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Chapter 1

The Israeli Economy: An Overview

i. INSTITUTIONAL AND POLITICAL FRAMEWORK

Israel was declared an independent state on May 14, 1948. Palestine, part of which became the state of Israel, had belonged for many centuries to the Turkish Ottoman Empire. During 1917–18, toward the end of the First World War, the country had been captured by the British army and remained subject to British military rule until 1921. In that year, Britain was accorded a mandate over Palestine (along with other territories in the Middle East) by the League of Nations. The mandate expired following the decision of the United Nations General Assembly, on November 29, 1947, to partition the country into two separate, independent states—one Arab and one Jewish—with close economic ties (such as a customs union) between the two. In fact, however, following the UN decision, a war (referred to in Israel as the War of Independence) broke out between the Jews and the Arabs of Palestine (joined later, on May 15, 1948, by the neighboring Arab countries). As a result, the intended Arab state in the parts of Palestine outside Israel did not come into existence; instead, most of this territory became part of the kingdom of Jordan. Since 1948, the state of belligerence has continued between Israel and the Arab countries; there are, therefore, no economic relations between Israel and the countries immediately bordering on it.[1]

During the period of the British mandate, Palestine was governed, for most purposes, as a British colony. The local sovereign was the British High Commissioner, but all principal decisions were made in London. In the economic sphere, the degree of local autonomy was rather small. The annual budget of the government, as well as any decision on specific taxes, had to be approved by the British government in London. The Palestinian currency (legal tender after 1927, when it replaced the Egyptian currency) was managed by the Palestine Currency Board (run, again, from London), and had 100 per cent coverage (in fact, slightly more) in British short-term assets in the form of Treasury bills. Thus, no fiat money was issued in Palestine, and there was no equivalent of a central bank. Israel's central bank, the Bank of Israel, was not established until 1954. From August 1948 until that time, Israeli currency (the pound) was issued, through a special treaty with the government of Israel, by the Issue Department of Bank Le'umi Le'Israel, the country's largest commercial (but publicly owned) bank. The treaty specified, first, a 50 per cent coverage of currency by foreign assets. But a change, introduced very shortly thereafter, made Israeli Treasury bonds and bills equivalent to foreign assets, thus in effect freeing loans to the government by the Issue Department from any legal ceiling. Under the Bank of Israel law, lending to the government may not exceed 15 per cent of the size of the annual budget and must be fully repaid by the end of each fiscal year. But this regulation has been circumvented by special legislation permitting frequent funding of current government borrowing from the Bank.

During the British mandate, the country as a whole lacked the mechanisms needed to conduct a discretionary economic policy. However, the Jewish sector had begun to develop, according to the popular phrase at that time, as a "state in the making." Its political and economic autonomy was partly the result of traditions inherited by the British government from the Ottoman Empire and partly the outcome of special circumstances applying to the Jews in Palestine. The Turkish Empire, particularly during the last century of its existence, had granted a large measure of autonomy to members of various religious groups and sometimes to ethnic or national groups. Thus, an autonomous Jewish community already existed during the period of Ottoman rule and further developed its institutions under the British mandate. Among the most important aspects of this development was the maintenance of a separate system of elementary education (not financed out of the government budget) which, while lacking the compulsory status a state law might have given it, was still almost universal. The other important source of autonomy was the recognition—first by the British government itself, in the "Balfour Declaration" of 1917, and then by the League of Nations—of the special status of the Jewish people in the affairs of Palestine. Under the terms of the 1921 mandate of the League of Nations, the Jewish Agency for Palestine was established. Its membership included representatives of both the world Zionist movement and (most of the time) other, non-Zionist elements of world Jewry. Under the terms of the mandate, the Jewish Agency was recognized as the political body representing the Jewish sector in Palestine, a body which the mandatory government was supposed to consult with continuously. Although the contact between the government and the Jewish Agency was rarely as harmonious as had been intended under the terms of the mandate or anticipated at the time of its granting, the Jewish Agency nevertheless became a very powerful institution, probably even more so in the economic than in the political sphere, since it became the channel for economic aid from world Jewry to the Jewish sector of Palestine. In particular, it was responsible for establishing most of the Jewish agricultural settlements in Palestine, and for promoting some (but not the major part of) industrial development.

When the state of Israel came into existence, the Jewish Agency of course lost most of its political functions. But, though most aspects of economic policy are conducted by the government of Israel itself, a few important economic functions have been left to the Agency. Relations between the Agency and the Israeli government were determined by a special treaty concluded a short time after the establishment of the state. The Jewish Agency is still the vehicle through which most donations from world Jewry are channeled. These funds are intended to finance the transfer of immigrants and, primarily, their resettlement in the country, functions still performed by the Jewish Agency. For the most part, resettlement of immigrants has been in agricultural settlements. Consequently, the task of establishing new settlements and supporting them financially for a time has been left primarily to the Agency. Other important areas of activity of the Agency have been housing and education.

Another very important economic-social (and, to some extent, political) organ is the Histadrut, the general organization of workers, which was established in 1921. It is, first, a comprehensive labor union, much more universal and centrally organized than most other labor union movements outside the Eastern bloc; the majority of the workers have always belonged to the Histadrut. The organization as a labor union is subdivided primarily into local (city or town) "councils," rather than being a federation of unions. Countrywide unions, within the Histadrut, are only a recent phenomenon. Due to the circumstances in which it operated under the British mandatory government, the Histadrut has grown, however, into much more than a labor union. It has developed a social security system, the most important part of which is its health service, which provides medical care for over half the Jewish population.

The Histadrut is also the roof organization of a widespread cooperative movement, which has a variety of forms of cooperative in production, distribution, and services, although in practice the connections between elements of this movement are rather loose. In production, cooperatives are found chiefly in agriculture, where they are the chief form of production unit. These have either the form of a "kibbutz," a collective settlement in which all production and most of the consumption are done jointly, with no private ownership of capital; or a "moshav," a settlement of separate farm holdings with a large measure of cooperative organization of production and distribution. Histadrut cooperatives also account for most passenger transportation and a large fraction of cargo transportation. In addition to its functions in the cooperative movement, the Histadrut owns a large number of manufacturing firms outright, through a wholly owned holding company. This direct involvement of the Histadrut started in the 1920s, in the construction industry, chiefly as a means of providing and assuring employment; but it has gradually spread into practically all branches of production.

Although it is likely that the Histadrut would not have been developed in the same way had it begun under the aegis of an independent Jewish state, the establishment of the state of Israel in 1948 has not radically changed the form, functions, or relative size of the organization. It has been estimated that in each of the years from 1953 to 1960 the share of the Histadrut sector in the widest interpretation of its involvement in the economy—including, among others, the health service, all cooperatives, and plants owned directly—amounted to about one-fifth of the net domestic product.[2]

On the whole, the British mandatory government of Palestine restricted itself to the "classical" roles of government. Its direct handling of productive activity was limited to two major public utilities, the postal services and the railways. The government of Israel, on the other hand, has interpreted its functions in a much broader sense, along the lines of a "welfare state." In addition, the Israeli government is heavily engaged, through a multitude of public corporations it owns either wholly or partly (very often jointly with the Jewish Agency or the Histadrut), in various aspects of the economy's productive process.[3] As a result, the share of government in the Israeli economy also exceeds the share of government usual in most Western-type economies, although the difference is probably not substantial. In the 1950s, the share of the public sector in the net domestic product is also estimated to have been about one-fifth. Of this, roughly three-quarters (that is, some 15 per cent of the domestic product) are accounted for by the government's general activity; and the other quarter (that is, 5 per cent of the product) is due to the productive activity of public corporations.[4]

The Israeli economy may thus be characterized as a "mixed" economy, in which roughly three-fifths of the product originates in the private sector, one-fifth in the public sector, and the other fifth in the Histadrut sector. As will be noted shortly, however, the impact of governmental activity on the economy is considerably greater and more pervasive than would be indicated merely by its share in the national product.

Despite enormous changes in all other aspects of Israel's economy and society, the country's political structure has been remarkably stable. Ever since the establishment of the state, the government has been run by a coalition of parties whose precise combination may vary, but which is always dominated by the country's main labor party (called "Mapai" until 1968 and since then the "Labor party"). In fact, since 1933, this coalition has also run the Jewish Agency, the main political organ before the establishment of the state. Thus the coalition has been in power for some forty years. The Labor party is also the dominant party in the Histadrut where, unlike in the country as a whole, it has been the majority rather than the largest minority party, and thus been exempted from the need of aligning itself with others to form a coalition "government." [5] The country's political conduct has thus been determined all along by the Labor party, which is a largely heterogeneous and nondogmatic grouping roughly similar to the main social-democratic parties of western Europe. As in most other aspects of Israeli political life, changes in economic conduct and economic policy have, therefore, been brought about almost exclusively through decisions by the organs (or individuals) of the same party, never by a complete transfer of power from one party to another, and only to a small extent by the changing nature and identities of the minor partners in the coalition government.[6]

Ever since the establishment of the state, economic policy has been conducted in a strong spirit of governmental interventionism. This is partly explained by the ideological background of the governing party, as well as that of a few other elements of the population. Partly, however, it is the consequence of the circumstances prevailing both before and after the establishment of the state. Under the British mandate, economic activities were to a large extent undertaken because they were conceived of as enhancing and furthering the national cause of the Jewish community, rather than as yielding maximum remuneration to the enterprises and people involved. This attitude was especially significant in agriculture, but it was evident in other sectors as well. Not only the community immediately involved, but the Jewish people everywhere, acting through institutions created for these express purposes, were expected to furnish financial and organizational support as well as much of the initiative for these enterprises.

The expectations inherited from that period were not only that the central organs of the community would play a major role in economic activities, but also that these activities would not necessarily be undertaken for the sake of profit making. Sometimes, the latter notion has even taken the extreme form of an implicit assumption that when profits are made, the national cause must have been subverted. Similarly, a substantial fraction of the population as well as many policymakers maintained at the beginning that "economic laws do not hold in Israel."

After the state was established, mass immigration began (see section ii, below), and its absorption was obviously a major economic effort which could be undertaken only by public organs (the government and the Jewish Agency); thus, again, the role of the government was stressed. Other evidence of the same process is that not only since the establishment of the state but before that time as well, the government (including under this term the Jewish Agency) has been a major recipient of capital transfers from abroad. This has led, again, to the assumption of additional roles by the government and has contributed to the idea that the economy should not be "left free" but should be managed by the government. One way, though, in which economic relations with the world—particularly with world Jewry—worked to mitigate this tendency was the perception that an overly managed economy would not be looked upon favorably by Jews in the Diaspora, particularly by the Jewish community in the United States; and would be likely to discourage private investment from abroad. Yet, to repeat, the government's economic policy has been determined throughout, although with diminishing force through time, by the notion that the government's impact should be pervasive and widespread, and that economic activities should be directed by governmental decisions rather than by general and nondiscriminatory policies. The area of foreign-exchange and foreign-trade policy, with which the present study will deal, is one of the more important manifestations of that interventionist spirit.

Interventionism in Israel has never approached the stage of etatism, in which the state is the main organ for carrying out economic activities. Moreover, even the common milder form of binding long-term investment planning—by way, say, of four- or five-year comprehensive plans—has been entirely absent. Even indicative plans, which have been prepared on occasions, have not generally been used as a guide to policy. Planning of large sectors has sometimes been more meaningful; but that, too, has been the exceptional case—found mainly in agriculture—rather than a common phenomenon. On the whole, then, the economy may be referred to as "managed" but not as "planned."

ii. POPULATION AND IMMIGRATION

At the end of 1948, the population in the area which eventually constituted the state of Israel[7] was roughly 900,000, consisting of about 750,000 Jews and 150,000 Arabs and other minorities. By the end of 1972, the population had reached about 3.2 million (see Chart 1-1), of which over 2.7 million were Jews and close to half a million, Arabs.[8] This is an increase of more than 250 per cent over this period of twenty-four years, or an average annual rate of increase of population of about 5.5 per cent, undoubtedly one of the highest rates of increase of population to be found in the modern world.

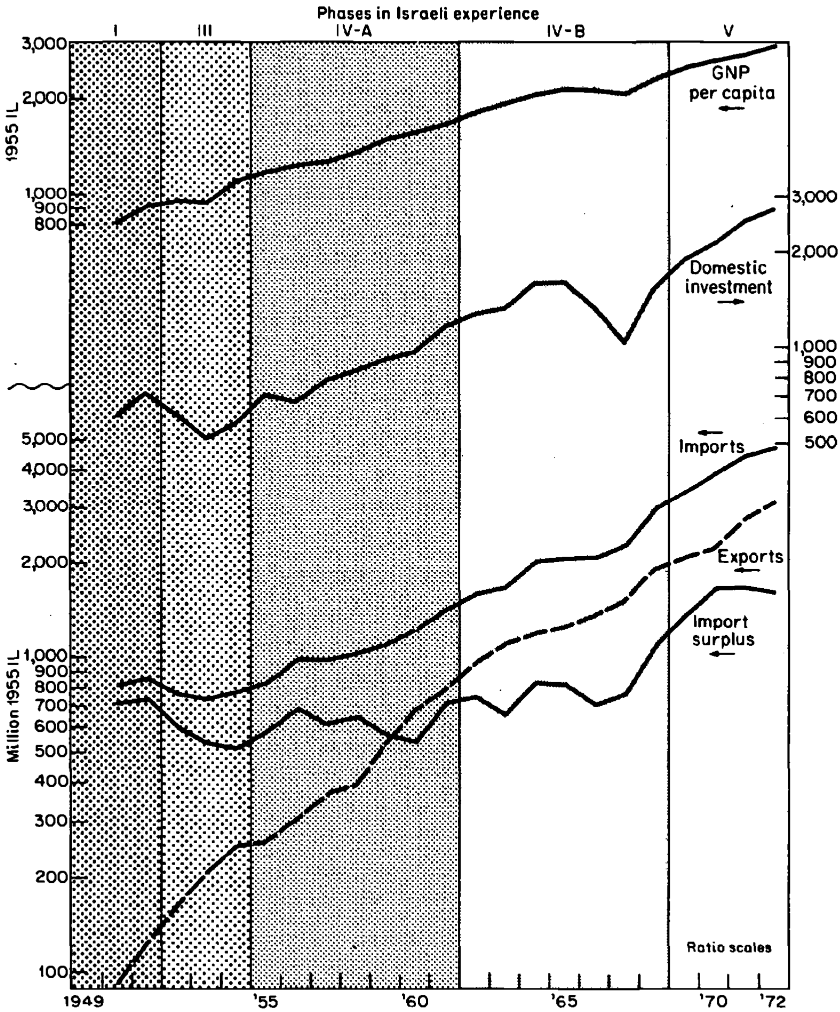
However, the rate of increase of population was far from uniform. The increase in the Arab population was determined almost entirely by the rate of natural increase, which was rather stable over the years (being, incidentally, the highest recorded rate in the world during the last generation). By contrast, for the Jewish population, who are the majority, less than one-third of the increase in population over the period as a whole is the result of natural increase; over two-thirds is accounted for by (net) immigration, the size of which has varied widely over the period. A sharp distinction must be made between the period of 3½ years from May 1948 to the end of 1951 and the rest of the period. In the second half of 1948 immigration amounted to about 100,000; in 1949, to 240,000; in 1950, to 170,000; and in 1951, to 175,000. Over this period of about 3½ years immigration thus amounted to roughly 700,000 people, more than the entire Jewish population in Israel in mid-1948. By the end of 1951, the total population of the country was almost double its size of three years earlier. Then an abrupt change took place, largely because the main sources of immigration were exhausted, but to some extent also due to establishment of a policy of selectivity in financing the transfer of immigrants. In 1952 immigration tumbled to less than 25,000; and in 1953 it was only 11,000. Since then, annual immigration has fluctuated mostly within a range of about 20,000 to 60,000 people. Consequently, the average annual rate of increase of population between 1951 and 1972 was less than 3½ per cent, in contrast to an average rate of over 20 per cent during 1949–51. Very roughly, the increase in Jewish population from 1952 on was provided for in equal shares by immigration and natural increase.

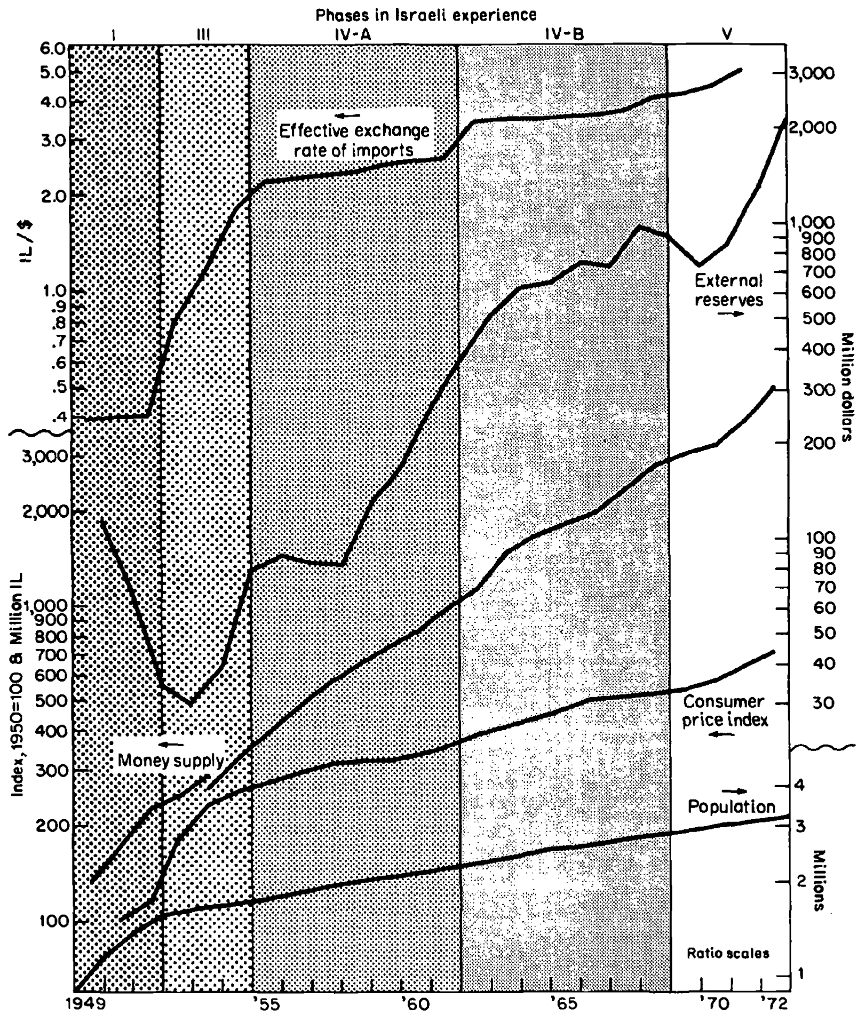
When the state of Israel was established, the educational level of the population was unusually high in comparison with other countries within the same range of per capita income. This was due primarily to the high level of education of immigrants: at that time, the large majority of the adult population had acquired all or most of its education abroad. In particular, the level of education was high among immigrants from Germany, who formed a large fraction of total immigration during the 1930s. The system of almost universal elementary education in the Jewish community in Israel also contributed to the high educational level. Thus, the rate of literacy in the Jewish segment of the population in 1948 was about 94 per cent (it was only some 20 per cent in the Arab segment); and about one-third of the adult Jewish population had completed secondary or higher education.

The great wave of immigration which followed the establishment of the state acted to lower educational standards. At first (in 1948 and early 1949) immigration consisted mainly of the East-European Jews who had survived the World War II holocaust, mostly in concentration camps, and had obviously been denied any education for many years. There followed, beginning in 1949, mass immigration from Asian and African countries, primarily Iraq, Yemen, and Morocco. The educational level of these immigrants was substantially lower than that of the mostly European immigrants of the 1920s and 1930s. Thus, the median number of years of schooling for people aged 14 and above was about 10 for immigrants who came before 1948 and only 7.7 for immigrants who came during 1948–51. By 1954, the degree of literacy of the adult Jewish population had fallen to 85 per cent, and the proportion of graduates of secondary and higher education, to 25 per cent. From then on,

CHART 1-1

Key Economic Variables, 1949–72





SOURCE: Effective exchange rate of imports—Table 4-3; external reserves—Table 2-2; money supply—Table A-16; consumer price index—Table A-17; population—Table A-1; GNP per capita—Table A-2, col. 2, divided by end-of-year population, Table A-1, col. 1; domestic investment—Table A-4; imports, exports, and import surplus—based on Don Patinkin "The Economic Development of Israel" (unpublished; January 1970), App. Table 5, with several modifications and with extensions based on Bank of Israel, *Annual Report*, 1972.

as immigration subsided, the educational system in Israel itself became a major factor. At first, the raising of educational levels by this means was offset by the declining number and weight of the better-educated veteran immigrants; therefore, for a few years, average standards remained at about the same level. By 1961, however, the degree of literacy of the Jewish population reached about 88 per cent (it approached 50 per cent among the Arabs). The proportion of people aged 14 and above with at least some post-elementary education was about 45 per cent, and 10 per cent of the population had at least some post-secondary education. By 1971, these proportions were, respectively, about 55 and 14 per cent.

The immigrants who arrived in the mass wave of the first few years not only had less formal education than the resident Jewish population, but their occupational skills were not in demand in Israel. The majority of the immigrants had been traders, clerks, craftsmen, and artisans, or they had been engaged in personal services. On the other hand, employment demand in Israel —to a large extent determined by governmental decisions about directions of investment and development—was in agriculture, industry, and construction. Even persons previously engaged in areas such as public administration most often could not find employment in the same occupation in Israel, due to language barriers. As a result, the majority of new immigrants—60 per cent —changed their occupation in Israel (even though "occupation" is defined quite broadly in the data), becoming in effect unskilled laborers.[9] Since the occupational structure in Israel itself, in the twenty years following, has not changed radically—and the changes which did take place were gradual— it may be assumed that involuntary mobility of labor among occupations is now much less than in those early years. As a result, it may safely be assumed that the level of skill and proficiency of the population has greatly increased, although, unlike formal schooling, this is not easily subject to comprehensive measurements.

iii. NATIONAL PRODUCT AND EXPENDITURES: SIZE AND COMPOSITION

Gross national product in 1950, the earliest year for which estimates for the Israeli economy are available, was about IL 460 million (in 1950 prices). With an average population of 1.27 million in that year, the per capita annual product is about IL 370. At the formal rate of exchange of that year (IL 0.357 per dollar) this would be approximately $1,000. There is no doubt, however, but that use of the 1950 formal rate of exchange for international comparisons grossly exaggerates the size of Israel's product. Thus, although estimates of per capita national product at constant prices show a substantial increase from 1950 to 1954 (as shown in Chart 1-1), the application of the 1954 formal rate (IL 1.80 per dollar) to the 1954 data on product and population would yield a per capita product of only about $570 per year. It appears that, for comparative purposes, per capita annual product in Israel around the time of its establishment was roughly $400 to $500. By this criterion Israel at that time would probably be classified as being in the border zone between developed and underdeveloped economies—in the same range, say, as the higher-income countries in Latin America.

From 1950 to 1970, the GNP increased (at constant prices) by 615 per cent—over sevenfold—an average annual rate of increase of about 10½ per cent. This is a rate rarely equaled or surpassed by any other economy during the last generation, Japan being the only other case which comes to mind. Part of this spectacular increase in the national product is, of course, due to the unusually large increase of the population and labor force. But even per capita GNP tripled between 1950 and 1971, at an average annual rate of increase of about 5.8 per cent, which is again outstanding (although not a rare exception) by current international standards. For international comparisons, again, per capita annual product in 1970 could be roughly estimated as being $1,500; that is, about the middle of the range of countries that would be normally classified as "developed."

Along with the expansion of population and labor force, growth of the stock of physical capital was another important source of the substantial and consistent increase in the national product. The average annual rate of growth of capital stock during the period 1950–65, for which estimates are available, was 13.1 per cent on a gross basis or 13.5 per cent on a net basis.[10] The increase was particularly rapid at the beginning of the period: in 1950–55 the annual rates of growth were 17.4 per cent gross or 19.5 per cent net. Yet the increase in both labor force and capital stock accounts for only a part of the increase in the national product. Beyond the expansion of the two factors of production, there was a substantial increase in productivity. For the period 1950–65, the average annual growth of "total-factor productivity" was estimated to be within a range of 2.5 to 3.3 per cent depending on the concept of productivity adopted.[11] If residential structures are excluded from the stock of capital, the annual growth of productivity of the private economy is about 4.2 or 4.3 per cent. Per capita product thus increased both by the rise of the stock of capital per capita and by the growth of productivity in the use of resources.

The rapid increase in the capital stock must, in turn, be due to a substantial investment. Indeed, relative to the size of the economy, investment in Israel has been apparently among the highest in the world. For the period 1950–71 as a whole, the ratio of gross domestic investment to GNP was 29 per cent. Although it declined somewhat over the period, the downward trend was rather slight. Thus, the average ratio was 31.7 per cent during the early years, 1950–55, and 27.7 per cent during the latest years, 1969–71. Only in the recession years 1966–68 was this ratio substantially below the trend line.

Normally, such a high ratio of investment would indicate a similarly high ratio of saving to income. This, however, is not the case in Israel, where the saving ratio has been low, the gap between saving and domestic investment being made up by an unusually large flow of capital imports, which will be noted shortly. During the period 1950–71, the average ratio of gross saving[12] to GNP was 7.3 per cent, with no noticeable trend of change over the period. Since this is roughly the ratio of depreciation to GNP, net saving in the economy appears to have been nil, on the average, or even slightly negative. This particularly low rate of saving in the economy is apparently due to the flow of capital imports. The relationship between the two can be explained in three primary ways. First, although the rate of household saving out of disposable income is quite similar in Israel to the rate in other economies at similar levels of development, an important segment of disposable income in Israel consists of unilateral transfers from abroad to the private sector (such as restitution payments from Germany or, mainly in the first few years, private gifts in cash or in kind). Since such transfer payments are treated as part of the national income and product of the paying country, rather than of Israel, consumption out of such income is recorded as negative saving in the Israeli accounts. Second, and similarly, transfers from abroad to the public sector (the government and the Jewish Agency) are, to a minor extent, spent on consumption, and these also are recorded as negative saving. Third, financing of private investment is available on easy terms from governmental sources. Funds are provided largely through governmental borrowing and from unilateral receipts from abroad. As a result, the need of the business sector to save has been reduced.

As the industrial composition of its product indicates, Israel has since its establishment possessed the structure usually associated with a highly developed economy. Agriculture, as has been mentioned, was particularly boosted both before 1948 and during the first few years after the establishment of the state, when a large fraction of the mass immigration was directed to agricultural settlements. But even at its peak, in the middle and late 1950s, agriculture contributed only about 12 or 13 per cent of the national product. This share has gradually declined since then, and by 1970 it was down to 6 per cent. Similarly, the share of agriculture in employment went down from about 17 per cent in the 1950s to less than 9 per cent by 1970. The share of manufacturing in the national product, on the other hand, increased gradually, from about 20 per cent in the first few years after the establishment of the state to about 26 per cent twenty years later. The share of manufacturing in employment increased, too, in roughly the same proportions. About half of the labor force, more than that in more recent years, has been employed in construction and services (close to 10 per cent of the labor force in the former, 40 per cent and more in the latter). The extremely large share of services—in comparison to its share in other economies with the same level of per capita income—is partly explained by the structure of demand (including, among other factors, the share of the public sector in the economy), and by the distribution of proficiencies and previous occupations of immigrants. But a great part of the explanation lies again in the size of the import surplus, which satisfies a large portion of local demand for goods and thus tends to direct local production toward services (which are, on the whole, much less tradable than goods).

iv. FOREIGN TRADE AND CAPITAL IMPORTS

Israel, and Palestine before it, have had a large import surplus ever since exports and imports have been recorded, and probably for many years before that. In Palestine, exports of goods were normally about one-third the size of imports. The Jewish sector of the population accounted for the major part of both exports and imports, and the ratio of exports to imports was even lower for that sector than for the country as a whole. The gap between the two was covered by capital imports. These consisted primarily of transfers by the Jewish Agency and other major public Jewish institutions, transfers of immigrants, and, to a much smaller extent, private investment from abroad. During the years 1940–47, from the beginning of World War II to the evacuation of the country by the British army, sales to the armed forces—recorded as exports of services—were a major source of earnings[13] and were just equal to the gap between imports and exports of goods. The continuation of large capital imports during these years thus led, as a net result, to a large accumulation of foreign assets, primarily short-term investments of the banking system and of the Currency Board in London. These external reserves, which by the end of World War II amounted to over £100 million sterling, were first frozen by the British government and then, near the end of 1949, released for gradual use by agreement between the two governments.

In the first few years after the establishment of Israel, the ratio of exports (of both goods and services) to imports was extremely low, lower than the ratio for Palestine as a whole before World War II, or probably even lower than that for the Jewish population in that period. In 1949 and 1950 exports were only about 15 per cent as large as imports. This ratio increased gradually, particularly during the 1950s, with many fluctuations along the upward trend. By the late 1950s or early 1960s the ratio of exports to imports was roughly 50 per cent; and by the end of the 1960s it was fluctuating around 60 per cent.

The increase in this ratio kept pace, however, with the increase in total imports; and the *absolute* size of the import surplus thus kept rising, as may be seen in Chart 1-1, albeit not monotonically. The annual import surplus (again taking both goods and services) was about $300 million in the late

1940s and early 1950s and, with fluctuations, remained around this level until 1960. During the 1960s, on the other hand, the import surplus rose substantially, especially with the increase in imports of military goods following the Six-Day War of 1967. In the mid-1960s the import surplus fluctuated around $500 million; in 1968 it was about $650 million; and in the early 1970s it was about $1,200 million. Similar trends would appear if trade in goods alone were considered, in order to eliminate the direct impact of military imports (which are recorded as services). On this basis the surplus of imports was about $250–$300 million in the late 1940s and early 1950s, and fluctuated around this level until the late 1950s. In 1965 this surplus was roughly $400 million; it approached $500 million in 1968 and averaged close to $800 million during 1970–72.[14]

Over the period as a whole, autonomous capital inflow from abroad, including both unilateral transfers and long-term borrowing, was roughly equal to the import surplus: by the end of 1971 Israel's external reserves amounted to about $600 million—about $500 million more than the size of reserves (mostly frozen sterling balances) at the end of 1949. This is low in comparison with the accumulated amount of capital imports over this period; and even most of this would be canceled out if short- and medium-term indebtedness to the outside world were offset against it. The over-all rough equality between autonomous capital imports and the import surplus does not mean, of course, that they were equal in any given year: year-to-year fluctuations in the (positive or negative) gap between the two were considerable, as may be seen from the movements of external reserves depicted in Chart 1-1. On this score, a few subperiods may be clearly distinguished. From 1949 to 1951, foreign-exchange reserves were drawn upon extensively and virtually disappeared; they began to recover in 1954, and increased substantially between 1958 and 1967. Between the end of 1967 and early 1970 reserves declined sharply. The trend was reversed again in mid-1970, with a substantial accumulation of reserves in 1971 and 1972, despite the unusually large import surplus in those years.

Over the period from 1950 to 1971, total autonomous capital inflow—including unilateral transfers, long-term (and a minor amount of medium-term) borrowing, and foreign direct investment—amounted to about $11.6 billion. The importance of the various sources of capital imports varied over the years. The most important, and most permanent, single source was contributions from abroad (primarily from the Jewish community in the United States) to Israeli institutions, mainly the Jewish Agency. Since 1951, the Jewish community abroad—again, primarily in the United States—has also provided capital by purchasing issues of a special governmental loan, termed first the "Independence Loan" and then the "Development Loan." In the early 1950s the U.S. government was a relatively important source through two

Export-Import Bank loans. Since 1970 it has again become important through large-scale lending primarily for military purchases. The German government has been another major source. First came the reparations agreement, by which the German government paid the Israeli government about $800 million during the period 1953–63; since 1954, Germany has also been making restitution payments to individuals in Israel, the annual amount of which has been rising continuously. Other important sources of capital imports have been private unilateral transfers, both gifts and transfers of capital by immigrants, and direct investment from abroad, which was substantial mainly in the first half of the 1960s and again in the early 1970s.

Of the above-mentioned total of $11.6 billion for 1950–71, about 23 per cent has been provided by contributions to Israeli institutions, another 10 per cent from the (net) sale of Independence and Development bonds, about 13 per cent through loans and grants in aid from the U.S. government, about 23 per cent from reparation and restitution payments by the German government, some 14 per cent from private unilateral transfers, about 8 per cent from direct private investment, and the rest (about 9 per cent) from an assortment of long- and medium-term loans. Alternatively, about 62 per cent of the total capital inflow consists of unilateral transfers, and 38 per cent, of transfers on capital account. The latter, although the smaller part of the total, have nevertheless left the country by the end of 1971 with a long-term indebtedness to the outside world of about $3.4 billion, in addition to an accumulated value of close to a billion dollars of foreign private direct investment. The combined size of this outstanding indebtedness, about $4.4 billion, was about 2½ times the size of Israel's exports in 1971. By way of a very rough comparison, it was almost as large as the country's national product in 1971, or equal to about 40 per cent of the value of the gross national physical capital at the end of the year. By these or similar yardsticks, Israel's national foreign indebtedness has apparently become by the early 1970s one of the world's highest.

In view of the rapid rise of the economy's product, the rising trend in capital imports and in the import surplus was still consistent with a decline in the relative importance of the import surplus for the economy, as measured, say, by the relation of the size of the import surplus to that of the national product. But, once more, this trend has been far from uniform over the period. Measured in constant (1955) prices, the ratio of the import surplus (excluding from it imports of military goods) to GNP fell from about 43 per cent in 1950–51 to around 14 per cent in 1960.[15] From then on, the average ratio has remained at about that level, with no noticeable trend (although with substantial year-to-year fluctuations). It was lowest during the years 1966–68—mostly a recession period, as will be noted later—when it averaged only 10.5 per cent; but in later years it climbed back to 15 or 16 per cent.[16]

The ratio of foreign trade to the national product, the simplest and most common index used to indicate the importance of the former to an economy, varies radically of course in the case of Israel, according to whether imports or exports are considered. To make these ratios more meaningful, the import component in exports (that is, in essence, reexported imports) is omitted on both sides, leaving only imports for domestic use on the one side and value added in exports on the other. Imports so defined (and again excluding military imports) amounted to 50 per cent of GNP in 1950 and 47 per cent in 1951. The ratio then fell by almost one-half, to 26 per cent, in 1954. From then on no trend appears: the ratio of imports to GNP fluctuates roughly around 25 per cent, reaching its highest level, close to 30 per cent, in the most recent years.[17] It may be presumed that the ratio of around one-fourth of GNP for most of the period is high by international standards, although similarly adjusted measurements for other economies are not readily available. The more conventional method of comparison—the ratio of total imports of goods and services to GNP, where imports include the import component in exports and military imports, GNP is estimated at current prices, and the import surplus is converted at the formal exchange rate—fluctuates most of the time around a level of 40 per cent.[18] This ratio is about the same as in other small, industrial economies. In distinguishing among major categories of national expenditure, it is seen that imports are the least important in private consumption, where the import component (whether direct or through the use of imports in domestic production of consumer goods) has been slightly over 20 per cent. The ratio is somewhat higher in public consumption, particularly in recent years, due to the large increase in military imports; still higher in investment; and highest in the production of export goods, where the import component approaches half of the gross value of exports, leaving only somewhat over half as value added.

The ratio of value added in exports to the economy's total value added, its gross national product, is a rough indication of the share of the country's productive resources involved in production for exports. This ratio, again valued in 1955 prices, was at first negligible: in the first half of the 1950s, it fluctuated around a level of 5 per cent. From then on, a rising trend is clearly visible: in the early 1960s the ratio was about 10 per cent, and by the early 1970s it approached 15 per cent. With time, then, a significant share of the national economy was accounted for by exports, although even in recent years that share has been less important than in other small economies.

The growth of exports was accompanied by a considerable change in their structure. In the early 1950s almost half of total exports of goods consisted of citrus fruits (mainly oranges). This category had a predominant share indeed of total exports when measured in terms of value added (the share of value added in total value of citrus fruits is particularly high—about 70 to 75 per cent). Of the rest, mostly industrial exports, about half were polished diamonds, in which the value added is only about 20 per cent of total value. Thus, all other industries accounted for only about one-quarter of total exports of goods (slightly less in terms of value added). Exports of services were at that time negligible. Since then, a few strong trends appear in the development of exports. The share of citrus fruits has fallen sharply, amounting in recent years to only about 12 per cent of the gross value of exports of goods or about one-fifth of value added. The share of polished diamonds has been roughly maintained, amounting to about a quarter of the gross value of exports of goods but less than 10 per cent of value added. In recent years, two-thirds of exports (in both gross and value-added terms), compared with a mere one-quarter in the early 1950s, have consisted of an assortment of industrial goods and some agricultural products other than citrus fruits, chief among the former being textile products, chemicals, and metal products. Valued in current dollar prices, exports of goods other than citrus fruits and diamonds increased between 1950 and 1970 from $7.5 million to $446 million, an average annual rate of growth of close to 23 per cent. Even in the latter part of the period, and starting from a higher base, the rate of growth of this group is still impressive: in 1960, for instance, these exports amounted to $108 million, and the average annual growth from then to 1970 has been about 15 per cent.

In addition to goods exports, a particularly rapid growth has occurred in exports of two services: tourism and transportation (both sea and air). While in the first few years these exports were negligible, even in relation to the size of exports of goods, by 1970 they amounted to $257 million for transportation and $103 million for tourist services. This is the equivalent of about half of the total of $730 million yielded by exports of goods; in terms of value added, which is high in the sale of tourist services but low in transportation, the fraction of services in total exports would probably not be much lower.

The structure of imports, too, has undergone a considerable change. At first, imports of consumer and investment goods were roughly equal, each amounting to close to one-quarter of the total value of imports of goods. Raw materials made up 40 to 45 per cent; and the rest, some 10 per cent, was fuel. Investment goods have approximately maintained their share over the years; but the share of consumer goods has been declining throughout, and that of raw materials rising. Thus, by 1970 imports of consumer goods constituted less than 10 per cent of the value of imports of total goods; imports of investment goods, about 24 per cent; imports of fuels—declining relatively over time despite spreading industrialization—about 5 per cent; and raw materials, over 60 per cent of the total. In imports of services, a noticeable relative increase has occurred since 1968 in imports of military material. These items are not appropriately termed "services," but are accounted as such (under the item "government, n.e.s.") in the balance of payments. Another noteworthy increase has been in the service charges for capital (interest and profit remittances), which in recent years have risen to about $200 million annually, a reflection of the country's growing indebtedness to the outside world.

v. THE INFLATIONARY PROCESS

Inflation has been a permanent attribute of the Israeli economy, although the rate has varied substantially. The increase in the consumer price index between 1949 and 1971 was about 560 per cent, an average annual rate of about 9 per cent. The implied GNP price deflator rose slightly more: from 1950 to 1971 it increased by close to 630 per cent, an annual increase of about 10 per cent. Roughly speaking, therefore, an annual price increase of 10 per cent has been the long-term norm in the Israeli economy.

The inflationary forces were strongest from 1949 to 1951, the first few years after the establishment of the state. But during this period inflation was severely suppressed. Consequently, inflationary pressure was only partially reflected in official prices. From the end of 1948 to the end of 1951, the official consumer price index increased by a mere 16 per cent; but from estimates of the inflationary potential, it would seem that, had prices been free to change, the increase in the index would have exceeded the recorded increase by at least 30 or 40 per cent. The result of the strong suppression of the inflation—accomplished by fixing constant ceiling prices and instituting severe rationing—was the development of widespread black markets, in which prices were often many times the official ones.

During the period 1952–54 the process was reversed. The basic sources of inflation were eliminated. Had price movements not been repressed earlier, price increases in this period would have been very small. In fact, however, prices were freed during this period, with the result that movements of the official prices reflected the preceding inflationary pressure, and with the further result of a closing (from both ends) of almost the entire gap between official and black-market prices. The increase in the official consumer price index from the 1951 to the 1954 average was 127 per cent (in 1952 alone, it increased by 58 per cent!). This was the highest rate for a (recorded) price increase in any period of some length in Israel's history, although at that time basic inflationary forces were weaker than ever. Since 1954, prices have been relatively free, and recorded price changes have probably reflected, by and large, the extent of inflationary pressures.

During the period 1955–61, inflation was relatively modest. Consumer prices rose somewhat less than 5 per cent per year on the average (the record low being achieved in 1959, when prices increased by only about 2 per cent).

From then on until 1965, inflation accelerated again: the average annual change in consumer prices between 1961 and 1965 was somewhat over 7 per cent.

By the fall of 1965, the inflationary trend was reversed, and Isarel's only severe recession started. At first, prices kept increasing. Indeed, consumer prices increased by about 6 per cent during the first half of 1966, when all the phenomena of recession were already obvious. But from then on, prices stabilized: from mid-1966 to the end of 1968 the increase in the consumer price index was less than 4 per cent (it was nil during 1967, the only year with complete price stability in Israel's history).

While the turning point toward renewed expansion probably came in early 1967, prices started to increase again only in early 1969, when the recessionary slack was exhausted. At first, these price increases were mild: the average annual change in the consumer price level from 1968 to 1970 was less than 4.5 per cent. But beginning in the fall of 1970, inflation assumed very substantial proportions: from August 1970 to December 1972, the consumer price index increased by 36 per cent, an average rate of increase of about 14 per cent per year. At the time of writing, it appears that in 1973 this rate of price increase will even be greatly surpassed. The rate of inflation in recent years thus approaches that experienced during the state's first few years, although the forms of inflation are radically different.

As in many other countries, it has very often been debated in Israel whether inflation originates from demand or whether it is of the "cost-push" variety. While the issue probably cannot be resolved with complete certainty, it appears to me that by and large the inflationary process in Israel has been determined by demand forces. Cost factors—increases in the exchange rate, price increases abroad, or autonomous increases in wages—can very rarely be blamed for having started an inflationary development, or having extended its magnitude significantly beyond what it would have been solely as a result of an autonomous increase in demand. More often, cost factors may have accounted for the precise timing of major price increases, increases which would otherwise have started somewhat later or stretched out over somewhat longer periods. A case of this nature which serves probably as the clearest example is the substantial price increase which followed the imposition of a 20 percent levy on imports in August 1970.

A clear association appears between price increases and increases in the money supply in Israel.[19] Over the period from 1949 to 1971 as a whole, money supply increased at an average annual rate of around 19 per cent, slightly less than the combined (and compounded) increase of the real GNP and its price level, which came to about 22 per cent.[20] More important, however, is the apparent association of movements of prices and the money supply over time: usually, the price level follows movements in the money supply with a time lag of about ten or twelve months. Another important factor in determining demand has been the government's deficit, both in its own right, as a direct source of demand, and in its effect on liquidity and money supply. Excess demand by the government has been a constant feature of the Israeli economy. During the "normal" years 1956–66,[21] the excess of purchases of goods and services by the government over net tax collections averaged about 2.5 per cent of the GNP. If net domestic lending by the government is added to it, the provision of liquidity by the government appears to be over twice this size. Other important determinants of the creation of liquidity and of demand have been credit expansion (the rate of which has been more stable than that of other major monetary variables) and, particularly since the late 1950s, the accumulation of external reserves.

It is consistent with the persistent expansion of demand and the inflation that Israel has only rarely experienced mass unemployment. In the first few years, structural unemployment was very substantial: the mass of new immigrants constituted a major addition to the labor force. If they were to be effectively absorbed, they required radical changes in labor qualifications (including changes in their attitude toward various professions). Also needed were major additions to physical capital, changes in the techniques and organization of production, and mass provision of housing for workers, all of which did not (and probably could not) match the rate of immigration and the virtual doubling of population within about three years. As a result, a high fraction of new immigrants (but not of the resident population!) remained for a long time either unemployed or occupied in relief work, a phenomenon which became gradually less important until its virtual disappearance by the late 1950s. As distinguished from this form of structural unemployment, unemployment attributable to insufficient demand appeared only twice. The first time was in 1953, when additional unemployment over that of the preceding years amounted to about 4 per cent of the labor force.[22] This is reflected also in the national product, which in 1953 increased in real terms by only about 1 per cent, compared with 7 per cent in 1952 and 22 per cent in 1954 (and with a long-term average of over 10 per cent).

The other episode of unemployment, which was more severe and lasted longer, was the recession that started in the fall of 1965. The bottom of this recession may be placed in late 1966 or early 1967, but full employment did not return until the end of 1968. Based on semiannual manpower surveys, unemployment in the second half of 1965 amounted to about 40,000 persons (this was nearly a "full-employment" situation); it then went up to a peak of just over 100,000 (more than 10 per cent of the labor force) in the first half of 1967. The number of unemployed then fell to about 60,000 in the first half of 1968; and by the first half of 1969 it was back to somewhat over 40,000, again a full-employment position (although a slight further reduction in the number of unemployed may be seen even in later years). This course is also reflected in the national product estimates: GNP increased in real terms by 6.8 per cent in 1965, 2.2 per cent in 1966, and 1.3 per cent in 1967, an annual average of less than 3.5 per cent compared with an average of close to 11.5 per cent in the four preceding years or with the long-term average of 10.5 per cent.

vi. FOREIGN TRADE AND FOREIGN-EXCHANGE POLICY: DELINEATION OF PHASES[23]

Except in the very early years, Israel's trade and payments policy has developed progressively from restriction to liberalization. The absence most of the time of major shifts in policy makes the delineation of phases difficult and sometimes rather arbitrary. In fact, as will be indicated below, the description of Israel's payments policy as belonging to Phase IV is applicable throughout most of the period, though the nature of this policy did undergo considerable change during that phase. With this qualification in mind, the phases of policy development are as follows:

1948: The Background.

When the state of Israel was established, it inherited a situation and a history of mixed attributes. During the British mandate period, the government's foreign trade policy was probably one of the most liberal. This was, in part, a reflection of the generally conservative way the government looked upon its functions. But it also reflected the conflict of interests between the two population groups in Palestine: the Arabs were mostly engaged in agriculture, which they dominated, whereas manufacturing was predominantly Jewish. Any encouragement of a specific industry by tariff protection or otherwise was likely to favor one nationality at the expense of the other, and was interpreted in this way by the two groups. The easiest way to avoid this issue was, of course, to follow a completely liberal trade policy. A very heavy dose of "natural" protection was introduced by World War II. The overwhelming difficulties in overseas transportation, almost completely isolating the Middle East for a few years, increased not only local demand but demand from the region as a whole for goods produced in Palestine. To this was added a heavy demand by the armed forces stationed in the Middle East. This gave a tremendous boost to manufacturing, which as noted was predominantly Jewish. With the end of the war, as transportation gradually eased, and wartime exchange-control regulations were gradually relaxed, much of this war-born industry disappeared. Thus, the industry still existing by 1948 was mostly competitive; but the memory of what industry had been when not faced by foreign competition remained vivid and was apparently a strong factor in steering trade policy toward protectionism. In addition, it should be recalled that the explicit policy of the institutions of the Jewish sector was always to encourage specific enterprises or economic sectors, and that the general approach of the community was one of interventionism.

By 1948, the foreign-exchange-control machinery was still maintained by the mandate government in its wartime form, although controls were much less severe than during the war. The legal framework of the machinery was adopted by the state of Israel when it came into existence. But the payments situation of the country was much more serious than in 1946 or 1947. In February 1948, as part of a complete "hands off" policy which Britain adopted following the UN partition decision, Palestine was expelled by the British government from the sterling area, and the country's sterling assets were for a time frozen. In addition, exports declined radically as the fighting spread: citrus plantations, the country's main export source, could not be cultivated for the most part, nor could the fruit be exported. The demand for imports, on the other hand, was particularly heavy, due both to the requirements of the war and to the wave of mass immigration which started immediately. Foreign-exchange control thus became much more restrictive as soon as Israel was established.

1949–51: Phase I.

During the period from the establishment of the state to the end of 1951 controls became rapidly more stringent. The foreign-exchange-control system was the vital component and focal point of the system of repressed inflation. The foreign-exchange rate was kept fixed all this time (aside from a slight adjustment in September 1949, when the pound sterling was devalued). With the accumulation of inflationary pressures, the gap between the actual rate and its equilibrium level kept growing, and imports approved under the licensing system as a proportion of the demand for imports kept falling. The major assumption on which policy at that time was based was that a free market for imports (at an equilibrium exchange rate) would result in the importation of luxuries, while low-income groups would remain without necessities; that is, the foreign-exchange policy was deemed to play an essential part in assuring an adequate level of equality in the distribution of real income. Another basic tenet of the system was that imports of final consumer goods should not be allowed if their domestic production was at all feasible.

As the degree of disequilibrium in the system grew, and rationing became more severe and more inclusive, the system started to deteriorate. Black markets became widespread, and production of various goods was often stopped for lack of imported raw materials. Foreign-exchange reserves were completely exhausted. Discontent with the economic policy gradually became widespread. The faith of the leaders of economic policy in the potential of intervention by the state and in the feasibility of directing the economy by orders weakened, as did their mistrust of the price mechanism. In 1951, it became obvious that a change in policy was due. This change came first in the summer and fall of 1951, with a shift from an expansive to a restrictive monetary-fiscal policy. But the major part of the switch came in February 1952 with the declaration of the "New Economic Policy." The departure from the preceding policy was radical; so Phase II of the exchange system may be said to have been bypassed altogether, with the economy moving directly to Phase III. From then on, the process of liberalization proceeded almost without interruption.

1952–54: Phase III.

The most important element of the policy introduced in February 1952 was a major devaluation. A system with three different exchange rates was introduced. The highest of these rates (IL 1 per dollar) was almost three times the previous rate (IL 0.357 per dollar), and the average of the three was set at more than twice the predevaluation rate. From then on the process of moving to an equilibrium exchange rate was rapid and progressive, through the introduction of new rates and the shifting of transactions from lower to higher rates. The process was almost completed by mid-1954, when most transactions were already subject to the rate of IL 1.80 per dollar, the rate which remained in force for a long period thereafter. Thus, within less than three years, the rate of exchange rose fivefold, compared with only about a doubling of domestic prices during the same period.

In addition, as already observed, monetary and fiscal policy was quite restrictive for about two years. This, together with the devaluation, resulted in a gradual reduction in the degree of disequilibrium in the system. By the end of 1954 the rate of exchange was roughly in equilibrium. Likewise, as has been mentioned earlier, domestic prices were allowed to rise. Consequently, rationing became gradually less severe, black markets became less widespread, and black-market prices and official prices moved closer to each other. Although by the end of 1954 foreign-exchange reserves were still very small, the balance-of-payments position with the new rate of exchange ceased to be the major basis for trade and payments restrictions.

1955–68: Phase IV.

This long period is best divided into two stages: 1955–61 and 1962–68. During the first stage, liberalization of imports proceeded gradually but along a very clear guideline: the system changed from one intended to regulate the balance-of-payments position into one intended primarily to protect local production. There was a rapid de facto liberalization of imports of raw materials of which local production was not feasible, although licenses were still required. Such products made up the greater part of total imports, owing partly to the control system itself. Imports of final consumer goods, on the other hand, were practically prohibited in almost all instances in which domestic production either was actually taking place or was contemplated by a potential entrepreneur. Policy toward imports of investment goods sometimes had to face conflicts of interest arising when the encouragement of local production of a particular investment good handicapped another branch of local production which required the use of that good. In effect, imports of most investment goods were also liberalized, but not to the same extent as raw materials.

The second stage started in February 1962 with the announcement of another "New Economic Policy." The currency was devalued, for the first time since the end of the progressive devaluation of 1952–54: the rate of exchange was raised from IL 1.80 to IL 3.00 per dollar. The net devaluation was, however, much less than the 67 per cent indicated by the formal change, since almost all export subsidies, which had increased gradually during the first stage, were abolished; and the rates of many import tariffs were lowered. The devaluation was intended, in fact, to be an act of unification of the effective exchange-rate system at least as much as an increase of the general level. This step was combined with the other major component of the new policy: a declaration of an intention to liberalize the imports of consumer goods (and some investment goods) which until then were excluded by quantitative restrictions (QRs). Procedures were set up to carry out this process. Most of this liberalization took the form of replacing the QRs by tariffs, at different rates for each good, which were intended to be approximately prohibitive—though some (relative) increase of liberalized imports did take place. The work of the liberalization machinery ended in 1968, and the process was supposed then to be completed.

1969 and After: Phase V.

By 1969, almost all imports were liberalized in the sense of not being subject to effective quantitative restrictions (although licenses were still required). The declared policy, since that time, has been gradually to lower the level of protection afforded by the tariff system by reducing all tariffs by a given (small) proportion at the beginning of each year. Such reductions have indeed been performed, and their cumulative effect has been a significant lowering of protective rates. Formal devaluations were undertaken twice after the 1962 devaluation: in November 1967 the rate of exchange was increased by 16.7 per cent, from IL 3.00 to IL 3.50 per dollar; and in August 1971 it was increased further by 20 per cent, to IL 4.20 per dollar. Conclusions about general attributes of this period would obviously be premature. It seems likely though that this period will be characterized by a chain of relatively minor devaluations, with the average of the effective rate of exchange being maintained, most of the time, close to its equilibrium level, and by a tendency toward unification of tariff rates and a reduction of discrimination in levels of protection.

NOTES

1. This has changed slightly since the Six-Day War of June 1967. A nearly free movement of goods (and, to a large extent, of labor) exists between Israel and the West Bank, the part of Palestine annexed to Jordan after 1948 and held by Israel since 1967. Due to the "open-bridges" policy of Israel and Jordan, goods flow rather freely between Jordan and the West Bank. As a result, some trade takes place indirectly between Israel and Jordan and, through the latter, with other Arab countries as well.

2. Haim Barkai, "The Public, Histadrut, and Private Sectors in the Israeli Economy" (in English), Falk Project for Economic Research in Israel, *Sixth Report 1961–63,* Table 1.

3. By 1972, the number of such corporations exceeded 200.

4. Barkai, "The Public," Tables 1 and 2.

5. The central organs of the Histadrut are elected by its members, periodically, by voting for party lists in proportional elections. This is similar to the system by which the country's parliament (the Knesset) is elected—and the parties running in both elections are by and large the same.

6. The only important exception was the municipal elections of 1950, in which a major shift from the Labor Party to the main Liberal Party was interpreted as a protest against current economic policy, and may have had an effect on the future course of this policy.

7. The de facto borders of Israel were determined in the series of armistice agreements concluded between Israel and its Arab neighbors during the period from March to August 1949.

8. Since June 1967, the data include the population of the eastern part of Jerusalem, roughly 70,000 people.

9. This is discussed in more detail in Nadav Halevi and Ruth Klinov-Malul, *The Economic Development of Israel* (New York: Praeger, 1968); see especially pp. 75–84.

10. See A. L. Gaathon, *Economic Productivity in Israel* (New York: Praeger, 1971), Chap. 3.

11. Ibid., Chap. 4.

12. This is derived as a residual: gross domestic investment minus the import surplus.

13. Estimates of the size of trade in other services are not available for the period of the mandate, but the trade was probably small enough to be ignored for most purposes.

14. These figures are based on a c.i.f. evaluation of imports. An f.o.b. evaluation materially changes the allocation of the import surplus between the goods and services account, lowering the import surplus in the former account and raising it in the latter.

15. This sharp downward trend largely disappears if the import surplus and the national product are measured in current rather than constant prices. The question whether, for this purpose, constant or current prices are appropriate was for a while a lively topic of discussion among academic economists in Israel; the use here of a constant-price measure is consistent with my position in that debate.

16. The addition of military imports would, of course, increase the weight of the import surplus, particularly in these recent years.

17. These ratios are computed with national product and imports taken in constant (1955) prices.

18. This ratio would exceed 50 per cent if effective rather than formal rates of exchange were used. See definition of concepts in Appendix C.

19. See, for instance, E. Kleiman and T. Ophir, "The Effect of Changes in the Quantity of Money on Prices in Israel, 1955–1965" (in English), Bank of Israel *Economic Review* (forthcoming).

20. Even in money terms, the import surplus increased substantially less than the national product. When this is taken into account, the rate of increase in the value of resources used by the economy would appear to be more similar to the rate of increase of the money supply.

21. Comparable data for earlier years are not available; however, in the years following the Six-Day War of 1967, the government's excess demand has been much larger.

22. The absolute figures—about 7 per cent of the labor force in 1952 and 11 per cent in 1953—are probably less meaningful than the change between the years. The rate fell to about 9 per cent in 1954, and to around 7 per cent in 1955.

23. See Appendix C for definitions of the phases distinguished in the project of which this study is a part. Note, however, that Phase IV is here divided into two subperiods designated IV-A and IV-B in Chart 1-1.