSINESS SECTOR PRODUCTIVITY, 1960-81

(Percent annual real increase)[b]

	Average							
	1960-72	1976-81	1976	1977	1978	1979	1980	1981
Gross domestic product	10	3	0	-1	5	4	3	5
Labor input	4	2	0	1	4	4	-1	2
Stock of fixed nondwelling capital (beginning of year)	9	5	6	5	4	4	5	3
GDP/labor input	6	1	0	-1	1	-1	4	3
GDP/capital stock	1	-2	-6	-5	1	-1	-2	2
Productivity[c]	4	0	-2	-2	1	-1	2	3

[a] Measured according to uses. For a similar table in which the business sector product is measured according to sectoral origin see Chapter VI.
[b] Percentage changes were calculated from unrounded data.
[c] Labor weighted 2/3 (a calculation in which labor is weighted 1/2 produces similar results).

The rebounding of the business sector in 1981 was not manifested in a heavier demand for labor. Employment inched up a mere 1 percent, while labor and overall productivity rose 3 percent. Although this surpassed the increases recorded in recent years by a comfortable margin, it was still not indicative of a definite turn for the better in this area. Changes in productivity have significance only within the context of a multiyear analysis, and such an analysis reveals a very slim gain in the national productivity level during the past few years.

The tailing off of the productivity curve during the past decade was typical not only of the Israeli economy but of western economies in general. This has generally been attributed in part to the energy crisis and its side-effects, although no explanation has yet been offered as to what else was responsible for this development. As regards Israel, it has been suggested that one factor was the nonadjustment of the capital stock to the lower rate of economic growth owing *inter alia* to the massive government subsidization of capital in recent years. It is worth noting in this connection that in view of the possible upward bias in the capital stock estimate (see above), the calculated change in productivity may be slightly on the low side.

Table II-9

NATIONAL PRODUCT AND INCOME, 1979-81

(IS million, at current prices)

				Percent annual increase		
	1979	1980	1981	1979	1980	1981
1. Gross national product, at market prices	42,664	100,085	237,098	87.5	134.6	136.9
2. Indirect taxes on domestic production	5,875	13,448	28,112	90.6	128.9	109.0
3. Subsidies on domestic production	1,511	2,971	15,967	96.2	96.6	437.4
4. Subsidy component of government loans for current business sector production[a]	1,848	3,913	7,372	126.7	111.7	88.4
5. Net indirect taxes (2-3-4)	2,516	6,564	4,773	68.0	160.9	-27.3
6. Gross national product, at factor cost (1-5)	**40,148**	**93,521**	**232,325**	**88.9**	**132.9**	**148.4**
7. Depreciation	6,520	15,256	36,214	84.4	134.0	137.4
8. National income[a] (6-7)	**33,628**	**78,265**	**196,111**	**89.8**	**132.7**	**150.6**

[a] See note 24 in this chapter.

SOURCE: Central Bureau of Statistics and Bank of Israel.

8. INCOME AND SAVING

The government's active tax policy, particularly with respect to the subsidization of basic goods and services, resulted in an appreciable growth of private disposable income (gross private disposable income from all sources rose more than 14 percent in terms of buying power). The public did not regard this hefty addition to its income as of a permanent nature, and so it spent only part of it on consumption and saved the rest. This added 3 percentage points to the private saving rate, after it had moved up 2 points the year before.

Analysis of the distribution of income from economic activity shows that the share of wages rose steadily from 1975 to 1979 in relation to nonwage income. In the last two years, however, it retreated a bit, although in 1981 it was still higher than at the beginning of the decade.[24]

SHARE OF WAGES IN NATIONAL AND BUSINESS SECTOR INCOME, 1975-81

(Percentages)

	1975	1976	1977	1978	1979	1980	1981
Shares of wages in national income	57	61	65	66	69	66	64
Share of wages in business sector income	51	56	60	61	65	60	59

9. NATIONAL SAVING

The rate of national saving, i.e. the portion of income available to the economy that has not been consumed (by either individuals or the government), is an indicator of the economy's future potential growth. The income available to the economy consists of GNP and unilateral transfers from abroad. Israel has enjoyed a large volume of such transfers to both individuals and the government, and these have enabled the economy to maintain a

[24] This year the Central Bureau of Statistics began to adjust the estimate of the subsidy component of government loans granted to the business sector for financing current production (the reference is to the subsidy element in exchange rate insurance and indexation, which is given to both investment and current production). At this stage the data still include the subsidy already taken into account in the measurement of the investment share of the national product. Consequently, the data on national income for the years 1975-81 are overstated and the share of wages in national income is understated.

Table II-10

GROSS DISPOSABLE PRIVATE INCOME, 1979-81

(IS million, at current prices)

	1979	1980	1981	Percent annual increase 1979	1980	1981
1. National income [a]	33,628	78,265	196,111	89.8	132.7	150.6
2. Public sector property and entrepreneurial income	1,176	3,275	7,686	124.9	178.5	134.7
3. Depreciation	6,520	15,256	36,214	84.4	134.0	137.4
4. Gross private income from economic activity (1-2+3)	38,972	90,246	224,639	88.0	131.6	148.9
5. Income tax	7,408	18,583	43,170	102.8	150.9	132.3
6. National insurance contributions	2,997	7,342	18,241	90.3	145.0	148.4
7. Total direct taxes (5+6)	10,405	25,925	61,411	99.0	149.2	136.9
8. Net transfer payments	8,047	19,257	47,358	76.7	139.3	145.9
9. Gross disposable income from domestic sources (4-7+8)	36,614	83,578	210,586	82.5	128.3	152.0
10. Personal transfers from abroad	2,690	5,873	12,518	69.5	118.3	113.1
11. Gross disposable private income from all sources (9+10)	**39,304**	**89,451**	**223,104**	**81.6**	**127.6**	**149.4**

[a] See note 24 in this chapter.

SOURCE: Central Bureau of Statistics and Bank of Israel.

Table II-11

PRIVATE DISPOSABLE INCOME, CONSUMPTION, AND SAVING, 1978-81

(IS million, at current prices)

					Percent annual increase					
					Nominal			Real[a]		
	1978	1979	1980	1981	1979	1980	1981	1979	1980	1981
Gross disposable private income from domestic sources	20,059	36,614	83,578	210,586	82.5	128.3	152.0	1.9	-0.5	15.3
Gross disposable private income from all sources	21,646	39,304	89,451	223,104	81.6	127.6	149.4	1.4	-0.8	14.2
Private consumption	14,576	27,956	62,037	149,750	91.8	121.9	141.4	7.1	-3.2	10.5
Gross private saving from domestic sources	5,483	8,658	21,541	60,836	57.9	148.8	182.4	-11.8	8.5	29.3
Gross private saving from all sources	7,070	11,348	27,414	73,354	60.5	141.6	167.6	-10.4	5.3	22.5
		Percentages								
Rate of gross saving from domestic sources	27.3	23.6	25.8	28.9						
Rate of gross saving from all sources	32.7	28.9	30.6	32.9						

[a] Deflated by the implicit price index for private consumption.

relatively high level of consumption (private and public), with a fairly small domestic saving.[25]

A glance at Table II-12 shows that the rate of gross national saving from total income available to the economy was unusually high at the beginning of the 1960s, thanks in no small measure to the sizable volume of unilateral transfers received from abroad. The public apparently viewed such income as being of a transitory nature, and so the rate of saving from this source was particularly high.

The Six Day War depressed the national saving rate, which stabilized at 12 percent until the end of the decade. In the early 1970s the rate turned up strongly, but after the Yom Kippur War it plummeted within two years to about half its level at the beginning of the 1970s. In recent years it moved up a notch and in 1977-81 averaged about 13 percent, similar to the rate during the boom period following the recession of the late 1960s; this year it again receded. The sharp changes in the national saving rate have invariably been caused by fluctuations in public sector saving. Thus we find that after the Six Day War the public sector's consumption expanded without a corresponding growth of its income, and after the Yom Kippur War a heavier public consumption resulted in a larger government demand surplus. This year the government's domestic demand surplus swelled drastically, due chiefly to a heavier subsidization of basic goods and services. There was also an increase in direct defense imports without any increase in foreign aid grants. The outcome of these developments was a larger public sector dissaving, from -7 percent in 1979-80 to -13 percent this year.

On the face of it, the national saving rate is not unduly low (apart from the deviant year 1981, which cannot be taken as indicative of any trend); but the development of net national saving (which is equal to net national investment) reveals a different picture (see Table II-12). This rate has sunk in recent years to a very low level owing to the obsolescence of the capital stock, which has not been counterbalanced by new saving. The gross national saving rate is not sufficient to renew the existing capital stock and to expand it at the pace achieved in earlier years. The rate of private saving apparently has not been high enough to make resources available for such a huge public consumption and simultaneously ensure rapid growth in the future.

[25] The rate of gross saving from GNP has been lower than the rate of saving from total income available to the economy, and was negative in most of the past few years: -3.7 percent in 1978, -1.1 percent in 1979, 0.9 percent in 1980, and -2.3 percent in 1981.

Table II-12
RATE OF NATIONAL SAVING FROM INCOME AVAILABLE TO THE ECONOMY,[a] 1960-81
(Percentages)

	Average 1960-64	Average 1967-70	Average 1971-73	1974	1975	Average 1976-78	1979	1980	1981
Gross national saving	20	12	21	15	10	13	14	14	10
Gross national saving, less discards	18	10	17	11	6	8	8	8	3
Net national saving	13	4	12	6	-1	1	1	1	-3

[a] Income available to the economy consists of the gross national product and unilateral transfers from abroad (less net public sector interest payments), at the effective rate of exchange.

SOURCE: Central Bureau of Statistics and Bank of Israel calculations.

Table II-13
RATE OF GROSS SAVING—NATIONAL, PUBLIC AND PRIVATE—FROM INCOME AVAILABLE TO THE ECONOMY,[a] 1971-81
(Percentages)

	Average 1960-69	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	Average 1971-81
Gross national saving	20	19	24	20	15	10	13	14	11	14	14	10	15
Gross public sector saving	-3	-8	-3	-8	-14	-17	-5	-6	-11	-7	-7	-13	-9
Gross private saving	23	27	26	27	29	27	18	21	22	21	21	24	24

[a] See the note to Table II-12.

Table II-A1

REAL GROWTH OF SOURCES AND USES, 1971-81

(Percentages)

	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981
Sources											
Gross national product	11.1	12.3	4.1	4.6	3.0	1.3	1.9	4.1	3.0	2.7	4.6
Imports [a]	10.9	1.7	33.6	2.4	4.2	-3.0	-2.0	10.6	3.5	-6.6	9.8
Civilian imports	19.1	4.0	17.0	9.0	-3.4	2.2	6.9	6.0	10.6	-10.8	7.9
Total sources	**11.0**	**8.6**	**14.2**	**3.6**	**3.7**	**-0.4**	**-0.2**	**6.8**	**3.6**	**-1.0**	**6.4**
Uses											
Private consumption	5.8	9.9	8.2	7.6	0.3	4.3	4.2	7.4	7.1	-3.2	10.5
Public consumption	1.2	-1.8	46.3	2.1	9.9	-10.4	-13.5	12.1	-8.7	7.6	7.7
Public consumption, less direct defense imports	10.3	1.2	19.1	14.0	-0.9	-5.2	-1.6	2.5	1.9	1.7	2.8
Gross domestic investment	21.8	12.8	5.3	-4.2	4.2	-12.5	-7.4	1.1	12.8	-17.4	-1.0
Domestic uses, less direct defense imports	10.8	8.9	9.5	5.7	1.1	-2.4	0.1	4.9	7.2	-5.4	6.5
Exports, at market prices [b]	23.8	12.5	4.9	5.9	2.0	16.2	11.7	5.2	3.3	6.3	3.9
Total uses											
Excl. direct defense imports	**13.4**	**9.7**	**8.5**	**5.7**	**1.3**	**1.7**	**3.0**	**5.0**	**6.2**	**-2.3**	**5.8**
Incl. direct defense imports	**11.0**	**8.6**	**14.2**	**3.6**	**3.7**	**-0.4**	**-0.2**	**6.8**	**3.6**	**-1.0**	**6.4**
Net factor payments abroad	11.4	5.1	56.1	-6.3	18.3	3.3	-23.2	14.7	24.8	2.6	-7.5
Gross domestic product	11.1	12.1	5.0	4.3	3.4	1.4	1.0	4.4	3.7	2.7	4.2
Gross domestic product, business sector [c]	12.4	13.9	2.0	3.7	2.9	0.5	0.0	4.5	3.5	3.0	5.3

[a] See note [a] to Table II-1.

[b] See note [b] to Table II-1.

[c] See note [c] to Table II-1.

SOURCE: Central Bureau of Statistics.

Table II-A2

ESTIMATED NONDWELLING INVESTMENT[a] BY INITIATING SECTOR, 1977-81

(Percent annual real increase)

	1977	1978	1979	1980	1981	IS million, at current prices 1981
Structures						
Public sector[b]	-5.7	-1.0	-5.1	-20.7	-13.1	5,851
Public sector companies[c]	6.0	7.5	-8.2	3.8	1.7	2,472
Total public sector	-3.2	1.0	-5.9	-14.7	-8.7	8,323
Private sector	-2.1	5.2	-9.4	-2.0	0.5	2,480
Total structures	**-3.0**	**1.8**	**-6.7**	**-12.2**	**-6.7**	**10,803**
Equipment						
Public sector	-22.1	26.6	22.1	-13.3	23.0	3,784
Public sector companies	-0.6	5.6	7.5	9.2	-6.8	4,601
Total public sector	-10.6	14.2	14.1	-1.7	5.9	8,385
Private sector	-11.0	11.9	21.0	-20.9	8.9	9,031
Total equipment	**-10.8**	**12.8**	**18.2**	**-13.3**	**7.6**	**17,416**
Structures and equipment						
Public sector	-10.2	5.5	2.6	-18.2	-0.2	9,635
Public sector companies	2.0	6.4	1.0	7.2	-3.7	7,073
Total public sector	-6.1	5.8	2.0	-9.0	-1.7	16,708
Private sector	-9.1	10.3	14.4	-17.6	7.2	11,511
Total structures and equipment	**-7.3**	**7.7**	**7.2**	**-12.9**	**2.1**	**28,219**

[a] Excludes transportation equipment.

[b] Includes nonprofit institutions and government business-type enterprises (railway, sea- and airports, and the Post Office), as well as investment in highways, afforestation, land reclamation, and some construction equipment.

[c] This category includes electricity and water production, the estimated investment in the chemical and refined petroleum products industries, mining and quarrying, and additional investment of government companies in industry, transportation, and services.

SOURCE: Bank of Israel.

Table II-A3

MEDIUM- AND LONG-TERM CREDIT BY DESTINATION, 1979-81

(IS million, at current prices)

Destination	1979	1980	1981	Percent annual real increase[a] 1980	Percent annual real increase[a] 1981
Business sector	3,285	6,898	16,172	-2.0	3.1
Industry	1,212	1,805	5,804	-31.7	43.1
Agriculture	601	1,130	2,994	-13.1	6.8
Construction	194	329	982	-18.2	26.3
Other	1,278	3,634	6,391	33.9	-21.8
Households	1,261	2,942	7,952	-9.1	15.8
Directed credit	615	1,793	4,222	13.6	0.9
Other credit	646	1,149	3,730	-30.7	39.1
Local authorities	545	860	2,073	-29.1	4.5
National Institutions	174	312	567	-19.4	-20.3
Total credit	**5,265**	**11,012**	**26,740**	**-9.9**	**5.9**

[a] Deflated by the relevant investment price indexes.

SOURCE: Bank of Israel.

Table II-A4

INDUSTRIAL INVESTMENT FINANCING,[a] 1979-81

(IS million, at current prices)

	1979	1980	1981	Percent annual real increase 1980	Percent annual real increase 1981
Medium- and long-term credit	1,212	1,805	5,804	-31.7	43.1
Thereof: Development loans	657	953	2,146	-33.5	0.2
Dollar-linked bond issues	—	116	113		
Investment grants	225	477	1,138	-2.8	6.2
Self-financing (incl. errors and omissions)	348	793	303		
Total industrial investment financing	**1,785**	**3,191**	**7,358**	**-18.0**	**2.6**
Percentage distribution of development loans by type of linkage					
Unlinked	86.1	22.6	15.5		
Loans in the pipeline[b]	13.9	64.0	47.9		
Full linkage	—	13.4	36.6		

[a] See note 13 in this chapter.

[b] Linked 100 percent to the dollar, or 70 percent to the consumer price index, plus a maximum of 2 percent interest.

SOURCE: Bank of Israel.

Table II-A5

CONSUMPTION OF NONDURABLE GOODS, 1978-81

(IS million, at current prices)

					Percent annual increase					
					Quantity				Price	
	1978	1979	1980	1981	1978	1979	1980	1981	1980	1981
Food, beverages, tobacco	3,964	7,106	17,858	37,648	4.7	1.9	-4.6	6.1	163.5	98.6
Household fuel and light	546	989	2,934	6,292	5.6	2.9	0	1.3	196.7	111.8
Clothing, footwear, and personal effects	1,170	1,853	3,363	10,443	17.9	-4.4	-10.7	23.2	103.3	152.0
Other	772	1,363	2,645	6,870	6.1	3.2	-14.3	14.8	126.4	126.2
Total	**6,452**	**11,311**	**26,800**	**61,253**	**7.1**	**1.0**	**-6.4**	**8.6**	**153.1**	**110.4**

SOURCE: Central Bureau of Statistics.

Table II-A6

PURCHASES OF DURABLE GOODS, 1978-81

(IS million, at current prices)

					Percent annual increase					
					Quantity				Price	
	1978	1979	1980	1981	1978	1979	1980	1981	1980	1981
Furniture	496	815	1,397	3,819	9.6	1.5	-15.7	22.8	103.4	122.7
Household equipment	733	1,556	3,216	6,911	31.8	52.8	7.9	22.9	91.5	74.9
Personal transportation equipment	406	889	885	4,317	29.8	43.1	-54.5	123.4	118.7	118.4
Total	**1,635**	**3,260**	**5,498**	**15,047**	**22.9**	**33.5**	**-11.1**	**39.0**	**89.7**	**96.8**

SOURCE: Central Bureau of Statistics.

Figure II-2
EXPENDITURE ON CURRENT CONSUMPTION GOODS, 1976-81
(IS million, at 1975 prices)

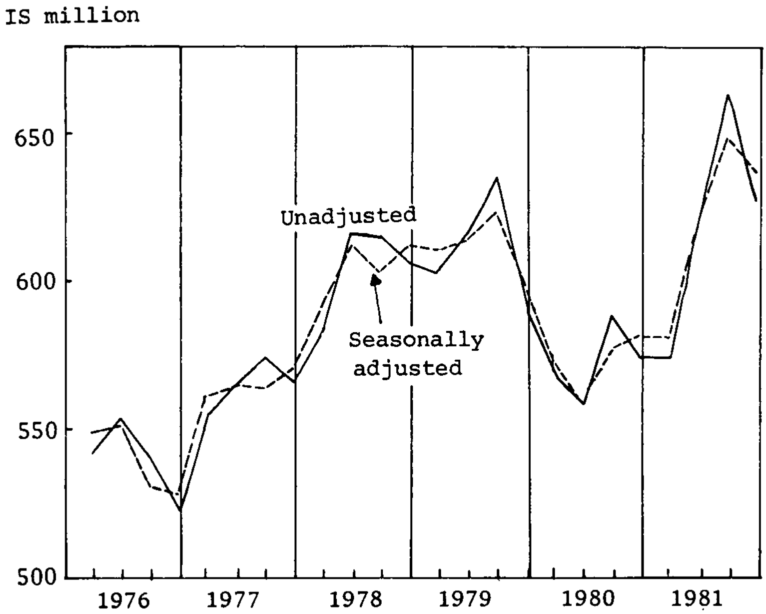


Figure II-3
PURCHASES OF DURABLE GOODS, 1976-81
(IS million, at 1975 prices)