

CHAPTER II

RESOURCES, USES, AND INCOME

1. MAIN DEVELOPMENTS

The Gross National Product rose by 1 to 3 percent in 1977, following a rise of 1.5–2.5 percent in the previous year and about 3.5 percent in 1975. The Gross Domestic Product of the business sector fell by about one half of one percent in 1977 according to one measure, and rose by approximately 3 percent according to an alternative measure¹.

In 1977 there was a continuation of trends that began to be felt in 1976, and in some cases even in 1975. The slowdown in the growth of the business sector product, which began in 1973, continued in 1977 as well. In the past few years, this slowdown was partly due to the sharp drop in the product of the construction branch; nevertheless, in the rest of the business sector, the product rose by only 5 percent in each of the past two years². These growth rates are lower than the growth of the product before 1973.

The actual product has continued to grow more slowly than the potential product³. This trend has continued since 1973, creating a situation in which the actual product of the business sector in 1977 was 22 percent lower than the potential product when labor input was measured according to the number of hours worked, and 28 percent lower when measured according to the working age population. Although the gap between the actual and potential product in 1977 was larger than that in 1967, when the previous economic recession had reached its lowest point, overt unemployment has not reached

¹ The lower limit of the estimates given above is derived from measuring the product as the difference between uses and imports. The upper limit is based on alternative estimates derived from indicators of the output in various economic sectors. At this point we have no means of determining which of the two measures is the "correct" one. The discussion in this chapter is generally based on the measure of uses; we used the measure based on economic sectors only a few times. In each case, the reader's attention is drawn to the existence of an alternative measure.

² According to the measure derived from economic sectors. See also footnote 1 above.

³ The potential product is that product which it is possible to derive from the growth of production factors, labor and capital, and according to the long-term growth of productivity in production. A more detailed explanation appears in Section 4 below.

TABLE
RESOURCES AND

	1974	1975	1976	1977
	(IL million, at current prices)			
RESOURCES				
1. GNP	52,979	75,268	96,895	138,927
2. Imports ^b	38,435	56,781	73,547	100,884
3. Imports, excl. ships, aircraft, & direct defense imports	30,864	43,526	58,472	86,641
4. Import surplus (2)-(14)	20,021	30,123	34,160	35,681
5. Total resources for domestic use (1)+(4)	73,000	105,391	131,055	174,602
6. Total resources (1)+(2)	91,414	132,049	170,442	239,805
USES				
7. Private consumption	33,237	46,676	62,880	88,148
8. Public consumption	22,073	33,935	41,144	51,983
9. Public consumption, excl. direct defense imports	15,250	20,976	26,499	38,721
10. Civilian public consumption	5,710	8,041	11,039	17,511
11. Gross domestic investment ^c	17,690	24,780	27,031	34,471
12. Gross domestic investment, excl. ships & aircraft	17,011	24,523	26,794	33,578
13. Total domestic uses (7)+(8)+(11)	73,000	105,391	131,055	174,602
14. Exports ^d	18,414	26,658	39,387	65,203
15. Exports, excl. ships & aircraft	18,345	26,619	39,194	65,115
16. Total uses, excl. ships, aircraft & direct defense imports (7)+(9)+(12)+(15)	83,843	118,794	155,367	225,562
17. Total uses (13)+(14)	91,414	132,049	170,442	239,805
18. Net factor payments abroad	1,577	2,753	3,351	4,138
19. Gross Domestic Product (1)+(18)	54,556	78,021	100,246	143,059
20. Gross product of housing services	6,193	8,385	10,720	13,482
21. Product of public services & nonprofit institutions	9,146	12,724	16,675	27,376
22. GDP of business sector (19)-(20)-(21)	39,317	56,912	72,851	102,201

^a Calculated at fixed 1970 prices until 1975. From 1976 it is calculated at fixed 1975 prices.

^b Valued at CIF prices and at the effective rate of exchange. Includes imports from the administered areas; excludes interest paid by the public sector.

II-1

USES 1974-1977

Annual increase or (-) decrease									
Quantity ^a					Price				
Average					Average				
1971-1972	1973-1974	1975-1977	1976	1977	1971-1972	1973-1974	1975-1977	1976	1977
(percent)					(percent)				
11.6	4.5	2.0	1.6	1.0	13.5	27.8	35.2	26.7	42.0
7.2	16.8	-0.5	-2.6	-3.0	18.3	29.5	38.6	33.0	41.4
12.5	12.9	1.8	1.7	5.0	17.3	31.3	38.6	32.0	41.1
-7.9	36.7	-11.7	-16.9	-22.4	23.1	30.0	37.3	36.5	34.5
7.8	10.0	-1.4	-3.7	-4.8	15.0	29.3	35.7	29.1	39.9
10.0	8.8	0.9	-0.2	-0.7	15.1	28.7	36.6	29.3	41.7
7.8	8.5	2.7	4.6	3.5	13.7	28.7	34.8	28.8	35.5
-0.3	22.3	-4.7	-8.7	-13.9	17.5	26.4	39.7	32.8	46.8
5.7	16.5	-1.9	-3.2	-1.7	15.1	29.2	39.1	30.6	48.6
6.5	5.4	4.1	5.0	2.6	16.7	29.8	39.7	30.7	54.7
17.2	0.9	-6.3	-12.5	-10.4	15.1	33.4	33.2	24.7	42.3
18.0	0.3	-5.8	-12.4	-11.5	15.1	32.9	33.2	24.7	41.5
7.8	10.0	-1.4	-3.7	-4.8	15.0	29.3	35.7	29.1	39.9
19.1	4.6	9.4	13.7	12.9	15.6	26.8	39.3	30.0	46.6
18.8	4.7	9.5	13.3	13.4	15.6	26.7	39.3	30.0	46.5
11.8	7.1	2.0	1.7	2.4	14.6	29.2	36.3	28.6	41.7
10.0	8.8	0.9	-0.2	-0.7	15.1	28.7	36.6	29.3	41.7
7.6	21.1	1.8	-0.6	-10.5	18.4	37.0	35.4	22.4	38.0
11.5	4.8	2.0	1.5	0.6	13.6	28.0	35.2	26.5	41.9
9.8	9.4	7.7	8.7	6.0	20.3	35.7	21.0	17.6	18.7
4.8	11.4	2.0	1.1	2.1	16.9	26.6	41.3	29.7	60.8
13.1	3.0	1.2	0.6	-0.6	12.2	27.1	35.9	27.2	41.2

^c Less ship and aircraft exports, including ships and aircraft from local production.

^d Valued at FOB prices and at the effective rate of exchange. Includes exports to the administered areas; excludes interest received by the public sector.

NOTE: In May 1978, the National Account data from 1968 onward was corrected.

SOURCE: Central Bureau of Statistics.

significant proportions in recent years. Part of the explanation for this lies in the decline in the rate of participation in the civilian labor force, in the large increase in the number of people employed in the public sector, in the decline in the number of employed from the administered areas, and in the decrease in the number of hours of work per employee. Nevertheless, it appears that this time, latent unemployment has grown to substantial proportions.

The current account deficit fell by about \$750 million in 1977. (When direct defense imports and trade with the areas is excluded, the deficit dropped by about \$220 million.) This is the second year in a row that the deficit in the current account improved, due to changes that took place during this period in both imports and exports. Regarding imports, growth began to slow in 1975. This was the result of exogenous factors (see below) as well as a policy designed to rein in domestic demands following the great increase in imports and in the import surplus of 1973 and 1974 (In these years import prices rose, and defense imports grew at a substantial rate.) At that time it was necessary to adopt such a policy, since it was not possible to increase exports to the required extent in the short run, despite the high price that had to be paid in terms of lost product.

Regarding exports, since 1976 they have been growing substantially, together with the slowdown in the growth of imports; this caused a decline in import surplus. The strengthening of the growth rate of exports followed three years of slowdown caused mainly by the recession in the world market, which was related to the oil crisis. These changes in the growth of exports took place although there has been no clear-cut increase in the profitability of exports in the past three years (see Chapter V).

For the most part, the policy of restraint of domestic demands, which had been harsh in 1976, did not continue in 1977.

Excluding direct defense imports, public consumption declined by about 1.5 percent in 1977. This was a continuation of a decline which began in 1976 (3 percent), as well as the public sector⁴: excluding public housing construction, investments declined by approximately 8 percent in 1977, after a drop of about 15 percent in 1976. The sharp drop in public housing construction is particularly striking: 50 percent in 1977, and about 25 percent in 1976.

Total direct public sector expenditures fell by about 7.5 percent in 1977, which is similar to 1976.

⁴ Investments of the government, the local authorities, the National Institutions, government enterprises, nonprofit institutions, and public housing construction.

TABLE II-2
DISTRIBUTION OF RESOURCES AND USES^a, 1976-1977
 (percent, at current prices)

	Average			1976	1977
	1971- 1972	1973- 1974	1975- 1977		
USES					
Private consumption	36.6	35.5	36.3	36.9	36.8
Public consumption	20.8	24.8	23.8	24.1	21.7
Civilian	6.7	6.3	6.6	6.5	7.3
Noncivilian	14.1	18.5	17.2	17.7	14.4
Gross domestic investment	20.6	19.7	16.3	15.9	14.4
Exports	22.0	20.0	23.6	23.1	27.2
Total uses	100.0	100.0	100.0	100.0	100.0
RESOURCES^b					
Gross National Product	63.5	58.1	57.2	56.8	57.9
Imports ^b	36.5	41.9	42.8	43.2	42.1
Total resources	100.0	100.0	100.0	100.0	100.0
USES^b					
Private consumption	39.2	39.2	39.6	40.5	39.1
Public consumption, excl. direct defense imports	16.3	17.8	17.3	17.1	17.2
Gross domestic investment, excluding ships and aircraft	20.9	20.8	17.5	17.2	14.9
Exports, excluding ships and aircraft	23.6	22.2	25.5	25.2	28.9
Total uses^b	100.0	100.0	100.0	100.0	100.0
RESOURCES^b					
Gross National Product	68.1	64.6	62.5	62.4	61.6
Imports ^b	31.9	35.4	37.5	37.6	38.4
Total uses^b	100.0	100.0	100.0	100.0	100.0

^a See note g to Table II-1.

^b Excluding direct defense imports, ships and aircraft.

SOURCE: Central Bureau of Statistics.

In 1977 the growth of tax rates which took place in 1976 halted. The lessened reliance on taxes had significance for the rate of inflation: it contributed to a decline in the rate of price rises in 1977 (until October, when the foreign currency reform was adopted) in relation to the previous year. It should be remembered that in recent years there was a substantial growth in transfer payments to the public; if it had not been for this policy, the tax rate for 1976 would have been even higher.

Within the framework of the restraint of public consumption in the past two years, the most notable cut was in public defense consumption. However, in civilian public consumption, especially the number of people employed in the public sector, the substantial growth of previous years continued. This step went contrary to the trend of helping export industries to mobilize workers. Nor was the wage increase in the public sector, which indirectly harmed exports by influencing wages in other sectors and raising incomes in the domestic economy, in the direction of the desired structural change. It should nevertheless be remembered that the wage increase in the public sector came after two years in which wages in this sector lagged behind those in the business sector.

It is possible to evaluate the total effect of the public sector by using an estimate of the public sector demand surplus (see Chapter XI). Real demand surplus (when imports and exports are calculated according to the official exchange rate⁵) did not change in 1977, after falling by about 40 percent in 1976.

The lack of a rise in the total tax burden in 1977 caused an increase in real private disposable income⁶. In sum, this income grew by about 6 percent after falling by 6 percent in 1976 and remaining stable in 1975. Despite this fact, real consumption rose by only 3.5 percent, after rising by 4.5 percent in 1976 and being stable in 1975. The fact that despite the end of the policy of lowering real disposable incomes the growth of private consumption was less than the growth in the previous year needs an explanation. It appears that special developments (discussed in this chapter last year in order to explain the drop in savings rates at that time) caused a slight rise in these rates in 1977. The sharp decline in real disposable income the previous year caused a delay in the adjustment of consumption in 1976; it is possible that this gap was closed somewhat in 1977. In 1976, savings in financial assets were adversely affected because of the harm to savings in bonds; it is possible that this development concluded in 1976. In addition, retroactive

⁵ The evaluation of import and export for calculation of the demand surplus in the official exchange rate includes in fiscal absorption the surplus of taxes on imports over export incentives, in addition to the taxes discussed in this chapter. The real change in demand surplus is also influenced by the wage per employee in the public sector.

⁶ Disposable private income from internal sources without subtracting compulsory loans.

wage payments were made in 1977 which also helped to raise the saving rate due to the smaller propensity to spend from this kind of payment.

In the area of money in 1977 (until October, when the foreign currency reform was adopted), there was expansion compared with the two previous years (see Chapter XVIII); at the same time, the demand for money rose with the slowdown in the inflation rate (until the reform) and with the increase in activity in the Stock Market and the apartment market (the latter occurring toward the end of the year). It appears that this monetary expansion had no effect on economic activity until the beginning of 1978.

The economic slowdown of recent years had a strong effect on investments other than those of the public sector: they fell by about 6 percent, compared with 9 percent in the previous year. If it had not been for subsidies granted through the Law for the Encouragement of Capital Investments, under the inflationary conditions of the past years, the decline in investment might have been even sharper (see Chapter IX "Investments and Construction").

The inflationary process which began in 1973, mainly as a result of production cost-push pressures, continued in 1977. Until October 1977 there was a decrease in the contribution of indirect taxes and the rise in import prices to inflation; the contribution of wages increased, as there was a large rise in the real wage. During this period there was a certain decline in the rate of price increases. Nevertheless, at an annual average, price increases were similar to those of previous years (the Consumer Price Index rose by about 35 percent), due to the sharp increase in prices following the foreign currency reform (mainly caused by the rise in import prices) and during the previous year.

At the end of October a reform was introduced affecting the balance of payments policy. There will be a broad discussion of the different aspects of this policy in Chapter III; here we will only mention some allocation of resources: the unification of exchange rates for export reduced the possibilities of fraud and inefficient export production; in addition, the discrimination against service exports, which existed before this policy was adapted, was eliminated. On the other hand, the effective devaluation on imports was larger than that on exports. Thus there was a withdrawal from the trend toward reducing the protection on Israeli products, which is supposed to encourage more efficient production of import substitutes.

2. USES

In 1977 total uses, excluding direct defense imports, ships and aircraft, rose by 2.4 percent. In the two previous years, 1975 and 1976, the rise was similar — about 2 percent,

while in the years 1971 to 1974 the annual change was 7 to 12 percent. There is also great similarity in the past three years, and especially in 1976 and 1977, in the rates of change in most uses.

The slowdown in uses over the past three years was not generally dependent on factors related to economic policy; but in 1976 they were joined by a powerful government restraint policy. Of the factors which were independent of economic policy, the principal one was the decline in the number of new immigrants which began in 1973. This factor has apparently led to a slowdown in the growth of demand for consumption, but especially for investment, and its effect was felt particularly in the area of investment for housing construction (see below). Another factor was the slackness in Israel's export market following the oil crisis. This slackness has caused the growth of Israeli exports to decelerate since 1973. As mentioned, the restraint policy of the government was added to these factors in 1976⁷. This policy was expressed in a restraint of the direct demands of the government in the area of public consumption and investments, and in higher taxes. The purpose of the restraint policy was to halt the growth of imports, since the current account deficit reached proportions which could not have been financed for a long period. Another aim of this policy was to increase exports by redirecting output and production factors to export instead of production for the domestic market.

Since in the short run it was not possible to increase exports to an extent which would sufficiently halt the growth of the deficit, and the possibilities of replacing imports over a short period are limited in the Israeli economy, there was no choice but to reduce imports with a drastic curbing of demands, even though this was accompanied by a drop in the growth rate of the economy to below the potential rate.

The conditions of the economy after the Yom Kippur War may have required this, but the real test of the government's policy lies in its ability to encourage export and the production of import substitutes so that the economy will return to maximum growth as quickly as possible.

Public consumption, excluding direct defense imports, declined by about 1.5 percent in 1977 after dropping by about 3 percent in 1976 and one percent in 1975. The restraint

⁷ In fact, the first buds of this policy could already be seen in many fields by 1975, although in that year the restraint policy was contradicted by the large increase in transfer payments to the public. In 1977 as well, the results of restraint policy are in doubt if we take into account the large wage increases in the public sector and consider the surplus of import taxes over export subsidies as public sector absorption.

TABLE II-3

CONTRIBUTION OF FINAL USES TO THE GROWTH OF TOTAL USES, 1975-1977

	1975	1976	1977	Annual increase or (-) decrease				Contribution of uses to growth of total uses			
				1974	1975	1976	1977	1974	1975	1976	1977
	(IL million 1975 prices)			(percent, fixed prices) ^a				(percent, fixed prices) ^a			
1. Investments of the government sector and nonprofit institutions, excl. ships and aircraft	5,534	4,720	4,332	1.0	12.9	-14.7	- 8.2	0.0	0.5	-0.7	-0.3
2. Building of public housing	3,631	2,731	1,427	11.2	8.3	-24.8	-47.7	0.3	0.2	-0.8	-1.1
3. Public consumption, excl. direct defense imports	20,976	20,297	19,961	14.1	- 0.8	- 3.2	- 1.7	2.4	-0.1	-0.6	-0.3
4. Total (1)+(2)+(3)	30,141	27,748	25,720	11.4	2.5	- 7.9	- 7.3	2.7	0.6	-2.0	-1.7
5. Exports, excl. ships and aircraft	26,619	30,148	34,184	5.5	2.2	13.3	13.4	1.3	0.5	3.0	3.3
6. Total (4)+(5)	56,760	57,896	59,904	8.6	2.4	2.0	3.5	4.0	1.1	1.0	1.7
7. Private consumption	46,676	48,831	50,536	8.4	0.1	4.6	3.5	3.4	0.0	1.8	1.4
8. Other investments, excl. ships and aircraft	15,358	14,041	13,270	-2.0	5.7	- 8.6	- 5.5	-0.3	0.7	-1.1	-0.6
9. Total (7)+(8)	62,034	62,872	63,806	5.8	1.4	1.4	1.5	3.1	0.7	0.7	0.8
Total uses, excl. direct defense imports ships and aircraft (6)+(9)	118,794	120,768	123,710	7.1	1.9	1.7	2.4	7.1	1.9	1.7	2.4

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

^a See footnote a, Table II-1.

of domestic public consumption⁸ followed two years, 1973 and 1974, in which public consumption grew at an unusual rate as a result of the Yom Kippur War and the defense situation which followed.

Keeping this in mind it should be emphasized that in 1977 the relatively large increase in civilian public consumption which began to be felt in 1975 continued, mainly in the number of people employed in the public sector. This growth stands in direct contradiction to the policy of restraining domestic demands adopted by the government. Especially serious is the substantial growth in the number of people employed in the public sector and the large increase in their wages. These factors made the development of exports more difficult, directly by mobilizing workers who should have been absorbed in the export sector, and indirectly, through the growth of wages in the economy, which has made our products more expensive in foreign markets. As previously mentioned, the increase in wages in the public sector has influenced the rest of the economy, increased the income of the public, and made more difficult the process of directing output from domestic to export production.

Regarding direct investment of the public sector, the trends of previous years also continued. As in 1976, the decline in this investment contributed to a decrease of about 1.5 percent in total uses, excluding direct defense imports, ships and aircraft. Particularly notable was the 50 percent decline in public construction for housing (which is included in direct investment of the public sector), which contributed one percent. This decline in public construction for housing is the result of the development of the construction branch in recent years. In 1973 and 1974 the number of new immigrants fell, causing a drop in the demand for apartments. Public building starts for housing continued to grow greatly until the beginning of 1975, even though market conditions did not justify this. The result was large supply surpluses of apartments. The decrease in building starts for public housing only began during the second quarter of 1975, and with the same steepness that had characterized the previous rise in starts. As a result there was a large-scale decrease in the public housing branch in 1976 and 1977. It should be noted that the private housing construction branch adjusted its activity better to the changes in demand, so there was no need for the branch to reduce its activity so drastically in the past few years.

There was no increase in the tax burden in 1977, while in the previous year a substantial increase had been recorded. The growth in net indirect taxes⁹ on domestic production

⁸ Public consumption, excluding direct defense imports. Domestic public consumption in this chapter includes civilian import n.e.s. and therefore differs from domestic public consumption as used in Chapter XI.

⁹ Indirect taxes less subsidies.

was similar to the rise in the Net National Product. The growth in total compulsory payments less transfer payments was also similar to the growth of the national income. Thus in 1977 the use of taxes as a policy measure for restraining domestic economic activity ceased, after being significant in 1976. As a result, disposable private income¹⁰ rose by about 6 percent in real terms after falling by about 6 percent in 1976 (with no change in 1975). In 1977 private consumption grew by about 3.5 percent in real terms and contributed about 1.5 percent to total uses. In 1977 there was a slight rise in the rate of saving, after it fell sharply in 1976. As in the previous two years, there was a significant increase in consumption by nonprofit institutions and housing services; these are not the result of direct or current decisions of households regarding the size of their consumption.

In addition to restraining domestic demands, the government has worked in recent years to increase exports by increasing their profitability. This was expressed in devaluations of the Israeli pound at a large cumulative rate. In 1977, before the election, the creeping devaluations continued, but at a very low frequency. In October there was a large devaluation of the pound together with floating of the exchange rate and a cancellation of export subsidies and import levies. As in previous years, the formal devaluation in 1977 was only marginally effective due to the rise in domestic expenditures, which offset the major portion of the devaluation. In 1977 there was a large increase in the share of wage rises in the direct factors eroding the devaluation. Nevertheless, according to various indicators there was a certain improvement in export profitability in 1977. Another factor which had a positive effect on exports was the standstill in the general level of demand, expressed in the large gap between the potential product and the actual product (see Section 4) and a certain rise in the rate of unemployment. In contrast, there was only slight growth of Israel's export markets in 1977 compared to the previous year (see Chapter VII, "Israel and the World Economy"). Taken as a whole, exports rose by approximately 13 percent in 1977 (as in the previous year) and contributed more than 3 percent to the growth of total uses (excluding direct defense imports, ships and aircraft) and a growth of 5 percent in the business sector product¹¹.

In the face of developments in other uses, the growth of exports in recent years has not been sufficient to lead to significant growth of the National Product. Perhaps there was no way to avoid adopting a policy of drastic demand restraint after the Yom Kippur War in order to reduce imports; but due to the heavy price paid in loss of product, the

¹⁰ Disposable private income from internal sources without subtracting compulsory loans.

¹¹ According to input-output computations. It should be remembered that the total growth in the business sector product according to input-output computations comes to approximately 3 percent, as opposed to a decline of one half of one percent according to the measure from the side based on uses.

TABLE II-4

EFFECT OF RESOURCE USE ON THE BUSINESS SECTOR PRODUCT^a
(BASED ON "INPUT-OUTPUT" ANALYSIS), 1974-1977
 (percent, 1968-69 prices)

	Distribution of the product by final use				Contribution of uses to growth of the product			
	1974	1975	1976	1977	1974	1975	1976	1977
Private consumption	40.3	40.2	40.9	40.8	2.2	0.4	1.2	1.1
Public consumption	13.1	12.5	11.3	10.4	2.5	-0.4	-1.1	-0.6
Gross domestic investment ^b	21.8	21.9	18.8	15.9	-0.2	0.4	-2.8	-2.4
Exports	24.8	25.4	29.0	32.9	1.5	0.9	0.4	4.8
Total product	100.0	100.0	100.0	100.0	6.0	1.3	1.3	2.9

^a Gross domestic product at factor cost, excluding the product originating in public sector and nonprofit institution services.

^b Excludes changes in stocks. Due to this, and to the different definitions and estimation techniques, the difference in this table is not the same as the difference shown in Table II-1.

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) or nonprofit institutions; public consumption excludes compensation of public sector employees; and exports exclude factor payments abroad, rent, and sundry domestic factor income. In addition, the direct import component has been deducted from all uses.

SOURCE: Central Bureau of Statistics data adjusted according to input-output data for 1968-69.

economic policy should have increased the profitability of exports so that the loss of product would have been extended over as short a time as possible. It would appear that in recent years the profitability of exports has risen no more than in previous periods (see Chapter V). It is possible that preventing the growth in the number of people employed in the public sector and a firmer stand against wage demands would have led to a greater rise in export profitability.

The standstill in the National Product also caused continuation of the decline in investments other than those of the public sector. The decline might have been greater had it not been for the large subsidy given to investments through the Law for the Encouragement of Capital Investments. The utilization of capital in the economy apparently fell once again in 1977.

3. RESOURCES

The value of imports in the domestic market fell by about 3 percent in 1977, which is similar to the decline noted in 1976. For the past three years a slight annual average decline in total imports was seen. The value of imports, excluding direct defense imports, ships and aircraft, rose by approximately 5 percent in 1977, compared with about 2 percent in 1976. In the past three years, imports as defined in this way have grown at an annual average of about 2 percent.

This slow growth of imports over the past three years in comparison to the large growth during the years 1971 to 1974 is the most important of those developments which caused the decline in the import surplus of the current account during the past two years.

In 1977 the slow growth of the National Product which was characteristic of the previous two years continued: the Gross National Product grew by about one percent at market prices in 1977, after rising by about 1.5 percent in 1976. In 1971 and 1972 the Product grew at an annual average rate of about 12 percent; in 1973 and 1974, the growth rate was about 4.5 percent, and in the years 1975 to 1977 the rate was 2 percent at an annual average.

Developments in the Gross Domestic Product in the past three years were similar to those in the Gross National Product. Nevertheless, the Gross Domestic Product of the business sector developed more slowly in the past two years: there was a decline of about one half on one percent in 1977 after a rise of about the same percentage in the previous year.

The source of the data given above on the development of the Product is a measure of

TABLE II-5

COMPOSITION OF RESOURCES FOR DOMESTIC USE, 1976-1977
(percent)

	Average			1976	1977
	1971- 1972	1973- 1974	1975- 1976		
(At current prices)					
A. Total resources for domestic use					
Import surplus ^a	18.6	27.3	25.0	26.1	20.4
GNP	81.4	72.7	75.0	73.9	79.6
Total	100.0	100.0	100.0	100.0	100.0
B. Total resources for domestic use, less direct defense imports, ships and aircraft					
Import surplus ^a	10.9	17.0	16.1	16.6	13.4
GNP	89.1	83.0	83.9	83.4	86.6
Total	100.0	100.0	100.0	100.0	100.0
(At fixed prices) ^b					
A. Total resources for domestic use					
Import surplus ^a	17.1	24.2	24.4	24.6	20.1
GNP	82.9	75.8	75.6	75.4	79.9
Total	100.0	100.0	100.0	100.0	100.0
B. Total resources for domestic use, less direct defense imports, ships and aircraft					
Import surplus ^a	9.9	14.0	15.9	15.6	13.7
GNP	90.1	86.0	84.1	84.4	86.3
Total	100.0	100.0	100.0	100.0	100.0

^a Calculated at the effective rates of exchange.

^b Until 1974, at 1970 prices; from 1975, at 1975 prices.

SOURCE: Central Bureau of Statistics.

uses and imports. It is also possible to derive an estimate of the growth of the Product, with certain assumptions, by using a measure of the development of output in the various economic sectors¹² (see Table II-6). This measure points to a much greater growth in the Product in 1977 than the alternative measure. This gap also existed in the same direction in 1976, but in 1977 the gap is even greater. Using the measure of uses, the Gross Domestic Product rose by about one half of one percent in 1977; using the measure of economic sectors, it rose by about 3 percent. The gap is even greater in relation to the estimated growth of the business sector product (excluding housing): from uses, there is a decline of about one half of one percent, while from the economic branches there is an increase of almost 3 percent. In addition, the calculation of the growth in the business sector product derived from input-output computations (see Table II-4), shows an increase of about 3 percent in the business sector product.

The development of the product in the economic sectors is very similar to the development in the previous year. Again there is a large decrease in the product of the construction branch and a large increase in the agriculture branch product.

In 1977 the number of local workers grew by 2.5 percent, after growing by about one percent in each of the two previous years. In contrast, the number of hours of work rose by about 0.5 percent, which is slightly lower than in the previous two years. The number of people employed in the business sector rose by about 2 percent in 1977, after rising by one half of one percent in 1976 and falling by one half of one percent in 1975. The number of hours of work in the business sector rose by about one half of one percent in 1977 after being stable in 1976 and rising by about one and one half percent in 1975.

These developments in employment reflect a growth of latent unemployment when viewed against the background of the growth of the product (if long-term growth in the productivity of production is assumed). We have no full explanation of the growth of latent unemployment and the nonappearance of large-scale overt unemployment. Part of the explanation may lie in the fact that the working age population grew at an annual average of 2.5 percent between 1973 and 1977, while the number of local employed in the business sector grew by 1.2 percent. This difference is explained by a drop in the participation rate, a slight rise in the unemployment rate, a decline in the number of employed from the administered areas, and the especially large increase in the number of people employed in the public sector. In addition, there was a substantial decline in the number of hours per employed in the business sector: the total number of hours of work in the

¹² In any comparison between the two estimates it is important to remember that the measure of the economic sectors does not take into account inventory changes.

TABLE

NET DOMESTIC PRODUCT AT FACTOR COST^a,

	Real annual increase		
	1966	1967	1973
			(percent at
1. Agriculture, forestry, fisheries	3.3	15.5	-2.0
2. Industry, mining, quarrying	1.3	-3.1	4.5
3. Construction, electricity, water	-12.4	-17.0	1.0
4. Transportation & communication	0.0	1.0	3.0
5. Finance, trade, services	2.1	-1.9	-3.5
6. Ownership of housing	7.0	5.5	9.8
7. Public & community services	7.7	12.2	17.8
8. Net domestic product ^a			
a. Total economy	1.4	0.9	4.1
b. Business sector (excl. housing) ^b	-0.9	-2.7	0.5

^a Before inventory and depreciation adjustments.

^b Defined as total product less public and community services.

NOTE: The real rates of change listed here do not necessarily coincide with those in Tables II-1 and II-8, since they have been calculated here according to sector.

BY SECTORAL ORIGIN, 1966-1967 AND 1973-1977

or (-) decrease				Sectorial structure		
1974	1975	1976	1977	1975	1976	1977
fixed prices)				(percent at 1975 prices)		
11.0	10.2	8.5	9.0	6.0	6.3	6.7
3.1	5.1	5.1	4.3	23.0	23.6	23.9
5.2	0.0	-10.4	-10.3	11.9	10.4	9.0
4.3	-0.9	7.4	8.0	7.5	7.8	8.2
-1.7	4.3	2.8	3.6	24.1	24.2	24.4
8.1	6.6	8.7	5.5	8.8	9.3	9.5
5.3	2.8	1.0	2.1	18.7	18.4	18.3
3.9	3.5	2.5	2.9	100.0	100.0	100.0
3.1	3.1	2.3	2.8	72.4	72.3	72.2

SOURCE: The sources for calculating the real rates of change are as follows:

- (1) Current account of agriculture, with the data converted from agricultural into calendar-year terms, except for 1977, which has been calculated according to the agricultural year.
- (2) Index of industrial production. In 1977 a correction was made, taking into account a decline in the number of hours of work possible.
- (3) Construction output, as calculated in Chapter VIII; electricity and water are calculated according to input-output data.
- (4) As calculated in Chapter XV. In calculating the rates of change there the change in the output of each subbranch was weighted by its share in the 1968/1969 product, as estimated on the basis of input-output data.
- (5) According to the rates of changes in hours of work, as measured by manpower surveys.
- (6) According to national accounts data.
- (7) According to national accounts data.

TABLE

**CHANGE IN ACTUAL DOMESTIC BUSINESS PRODUCT,
1966-1967**

(Percent)

	Annual average				
	-1961 1965	-1966 1967	-1968 1972	-1966 1972	-1973 1977
	(Quantitative changes)				
1. GDP of business sector from uses, excluding housing	11.1	0.0	13.5	9.4	1.9
2. Net domestic business product from sectors, excl. housing	-1.8	-1.8	11.8	7.7	2.3
3. Net domestic business product from sectors, excl. housing and construction					3.4
4. Gross fixed capital stock, excluding housing ^a	10.4	7.4	7.6	7.5	7.4
5. Working-age population	4.4	3.4	3.4	3.4	2.5
6. Domestic workers	4.5	-3.8	6.1	3.2	1.2
7. Work hours	4.2	-5.8	6.6	3.0	0.0
8. Product per factor unit (productivity) ^b					
a. By work hours	4.5	1.4	6.1	4.7	-0.5
b. By workers	4.3	0.0	6.4	4.6	-1.3
9. Potential product ^c					
a. When labor input is measured according to work hours		3.1			7.2
b. When labor input is measured according to working-age population		9.5			9.0 (ratios)
10. Share of product gap ^d in potential product					
a. When labor input is measured according to work hours		3.0			5.0
b. When labor input is measured according to working-age population	8.7				6.5

^a Capital stock at the beginning of the year.

^b Weighing labor input as 2/3.

^c The growth of productivity for calculating the potential product of the business sector is assumed to be 4.6 percent, which is the average annual growth between 1961 and 1977, when labor input is measured according to hours of work and weighted as 2/3. Similar results are received when labor input is weighted as 1/2.

**PRODUCTION PRODUCTIVITY, AND POTENTIAL PRODUCT,
AND 1973-1977**

Annual increase or (-) decrease							1967	1977
1966	1967	1973	1974	1975	1976	1977	compared to 1965	compared to 1972
-0.9	0.9	2.1	4.0	3.5	0.6	-0.6	0.0	9.9
-0.9	-2.7	0.5	3.1	3.1	2.3	2.8	- 3.6	12.3
	0.5	2.7	3.8	4.9	5.0			18.0
8.6	6.2	8.3	9.3	7.7	6.6	5.4	15.3	43.2
3.8	3.0	3.6	3.0	2.0	1.9	- 2.1	6.9	13.2
-0.9	-6.6	4.3	-0.7	-0.3	0.5	2.0	- 7.4	5.9
-1.7	-9.8	-3.4	0.7	1.7	0.2	0.5	-11.3	-0.4
-2.6	5.6	1.6	0.4	-0.2	-1.7	-2.6	2.9	-2.5
-3.1	3.2	-3.3	1.4	1.1	-1.9	-3.6	0.0	-6.3
6.4	-0.1	5.1	8.4	8.5	7.0	6.9	6.3	41.4
10.2	8.9	10.0	9.9	8.7	8.3	7.9	20.0	53.6
6.9	-1.0	2.9	4.1	4.6	6.0	7.0	6.0	21.7
10.1	7.3	7.2	5.4	4.8	7.1	7.9	16.7	28.5

^d Potential product minus actual product from uses.

SOURCES: Product from uses - Table II-1; product from sectors - Table II-6; workers, work hours and working-age population - Central Bureau of Statistics; capital stock - Bank of Israel.

business sector did not change between 1972 and 1977. Nevertheless, as already indicated, these explanations are not complete: the increase of the actual product of the business sector in the past four years, totalling about 10 percent, should have caused a decline in labor input, if it is assumed that total productivity continued to grow at rates recorded in the past. The stability of labor input means an accumulation of latent unemployment.

4. THE ACTUAL AND POTENTIAL PRODUCT

The slow growth of the Product recorded in 1977 widened the gap between the potential and the actual product; this gap was already fairly wide in the previous year.

The gap between the potential and actual product is calculated in this chapter for the business sector excluding housing.

The calculation of the potential product is made using the following assumptions:

1. The potential growth in the number of employed is reflected by the growth of the working age population. This assumption is based on the fact that in periods of full employment, or over an entire business cycle, the growth in the number of people employed in the business sector was similar to the growth in the working age population, while in periods of slack demand, the growth in the number of employed lags behind the growth in the working age population (see Table II-7) due to a drop in the participation rate in the work force and a rise in the unemployment rate. Some of the decline in the participation rate in the labor force and the number of hours of work per employed which took place in recent years may not be the result of slackening demand, so the potential product may have an upward bias. In order to examine the effect of this factor, we have computed the potential product according to the actual growth in the number of hours worked. On the other hand, it is reasonable to assume that the relatively slow population growth in recent years, which is primarily due to the decline in the number of new immigrants, is also partly due to the standstill in economic activity, and therefore the potential product may be underestimated.

2. The potential growth in capital stock is reflected by the actual growth in capital stock excluding housing. Since the standstill in economic activity undoubtedly had an effect on the slowdown in the growth of capital stock through the drop in investments, this may have caused a downward bias in the potential growth of the product.

3. The potential growth in productivity is reflected by the actual growth which took place between 1961 and 1972, which included years of full employment growth (1961 to 1965), and a subperiod in which there was a complete business cycle (1966 to 1972).

The gap between the potential product and the actual product grew by 7 to 8 percent in 1977. Calculating from 1972, the product gap reached 22 percent in 1977 when labor input is measured in work hours, and 28 percent when labor input is measured according to working age population. The cumulative loss of the product of the business sector from 1973 to 1977 is equal to the whole business product for 1977. Part of the cumulative loss is a result of the loss of product during the Yom Kippur War in 1973 and the period of increased call-up in 1974.

It cannot be concluded from the product gap and the cumulative loss of product shown here that full growth was possible given the structure of demands that existed before the balance of payments crisis. The loss of product may have been to a great extent a necessary price to pay in order to halt the growth of imports in the face of the inability to increase the import surplus. At the same time, the gap and the loss of product reflects the importance of increasing the profitability of exports. It is difficult to determine in an unambiguous manner that the achievements in this area exceeded those of the previous periods, when there was less need for increasing the profitability of exports.

5. INCOMES

Disposable private income from internal resources, without excluding compulsory loans, rose by 6 percent in real terms, compared with a real decrease of 6 percent in 1976 and stability in 1975.

Two factors have affected disposable private income in recent years: the first is slackening in the economic activity between 1975 and 1977, and the second is taxes. As mentioned above, the tax burden did not grow in 1977, following a substantial rise in 1976. What stands out in 1977 is the similarity between the nominal rise of net indirect taxes on domestic production, the rise in direct taxes, the rise in transfer payments, and the nominal rise in the product. As a result, disposable private income also rose at the same rate. Since private consumption rose at a somewhat lower rate, there was a slight rise in the rate of saving.

In the previous year direct and indirect taxes both rose at much higher rates than the Gross National Product. Together with the large increase in indirect taxes, subsidies on domestic production rose even higher; nevertheless, the rate of increase of net indirect taxes rose much more than the growth of the product. As a result, real disposable private income fell in 1976. In 1977, as already mentioned, net indirect taxes on domestic production rose at a rate similar to the nominal rise in the Gross National Product (about 43 percent). At the same time, the growth of both indirect taxes and subsidies, which was faster than the growth of the product, continued, as it had in the previous year.

TABLE

THE NATIONAL PRODUCT

	1974
	(IL million,
1. GNP at market prices ^a	52,979
2. Depreciation	6,273
3. Net National Product (1)–(2)	46,706
4. Indirect taxes on domestic production ^b	5,243
5. Subsidies on domestic production ^c	1,133
6. Net taxes on domestic production	4,110
7. National income (3)–(6)	42,596
8. National income per capita (IL)	12,614

^a At effective rates of exchange

^b Includes the payroll tax, whose collection began in 1975.

Direct taxes rose by 42 percent in 1977, which is similar to the growth of the national income; in the previous year, direct taxes rose at a much higher rate than the national income. Transfer payments to the public also rose by 42 percent; in each of the past two years they rose at a faster rate than the national income. The gross private saving rate from internal resources before deduction of compulsory loans rose to 23.3 percent in 1977, compared with 21.6 percent in 1976, 29.3 percent in 1975, and 29.8 percent in 1974.

This is a moderate increase in the rate of saving, but this finding is strengthened by the increase in financial saving (see Chapter XIX).

In 1977 the decline in the rate of saving which took place in 1976 therefore ended, and there was even a slight rise. The 1976 drop in the saving rate was partly a reflection of the delayed adjustment of consumption to the decline in incomes. This adjustment may have taken place in 1977, at least partially. In addition, substantial retroactive wage payments were made in 1977, which should have caused a rise in saving rates. Part of the decline in the saving rate in 1976 is explained by the harm to financial saving of certain measures adopted by the government in the linked bond market; this effect did not continue in 1977 (see Chapter XX). Acting in the opposite direction, the rise in the share of

AND INCOME, 1974-1977

	1975	1976	1977	Annual change		
				1975	1976	1977
at current prices)					(percent)	
	75,268	96,895	138,921	42.1	28.7	43.4
	9,229	12,729	19,240	47.1	37.9	51.2
	66,039	84,166	119,681	41.4	27.4	42.2
	8,722	13,404	19,697	66.4	53.7	46.9
	2,137	4,035	6,320	88.6	88.8	56.6
	6,585	9,369	13,377	60.2	42.3	42.8
	59,454	74,797	106,304	39.6	25.8	42.1
	17,208	21,171	29,431	36.4	23.0	39.0

^c The definition has been changed. It now includes linkage insurance, which was formerly included in transfer payments. 1974 estimate: IL 25 million. 1975: IL 100 million. 1976: IL 735 million. 1977: IL 789 million.

SOURCE: Central bureau of Statistics.

labor in the national income continued in 1977 (see below), and this in itself caused a decline in the saving rate. The combined result of all these influences was apparently a slight rise in the rate of saving.

The rate of saving from the National Product continued to be negative, i.e. the expenditure for public and private consumption was larger than the National Product. This is also true with regard to gross savings from the GNP. Nevertheless, there was a substantial rise in the rate of national saving from the National Product, mainly because of the decrease in real public consumption.

In 1977 the upward trend in the share of labor in the revenues of the business sector continued. The share of labor in the Net Domestic Product of the business sector, excluding housing, rose from 78 percent in 1975, to 89 percent in 1976, and to 94 percent in 1977. Part of this increase may derive from the practice of company owners to take profits in the form of salary, a practice which became profitable following the income tax reform. But this is also a reflection of the fact that under the conditions of a slack domes-

TABLE

TOTAL AND DISPOSABLE GROSS

	1974
	(IL million,
1. National income	42,596
2. Public sector property and entrepreneurial income ^a	908
3. Depreciation	6,273
4. Gross private income from economic activity (1)-(2)+(3)	47,961
5. Income tax ^b	6,300
6. National insurance payments ^c	2,806
7. Total direct taxes (5)+(6)	9,106
8. Net compulsory loans ^d	2,475
9. Total compulsory payments (7)+(8)	11,581
10. Net transfer payments ^{c,e}	8,496
11. Gross disposable income from domestic sources	
a. Incl. net compulsory loans (4)-(7)+(10)	47,351
b. Excl. net compulsory loans (4)-(9)+(10)	44,876
12. Personal transfers from abroad	3,429
13. Gross disposable income from all sources	
a. Incl. net compulsory loans (11a)+(12)	50,780
b. Excl. net compulsory loans (11b)+(12)	48,305

^a Excluding revaluated profits of the Bank of Israel in foreign currency.

^b 1) Excluding the change in unpaid payment agreement balances.

2) Including surtax on inventories.

PRIVATE INCOME, 1974-1977

59,454	74,797	106,304	39.6	25.8	42.1
1,438	2,493	3,664	58.4	73.4	47.0
9,229	12,729	19,240	47.1	37.9	51.2
67,245	85,033	121,880	40.2	26.5	43.3
10,151	17,125	23,445	61.1	68.7	36.9
4,077	6,147	9,609	45.3	50.8	56.3
14,228	23,272	33,054	56.2	63.6	42.0
1,883	222	-67	-23.9	-88.2	..
16,111	23,494	32,987	39.1	45.8	40.4
12,995	18,430	26,096	53.0	41.8	41.6
66,012	80,191	114,922	39.4	21.5	43.3
64,129	79,969	114,989	42.9	24.7	43.8
4,754	5,344	7,772	38.6	12.4	45.4
70,766	85,535	122,694	39.4	20.9	43.4
68,883	85,313	122,761	42.6	23.9	43.9

^c Including collection of employers' matching contributions, starting in April 1973. Total collections: 1973, IL 219 million; 1974, IL 449 million; 1975, IL 677 million; 1976, IL 1,030 million; 1977, IL 1,627 million.

^d Collection, less distribution of certificates and redemption of compulsory saving loans.

^e Less linkage insurance. Linkage insurance is defined as support for domestic production.

tic market it is not possible to raise the compensation to capital at the same rate as wage increases. At the same time, the compensation to equity capital may have risen because of the loans at relatively low interest granted to owners of capital under the Law for the Encouragement of Capital Investments.

TABLE II-10

GROSS PRIVATE SAVING^a, 1974-1977

	1974	1975	1976	1977	Annual change		
					1975	1976	1977
	(IL million, at current prices)				(percent)		
1. Gross disposable private income from domestic sources							
a. Incl. compulsory loans	47,351	66,012	80,191	114,922	39.4	21.5	43.3
b. Excl. compulsory loans	44,876	64,129	79,969	114,989	42.9	24.7	43.8
2. Gross disposable private income from all sources							
a. Incl. compulsory loans	50,780	70,766	85,535	122,694	39.4	20.9	43.4
b. Excl. compulsory loans	48,305	68,883	85,313	122,761	42.6	23.9	43.9
3. Private consumption	33,237	46,676	62,880	88,148	40.4	34.7	40.2
4. Gross private saving from domestic sources (1)-(3)							
a. Incl. compulsory loans	14,114	19,336	17,311	26,774	37.0	-10.5	54.7
b. Excl. compulsory loans	11,639	17,453	17,089	26,841	50.0	- 2.1	57.1
5. Gross private saving from all sources (2)-(3)							
a. Incl. compulsory loans	17,543	24,090	22,655	34,546	37.3	- 6.0	52.5
b. Excl. compulsory loans	15,068	22,207	22,433	34,613	47.4	1.0	54.3
	(percent)						
6. Rate of gross saving from domestic sources (4)/(1)							
a. Incl. compulsory loans	29.8	29.3	21.6	23.3			
b. Excl. compulsory loans	25.9	27.2	21.4	23.3			
7. Rate of gross saving from all sources (5)/(2)							
a. Incl. compulsory	34.5	34.0	26.5	28.2			
b. Excl. compulsory loans	31.2	32.2	26.3	28.2			

a. Of households, business, and nonprofit institutions, for which there are no separate data.
SOURCE: Central Bureau of Statistics and Bank of Israel data.

TABLE II-11

NATIONAL SAVINGS, 1974-1977

(At current prices)

	1974	1975	1976	1977
	(IL million)			
1. Gross private saving ^a	14,114	19,336	17,311	26,774
2. Public sector saving	-16,435	-24,679	-24,440	-27,984
Net public sector income ^b	5,638	9,256	16,704	23,999
Less: Public consumption	22,073	33,935	41,144	51,983
3. Gross national saving from GNP (1) + (2)	-2,321	-5,343	-7,129	-1,210
4. Unilateral transfers from abroad ^c	7,474	10,110	16,248	19,484
5. Gross national saving from all sources (3) + (4)	5,153	4,767	9,119	18,274
6. Depreciation	6,273	9,229	12,729	19,240
7. Net national saving from NNP (3)-(6)	-8,594	-14,572	-19,858	-20,450
8. Net national saving from all sources (5)-(6)	-1,120	-4,462	-3,610	-966
	(percent)			
9. Rate of gross saving from GNP	-4.4	-7.1	-7.4	-0.9
10. Rate of gross saving from all sources	5.6	3.6	5.4	7.6
11. Rate of net saving from GNP	-18.4	-22.1	-23.6	-17.1
12. Rate of net saving from all sources (less depreciation)	-1.3	-3.6	-2.3	-0.4

^a Out of income from domestic sources, before deduction of compulsory loans.

^b Excludes net taxes on imports, which are included in the import surplus when calculating the effective rate of exchange.

^c Less net interest payments of the public sector.

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