

CHAPTER IV

BALANCE OF PAYMENTS CURRENT ACCOUNT

1. MAIN DEVELOPMENTS

Imports in 1976 amounted to \$ 7,540 million, about \$ 140 million less than in 1975 (see Table III-1).

This decline was due to direct defense imports, which were \$ 243 million lower than in 1975. Apart from this item, imports increased in real value by 2 percent and their prices stabilized.

In commodity imports there was a real rise of about 2 percent in 1976, after a quantitative decline of 6 percent in the previous year. Imports of services grew quantitatively by one percent, after a real growth of 6 percent last year.

The slow growth of imports this year was due to the government's policy of moderation, which brought about a slowdown in the economy and an increase of the relative price of imports. Between 1974 and 1976 GNP prices increased by 70 percent, while prices of imports in Israeli pounds (excluding ships, aircraft and direct defense imports) increased by 92 percent. The effect of the economic slowdown is evident in the import of inputs and of capital goods, while the effect of the relative price of imports was felt on certain consumer items. The reduction of economic activity and the absence of expectations, both for a drastic change in the exchange rate and for an increase of international prices, brought about a decline in the import of inputs above the level required for the needs of the economy. Such a decline in inputs was made possible by the reduction of inventories that had been accumulating considerably during the previous two years. Imports of inputs, apart from diamonds, but including inputs of the defense forces¹ decreased quantitatively by 8 percent as against a real increase of 4 percent in the estimate of imports derived from the uses in domestic output.

It should be pointed out that the difference between actual expected imports of inputs can also be partially explained by a certain amount of import substitution that took place in the economy with the rise in the relative price of imports during the last few years.

Imports of consumer goods increased quantitatively, mainly due to a considerable growth in foodstuffs and motor vehicles. The rise in current consumption, excluding

¹ Part of the imports of defense inputs is included in direct defense imports. For purposes of comparison with the import of derived inputs, this component has been included in the data on actual imported inputs.

TABLE
COMMODITY IMPORTS, BY ECO
(\$)

		Total ^a		Quantity index ^d	Consumer	
		Unadjusted	Seasonally adjusted		Unadjusted	Seasonally adjusted
ANNUAL DATA						
1973		2,295.8		89.0	110.5	
1974		3,619.0		100.0	149.1	
1975		3,652.6		96.5	106.4	
1976		3,399.3		92.6	115.0	
QUARTERLY DATA						
1974	I	828.8	812.5	97.0	35.5	34.5
	II	903.1	895.6	99.4	43.6	43.9
	III	881.5	935.1	101.3	34.2	37.7
	IV	1,005.6	975.4	102.3	35.8	34.0
1975	I	949.0	943.6	97.0	21.3	22.5
	II	933.6	938.8	93.9	22.6	22.6
	III	857.1	896.5	98.4	24.9	27.3
	IV	912.9	876.7	96.5	37.6	32.6
1976	I	860.4	839.9	96.7	33.9	35.3
	II	890.4	907.4	95.4	34.7	35.5
	III	766.6	787.5	88.5	19.9	21.7
	IV	811.9	863.4	88.9	26.5	23.5

^a Excluding ships, aircraft and diamonds.

^b Excluding diamonds and fuel.

^c Excluding ships and aircraft.

^d The quantity index is calculated according to seasonally adjusted data. The adjustment is made on the original series in fixed prices.

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NOMIC DESTINATION, 1973–1976
million)

durables Quantity index ^e	Intermediates ^b		Quantity index ^d	Capital goods ^c		
	Unadjusted	Seasonally adjusted		Unadjusted	Seasonally adjusted	Quantity index ^d
80.5	1,344.0		83.1	457.4		89.5
100.0	2,108.3		100.0	553.7		100.0
62.6	2,081.3		94.5	609.7		98.0
66.4	1,834.0		87.0	566.4		90.9
100.2	434.8	418.5	86.5	133.9	135.8	103.6
116.2	543.1	524.2	97.5	148.3	144.9	100.7
91.7	526.5	555.4	107.2	126.8	137.4	100.7
91.3	604.0	620.3	108.9	144.7	137.4	94.2
48.3	557.6	543.9	95.8	145.5	150.6	90.6
51.2	542.6	530.6	91.8	164.9	159.1	95.0
60.4	478.9	505.5	93.9	141.5	149.9	102.9
90.6	502.2	512.1	95.4	157.8	148.8	102.2
80.3	458.5	437.7	89.6	150.3	152.9	100.0
81.0	481.4	477.3	87.9	175.1	172.9	105.8
45.8	417.2	432.0	85.6	199.6	127.4	83.5
57.5	476.9	498.2	84.8	121.4	117.0	74.1

^e The quantity index of the original data in fixed prices. The irregularity which stands out in this series, caused by anticipation of, and reaction to various economic measures, complicates the seasonal adjustment. Therefore, it was decided to present quantity indices of the original data.

SOURCE: Central Bureau of Statistics.

imported foodstuffs, is lower than the rise in total consumption in this item, which means a reduction in the weight of direct imports, together with the increase of their relative price.

Imports of capital goods, except for ships and aircraft, have decreased quantitatively by 7 percent due to the decline in machinery and equipment. This decrease of imports was more moderate than the decline of the total investment in machinery and equipment. This phenomenon reflects an increase in the weight of direct imports, which occurred simultaneously with the relative increase of the price of imported equipment over the past two years. It is possible that the explanation for this is the structural change that occurred in investments.

1976 is the second year in which total domestic uses have contributed to a shrinking in product imports, while exports contributed to their growth². The growth in the range of uses explains only a small part of the growth in commodity imports in 1976. An examination of the composition of uses shows that the economy has gone over to a basket of uses which is less import-intensive than 1975, due to a great decline in investments (excluding ships and aircraft) and in public consumption. An offsetting influence was exerted by the increase in the weight of direct imports in consumption and in investments (excluding ships and aircraft). This year, in uses of domestic output there was a transition to an import-intensive basket, due to the change in exports (excluding diamonds).

Import commodity prices declined by about 2 percent in 1976, following a moderate rise of 5 percent in 1975, and a cumulative rise of 76 percent in the previous two years. The world-wide decline in primary commodity prices during the second half of 1974, their stabilization in 1975, and the strengthening of the dollar vis-à-vis the European currencies in 1976, brought about a drop in import prices in 1976. It should be mentioned that in 1976 international prices began climbing again and their rise will influence the prices of Israeli imports in the near future.

A comparison of the prices of Israeli imports, excepting fuel (after discounting the effect of changes in the dollar exchange rate) to the export prices of industrial countries in local currency shows that there has been an improvement in the status of Israel in the area of prices over the past two years, following its deterioration until 1974. This improvement can be partially explained by the drop in world basic commodity prices, which exerted a delayed influence on Israeli import prices.

In examining the development of imports (excluding ships, aircraft and diamonds³) over the course of the year it appears that the real decline took place in the second half of the year; in the first half the average level was similar to that of 1975.

² In this analysis, it refers to expected imports rather than to actual imports of inputs.

³ The extreme irregularity of raw diamond imports distorts seasonal adjustment of total imports, excluding ships and aircraft. Therefore the seasonal adjustment of imports has been calculated while excluding ships, aircraft and diamonds.

The growth of Israeli exports was very much accelerated in 1976, reaching 13.3 percent in real terms. Export growth directly contributed 3.0 percent to the growth of total uses (excluding imports of ships and aircraft, and direct defense imports), and were it not for this, the national product would have decreased in 1976. This strengthening of export growth essentially reflects the change that took place at the end of 1975 in industrial civilian exports. The growth in exports of services was much more moderate than the growth of commodity exports, and centered mainly in tourism⁴.

The growth in commodity exports included most export branches this year; however, it was mostly due to the growth of agricultural exports, excluding citrus, and of diamond and defense exports. The export of light industrial products, being mostly consumer goods, benefited from the recovery of the world economy this year, while mineral and chemical exports continued to suffer from the crisis in the international markets of these products.

In examining the changes that took place in industrial exports, a distinction should be made between defense⁵ and civilian exports. In recent years defense exports underwent a very fast development (about 80 percent in quantitative terms in each of the years 1975 and 1976). The rapid growth of these exports is to a large extent the consequence of special factors, both from the aspect of supply as well as demand. The growth of the civilian part of industrial exports in the years 1973–1975 was very slow as compared to the years 1968–1972, and in 1975 there was even a regression. Only in 1976 was the growth renewed, at a rate of 15 percent over the previous year.

At the end of 1976 and at the beginning of 1977, the growth of industrial exports, excluding diamonds, ceased. This phenomenon reflects the continued growth of civilian exports and a decline in defense exports. It is hard to determine the significance of this decline, since the period of time during which it took place is short, and defense exports are, in general, subject to great irregularity.

This year there was a continuation of the change in the sectorial structure of exports in favor of agriculture and the advanced sectors of industry, such as metal products, machinery, transport equipment, electricity and electronics. In view of the fact that there was no growth in domestic output destinations, the increase of exports brought about an accelerated growth in the weight of exports in the total output of the agricultural and industrial sectors in particular, and in the output of the economy in general.

The growth of exports in 1976 took place against a backdrop of positive changes in the complex of factors that influence exports, part of which have been taking place for

⁴ Tourism is measured by foreign currency conversion by tourists. This fact reduces the estimates of tourism growth in 1976 (see also explanation in Part 6).

⁵ In addition to the export of defense products, defense exports include, both here and in the other chapters of the report, a certain component of civilian products being exported by companies dealing with defense exports. The reason for this is the impossibility of separating the two.

over a year. Among those are a slackness of domestic demand that was already felt in 1974, an increase in the relative price of exports two years ago, and the recovery of the world economy as compared to 1975.

TABLE IV-2

EXPORTS BY MONEY SUPPLY AND BY NATIONAL ACCOUNTS, 1972-1976

	1972	1973	1974	1975	1976
COMMODITY EXPORTS (\$ million)					
1. Exports by foreign trade (net)	1,107.7	1,386.6	1,736.6	1,834.3	2,307.2
2. Exports to administered areas	129.6	191.2	209.2	370.0	399.2
3. Balance of payments adjustments	-19.3	-20.8	-30.8	-23.3	-26.4
4. Total by balance of payments ^a (1)+(2)+(3)	1,212.0	1,557.0	2,005.0	2,181.0	2,680.0
EXPORTS OF SERVICES (\$ million)					
5. Exports of services (CIF values)	1,047.3	1,290.1	1,749.1	1,704.6	1,844.8
6. Exports to administered territories	44.0	51.1	77.0	77.4	74.9
7. Import adjustment from CIF to FOB	-78.3	-119.2	-183.1	-197.0	-177.7
8. Total by balance of payments ^b (5)+(6)+(7)	1,013.0	1,222.0	1,643.0	1,585.0	1,742.0
9. Receipt of interest of the public sector	4.1	94.1	129.0	133.0	98.7
10. Total exports of services ^a (5)+(6)-(9)	1,087.2	1,247.1	1,697.1	1,669.0	1,820.2
EXPORTS BY NATIONAL ACCOUNTS^b (IL million)					
11. Exports of commodities and services (current prices)	10,469	12,819	18,412	76,652	39,251
12. Exports of commodities and services (1970 prices)	7,856	8,136	8,595	8,784	9,950

^a Adjusted to national accounts.

^b Exports at the official exchange rate plus export supports.

SOURCE: Central Bureau of Statistics.

The slackness of domestic demand encourages exports at various levels. The creation of surplus production capacity forces companies to search for export markets as an alternative to the domestic market. The effect of a drop in domestic demand is both rapid and massive when the defense production branch is involved, where there is good substitution of production between exports and domestic uses of output. In broader sections of the economy, the shifting of production capacity to export is more prolonged, and it apparently did not find full expression in 1976. The slackness of domestic demand, in conjunction with other factors, contributed to the creation of an economic climate in which certainty connected with export activity is growing compared to activity in local markets. The present recession increases the uncertainty of companies regarding the domestic market in long-range planning. The continuing existence of a severe balance of payments deficit means that there is no justification for expecting a renewed growth of domestic demand to accustomed dimensions in the past. A number of government policy measures have also contributed to the relative security of exporters: the creeping devaluations have reduced the uncertainty concerning the timing of general exchange rate changes for exports, and this is also the case for the policy of expanding directed credit for exports at a time of credit shortage for production for domestic uses.

The policy of nominal devaluations was the main instrument in bringing about the change in the relative price of exports during the last two years. As compared to the prices of the nontradeable domestic product, export product prices increased in 1975 and 1976 by 35 percent; however, the change in the relative price also reflects the relatively slow rise of producer prices in the domestic market that resulted from the slackness of domestic demand. A return to growth in domestic uses in the future may cancel out part of the improvement that took place in the relative price of exports. This improvement is taking place in the entire economy, including branches where substitution between sectors is slow, and not high even over the long run, for instance between industrial exports and the construction sector. In industry lies the main potential for the growth of exports, and substitution in production between exports and domestic end uses is relatively high. Despite the fact that the relative price of exports has also risen in industry, this change has not taken place together with an increase in profitability of industrial exports but through a decline in profitability of production for domestic uses. In 1976, the profitability of exports was not substantially higher than in 1973, and it was subject to numerous fluctuations and instability during this entire period.

The main effect of the relative price on the growth of exports should come from the structural change of the economy; naturally, this is not a short-term process. Nevertheless, in the areas of employment and wages there have been no developments towards the desirable structural changes in 1976; most of the additional work force was absorbed by the public sector, and the collapse of the wage policy at the end of 1976 and the beginning of 1977 showed that no real improvement in relative wages in industry has been achieved.

TABLE IV-3

COMMODITY IMPORTS^a, BY ECONOMIC DESTINATION, 1973-1976

	1973	1974	1975	1976	Annual increase or (-) decrease					
					Price			Quantity		
					1974	1975	1976	1974	1975	1976
	(\$ million, at current prices)				(percent)					
CONSUMER GOODS										
Food	118.6	144.8	159.4	141.1	41.3	12.2	-30.1	-13.6	-1.9	26.6
Other nondurables	57.3	64.5	57.1	61.3	13.9	8.8	1.4	-1.2	-18.6	5.9
Durables	110.5	149.1	106.4	115.0	8.6	14.0	2.0	24.2	-37.4	6.0
Transport equipment	40.0	60.6	37.1	47.0	(8.6)	(14.0)	(2.0)	(39.5)	(-46.3)	24.2
Total	286.4	358.4	322.9	317.4	20.8	12.1	-14.6	3.6	-19.6	15.1
PRODUCTION INPUTS										
For current production	1,118.8	1,808.4	1,739.5	1,557.8	30.3	4.5	-4.3	24.1	-8.0	-6.4
Spare parts	225.2	299.9	341.8	276.2	30.3	4.5	-4.3	2.2	9.1	-15.6
Subtotal	1,344.0	2,108.3	2,081.3	1,834.0	30.3	4.5	-4.3	20.4	-5.5	-7.9
Fuel	211.0	596.4	637.9	681.2	278.6	-4.1	3.7	-25.3	11.5	3.0
Subtotal, incl. fuel	1,555.0	2,704.7	2,719.2	2,515.2	52.3	2.3	-2.1	14.2	-1.7	-5.5
Rough diamonds (net)	448.0	407.0	412.0	616.0	15.6	2.7	1.1	-21.4	-1.4	48.0
Total	2,003.0	3,111.7	3,131.2	3,131.2	47.8	2.3	-1.5	5.1	-1.6	1.5

CAPITALS GOODS

Plant	350.4	426.9	542.8	493.3	9.2	11.7	-0.3	11.6	13.8	-8.9
Land transport equipment	107.0	126.8	66.9	73.1	4.9	18.8	4.3	13.0	-55.6	4.8
Subtotal	457.4	553.7	609.7	566.4	8.3	12.3	0.1	11.8	-2.0	-7.2
Ships and aircraft	224.8	150.5	42.7	53.3						
Total	682.2	704.2	652.4	619.7	8.3	12.3	0.1	-4.7	-17.5	-5.1
Goods n.e.s.	0.1	5.0	7.7	9.8						
Total gross imports	2,971.7	4,179.3	4,114.2	4,078.1	37.0	4.5	-2.4	2.7	-5.8	1.6
Total imports, excl. ships, aircraft & diamonds	2,298.9	3,621.8	3,695.5	3,408.8	40.4	4.7	-3.0	12.2	-3.5	-4.0
Imports returned, excl. diamonds	3.2	2.8	6.9	9.6						
Total net imports	2,968.5	4,176.5	4,107.3	4,068.5						
Less: balance of payments adjustments	27.5	104.0	102.9	94.3						
Total net imports, excl. administered areas according to balance of payments)	2,896.0	4,072.5	4,004.4	3,974.2						
Commodity imports from administered areas	66.7	103.4	123.1	139.2						
Total imports according to balance of payments	2,962.7	4,175.9	4,127.5	4,113.4						

a CIT values.

SOURCE: Central Bureau of Statistics.

There was a considerable positive effect on exports since the end of 1975, due to the recovery of the world economy from the economic crisis. International trade expanded by more than 10 percent in 1976, and its contribution to the growth of exports was considerable, particularly in sectors producing consumer goods: food, textiles, clothing, and other light industries.

2. COMMODITY IMPORTS⁶

Commodity imports amounted to about \$ 4,080 million in 1976, which represents a 1.5 percent increase, following a decline of 6.0 percent in the previous year.

Two large items are included in total imports. One is the import of ships and aircraft, an item characterized by considerable irregularity. Its volume in the past two years was relatively low — \$ 53 and \$ 43 million in 1976 and 1975 respectively, after two years of high volume — \$ 255 million in 1973 and \$ 150 million in 1974. The other item is raw diamond imports, whose relation to domestic economic development is weak. This item increased in value in 1976 by about 50 percent amounting to \$ 616 million; there was only a slight increase in diamond prices⁷, so that imports grew by about 48 percent. The large increase in diamond imports is related to the recovery of diamond exports following an ebb that had lasted since the end of 1973; in 1974, the branch reduced its inventories to correspond with a lower level of activity, and it stabilized at this level in 1975. With the recovery of exports in 1976, the level of raw diamond inventories rose. In the second half of the year there were rumours about the possible imposition of quotas by the syndicate, and this also contributed to the increase of imports.

For a correct analysis of the influence of economic events on import trends, the items mentioned above should be discounted. Thus we find that "net" imports (not including diamonds, ships and aircraft) declined by 4 percent this year after a similar decline last year.

A. IMPORTS BY ECONOMIC USE

The source of the real decline of imports is the decline of inputs, excluding diamonds (about 6 percent in 1976 after a 2 percent drop last year) and the decline in imports of capital goods, excluding ships and aircraft (about 7 percent this year, after a 2 percent decrease in 1975). In contrast, imports of consumer goods grew at a rate of about 15 percent (Table IV-3).

Consumer goods. All subitems of consumption imports increased in quantity, except for durables excluding motor vehicles. Food imports rose by about 27 percent after they

⁶ The rates of growth here are real unless otherwise stated.

⁷ The diamond price index is problematical from the statistical point of view, and its reliability is deficient.

had dropped by about 2 percent in the previous year. A considerable part of these imports consists of frozen meat, imported by the government, and sugar, imported both by the government and by private importers. In 1976 the weight of these two items in total food imports declined (from 76 percent in 1975 to 60 percent in 1976), due to a 22 percent real drop in meat imports and a 53 percent reduction in the price of imported sugar. Quantitatively, sugar imports grew by about 39 percent. After deducting these two items, food imports grew considerably, following a trend that had already made itself felt in 1975. The main growth took place in imports of beer, tobacco, canned fish, nuts, olive oil and candy. Some duties were reduced so as to expose local products to competition. One of these products is beer; it has been contended that it is being sold at dumping prices. For products that are subject to fixed duties, the duty burden per dollar declined as a result of the devaluation of the pound. It is also possible that the growth is connected with the recovery of the tourist branch in the last year.

The import of durables rose by 6 percent, following a drop of 37 percent in the previous year; however, in 1975 the import of both motor vehicles and other durables had decreased, while in 1976 there was a 24 percent quantitative increase in the import of motor vehicles, while other durable imports decreased by about 4 percent. The great increase in the import of motor vehicles in 1976 has to be viewed in light of administrative limitations that had been imposed on these imports during the first nine months of 1975, though the level of imports in this item in 1976 is still much lower than its level in 1974.

Consumer goods imports depend on total consumption which is determined by real income and relative prices; changes in these factors and expectations of changes influence these imports. Restraint policy measures that have been taken since November 1974 to reduce the balance of payments deficit resulted in the reduction of free real income and in the relative increase of import prices, i.e., an increase in indirect taxes, lifting of subsidies, and the rise of the exchange rate in a series of creeping devaluations. And, in fact, incomes did go down in 1976, but private consumption increased (see discussion in Chapter VII). At the same time, the greater price increase of some imported products brought about a decline in the weight of direct imports both in current product consumption, excluding foodstuffs, and in the consumption of durables: between 1974 and 1976 current consumption products, excluding imported foodstuffs, became 2.1 times more expensive, while the prices of total products in this item (imports and domestic production) increased by a factor of 1.8 (Table IV-4)⁸. As a result, imports dropped by about 14 percent, while consumption of all consumer products in this item grew by about

⁸ The changes in the prices and quantities of imports are based on foreign trade data and estimates made by The Bank of Israel, while the data concerning totals (imports and domestic production) are based on national accounts data. There is no immediate possibility of separating imports from domestic production in the national accounts data, and we have therefore given data concerning totals and imports instead of a direct comparison between imports and domestic production.

8 percent (naturally consumption of domestic production grew even more).

The trend is similar in durables as well, although in this area there are fluctuations from year to year, whose source is the effect of expectations of changes in the relative prices of these products and the administrative steps taken by the government. The general picture that appears shows that, despite fluctuations, here too, the greater increase in the import prices brought about a decline in their weight in the total consumption of durables; since 1974 their import prices increased by a factor of 2.2, while their total consumption became 1.9 times more expensive. Between these two years imports declined by 34 percent, while total consumption of durables decreased by 21 percent, so that a substitution for imports had clearly taken place. It should be pointed out that the drop in the number of immigrants in these two years also contributed to the decline in the weight of direct durable imports in their total consumption.

TABLE IV-4
CONSUMPTION AND INVESTMENT^a, CHANGES IN QUANTITY AND IL PRICE,
1974-1976
(percent)

	Quantity changes			IL price changes		
	1974	1975	1976	1974	1975	1976
1. Consumption						
Current consumption, excl. food						
Imports	-1.2	-18.6	5.9	39.4	57.5	35.0 ^b
Total imports and domestic production	10.2	-0.5	8.1	42.9	39.8	32.5
Durables						
Imports	24.2	-37.4	6.0	26.5	65.4	35.2 ^b
Total imports and domestic production	10.9	-17.6	-4.0	34.3	45.3	32.3
2. Plant investment						
Import		14.2	-9.2		44.7	27.0
Domestic production		7.0	-17.9		36.9	25.5
Total		11.7	-12.1		41.8	26.8

^a Selected items.

^b Changes in import prices for 1976 are rough estimates of the Bank of Israel.

SOURCE: Import consumption - Foreign Trade Division; Total consumption and investment (import and domestic production) - National Accounts data, Central Bureau of Statistics.

In the course of the year, there was a downward trend in the import of consumer goods, particularly durables; most prominent is the low level in the third quarter, when the Value Added Tax was imposed, which was preceded by advanced purchases of imported commodities (Table IV-1).

Capital goods (excluding ships and aircraft). In the subitems that constitute imports of capital goods (excluding ships and aircraft) various trends have been felt this year: machinery and equipment imports declined by 9 percent following a 14 percent rise in 1975, while the import of land transport vehicles rose by about 5 percent, following a 56 percent drop last year.

The import of capital goods is generally influenced by long-range considerations; current developments have no great influence on them, since the investment process requires early planning and is not easily given to immediate changes, and delivery dates are distant. Expectations of continued economic development are the main influencing factor. In view of the fact that 1976 was the second year of relative stagnation of production, and a certain pessimism concerning economic development after the elections prevailed, imports of capital goods did not grow this year.

Since 1974, an upward trend in the weight of direct imports in total machinery and equipment investments has been felt. Between 1973 and 1975, investments in imported machinery and equipment rose by 26 percent, while investments in domestic production increased by less than 3 percent⁹. The decline in exports in 1976 is much more moderate than that of domestic production, 9 percent as against 18 percent. In 1974 there was a considerable drop in relative import prices in Israeli currency, but in the following two years they rose by about 84 percent, against an increase of 72 percent in domestic product prices, so that the increase in the weight of direct imports in machinery and equipment investments in the last two years occurred together with a relative increase of import prices. The growth of the direct import component in investments is conspicuous in industry, agriculture, and in services. It is possible that the explanation for this is the change in the investments composition of these sectors. In agriculture, there has been a visible transition to large mechanized cattle-barns in kibbutzim in recent years, and the import of finished chicken-coops has also begun. The enlargement of the hot-house branch is also significant, as its equipment is imported. In industry, a growth of the mining and quarrying branches took place between 1974 and 1976, partially caused by investments in the Nahal Zim project as well as investments in drilling equipment. Most of the growth in the chemical and petroleum branches is also due to a single enterprise — the petrochemical project.

The development of capital goods imports, excluding ships and aircraft, in the course of the year shows a sharp decline in the second half of the year; the level is about 23 percent lower than that of the first half. A particularly high level was notable in the second

⁹ The following discussion is based on national accounts data.

TABLE IV-5

USES OF DOMESTIC OUTPUT AND THEIR IMPORT COMPONENT, 1971-1976

	Exports			Domestic uses					Actual import less expected imports			
	Total	Excl. diamonds	To administered areas	Total	Private consumption	Public consumption	Investment	Total uses	Total uses excl. diamonds	Actual imports excl. diamonds	Total less diamonds	Total less diamonds & fuel
Uses of domestic output (producer prices IL million, at 1968-69 prices)												
1971	5,707	4,879	326	13,533	7,440	2,394	3,699	19,566	18,738			
1972	6,382	5,358	412	15,108	8,193	2,423	4,492	21,902	20,878			
1973	6,499	5,326	421	16,113	8,662	2,672	4,779	23,033	21,860			
1974	6,938	5,847	458	17,063	9,063	3,207	4,793	24,459	23,368			
1975	7,053	5,972	560	17,063	9,131	3,142	4,790	24,676	23,595			
1976	8,129	6,820	571	16,522	9,506	2,920	4,096	25,222	23,913			
Required imports of current commodity inputs (\$ million, at current prices)												
1971	422	236	28	654	344	164	146	1,104	918	—	—	—
1972	520	265	36	763	395	186	182	1,319	1,064	—	—	—
1973	693	324	50	1,086	561	273	252	1,829	1,460	—	—	—
1974	1,009	612	95	1,793	955	466	372	2,897	2,500	2,841	341	319
1975	1,013	606	119	1,841	1,015	453	373	2,973	2,566	2,880	314	193
1976	1,244	746	117	1,760	1,016	425	319	3,121	2,623	2,606	-17	-123

Required imports of current commodity inputs (\$ million, at 1972 prices)

1971	452	246	29	683	361	171	151	1,164	958	—	—	—
1972	520	265	36	763	395	186	182	1,319	1,064	—	—	—
1973	548	256	38	833	424	214	195	1,419	1,127	—	—	—
1974	571	299	40	888	446	245	197	1,499	1,227	1,447	220	218
1975	576	307	50	881	450	233	198	1,507	1,238	1,434	196	174
1976	702	376	50	859	468	220	171	1,611	1,285	1,323	38	20

Increase or (-) decrease in uses of domestic output (percent)

1972	11.8	9.8	26.5	11.6	10.1	1.2	21.4	11.9	11.4			
1973	1.8	-0.6	2.2	6.7	5.7	10.3	6.4	5.2	4.7			
1974	6.8	9.8	8.8	5.9	4.6	20.0	0.3	6.2	6.9			
1975	1.7	2.1	22.3	0.0	0.7	-2.0	-0.1	0.9	1.0			
1976	15.3	14.2	2.0	-3.2	4.1	-7.1	-14.5	2.2	1.3			

Increase or (-) decrease in required imports of current inputs (percent)

1972	15.0	7.7	24.1	11.7	9.4	8.8	20.5	13.3	11.1			
1973	5.4	-3.4	5.6	9.2	7.3	15.1	7.1	7.6	5.9			
1974	4.2	16.8	5.3	6.6	5.2	14.5	1.0	5.6	8.9			
1975	0.9	2.7	25.0	-0.8	0.9	-4.9	0.5	0.5	0.9	-0.9		
1976	21.9	22.5	0.0	-2.5	4.0	-5.6	-13.6	6.9	3.8	-7.7		

quarter of the year, perhaps because of advanced purchases prior to the imposition of the Value Added Tax (despite tax refunds due to authorized businesses on their investments).

Inputs (excluding diamonds). In the import of inputs, apart from raw diamonds, the downward trend that began in 1975 became sharper: a 6 percent decline this year following a 2 percent decline in 1975.

The composition of petroleum imports changed in 1976, following the return of the Abu-Rodeis oilfields. The quality of oil obtained from Abu-Rodeis was poor, i.e. the quantity of refined products obtained from one ton of oil was small and, as a result, its price was also relatively low. In 1976, high quality oil was imported in its place, its price also being relatively high, but the amount of tonnage imported was smaller. In Table IV-1 we have given the derived price index in which the composition change appears as a quantitative change: a real growth of 3 percent.

Apart from petroleum and diamonds, inputs dropped by 8 percent in 1976, after a decline of about 6 percent in 1975 and 20 percent in 1974.

The import of inputs, excluding diamonds¹⁰, derived from current economic activity in 1976 was 4 percent higher than that in 1975¹¹. Imports of inputs, excluding diamonds, but including the inputs of the Defense Forces, declined by 8 percent.

After two years of large, positive differences between actual and expected imports, the difference became negative in 1976. These fluctuations are due to the fluctuations of inventories arising from speculative considerations. The increase of international prices since the end of 1972 and the steep drop in the exchange rates of the dollar on European markets in 1973 brought about a considerable increase of import prices and increased the profitability of high level inventories, owing to domestic demand pressures. International prices continued to increase in the first half of 1974, which led to added expectations for an increase of import prices under the new economic policy; credit granted for the purchase of inputs has encouraged the accumulation of inventories. In the second half of 1975, with the deterioration of the balance of payments situation, the difficulties in obtaining American aid, and the worsening of its conditions, expectations of an increase of import prices were strengthened. The decline in the relative attractiveness of index-

¹⁰ Calculations of required imports are based on the input-output table for 1968-69 assuming no technological change. This is a rather questionable assumption, owing to the great number of years that have elapsed since, and the results of the calculations should therefore be considered carefully and should only be looked upon as a reinforcement of the theory. In addition, inventories are missing from the final uses from which required imports have been calculated, and as a result there is a downward deviation in total required imports. It follows that differences between actual imports and required imports in Table IV-5 are small. An estimate of the indirect import of inputs for inventory production has been calculated in the Research Department, and it amounts to about \$ 90 million in 1975 and in 1976.

¹¹ Required imports and actual import of inputs shown in Tables IV-5 through IV-7 include the inputs of the Defense Forces. In fact, this import of inputs is included in direct defense imports and is not included in foreign trade data.

linked financial assets, and in particular bonds (because of the change in their terms of issue and the fear of additional worsening, and a relatively small increase of prices), has increased the profitability of a transition to the product market, despite the rise of real interest in the third quarter of the year. In addition, the slowdown of economic activity in 1975 brought with it the creation of involuntary inventories of the importers, who had not been expecting the slowdown or considered it to be only temporary. It should be pointed out that keeping inventories was also a means of holding onto "black" capital. In 1976, the accumulation of inventories ceased, and they may even have started to drop. The reason for this reorientation is the change of the underlying conditions which had brought about accumulation; the expectations of drastic changes in the exchange rate have lessened considerably, while a large rise in interest rates took place, increasing the prices of holding inventories. Expectations for a continuation of world price increases were not fulfilled after prices declined in the second half of 1974, and stabilized during 1975¹². The level of inventories continued to adjust itself to the lower level of economic activity, for the second year, and pessimistic expectations concerning developments that would occur after the elections furthered this transition as well. Inventories decreased at a considerable rate in the metal and wood branches.

A possible explanation of part of the difference between actual and required imports is import substitution¹³. This may have occurred in the cotton branch, through local cultivation of a strain hitherto imported. It is also possible that the erection of a foundation of knowledge-intensive enterprises, following the growth of exports, also made possible the substitution of locally made electronic equipment, precision and optical instruments, and drugs for imports.

In the development of the import of inputs, excluding diamonds, a downward trend was noticeable throughout the year. In the original series, in fixed prices, a decrease appears in the third quarter of the year following the imposition of the Value Added Tax; seasonal adjustment "straightens out" the series, so that the decrease in this quarter, which had also occurred in 1975, is interpreted as seasonal.

B. IMPORTS BY USES

Uses from domestic output (excluding diamonds) grew in 1976 by one percent (Table IV-5). Domestic uses dropped by 3 percent as a result of the decline in investments and in public consumption, which was partially offset by the rise in private consumption. In exports there was a 14 percent increase.

¹² In this connection it should be remembered that in 1976 an upward trend in primary product prices is again noticeable, and it will have a delayed effect on imports.

¹³ Data relating to actual imports according to sector source are not very reliable, making a detailed examination difficult.

TABLE

COMMODITY IMPORTS^a BY

	1971	1972	1973b	1973c
	(\$ million)			
Private consumption	562	624	685	648
Direct imports	201	229	261	224
Indirect imports	361	395	424	424
Investment, excl. ships & aircraft	494	603	641	569
Direct imports	343	421	446	374
Indirect imports	151	182	195	195
Total private domestic demand	1,056	1,227	1,326	1,217
Public consumption	171	186	214	214
Total domestic demand	1,227	1,413	1,540	1,431
Exports, excl. diamonds (incl. administered areas)	275	301	294	294
Total imports, excl. diamonds, ships & aircraft	1,502	1,714	1,834	1,725

a This table presents the direct imports for the various final demands and indirect imports as calculated according to input-output coefficients. Hence there is a discrepancy between total imports as listed here and actual total imports. Until 1972 direct imports are according to the old classification, and from 1974 onward according to the new classification.

FINAL DEMAND, 1971-1976

			Weight of imports					
1974	1975	1976	1971	1972	1973	1974	1975	1976
at 1972 prices)			(percent)					
678	636	682	37.4	36.4	37.6	36.1	34.7	36.3
232	186	214	13.4	13.4	13.0	12.3	10.1	11.4
446	450	468	24.0	23.0	24.6	23.8	24.6	24.9
614	607	551	32.9	35.2	33.0	32.7	33.1	29.3
417	409	380	22.8	24.6	21.7	22.2	22.3	20.2
197	198	171	10.1	10.6	11.3	10.5	10.8	9.1
1,292	1,243	1,233	70.3	71.6	70.6	68.8	67.8	65.6
245	233	220	11.4	10.8	12.4	13.1	12.7	11.7
1,537	1,476	1,453	81.7	82.4	83.0	81.9	80.5	77.3
339	357	426	18.3	17.6	17.0	18.1	19.5	22.7
1,876	1,833	1,879	100.0	100.0	100.0	100.0	100.0	100.0

b Old classification.

c New classification.

Domestic uses of output contributed significantly to the decrease in domestic demand for inputs from imports: the growth that had resulted from private consumption was offset by an even larger decrease of inputs resulting from public consumption and from investments. The considerable rise of exports (excluding diamonds) caused a great increase in the import of inputs for export production. Exports underwent a change in sectorial structure, and are becoming more import-intensive. If we add in direct imports (Table IV-6), the increase of export weight in total imports (excluding diamonds) stands out. At the same time, there was a decrease in the weight of local destinations, and their composition changed as well, as already mentioned. The weight of domestic consumption increased, while the weight of investments and public consumption decreased. Exports (excluding diamonds) contributed a total of \$ 69 million (in 1972 prices) to the growth of imports¹⁴ (excluding diamonds, ships and aircraft), while domestic uses contributed a decline of \$ 23 million. This is the second year in which domestic uses have contributed to the decline of imports.

C. SOURCES OF IMPORT GROWTH

An examination of the sources of import growth (Table IV-7) shows that in 1976 the growth in the scope of uses caused only a small part of the import growth. As to the composition of uses, the economy went over to a basket in which import intensiveness is lower than last year owing to the decrease in investments, apart from ships and aircraft, and in public consumption. The increase of the weight of direct imports in investments, apart from ships and aircraft, and in total private consumption¹⁵ had a compensating influence. In uses from domestic output there was a transition to an import-intensive basket, caused by exports. In the other uses from domestic output there was no significant change in import intensiveness.

The growth in the scope of total uses explains a considerable part of the growth in imports between 1972 and 1974, while in 1975 and 1976 the importance of this factor decreased. The main reason for the drop in imports in 1975 was the decline in the weight of direct imports in private consumption, with a reduction of the import of durables.

D. IMPORT PRICES

After a moderation in the rate of increase of import prices in 1975, they decreased this year by about 2 percent. The 30 percent decrease in food prices is notable; its main cause was the decrease of imported sugar prices in 1976. It should be pointed out that

¹⁴ A growth of imports that is explained by the growth in uses. The difference between actual and required imports is not included here.

¹⁵ In private consumption this was caused by the considerable increase in food imports and in the import of motor vehicles. The reverse phenomenon in the current consumption of products, apart from food, should be pointed out.

in 1976 the increase of world primary product prices was renewed, and this will surely find its expression in Israeli import prices in the near future.

A comparison of Israeli import prices (excluding petroleum) in dollars, to export prices of industrial countries in local currency (Table IV-9), shows a 4 percent decrease of Israeli import prices this year, while the prices of industrial countries rose by about 8 percent. Part of the decrease of Israeli import prices was due to the strengthening of the dollar in relation to European currencies: 7 percent in 1976 as against 1975; after discounting this factor, import prices in 1976 rose by about 4 percent. Last year they increased at a similar rate, while foreign prices increased by 11 percent; between 1972 and 1974 import prices increased by 48 percent as against 36 percent abroad.

The greater increase of Israeli import prices until 1974 and the relative improvement that took place in the last two years is partly due to the relatively great weight of basic commodities in Israeli imports. Their prices rose at a considerable rate until the middle of 1974, then began to fall until the beginning of 1976. The effect of these changes on Israeli import prices was felt after a delay and it therefore found its expression in 1976 in the import of basic commodities at low prices, while the increase of international prices that occurred in 1976 was not yet noticeable. After deducting basic commodities from imports, there was an increase of 40 percent¹⁶ in import prices between 1972 and 1974; in 1975 they increased by about 5 percent and in 1976 — by 8 percent. It follows that in the last two years basic commodities contributed to a decrease in Israeli import prices.

3. IMPORTS OF SERVICES¹⁷

In the import of services, excluding defense imports and imports to the administered areas, a reduction in the rate of growth took place: the rate was about 7 percent in 1976, and 14 percent in 1975, and much higher in 1973 and 1974 — 35 and 37 percent, respectively. The prices of imports of services¹⁸ increased by about 5 percent, or quantitatively by about 2 percent after increasing by 6 percent last year.

The transport item totaled about \$ 490 million in 1976; its growth rate dropped considerably — by 6 percent following a 24 percent drop in 1975. In real terms there was a decrease of about 4 percent in these expenditures in 1976 due to a decrease in transport expenses for import freight with foreign companies (about 9 percent, and about 13 percent in quantity) due to the quantitative reduction of commodity imports. In other items included in transport expenditures, the increase of the expenses of Israeli crews abroad should be mentioned; they amounted to \$ 182 million, as against \$ 150 million in 1975. An increase also occurred in the purchase of petroleum by Israeli crews, amounting to

¹⁶ This is only a rough estimate.

¹⁷ Growth rates here refer to approximate growth unless otherwise stated.

¹⁸ The price indices of the various service items are only estimates, as are the quantity indices derived with their help.

TABLE IV-7

GROWTH OF COMMODITY IMPORTS^a BY COMPONENT^b, 1972-1976
(\$ million, at 1972 prices)

	1972	1973	1974	1975	1976	Total 1972- 1976
Increase in imports due to:						
1. Increase in total uses	169.7	149.2	141.4	11.3	20.2	491.8
2. Change in composition of uses	21.6	-40.0	20.4	-2.1	-50.3	-50.4
Domestic uses	22.7	-12.6	16.0	-12.3	-93.5	-79.7
Exports	-1.1	-27.4	4.4	10.2	43.2	29.3
3. Change in local production & direct import shares of uses	15.3	-0.2	-19.4	-52.8	49.6	-7.5
4. Change in sectorial origin of demand for domestic output	5.2	10.8	8.6	0.8	26.6	52.0
Domestic uses	9.1	16.5	-7.9	-5.0	4.8	17.5
Export	-3.9	-5.7	16.5	5.8	21.8	34.5
Total	211.8	119.8	151.0	-42.8	46.1	485.9
Domestic uses	185.7	126.7	106.0	-60.8	-22.8	334.8
Export	26.1	-6.9	45.0	18.0	68.9	151.1

^a Excluding diamonds, ships and aircraft.

^b The data here include direct imports for the various uses and indirect imports as calculated with the help of input-output tables. Hence there is a discrepancy between total imports as listed here and actual imports, amounting to the difference between total actual imported inputs and total required inputs computed according to input-output coefficients. The uses referred to in this table are private consumption (excluding direct defense imports), investment (excluding ships and aircraft), and exports (excluding diamonds and including the administered areas). The source of increase in line 2 is the change in the weights of these uses in total uses, due to the difference between the rate of increase in total uses and total commodity import increase; in line 3 - the change in the direct import and domestic output shares of each use; line 4 - the change in the sectorial origin of demand for domestic output.

Until 1973, the increase in imports was calculated according to the old classification, and from 1973 onward according to the new classification.

about \$ 96 million (\$ 81 million in the previous year), although the rate of growth was more moderate than last year due to the stabilization of petroleum prices. Another item included in transport expenditures is the payment of rental fees, amounting to \$ 83 million, against \$ 92 million in 1975.

Expenditure for passenger transportation by foreign companies increased in value by 10 percent. In view of the fact that international travel prices increased by about 8 percent, a real increase of about 2 percent took place, which corresponds with the slight rise in the number of those traveling abroad.

The allocation of foreign currency to traveling Israelis is included in travel abroad; this item decreased in 1976 by about 4 percent after a sharp increase in 1973 and 1974; 51 and 34 percent respectively, and a 10 percent drop in 1975. The sum of the allocation remained unchanged in 1976, and the decrease in the total amount is connected with the slowdown, continuing for the second year, in the number of Israelis traveling abroad. This slowdown is relative to the great number of Israelis who went abroad in 1973 and in 1974; it also occurred against a backdrop of economic restraint in the last two years.

In insurance considerable amounts were recorded, both on the credit and the debit side; however, the net balance is small. There is a close connection between the amounts of the credit (payments of premiums), and the debit (payments of claims and commissions).

Domestic interest payments totaled \$ 690 million in 1976, a decrease of about \$ 20 million from last year. Of this sum, about \$ 250 million is interest payments of the public sector, which also decreased somewhat as compared to 1975. In recent years, a considerable increase in interest payments took place: from \$ 250 million in 1972 to \$ 710 million in 1975. This increase is connected with the growth of the effective debt of the economy. In 1976 there was an increase of general domestic indebtedness to foreign sources, but it is possible that the decrease of interest payments is connected with the reduction of interest rates in the world. We can estimate the real growth of interest paid by the economy by considering interest payments as sums that could have been used for financing imports. Thus, interest payments more than doubled in real terms between 1972 and 1976.

The expenses of Israeli representations abroad increased by 23 percent. Prices abroad increased by 9 percent on the average, so that from the point of view of purchasing power, expenditure in this item increased by about 12 percent.

Expenditures for various services increased in 1976 by about \$ 63 million, as against an increase of \$ 9 million in 1975. This item is heterogeneous, including exporters' commissions to their agents abroad, payments for contracted work, advertising, film rentals, royalties, and patent fees. Growth in 1976 was concentrated in the "miscellaneous" item.

The import of services from the administered areas amounted to \$ 190 million, as against \$ 210 million in 1975. The main component of this item is the income of workers

TABLE IV-8
IMPORT PRICE INDEX, 1973-1976
(1972=100)

		Imports							
		Total	Excluding diamonds	Excluding diamond- & fuel	Total consumer goods	Food	Inputs excluding diamonds & fuel	Fuel	Capital goods
ANNUAL AVERAGE									
1973		127.9	128.2	127.0	128.1	138.6	128.4	141.6	122.5
1974		175.2	180.0	160.0	154.8	195.8	167.3	536.3	132.7
1975		183.0	188.4	167.7	173.5	219.8	174.8	514.1	149.0
1976		178.6	182.8	160.0	148.1	153.7	167.3	533.2	149.2
QUARTERLY DATA									
1975	I	178.5	194.0	176.9	200.6	280.2	182.9	481.0	155.5
	II	189.3	195.5	173.3	190.0	254.5	178.5	537.5	155.3
	III	180.6	185.1	163.9	155.3	178.1	174.0	520.2	143.5
	IV	175.2	179.5	157.4	155.8	173.1	164.0	522.7	142.3
1976	I	174.0	177.7	154.9	140.4	145.5	162.8	532.5	146.5
	II	178.9	182.7	160.2	159.9	169.5	165.2	534.0	148.4
	III	178.6	182.1	159.5	146.1	150.8	166.5	533.3	150.2
	IV	182.7	187.2	164.8	148.1	156.3	174.6	533.1	152.8

SOURCE: Central Bureau of Statistics.

from the areas, which decreased to \$ 170 million in nominal value in 1976, as against \$ 177 million in both 1974 and 1975. This decrease is connected with the reduction in the number of workers from the areas resulting from the slowdown in the construction branch.

4. FACTORS AFFECTING EXPORTS

Most of the factors affecting exports underwent positive developments in the course of the last two years, some of them in contrast to the trends prevailing in 1973 and 1974. The price of exports increased in comparison to domestic uses, but exports became less competitive abroad, and there was no significant improvement in the profitability of industrial exports.

The slackness of the domestic market helped increase exports by releasing production factors and hurting expectations for renewed development of the domestic market; in important export branches, such as other agricultural exports and defense exports, production capacity increased considerably, also as a result of extensive investments made in recent years; and finally, a recovery process in the world economy since the middle of 1975 increased the demand for Israeli exports, mainly in the areas of civilian commodity exports, tourism and transportation.

Economic policy can directly and instantaneously influence the profitability of exports by changing their relative prices. The upward trend of export product prices in relation to product prices for domestic uses¹⁹ that began in 1975, continued in 1976 (at a rate of 16.5 and 13.4 percent respectively). During the preceding two years, 1973 and 1974, there was a decrease in the relative price, resulting from two factors acting in the same direction: the change in the exchange rate did not completely offset the increase in domestic prices, while the worsening of terms of trade of Israel had a more adverse effect on export product prices than on domestic uses, mainly due to the import component, which is greater in exports.

¹⁹ Prices of nontradeable products are not measured directly, but are calculated as a remainder between total product prices and export product prices plus other tradeable product prices (import and export substitutes). Such a calculation is based on assumptions concerning the share of nontradeable and tradeable products other than exports in the total product. These assumptions can be avoided by comparing export product prices with product prices in domestic uses, but in that case the latter include a tradeable product component other than exports. The use of the relation between the export price itself and the domestic use prices is based on fewer assumptions (there is no need for assumptions concerning the product component in exports and import prices for export production), but its drawback is that it compares output prices and not prices of value received by production factors (see Table IV-11).

TABLE IV-9

IMPORT PRICE INDEX OF ISRAEL AND SIX INDUSTRIAL COUNTRIES, 1970-1976
(1970=100)

	Israeli import prices excluding fuel (in dollars)		IL rate against basket of selected currencies ^a		Israeli import prices excl. fuel, adjusted for change in IL rate		Export price index of industrial countries (in local currency)		Israeli import prices (adjusted)/export prices of industrial countries	
	Index	Percent change	Index	Percent change	Index	Percent change	Index	Percent change	Index	Percent change
ANNUAL DATA										
1971	102.7	2.7	102.8	2.8	99.9	-0.1	102.7	2.7	97.3	-2.7
1972	108.6	5.7	104.4	1.6	104.0	4.1	103.9	1.2	100.1	2.9
1973	137.8	26.9	111.3	6.6	123.8	19.0	113.1	8.9	109.5	9.4
1974	168.8	22.5	109.6	-1.5	154.0	24.4	141.7	25.3	108.7	-0.7
1975	179.3	6.2	112.2	2.4	159.8	3.8	157.9	11.4	101.2	-6.9
1976	173.0	-3.5	104.4	-7.0	165.7	3.7	169.9	7.6	97.5	-3.7

^a Weighted by the composition of Israel's imports in 1972.

SOURCE: Central Bureau of Statistics, Monthly Foreign Trade Statistics, May 1976, September 1976; NIER March 1975, April 1974, January 1977; and Bank of Israel calculations.

The increase of the relative price has occurred together with a decline in domestic uses over the last two years. This decline has helped domestic use prices and nontradeable use prices in them to rise at a slower rate than tradeable product prices; the change in the relative price was not entirely the result of the nominal devaluation. In view of the fact that the struggle with the balance of payments problem cannot rest solely on a slowdown process for any length of time, the renewed growth of domestic uses in the future will to a certain extent eat away at the improvement that took place in the relative price of exports.

Despite the improvement in the relative price of exports, its level was still lower than in 1972, the last year in which the economy was growing, and the balance of payments problem was still "tolerable" in the short run. In view of the fact that the dimensions of the current account deficit require a relatively larger amount of exports than in 1972, the rate of change of the relative price was insufficient.

The main effect of a relative change in prices may come from a structural change in the economy in favor of exports, and as such it is expected to be felt only after a certain lag. A reallocation of production factors in the economy — a transition from the production of nontradeable goods to export production and the production of import substitutes — is not a rapid process: it requires new investments, the training of personnel, the development of products and penetration of markets. Indeed, in the last two years the relative price of exports rose by about 32 percent, while real exports increased by only 16 percent. It seems that, at least in 1975, the economy was still under the influence of the change in the preceding two years, when there was a deterioration in the relative price of exports. A slow and relatively weak reaction to the changes of the relative price of exports was also felt when it was decreasing: in 1974 exports increased by more than 6 percent, in fixed prices. Although this was the second year in which the relative price of exports had dropped, there were many difficulties in the world market, and the level of aggregate demand was relatively close to total production capacity.

In this context, it is worth examining the influence of the relative price not only on the economy as a whole, but also on industry taken separately, where the main potential for export growth is found. Here the change in relative prices also exerts a short-range influence as well as do other variables. It is also possible to base the discussion specifically on the industrial price index.

The direct measurement of exporter profitability (the export profitability index) in industry is made by comparing the price in Israeli currency which the producer receives for each output unit to the estimate of average costs in its production, assuming that the composition of purchased inputs is constant. Due to the direct ratio between the current profit per output unit and the profit relative to capital (this ratio is expressed as "capital/output"), this measurement can be used as an indicator of the trend in profit per unit of capital in export industries. The profitability index can show whether developments have taken place which could bring about short-range growth of the quantity available

TABLE
IMPORT OF SERVICES,

	1972	1973	1974	1975
	(\$ million)			
Transportation, CIF	221.4	273.7	372.8	461.4
Passenger	(22.7)	(26.6)	(32.0)	(30.0)
(+) other shipping costs, FOB	(247.9)	(322.0)	(458.8)	(548.0)
(-) import cargo shipping by foreign firms	(49.9)	(74.3)	(118.0)	(116.6)
Travel	70.2	106.0	142.4	156.8
Insurance, CIF	157.1	194.6	247.2	234.1
(-) import cargo insurance by foreign firms	(7.9)	(9.1)	(9.8)	(11.3)
Capital services	246.8	384.0	585.0	709.0
Government n.e.s.	55.0	95.0	102.0	102.0
Other services	120.6	122.7	156.0	165.1
Total (excl. defense imports), CIF	871.1	1,176.0	1,605.0	1,828.4
Defense imports	490.0	1,253.0	1,224.0	1,946.0
Import from administered areas	105.0	146.6	211.8	209.7
Total, CIF	1,466.1	2,575.6	3,041.2	3,884.1

The change in the relative price of exports in the economy was, as mentioned, closely connected with the slackness in the domestic market. A decrease took place, for the second consecutive year, in domestic uses, following an increase, both in 1973 and in 1974, more moderate than the average over the preceding years. Due to the composition of the decrease, the required output did not decrease in 1975, and it decreased for the first time in 1976 at a rate of 3 percent. Required industrial output decreased at a slower rate due to the growth of private consumption in 1976, which has a relatively large weight in required industrial output.

1972-1976

Annual increase or (-) decrease								
1976	1973	1974	1975	1976	1973	1974	1975	1976
(\$ million)					(percent)			
489.7	52.3	99.1	88.6	28.3	23.6	36.2	23.8	6.1
(33.0)	(3.3)	(6.0)	(-2.0)	(3.0)	(14.5)	(23.1)	(-6.3)	(10.0)
(562.2)	(74.1)	(136.8)	(89.2)	(14.6)	(29.9)	(42.5)	(19.4)	(2.7)
(105.9)	(25.1)	(43.7)	(-1.4)	(-10.7)	(51.0)	(58.8)	(-1.2)	(-9.2)
151.2	35.8	36.4	14.4	-5.6	51.0	34.3	10.1	-3.6
279.5	37.5	52.6	-13.1	45.4	23.9	27.0	-5.3	19.4
(10.5)	(1.2)	(0.7)	(1.5)	(-0.8)	(15.2)	(7.7)	(15.3)	(-7.1)
690.0	137.2	201.0	124.0	-19.0	55.6	52.3	21.2	-2.7
125.0	40.0	7.0	—	23.0	72.7	7.4	—	22.5
227.7	2.1	33.3	9.1	62.6	1.7	27.1	5.8	37.9
1,963.8	304.9	429.4	223.0	134.7	35.0	36.5	13.9	7.4
1,603.0	763.0	-29.0	622.0	-243.0	155.7	-2.3	50.8	-13.2
189.5	41.6	65.2	-2.1	-20.2	39.6	44.5	-1.0	-9.6
3,755.6	1,109.5	465.6	842.9	-128.5	75.7	18.1	27.7	-3.3

CHANGES IN OUTPUT DUE TO DOMESTIC USES, 1972-1976

(percent, in fixed prices)

	1972	1973	1974	1975	1976
In the general economy	12.1	6.4	5.9	0.9	-2.9
In industry (excl. diamonds, minerals and fuel)	13.2	8.8	7.6	0.8	-1.7

for export, and the long-range growth of investments for export. The assumption regarding a fixed composition of inputs may lead to an overestimation of production expenses per output unit over long periods of time, when the structure of the firms changes and they acquire advantages of size during the process of growth. Another drawback of the profitability index is the fact that it does not measure the profitability of exports in relation to the profitability of domestic market activity, a point that is important in industrial exports for which the domestic market is a good substitute. The relative compensation index for the exporter in industry ignores the cost structure of exports. It compares the relative price of output for export to output for the domestic market (for the producer), and it serves as an indicator for problem of output allocation among the various destinations.

After long years of unequivocal rises of these two indices, contradictory trends have become noticeable since 1974. Export profitability fell and rose alternately, and in 1976 it was at the same level as in 1973, while relative compensation to the exporter rose in those years by about 11 percent. To a great extent this increase reflects the existence of cost inflation together with a slackness in the domestic market. It expresses the relative decline of profits from domestic market activity but, as the profitability index shows, without a clear rise in the profitability of exports. During 1976, an improvement in both indicators took place after a clear deterioration in the course of 1975, due to price drops abroad that were not offset by a suitable correction of the effective exchange rate for exports. The significance of these developments is that in the area of industrial exports, where the main potential for export growth is found, the change of relative prices in favor of exports is less unequivocal than in exports as a whole.

The positive trend in the competitiveness of the economy, which continued between 1965 and 1973, came to a standstill in recent years. This fact can be determined by a comparison of the competitiveness of Israeli exporters with exporters from other countries and with local producers in export destination countries. A comparison of wages per output unit, discounted by the appropriate index of output prices, shows a deterioration in 1974, an improvement in 1975, and an additional deterioration in 1976 – according to both comparisons.

The use of wages per output unit implies an assumption that is a good approximate definition of the price of production factors facing the exporter. However, the picture presented by it is incomplete; a great part of capital compensation in recent years has been expressed particularly in the export sector, by great capital profits resulting from cheap credit, liberally granted, under conditions of rapid inflation. In other words, there is another latent factor which considerably lowers the cost of using production factors, from the point of view of the company. The existence of nontradeable production inputs for export should not be ignored either, although their weight is probably small. The rise of prices in the last two years lagged far behind the rise of export prices

The decline in domestic demand took place alongside the continued growth of production capacity, and in many branches excess production capacity and unemployment (mostly latent) were created. This situation brought about a rise in average production costs and a decrease of marginal costs in the enlargement of production, and it might encourage firms to export above the level implicit in the change of the relative price and the profitability of exports. When a decrease of demand occurs in products that are also exportable, or in export branches, its contribution to the broadening of the scope of exports is direct and relatively fast. In branches where the transition to exports requires a substantial change of the product or specialization in the production of new goods, the increase of exports may take place indirectly and over a longer period. The increase of exports entails special organization and investments, and sometimes, due to lack of profitability, a transfer of production factors to other firms or branches.

Such a direct contribution resulted from the reduction of expenditures for domestic purchases in defense consumption (see discussion of defense exports below), the slowdown of investments in locally manufactured equipment, and the decrease of private consumption in 1975.

The decline in construction branch activity did not directly contribute to the growth of exports. Its indirect contribution was also limited to its influence on required industrial output; despite the decrease in the number of employees in the branch, no overt unemployment resulted, and there was no transfer of manpower to export branches.

Despite the extended slowdown, no overt unemployment was created in the economy (except at the end of 1976, when unemployment rose very slightly); surplus production capacity was expressed in latent unemployment. This phenomenon encompassed many branches, including industry, and even branches where exports increased considerably in 1976. It should not be concluded from this that overt unemployment would not have assisted the growth of exports. Evidence of latent unemployment relates to the branch level, and this does not constitute proof that individual companies have not suffered manpower shortages. It could have been expected that the discharge of workers from problematic factories would facilitate the quick hiring of workers by successful export firms, but this is not the case in latent unemployment.

It should be pointed out that overt unemployment in the economy, even in nonexport branches, could have furnished considerable indirect assistance to exports by lowering real wages in the economy, particularly in industry. This possibility is doubly important for two reasons: (a) in the last two years industrial wages increased more than any other input and contributed the main increase in production costs; (b) a deterioration took place in 1976 in the competitive position of the Israeli economy as expressed by comparing wages per output unit in Israel and in other industrial countries. The government could have taken effective steps in this area which would have exerted a direct influence on the labor market by not absorbing additional workers in the public sector and in service sectors that are under its influence. Such a step would have exerted a positive long-

TABLE IV-11
PRICE OF EXPORT COMPARED TO PRICE OF OTHER DOMESTIC USES, 1972-1976
(1972=100)

	GNP	Exports	Domestic uses	Product in export	Product in domestic uses	Non- tradeable product	Exports/ domestic uses	Product in export/ product in domestic uses	Product in export/non- tradeable product in GNP
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1972	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1973	122.5	118.2	122.8	110.3	125.6	127.6	96.3	87.6	86.4
1974	165.0	160.8	169.7	125.7	175.8	181.4	94.8	71.5	69.3
1975	221.3	227.7	232.5	191.4	229.9	234.3	97.8	83.3	81.7
1976	272.2	296.0	293.0	260.8	275.9	277.9	101.0	94.5	93.8

NOTE: All calculations are in export factor prices and based on national accounts data.

Column (1) – GNP excluding attributed housing services.

Column (3) – Domestic uses excluding imports of ships and aircraft, direct defense imports and attributed housing services.

Column (4) – Discounting general import component of 40 percent in export in 1972 prices. Input from import prices (CIF) were used as import component prices.

Column (5) – The difference between GNP prices (excluding attributed housing services) and product in export prices.

Column (6) – Taken from the GNP prices and the product in export prices, assuming that the tradeable product (including exports) was 30 percent of the product in 1972. This share changes from year to year according to the share of exports in the GNP during that year.

range influence, because part of the manpower not absorbed by the public sector would have been forced to change its professional training and go over to export branches.

In the years following 1973 the world economy underwent both recession and renewed prosperity. After the recovery of most large industrial economies beginning in the second half of 1975, the growth rate of the product slowed down in the second half of 1976. Developments in world trade were generally coordinated with the growth of economic activity. Taking into account the cessation of Israeli economic growth, the sharp changes in the relative price of exports, and the uncertainty concerning future development of the economy, the state of the world economy in recent years should be accorded a greater weight than in the past when explaining export behavior.

In order to assess changes in world demand for Israeli products one should carefully chose the variable that represents them, according to the special circumstances of each year. The imports of industrial countries, which are the main targets of Israeli exports, include trade in raw materials in which Israeli exports do not have a part (except minerals). Exports of industrial countries are similar in character to Israeli exports, and they can serve as an approximation of the changes in the export markets of Israel, except that their target-countries are not always identical with those of Israel²⁰.

REAL TRADE CHANGES IN EXPORT MARKETS, 1973–1976

(percent)

	1973	1974	1975	1976
Export of industrial countries	13.3	7.8	–4.6	10.9
Import of industrial countries weighted by each one's share in Israeli export	9.0	–1.8	–7.4	16.2

From a more thorough examination of foreign market developments since the middle of 1975, it appears that world market growth is relevant mainly to the export of Israeli consumer goods. Such a growth did not occur in intermediate products such as minerals and chemicals, and those have not in fact contributed to export growth in 1976. The growth of the markets for defense exports (see explanation below), which contributed a great part of export growth in 1976, is of a different character than that of the world economy as a whole. More than half of the production growth of developed countries resulted in the last year and a half from the growth of private consumption, while con-

²⁰ Compare, for instance, the striking difference between the two kinds of data in 1974 and in 1976. In 1974 exports of industrial countries grew mainly as a result of the great increase in the imports of the OPEC countries, while imports in the same year reflect their own entry into a period of economic recession. Import data in 1976 are influenced by a considerable swelling in the petroleum trade towards the end of the year.

TABLE

COMMODITY EXPORTS (FOB) BY BRANCH

	1972	1973	1974	1975	1976
	(\$ million, at current prices)				
AGRICULTURAL EXPORTS					
Citrus	109.0	108.8	120.8	176.4	171.9
Other	51.9	61.1	71.3	101.2	152.3
Total	160.9	169.9	192.1	277.6	324.2
INDUSTRIAL EXPORTS					
Mining & quarrying	43.3	48.1	90.2	84.4	61.1
Cement, copper	11.1	14.7	20.3	8.5	3.3
Potash	26.1	29.6	44.8	55.4	38.3
Phosphates	4.6	3.2	21.1	14.3	12.5
Food	95.0	105.5	128.8	125.7	154.8
Textiles	45.6	60.4	62.7	52.3	60.6
Clothing	77.6	86.9	97.6	104.1	125.3
Leather	6.4	7.0	7.0	5.4	8.0
Total textiles, clothing, leather	129.6	154.3	167.3	161.8	193.9
Wood	15.3	19.0	14.9	12.8	20.3
Plywood & Construction carpentry	10.5	13.5	11.2	8.4	10.4
Furniture	3.7	4.2	2.8	3.3	8.2
Paper	2.2	2.3	3.8	2.8	3.9
Printing & publishing	12.5	14.3	19.3	18.6	11.5
Rubber and plastics	26.5	25.8	36.3	44.7	53.6
Tires and tubes	19.7	16.4	23.4	29.4	31.9
Chemicals	61.8	81.6	218.6	185.9	219.4
Basic chemicals	23.9	36.8	102.5	99.6	86.7
Medicines	13.3	13.7	20.3	27.7	39.5
Pesticides	15.0	21.6	44.1	49.9	36.8
Chemicals excl. fuel					

IV-12

AND MAJOR GROUP, 1972-1976

Annual increase or (-) decrease							
Quantity				Price			
1973	1974	1975	1976	1973	1974	1975	1976
(percent)							
-54.	3.6	16.2	-2.2	5.6	7.2	25.7	-0.4
-5.9	4.0	34.1	29.7	25.2	12.2	5.8	16.0
-5.0	3.9	23.2	9.6	11.2	8.8	17.3	6.5
-12.1	17.8	-15.2	-1.5	29.4	59.2	10.3	-25.9
-20.0	6.0	-19.9	-65.5	65.6	30.2	-47.7	12.5
-5.1	8.5	-10.6	-9.9	19.5	39.5	38.4	-23.3
-39.5	61.9	-40.5	35.3	14.3	307.2	13.8	-35.4
0.1	-1.6	-8.6	22.2	10.9	24.1	6.8	0.8
-2.7	-7.5	-8.1	16.3	36.2	12.2	-9.2	-0.3
-8.8	1.2	1.9	12.9	22.8	11.0	4.7	6.6
-6.8	-8.7	-18.6	24.9	17.4	9.5	-5.2	18.6
-6.4	-2.6	-3.6	14.2	27.2	11.3	0.4	5.0
-11.1	-38.0	-5.9	48.7	39.6	26.4	-8.7	6.7
-12.6	-37.7	-6.8	13.7	47.1	33.1	-19.5	8.9
-10.8	-42.1	5.9	138.7	27.2	15.1	11.3	4.1
-15.2	4.2	-12.6	38.1	23.3	58.5	-15.7	0.9
-7.2	-14.8	14.3	-38.7	23.3	58.5	-15.7	0.9
-7.5	3.9	9.0	21.3	5.2	35.5	12.9	-1.2
-16.3	6.4	5.3	9.4	-0.5	34.1	19.3	-0.8
14.3	48.2	-18.4	31.0	15.5	80.7	4.3	-9.9
35.5	59.0	-5.0	3.6	13.7	75.2	2.3	-6.0
-11.9	1.3	33.9	49.6	16.9	46.3	1.9	-4.7
23.6	59.7	-3.5	-11.1	16.5	27.9	17.2	-7.1
18.8	41.7	-1.5	7.6				

TABLE

COMMODITY EXPORTS (FOB) BY BRANCH

	1972	1973	1974	1975	1976
	(\$ million, at current prices)				
Nonmetallic mineral products	2.2	2.7	5.8	6.5	7.1
Glass & glass products	1.5	1.9	4.6	4.4	4.5
Basic metals	8.0	13.7	23.2	25.5	18.9
Metal pipes	4.5	5.9	13.4	19.5	8.7
Metal products	48.3	46.0	64.7	103.7	187.8
Machinery	10.5	17.2	26.6	30.8	41.6
Transport equipment	14.2	30.6	40.3	39.7	91.6
Aircraft and parts	10.6	27.5	26.6	31.4	74.6
Electrical & electronic equipment	34.0	36.1	59.7	97.8	112.5
Communications equipment	14.3	12.0	20.5	48.5	60.2
Total metals & electronics	115.3	143.6	214.5	297.0	452.4
Excluding defense exports					
Diamonds (gross)	427.1	617.4	641.5	641.1	800.1
Diamonds (net)	385.7	551.9	562.6	548.9	712.3
Various industries	23.6	27.9	28.2	29.9	42.1
Total industrial exports	953.4	1,242.5	1,569.0	1,611.2	2,020.7
Excl. diamonds	526.3	625.1	927.5	970.1	1,220.6
Excl. diamonds, minerals & fuel					
Excl. defense exports					
Total industrial & agricultural exports	1,114.3	1,412.4	1,761.1	1,888.8	2,345.2
OTHER EXPORTS	34.5	46.6	63.8	51.7	69.1
Fuel & food for ships & aircraft	11.0	18.4	28.8	18.2	23.2
Sale of old ships & aircraft	13.1	8.8	14.0	6.2	23.6
Total commodity exports (gross)	1,148.8	1,459.0	1,824.9	1,940.5	2,414.3
Returned exports	47.1	72.4	88.3	106.2	107.1
Total commodity exports (net)	1,101.7	1,386.6	1,736.6	1,834.3	2,307.2
Commodity exports, excl. ships & aircraft (net)	1,088.6	1,377.8	1,722.6	1,828.1	2,283.3

IV-12 (Cont.)

AND MAJOR GROUP, 1972-1976

Annual increase or (-) decrease							
Quantity				Price			
1973	1974	1975	1976	1973	1974	1975	1976
(percent)							
1.8	97.2	7.1	5.7	20.5	8.9	4.6	3.3
3.0	124.7	-4.2	-1.8	23.0	7.7	-0.2	4.1
34.6	16.3	0.4	-20.8	27.2	45.6	9.5	-6.5
1.8	43.5	29.6	-45.3	28.8	58.2	12.3	-18.4
-20.2	22.3	46.6	82.2	18.7	15.0	8.8	-0.1
32.0	45.4	9.1	36.0	24.1	6.4	6.2	-0.7
73.9	20.3	-16.7	126.4	23.9	9.5	18.3	1.9
110.3	-11.7	-0.1	125.4	23.4	9.5	18.1	5.4
-12.7	55.3	-55.8	15.1	21.6	6.5	5.1	0.0
-31.9	60.4	125.5	23.9	23.3	6.5	4.9	0.2
0.8	30.3	28.3	52.7	23.6	14.6	7.9	-0.3
9.4	42.1	-8.6	16.5				
12.2	-2.2	1.6	16.4	28.8	6.3	-1.6	7.2
11.1	-4.1	-0.8	21.0	28.8	6.3	-1.6	7.2
-3.8	-10.8	-0.2	34.6	22.9	13.3	6.3	4.6
4.5	5.5	0.1	24.3	24.8	19.7	2.6	0.9
-1.5	12.0	-1.2	20.6	29.6	32.5	5.8	-3.1
0.0	11.4	5.1	27.7				
1.1	11.0	-5.0	15.0				
3.1	5.3	2.4	22.1	22.9	18.4	4.7	1.7
12.4	15.8	-27.3	12.7	20.2	18.2	11.5	18.6
3.3	5.7	1.6	22.3	22.9	18.4	4.7	1.7
2.4	5.8	0.9	23.7	22.9	18.4	4.7	1.7
3.0	5.6	1.4	22.8	22.9	18.4	4.7	1.7

struction and investments did not recover at the same pace. These factors all left their marks on the course of export growth in the appropriate branches.

The slackness of the domestic market most probably enhances companies' assessments of the long-range dangers inherent in the domestic market as compared to exports. This fact in itself should have served as an incentive for the increase of export weight in output. At the same time it should be remembered that in international markets too there were more fluctuations in the last three years than in the past. The domestic economic climate does not create expectations for a renewal of growth. Firms wishing to grow must therefore transfer their activity to foreign markets. The influence of this factor becomes greater, the greater the firms' aspirations of growth and the greater the part of their output intended for the domestic market.

Exchange rate policy also assisted to reduce uncertainty in exports. The method of creeping devaluation of the official exchange rate was introduced in July 1975, and since March 1976 a creeping devaluation of export incentives was linked to it as well. Implementation of the creeping devaluation at regular intervals enables exporters to verify continuously the intentions of the government to maintain the exchange rate for exports and reduces uncertainty concerning the timing of expected changes in the exchange rate.

An additional reduction of the uncertainty connected with conducting business abroad resulted from the linking of the Israeli pound to a basket of five currencies in July 1976. This linkage was intended to ensure that total compensation in Israeli currency to exporters remain constant despite changes of the exchange rates of the currencies in relation to each other. Contrary to the influence of the creeping devaluation, the contribution of the linkage to the basket is not equally effective for all exporters, since it is dependent on the composition of countries of destination with which the exporter is trading. Some of the problems, requiring governmental intervention to prevent great upheavals in the compensation of exporters, were not solved by the exchange rate policy. The fluctuation of export prices (in dollars), partly expressing fluctuations of the dollar exchange rate vis-à-vis the main western currencies, and partly fluctuations of prices abroad, were in different directions and intensities at various periods of time. In some cases there were fluctuations that could not be neutralized by a devaluation of the Israeli pound without seriously deviating from the policy of creeping devaluations or, due to a delayed reaction, were neutralized too late. The linkage of the Israeli pound to the basket of currencies was meant to ensure the independence of export revenues in Israeli pounds from fluctuations of world currencies. Ironically, the basket was introduced at the end of a continuous year-long process of revaluation of the dollar (in the middle of 1976). This process increased the burden on the exchange rate policy due to the linkage of the Israeli pound to the dollar at that time, and the linkage to the basket of currencies was of great importance just when the process of revaluation of the dollar was at its peak.

The policy of increasing the export exchange rate is based on the existence of a higher exchange rate for exports than for imported inputs for exports. Thus, the exchange rate

for added value in exports increases more rapidly the smaller the added value in exports. The need for quick nominal devaluations enhances the distortion, and the profitability of export transactions with a small added value in foreign currency increases with time. The increase of import prices, which at a certain stage was faster than the increase of export prices, enhanced the distortion, which can only be eliminated by a policy of unification of exchange rates.

5. COMMODITY EXPORTS

Exports of commodities grew by 22 percent in 1976 at fixed prices, a rate unequaled for several years. This growth followed a deep recession in exports in 1975 and a serious slowdown in the preceding two years.

Part of the growth in 1976 stems from the substantial renewal in exports of petroleum distillation products — an export that did not exist in 1975. An analysis of export development in recent years necessitates a differentiation between defense and other exports. Defense exports developed very rapidly in recent years and their growth rate greatly exceeded the growth of exports as a whole and even of sectors with fast-developing exports (such as other agricultural ones). In view of its rapidly-growing weight in exports, the share of defense in export changes is also rising.

The factors affecting defense exports are different from those affecting other exports (see below), the profitability of exports is only a small factor affecting them, as compared to civilian exports. Industrial exports, excluding defense (also excluding diamonds, minerals and petroleum), declined in 1975 by 5 percent, while in 1976 they increased by 15 percent; defense exports increased in those years by 5 percent and 28 percent, respectively. The moderate development of civilian exports strengthens the argument that the improvement in the profitability of industrial exports was not sufficient to bring about rapid growth in the civilian share of exports.

Drastic changes took place in the sectorial structure of exports over the past few years: the share of other agricultural products and of metal, metal products, machinery, transport equipment, and electronics in total exports is growing, while the share of food industries, textiles, clothing and other light industries is shrinking. This trend continued in 1976 as well, but with reduced intensity, since this year there was an increase in the exports of branches with a diminishing relative share. No consistent trend is noticeable in recent years in the weight of the diamond and mineral sectors in exports (these are purely export sectors). The rise in the relative weight of the chemistry sector in 1973 and 1974 ceased in the last two years, but the excess production capacity available in the branch ensures a quick growth of its relative share in exports, should there be an improvement of conditions in the world market. It seems that this process reflects a drastic change in the constellation of relative advantages of the various sectors of the economy, resulting from the proportional growth of the economy and from changes in the structure

TABLE

INDUSTRIAL EXPORT PROFITABILITY^a RELATIVE TO INPUTS AND EXPORTER

(Index:

		Exporter compen- sation in IL	Change from previous period	Import input prices for exporter in IL	Wage per output unit	Domestic input prices	Capital goods prices (depre- ciation)
		(1)	(1A)	(2)	(3)	(4)	(5)
1966		55.7		55.4	83.1	72.5	74.8
1970		77.6	39.3	69.3	87.8	82.0	74.3
1971		17.5	12.8	84.5	92.8	89.3	87.8
1972		100.0	14.3	100.0	100.0	100.0	100.0
1973		125.7	25.7	129.1	113.4	118.9	123.8
1974		175.8	39.9	184.7	149.7	174.6	167.6
1975		250.4	42.4	246.9	206.3	238.0	236.1
1976		309.9	23.8	304.8	266.6	296.4	303.3
QUARTERLY DATA							
1974	I	148.8	6.1	160.4	128.9	150.5	141.3
	II	162.4	9.1	174.2	139.3	166.3	154.9
	III	178.8	10.1	186.0	160.9	179.0	170.3
	IV	209.2	17.0	217.1	169.9	202.7	199.7
1975	I	244.8	17.0	248.3	196.1	226.4	231.3
	II	247.9	1.3	241.5	200.3	232.6	233.9
	III	241.7	-2.5	238.7	209.1	235.8	219.3
	IV	259.2	7.2	255.5	219.3	257.1	254.8
1976	I	275.0	6.1	270.4	230.4	268.8	269.8
	II	299.6	8.9	292.3	260.6	289.9	293.0
	III	308.2	2.9	314.2	268.5	302.7	312.3
	IV	345.8	12.2	342.0	307.0	324.3	338.0

^a These data are for industrial exports excluding diamonds, minerals and fuel.. Input prices are weighted according to each input's weight in total purchases for these branches, according to the Input-Output Table 1968/69 (adjusted to 1972 prices). Output prices for the domestic market are weighted by the sector composition of import.

COMPENSATION RELATIVE TO THE DOMESTIC MARKET, 1966-1976
 1972=100)

Weighted price of inputs	Change from previous period	Relative profitabi- lity of inputs (1):(6)	Change from previous period	Output prices in domestic market	Change from previous period	Relative compen- sation to exporter (1):(8)	Change from previous period
(6)	(6A)	(7)	(7A)	(8)	(8A)	(9)	(9A)
70.8		78.7		74.3		75.0	
79.5	12.3	97.6	24.0	82.7	11.3	93.8	25.1
88.8	11.7	98.5	0.9	90.0	8.8	97.2	3.6
100.0	12.6	100.0	1.5	100.0	11.1	100.0	2.9
120.6	20.6	104.2	4.2	117.9	17.9	106.6	6.6
171.0	41.8	102.8	-1.3	163.9	39.0	107.3	0.7
233.1	36.3	107.4	4.5	216.3	32.0	115.8	7.9
292.5	25.5	105.9	-1.4	464.3	22.2	117.3	1.3
147.4	9.3	100.9	-3.0	142.7	10.4	104.3	-3.9
161.4	9.5	100.6	-0.3	158.0	10.7	102.8	-1.4
176.0	9.0	101.6	1.0	169.2	7.1	105.7	2.8
198.8	13.0	105.2	3.5	185.5	9.6	112.8	6.7
225.6	13.5	108.5	3.1	205.2	10.6	119.3	5.8
227.8	1.0	108.8	0.3	212.0	3.3	116.9	-2.0
229.3	0.7	105.4	-3.1	215.2	1.5	112.3	-3.9
248.2	8.2	104.4	-0.9	232.8	8.2	111.3	-0.9
260.8	5.1	105.4	1.0	242.2	4.0	113.5	2.0
284.3	9.0	105.4	0.0	258.2	6.6	116.0	2.2
298.8	5.1	103.1	-2.2	268.8	4.1	114.7	-1.1
326.0	9.1	106.1	2.9	228.0	7.1	120.1	4.7

Since the rise in domestic prices, caused by cancelation of subsidies or rising indirect taxation, do not reflect the rise of producer prices, their effect has been deducted since the beginning of 1974. This deduction should be regarded as only an estimate.

of world trade. There has been rapid development in Israel in recent years in sectors making extensive use of advanced know-how and technology, while in world trade in conventional industrial products the weight of developing countries, where manpower is relatively cheap, increased considerably.

a. Agricultural Exports

In these exports there was a slowdown in 1976 after the rapid growth of 1975. This stems from the quantitative decline in citrus exports, but in other agricultural exports as well, there was a slowdown in the main components: vegetables, flowers, fruit and cotton.

Israeli exports have a great weight on the citrus market in Europe, and their development is therefore dictated mainly by demand. In the previous citrus season the countries competing with Israel suffered from unsuitable weather while the local crop enjoyed favorable conditions, and growth was better than usual. This combination of factors made possible the extraordinary increase in the quantity of citrus exports and in their prices in 1975. This year the citrus crop has not enjoyed these exceptional advantages, and the high export level of the previous year was maintained because the fast-growing Eastern European market is open to Israel's competitors.

Other agricultural exports grew in the last two years, in real terms, by about 30 percent per year. The price increases of these exports in dollars were more rapid than the general rate of inflation in the countries of destination and of industrial exports. This rapid expansion is due to a number of factors: agricultural export, like agriculture as a whole, is a very organized sector. This makes possible the efficient assimilation of know-how and professional experiences, which are the basic reason that Israeli agricultural products are singled out abroad. The strong internal organization also contributes to the ability to determine production quotas and to prevent internal competition. Marketing of exports is almost entirely in the hands of one company, whose only task it is. Commercial activity in this field is concerned with the following subjects: differentiation of prices among various markets in order to maximize revenue in a short time; determination of a price policy that will prevent the penetration of competitors over the long run; quality control and building a solid reputation. Penetration of new markets and introduction of new products to existing markets are also being carried out. A great part of the agricultural products are at a stage of "making acquaintance" in the market, and the quick growth of exports is being made possible due to a process creating demand by supply. The expansion of demand for Israeli agricultural products can furnish the explanation for the growth in the quantities exported and their prices.

b. Industrial Exports

The fast upward trend in exports that began at the end of 1975 continued until the third quarter of 1976. In the last quarter of the year, the growth of industrial exports, excluding diamonds, slowed down considerably. There was no significant change in the first quarter of 1977.

The quick growth stemmed from the group of metal branches and electronics. This group has been characterized by rapid growth since 1974, mainly due to the growth of defense exports. The halt of industrial export growth (excluding diamonds) at the end of the year and at the beginning of 1977 also stems mainly from defense exports.

In the light industries group there has been a fitful increase since the end of 1975. In this group, which mainly includes products intended for private consumption, the main influence of the world economic recovery on Israeli exports is concentrated. In contrast to 1975, there was an increase of exports in these sectors in 1976, together with growth in their output for the domestic market; at the same time the weight of exports in output increased.

In the chemistry and mineral branches, a significant rise in the real level of exports became noticeable only at the end of 1976 and the beginning of 1977, while in diamonds, in contrast to other industrial exports, growth was accelerated in the second half of the year and at the beginning of 1977.

The dollar prices of industrial exports fell in 1976 as compared to 1975, although the trends in each of these years were different: during 1975 prices fell, while in the course of 1976 they rose. This course of development was affected by the changes in the export prices of all industrial countries, and it demands an explanation, because it took place at a time of a continuous increase of domestic prices in most countries. The global recession in 1974 and 1975 brought about, somewhat belatedly, a decline in input prices in the course of 1975, a sharpening of the competition in export markets, and a moderation of wage increases in industrial countries at the end of 1975 and the beginning of 1976. The rapid emergence from the recession at the end of 1975 was expressed in a quick rise of productivity until the beginning of 1976, and the combined result of these factors was a reduction of costs and prices in the course of 1975. At the end of 1976 the continued recovery brought an inversion in trends and the renewal of price increases. In addition, the dollar became stronger in relation to the main Western currencies between the middle of 1975 and the middle of 1976, and this resulted in a drop of dollar prices.

1. Defense exports

After declining in real terms in 1973, defense exports rose by 15 percent, 85 percent and 80 percent in the years 1974, 1975 and 1976, respectively. The changes that took place in defense exports had a decisive influence on the development of the metal and

TABLE IV-14
UNIT WAGE COSTS IN ISRAEL AND EIGHT LARGEST INDUSTRIAL COUNTRIES^a, 1966-1976
 (Index: 1970=100.0)

Year	Israel			8 largest industrial countries		Unit wage cost ratio between Israel and the Eight	
	Unit wage cost	IL return to exporter	Unit wage cost less IL return to	Unit wage cost less return to exporter	Unit wage cost discounting domestic exporter ^b		
	(1)	(2)	(3)	(4)	(5)	(3):(4)= (6)	(3):(5)= (7)
1965	85.4	69.3	123.2	101.7	102.2	121.2	120.6
1966	94.6	71.8	131.8	102.0	101.6	129.2	129.7
1967	94.6	80.2	118.0	100.4	99.9	117.5	118.1
1968	90.2	87.2	103.4	98.4	99.6	105.1	103.9
1969	90.2	90.5	99.7	97.9	99.3	101.8	97.9
1970	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1971	105.7	112.8	93.7	103.2	100.4	90.8	93.3
1972	113.9	128.9	88.4	105.4	99.5	83.3	88.8
1973	129.2	162.0	79.8	102.8	96.6	77.6	82.6
1974	170.5	226.5	75.3	94.1	88.0	80.0	85.5
1975	235.0	323.3	72.7	98.7	93.1	73.6	78.1
1976	302.0	400.4	75.6	94.7	88.8	79.8	85.1

^a Column (2) — the average effective exchange rate doubled in the export price index in dollars (industrial exports, excluding diamonds, minerals and fuel).

Column (4) — the data of the eight countries has been weighted according to each country's weight in the total exports of these countries.

Column (5) — the data of the eight countries has been weighted according to each country's weight in Israel's industrial export, excluding diamonds.

^b Discounted by the exchange rate.

SOURCE: Publications of the IFS, OECD and NIER for various years.

electronics sectors, and they were the main cause for most of the increase in the weight of exports in industrial output at fixed prices.

Defense exports are characterized by a high degree of substitution in production between domestic and export targets: there is almost no difference between products for the domestic market and for export from the point of view of the general character of the product and its quality — a situation that is different from that in other industrial exports. In this situation, the transfer to exports is easier and quicker. The contribution of the reduction in domestic demand to the increase of exports in these sectors should be viewed against this backdrop: after a considerable growth in the domestic defense consumption of industrial products in 1974, it decreased both in 1975 and 1976.

Considerable marketing efforts have been made in recent years in the field of defense exports. These efforts were made at a time of substantial growth in the world market for military products. This development is related to the effects of the Yom Kippur War on the build-up of arms reservoirs in various countries as well as the growth of demand for arms by the OPEC countries, a market that is generally closed to Israel. At the same time the share of small and medium-sized countries in arms trade has been on the rise for a number of years at the expense of the U.S. and the Soviet Union (The sudden decrease of their share in trade in 1973 is an expression of the influence of the war on arms consignments of the U.S. and the Soviet Union to the Middle East, but it seems that the trend is being maintained.) The demand for these exports is apparently dictated to a great extent by political developments that are in the nature of things unstable.

CHANGES IN INTERNATIONAL ARMS TRADE, 1970–1975

(percent)

	1970	1971	1972	1973	1974	1975
Change in arms import of Third-World countries (excl. Vietnam and the Middle East)	–18	44	–21	11	50	39
Weight of countries, excl. the U.S. and the Soviet Union, in arms exports to Third-World countries (incl. Vietnam and the Middle East)	20	29	37	17	33	29

SOURCE: Stockholm Institute for Peace Research, 1975.

Defense exports are generally composed of a large group of relatively old-established products, and a fair-sized group of new and sophisticated products that represent advanced technology, being partly the result of local development in recent years. This differentiation is important in order to determine the source of competitiveness of defense exports. In the latter group, quality and the suitability to specific requirements are more

TABLE
COMMODITY EXPORTS BY BRANCH,
(Index: 1972=100.0;

		Total agricul- tural exports	Mining and quarrying	Food	Textiles clothing & leather	Other light industry ^b
1973		95.0	87.9	100.1	93.6	94.9
1974		98.7	103.5	98.5	91.2	87.8
1975		121.6	87.7	90.1	87.9	87.8
1976		133.3	86.5	110.0	100.3	103.2
1973	I	98.1	93.8	103.4	98.0	102.8
	II	92.0	89.9	105.0	98.9	96.4
	III	97.6	111.5	113.7	93.9	102.7
	IV	89.0	57.6	79.7	84.0	79.1
1974	I	91.2	88.9	105.3	102.1	98.4
	II	106.6	98.6	105.9	91.9	86.3
	III	91.9	118.2	88.9	89.2	86.3
	IV	107.2	111.5	94.4	82.9	82.2
1975	I	112.6	109.4	89.5	80.0	82.7
	II	117.8	95.3	82.1	80.8	87.4
	III	128.4	62.3	94.7	90.3	89.4
	IV	140.6	80.8	93.7	98.1	91.1
1976	I	125.2	79.7	94.6	102.4	93.0
	II	141.9	84.9	103.8	100.9	99.8
	III	155.2	87.6	119.1	99.7	101.7
	IV	136.0	93.7	120.5	97.8	113.9
1977	I ^d	121.7	94.9	103.9	113.1	142.8

^a The adjustment was made from quarterly data, in order to take seasonal prices into account.

^b Exports of wood, paper, printing, rubber and plastics, nonmetallic minerals and other industries.

AT FIXED PRICES, 1972-1976
 seasonally adjusted data^{a)}

Chemicals, excl. fuel	Metal & electronics industries ^c	Diamonds gross	Total industrial export, (gross)	Industrial exports, excl. diamonds	Industrial excl. diamonds, & fuel	Total net exports, excl. ships & aircraft
118.8	101.0	112.2	104.5	98.5	100.0	103.0
168.3	131.7	109.8	110.2	110.3	111.5	108.8
165.9	169.0	111.5	110.3	109.0	117.1	116.3
178.5	258.2	129.8	137.1	141.5	149.6	135.4
113.9	100.9	111.5	105.9	100.1	100.8	104.9
115.1	100.0	122.2	109.1	99.7	101.2	108.0
143.4	104.4	129.5	118.9	111.1	111.7	116.2
105.4	97.6	85.1	84.4	84.3	87.0	83.9
151.0	113.9	109.2	109.9	108.8	110.1	105.3
166.0	122.4	109.2	108.4	108.8	110.2	108.7
181.3	143.8	101.4	109.6	115.9	116.5	109.1
171.8	143.7	118.6	112.4	107.8	108.6	111.9
174.2	152.7	106.7	107.1	106.5	111.5	105.7
160.5	153.6	113.4	107.5	103.4	109.5	107.3
154.0	144.8	110.7	107.4	104.6	114.6	109.0
172.3	222.4	114.7	118.5	120.8	131.4	119.1
140.1	217.0	120.7	123.3	124.9	129.8	122.3
170.6	254.7	117.7	129.1	136.7	145.3	129.5
181.6	272.5	137.2	145.8	150.3	159.7	144.7
201.7	289.5	143.3	148.6	151.6	160.0	146.1
222.8	247.6	168.2	160.6	152.0	160.2	

^c Industrial exports of metal and metal products, machinery, transport equipment, electricity and electronics.

^d The data for the first quarter of 1977 are temporary, and were calculated at prices of the last quarter of 1976.

TABLE IV-16

INDUSTRIAL EXPORT PRICES OF ISRAEL AND THE INDUSTRIAL COUNTRIES

(Index: 1972=100)

		Israeli industrial export, excl. diamonds	Industrial countries export
1972		100.0	100.0
1973		120.6	119.3
1974		159.8	150.0
1975		169.1	167.5
1976		163.9	168.4
1975	I	178.1	172.8
	II	175.2	171.9
	III	165.3	167.0
	IV	160.1	162.3
1976	I	162.7	164.0
	II	163.0	164.9
	III	162.4	169.3
	IV	166.9	173.7

important than the price, and the Israeli product stands on its own mainly due to its uniqueness and the quality of service that it is able to provide. In the former group of products, Israel's advantages are mainly due to size and relatively low wages.

The rapid development of defense exports and their great relative importance in exports raises certain questions : does Israel in fact have a relative advantage in the export of technologically advanced products in general, and in defense in particular; does the policy of export encouragement – which has not been directed to these branches to any great extent – allow this advantage to be measured²¹. Another question is whether one should view positively the growing dependence on defense exports, which are to a great extent tied to unstable factors. The fear of instability in defense exports necessitates the growth of civilian exports at a pace more rapid than that of the past year. It should be remarked here that trade in durable products, with a level of exclusivity, similar to defense exports, to a great extent dictates trade relations in the future due to the clients' need for continuous service from the supplier, and there, at least, is a basis for stability.

2. Diamonds

Exports of the diamond sector grew in 1976, and their growth even accelerated towards the end of the year. The demand for ornamental diamonds is related to the level of real income in developed countries, which have in fact been on a course of recovery since the end of 1975. However, the 16 percent (gross) annual growth rate of diamond exports exceeds what could have been expected from such a rate of recovery of incomes. It seems that there are a number of reasons for this development: Israel's competitors did not reach their full strength in 1976 – the Indian diamond industry is undergoing a prolonged crisis due to governmental policy, and the Russian industry, an important competitor, has in the last year directed a great part of its output to internal needs, apparently as a means of fighting inflation; the Israeli diamond sector specializes in small stones, and in view of the fact that diamonds have a high income-elasticity, mainly in the middle-income strata, this kind of product is more suitable than large diamonds to this public. In addition, the effective exchange rate for diamonds has increased very quickly since the end of 1975 as compared to other exports. At the end of 1976, demand for diamonds was also influenced by speculative factors due to an expected increase in the prices of raw materials in 1977 (which indeed materialized).

The outstanding development in the diamond sector this year was an increase in the number of employees. In addition, for a number of years the sector has been undergoing a process of development and investment in equipment, which has apparently enhanced the relation between capital equipment and output.

²¹ For example: the law for the encouragement of investments deals mainly with the encouragement of investments in physical assets, and it does not deal with industries that invest relatively great amounts in the development of knowhow.

TABLE IV-17
CHANGES IN EXPORTER COMPENSATION COMPONENTS, 1973-1975
 (percent)

	1973	1974	1975	Increase or (-) decrease from previous period								
				1976	1975				1976			
					I	II	III	IV	I	II	III	IV
1. Export prices in dollars ^a	18.3	24.4	9.4	-1.3	3.3	0.8	-4.5	-2.7	1.1	-1.5	3.6	2.8
2. Dollar exchange rate against basket of currencies ^b	8.2	-1.5	3.3	-6.4	5.6	0.9	-5.9	-2.2	-0.6	-2.0	-0.2	1.1
3. Export prices, deducting the influence of currency fluctuations, (1):(2)	9.3	26.3	5.9	5.5	-2.2	0.8	1.4	0.1	-1.8	0.5	3.8	1.7
4. Average effective IL exchange rate against the dollar	5.0	11.7	34.2	25.3	11.8	1.8	2.3	11.7	4.4	5.9	4.3	7.6
5. Average effective IL exchange rate against basket of 15 currencies, (2)x(4)	13.6	10.0	38.6	17.2	18.0	1.8	-3.7	9.2	3.8	3.7	4.1	8.8
6. Exporter compensation excl. influence of currency fluctuations, (3)x(4)	14.8	41.1	42.0	32.2	9.4	2.6	3.8	11.8	6.2	6.4	8.2	9.5
7. Exporter compensation in IL (1)x(4) or (3)x(5)	24.2	39.0	46.7	23.7	15.4	2.6	-2.3	-9.4	5.5	4.3	8.0	10.6

^a Commodities exports excluding diamonds and fuel.

^b Weight of fluctuations in the dollar rate against the 15 currencies according to the relative weight of each country in export to Israel.

^c Reflects the export prices in the currency of the destination countries.

3. Minerals, chemicals and petroleum

These sectors operated in 1976 in the shadow of a crisis in world trade which began in the second quarter of 1975²². The crisis mainly affected price levels and restrained the rapid real development of 1974, but a slow increase became noticeable in the course of 1976, becoming more prominent at the end of the year and at the beginning of 1977.

Developments of a different character took place in the three main minerals. The Timna mines were shut down in 1976 and copper exports stopped during the year. Potash exports declined in 1976 by 10 percent after a similar decline in 1975. Trends in the course of each of these two years were opposite: there was a drop in the course of 1975 and a slight rise during 1976. Difficulties in exports did not bring about a reduction of the level of activity in the sector, and this resulted in stock accumulation equal to about half the nominal yearly output (at the end of 1976). This is mainly because the current expense component in this sector is small in relation to fixed expenditures.

In the export of phosphates²³ the price level is much lower than that of the first quarter of 1975; but here, too, prices have increased compared to 1975 (although not compared to 1974).

In 1976 petroleum exports increased considerably. This is mainly a conjunctural export, made possible by the geographic location of Israel along the line of transport of raw petroleum to Europe. In fact, part of the excess production capacity in petroleum refining, existing in the country for a number of years, is in this way being used for export.

In the chemistry sector there has been excess production capacity for two years, mainly in raw plastics, fertilizers (basic chemistry) and insecticides. A considerable nominal growth took place in the production of medicines, mainly in real growth at a rate of 34 percent in 1975 and 50 percent in 1976. In the past year and a half, this sector has been an example of considerable export expansion through investments of a marginal nature. The main investments of the sector were concentrated on the adaptation of equipment and plants to accepted international production standards for medicine. These standards are an indispensable condition for world market penetration of these products.

6. EXPORTS OF SERVICES

In 1976 there was an increase of \$ 140 million in the exports of services, as against a decrease of \$ 45 million last year (according to CIF registration of imports), the inclusion of exports to the administered areas does not change this picture. Real growth was much

²² A more extensive survey of this crisis can be found in the report of 1975.

²³ Part of phosphate exports which undergoes additional processing into agricultural fertilizer, appears in the exports of basic chemicals and not in mineral exports.

TABLE IV-18
EFFECTIVE EXCHANGE RATES FOR COMMODITY EXPORTS
(Index: 1972=100)

		Official exchange rate	Average effective exchange rate for industrial exports	Effective exchange rate in the high incen- tive group	Effective exchange rate for import production	Effective exchange rate of added value			
						Commodities with added value of:		Corrected by import & ex- port prices on commodities with added values of	
						40%	60%	40%	60%
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1972		100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1973		100.0	105.0	105.4	100.7	112.5	108.5	113.9	108.9
1974		106.1	117.6	117.1	111.8	125.1	120.6	127.5	121.3
1975		150.7	158.2	158.2	144.4	178.9	167.4	183.6	168.7
1976		189.0	198.4	197.8	181.2	222.7	208.9	228.1	210.3
1974	I	100.0	109.5	109.6	104.2	117.7	113.2	121.1	114.1
	II	100.0	109.5	109.6	104.2	117.7	113.2	120.9	114.0
	III	100.0	116.3	117.7	112.3	125.8	121.3	127.6	121.8
	IV	124.2	132.6	131.7	126.3	139.8	135.3	141.9	135.9
1975	I	142.9	148.6	149.0	136.9	167.2	157.1	172.5	158.5
	II	143.2	151.6	152.2	137.3	174.6	162.1	179.3	163.4
	III	148.7	156.0	157.9	142.5	181.0	168.2	186.4	169.6
	IV	167.6	172.8	173.4	160.7	192.5	181.9	195.6	182.7
1976	I	174.7	180.1	180.6	167.4	200.4	189.4	203.4	190.3
	II	183.8	191.5	192.0	176.2	215.7	202.5	219.7	203.6
	III	193.3	199.6	202.1	185.3	227.3	213.3	234.7	215.3
	IV	203.9	214.6	216.1	195.4	247.2	229.9	254.8	232.0

NOTES: Column (2) – the effective exchange rate is the average of the official exchange rate and the incentive groups in different periods during the year. The data refer to industrial exports excluding diamonds, minerals and fuel. Column (4) – the official exchange rate plus the defense levy on imports. Columns (5) and (6): (import component – 1 / (4) x (import component) – 3. Columns (7) and (8) – for the correction the appropriate price indices for imports and import inputs were used.

lower than that of commodity exports, and there is no deviation from the long-term trend from this point of view: in the years 1972–1976 exports of services increased by about 14 percent in quantitative terms, while commodity exports increased by 35 percent. The 55 percent increase in prices was identical in both kinds of exports.

The current developments in about half of the exports of services, including tourism and transportation (except those connected with Israeli imports and exports) are dictated mainly by various factors abroad. The influence of the economy on these sectors is exerted mainly through the general level of prices that determines competitiveness with other countries, and through investments that determine the long-range capital stocks in these sectors.

In 1976, there was a great increase of tourism to Israel, causing a growth in the income of the tourism sector and of passenger transportation to Israel by El-Al. The increase in the number of tourists – a process that began during 1975 – reached 28 percent compared to the average of the previous year²⁴. The number of tourists even exceeded the peak level attained in 1972.

For the first time since 1972, there was an increase in tourism from the two main sources: Europe and the United States. Tourism from Europe declined in 1974, and rose again in 1975 and 1976 in accordance with the development of the economic situation in these countries. American tourism, which had grown rapidly in the years following the Six Day War, declined sharply between 1973 and 1975, and began to recover only in 1976.

Due to the great weight of the United States in tourism to Israel (46 percent in 1972 and 35 percent in 1976), the changes that occurred in American tourism, which were more outstanding than those of European tourism, have dictated the general trend in recent years.

The income of the tourism sector increased by about \$ 58 million. The income recorded in the balance of payments is the amount obtained from foreign currency exchanges in banks by tourists and by those providing services to tourists. It therefore does not represent the entire domestic income from tourism, and its fluctuations (apart from the fluctuation in the number of tourists and in the average tourist expenditure) reflect changes in the average exchange per tourist.

The average exchange per tourist rose in 1976, after a drop in 1975 (\$ 541 in January 1975, \$ 298 in December of the same year, and \$ 441 in December 1976 – seasonally adjusted). The annual average level reached \$ 367 per tourist, as against \$ 337 in 1975 and \$ 312 in 1974. The growth in exchanges is only connected to a small extent with the change in the method of payment of incentives to hotel owners, introduced in May 1976²⁵: amounts received by hotels in foreign currency are only about 30 percent

²⁴ For detailed data on developments in tourism, see Chapter XV.

²⁵ At this time there was a change from payment of incentives per declared tourist bed-nights according to a calculation of the amounts received in foreign currency, to payment according to actual foreign currency exchanges.

TABLE IV-19

EXPORT WEIGHT IN INDUSTRIAL OUTPUT, BY TYPE, 1969-1976
(percent)

	Average 1969- 1972	1973	1974	1975	1976
LIGHT INDUSTRIES					
Growth in total output	10.1	7.4	1.1	-1.7	6.0
Direct export	2.5	-0.9	-0.5	-0.4	2.9
Export weight in output	17.5	15.4	15.1	15.0	16.9
Export weight in output ^a	16.6	17.2	14.7	13.7	15.8
TECHNOLOGICALLY ADVANCED INDUSTRIES					
Growth in total output	15.1	3.3	10.6	9.0	3.8
Direct export	1.2	-0.1	2.9	3.4	7.2
Export weight in output	9.0	9.4	11.2	13.4	19.8
Export weight in output ^a	11.2	12.1	12.3	15.5	21.3
TOTAL INDUSTRIES					
Growth in total output	11.7	5.9	5.2	2.1	5.3
Direct export	2.0	-0.3	1.3	1.0	4.2
Export weight in output	14.3	13.7	14.3	14.9	18.1
Export weight in output ^a	14.9	16.1	15.4	16.2	19.0

^a At current prices and effective exchange rate; elsewhere – calculated at producer prices; fixed 1968 prices.

DEFINITIONS: Light industries: Food, textiles, clothing, leather, wood, nonmetallic minerals, rubber and plastics, and other industries.

Technologically advanced industries: metal and metal products, machinery, transport equipment, electricity and electronics.

Total industries: all industries excluding diamonds, minerals and fuel.

SOURCE: Bank of Israel calculations.

of the total in the tourism sector. An explanation of this phenomenon lies mainly in the shrinking of the gap between the official dollar rate and its rate on the black market (it should be noted that the turn-about in the average exchange per tourist occurred before May 1976. See Figure IV-2).

Two central policy subjects in the tourism sector — chartered flights and the effective exchange rate — were discussed this year, though there was no crystallization of policy in either.

There exist mutual influences between tourism and air passenger transportation: prices determined in each sector affect demand in the other. In 1976, discussions focused on chartered flights; the decision to expand these flights in October 1976 was part of a limited controlled experiment. It is worth noting that due to conflicts of interest between the various suppliers of services to tourists, there were similar problem inside the tourism sector itself, which have not yet been dealt with.

The effective exchange rate for the tourism sector is very low compared to that in force in commodity exports, though the added value of the sector is higher than that of most commodities. Over the last four years, the effective rate for hotels was in fact raised more rapidly than the rate for other exports²⁶, but the economic considerations behind the differentiation in exchange rates, as well as the relative downward trend in tourism rates, have not been discussed and are not clear. Within the tourism sector itself, there are differences in incentives to various groups of suppliers of services. Most of the incentives are given to tourist hotels, and the rest to other areas of the sector. This aspect of the policy of effective exchange rates is also surprising.

In the exports of transport services there has been no real change for two years, but there were developments in opposite directions in the subitems during both years. Exports of this sector are closely related to changes in the scope of Israeli trade and that of the world in general. Transport of imports by Israeli companies fell this year more than the decline of imports to Israel, due to serious competition that brought pressure from American shipping companies to increase their share in transport.

The 9 percent growth rate in freight transport between foreign ports was mainly due to the expansion of the world petroleum trade and its repercussions on the activity of the Eilat-Ashkelon pipeline. The decline in the "other transport" items stems from the decrease in amounts received from ship rentals due to the dissolution of the Maritime Company for Fruit Transport. The other components of this item are various port services extended to ships and planes arriving in Israel, and in these there was no significant change. Transportation of passengers by El-Al was affected, as mentioned above, by the increase of tourism in 1976.

²⁶ The effective exchange rate for hotels increased, from the beginning of 1973 until the end of 1976, by 134 percent, as against 114 percent in the group of products with a high added value, but at the end of this period, it had only reached 92 percent of the group's rate, despite the high added value of hotel services to tourists.

TABLE IV-20
EXPORTS OF SERVICES^a, 1972-1976

	1972	1973	1974	1975	1976	Annual increase or (-) decrease in quantity				1976 indices based on 1972	
						1973	1974	1975	1976	Quantity	Price
	(\$ million)					(percent)					
TRANSPORT	396.2	476.9	752.2	738.1	786.9	11	24	-1	0	137	145
Export shipments	33.5	42.2	62.4	77.6	81.3	15	13	25	1	162	150
Shipments between foreign ports	134.3	164.4	284.5	263.8	300.3	11	32	-7	9	149	150
Import shipments with Israeli firms	71.7	104.8	167.5	181.2	165.6	33	24	9	-12	157	147
Passengers	86.0	86.3	117.6	107.0	130.1	2	12	-14	12	109	139
Other	70.7	79.2	120.2	108.5	109.5	-2	27	3	-12	112	138
INSURANCE	148.1	178.4	249.7	202.4	248.5	4	15	-29	13	96	176
Export shipments	6.0	7.2	10.7	8.0	8.0	-10	35	-33	-2	81	165
Import shipments with Israeli firms	6.1	12.2	14.6	14.4	13.4	56	-8	-2	-5	135	163
Other	136.0	159.0	224.4	180.0	227.1	2	15	-31	15	94	177
Tourism	212.0	230.4	195.0	233.6	291.3	-7	-36	20	16	84	164
Capital services	127.0	239.7	354.0	321.0	303.2	54	25	-13	-8	154	155
Government n.e.s.	27.0	19.0	26.0	24.0	24.0	-39	4	-7	-5	56	159
Other services	137.0	145.7	172.2	185.5	190.9	-9	-10	8	-2	87	160
Total	1,047.3	1,290.1	1,749.1	1,704.6	1,844.8	8	8	-4	2	114	155

^a Exports, FOB, imports, CIF, excluding exports to the administered areas.

The freight insurance item is related to the extent of import and export transport and is not subject to great fluctuations. In the "other insurance" item, there is a close relationship between the credit and the debit side of the balance of payments, since claims payments on the credit side are offset by premium payments and commissions on the debit side and vice-versa. The net balance was negative, but there was a reduction from \$ 40 to 30 million this year.

The credit side in the item of capital services is connected with foreign currency balances of the economy. Despite the increase that occurred in 1976 in the balances, there was a decline in amounts received for capital services. The reason is the drop in interest rates in the large industrial economies during 1975, and their stabilization at a low level during 1976, due to the slow recovery of investments in those economies. In addition, currency fluctuations brought a larger share of the income received in this item in 1975 than in 1976.

Exports of other services include production factor payments in Israel for management, performance of work abroad, and various commissions and royalties. The small increase of value in this item (\$ 7 million) mainly reflects price increases.

