

# GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

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Committee on Balance-of-Payments Restrictions

REPORT ON THE 1982 CONSULTATION WITH ISRAEL

1. The Committee consulted with Israel in accordance with its terms of reference and the Declaration of the CONTRACTING PARTIES on Trade Measures Taken for Balance-of-Payments Purposes (BISD 26S/205). The consultation was held on 30 November 1982 under the chairmanship of Mr. J.N. Feij (Netherlands). The International Monetary Fund was invited to participate in the consultation pursuant to Article XV of the General Agreement.

2. The Committee had the following documents before it:

- Report on the last consultation with Israel held on 9 May 1980 (BOP/R/113)
- Basic document supplied by the Israeli authorities (BOP/230)
- Background paper by the secretariat (BOP/W/65)
- IMF, Recent Economic Developments, dated 29 April 1982
- IMF, Supplementary Background Material, dated 15 November 1982

Opening statement by the representative of Israel

3. In his opening statement, the representative of Israel stated that his authorities had continued the trade liberalization process initiated two decades ago in spite of unfavourable developments in Israel's balance-of-payments. The import deposit requirement of 10 per cent had been abolished on 20 November 1980. On the other hand, a three per cent ad valorem levy had been imposed on all commercial imports as of 15 June 1982. This levy would remain in effect until 1 April 1983. The import restrictions maintained by Israel should be assessed in the light of the present size of the current account deficit which was expected to increase to a record level of about US \$ 4.5 billion in 1982. The deterioration in Israel's current account had led to an increase in the total foreign debt by 25 per cent since the last consultation to over US \$ 20 billion by the end of 1982. Total debt servicing amounted to US \$ 3.9 billion in 1982. Gross reserves of the Bank of Israel amounted to US \$ 3.6 billion at the end of August 1982.

4. The representative of Israel further stated that, according to provisional figures, merchandise exports would decrease in 1982 by 6 per cent in nominal terms mainly due to a sharp decrease in exports of polished diamonds by 25 per cent, of textiles and apparel by 6 per cent, of chemicals, plastics and rubber products by 5 per cent and of citrus fruits by 20 per cent. The recent decline in exports in real terms was mainly due to the slackening of demand in major export markets, a fall in export prices, fluctuations in exchange rates and high rates of interest which affected mainly exports of polished diamonds for investment purposes.

5. The representative of Israel said that there had been substantial changes in the structure of exports. Israel had been encouraging the establishment of research-based industries and new service sectors for exports such as computer software and programming, engineering and turn-key projects based on know-how and technology developed in Israel. This was reflected in the changes in the composition of exports over the period 1976 to 1981. The share of food products in total exports had declined from 17 to 9 per cent and of textiles from 25 to 11 per cent. The share of metal and electronic equipment in total exports had increased from 20 to 42 per cent and of chemical products from 19 to 23 per cent over the same period.

6. The representative of Israel stated that the two major problems of the Israeli economy in recent years had been inflation and slow growth. Inflation, which had stabilized around 130 per cent in the last three years, had eroded the purchasing power of wages and income and had affected export prices. The rate of GNP growth, which stood around 4 to 4.5 per cent in the last two years, had declined to 2 to 3 per cent. Policy measures introduced in 1982 to fight inflation and improve the balance-of-payments, included a reduction of 6 per cent in government expenditures, the cutting of subsidies to consumer goods, a tightening of credit facilities, and an increase in the value added tax from 12 to 15 per cent.

7. Major policy aims for 1980's included sustained, yet controlled, growth at rates gradually rising from 4 to 7 per cent, increased productivity, securing capital inflows, increasing the export and investment component in total production, and maintaining the profitability of exports through currency depreciations while continuing liberalization of imports. Open export markets and recovery in external demand, as well as stability in exchange rates, were the main conditions for achieving these targets.

#### Statement by the representative of the International Monetary Fund

8. At the invitation of the Committee, the representative of the International Monetary Fund made a statement, the full text of which is reproduced in the Annex.

#### Balance-of-Payments position and prospects - alternative measures to restore equilibrium

9. One member, noting that the competitiveness of exports had declined due to an appreciation of the shekel in real effective terms during 1981 and 1982, asked how the Israeli authorities intended to cope with this problem in the future. The Israeli representative replied that the long-term policy of Israel, as declared and applied, was to keep the depreciation of Israeli currency in line with the difference in the inflation rate in Israel and the average inflation rate in its major trading partners. In 1981 there had been a real effective appreciation of the shekel of 0.5 per cent. At that time there had been no reason to depreciate the currency because exports had increased by about 7 per cent in real terms. In 1982, from January to September, the real effective appreciation of the shekel was about 4 per cent. However, there were indications that this appreciation was likely to be of a temporary nature. The purpose of the appreciation was to reinforce restrictive fiscal and monetary policies. Once these policies had had their impact, the government could again apply its long-term exchange rate policy.

10. Asked about Israel's balance-of-payments prospects, the Israeli representative said that during the years 1983 to 1986 the rate of export growth was projected to accelerate from 5 to 10.5 per cent. This was not unrealistic - exports had frequently grown in the past at the rate of over 12 per cent per annum. Non-military imports were projected to grow during the same period from an annual rate of 5 per cent in 1983 to 7 per cent in 1986. The trade balance was thus forecast to remain in 1983 as in 1982 and improve gradually from 1984 onwards. The trade deficit (excluding military imports) was estimated to be around US \$ 3 billion in 1982 and 1983; it would then gradually decline and reach US \$ 1.6-1.7 billion in 1986. No economic aid, besides regular capital imports, would then be required to cover the deficit.

11. One member of the Committee asked what the present balance-of-payments estimates for 1982 were. The Israeli representative replied that these estimates had been revised as follows:

BALANCE OF PAYMENTS ESTIMATES FOR 1982  
(Millions of dollars)

1.	Imports of Goods*	8,355
2.	Imports of Services	5,650
3.	(= 1+2) Total Civilian Imports	14,005
4.	Military Imports	1,605
5.	(= 3+4) Total Imports	15,610
6.	Exports of Goods	5,825
7.	Exports of Services	5,170
8.	(= 6+7) Total Exports	10,955
9.	(= 1-6) Trade Deficit	2,530
10.	(= 2-7) Deficit in Service Account	480
11.	(= 5-8) Current Deficit	4,615
12.	(= 3-8) Civilian Deficit*	3,010

\* Excluding direct military imports

12. Several members asked why agricultural exports had performed poorly in 1982 and one member wondered whether the import policies in major markets had played a role. The representative of Israel replied that the poor performance had been mainly due to bad crops. Difficult economic conditions in major export markets and the erosion of Israel's competitiveness resulting from the real appreciation of the shekel had also played a role. Citrus fruit exports had declined by 20 per cent, while other agricultural exports had increased by one per cent. The following figures were given by the representative of Israel on the developments in the main product categories:

AGRICULTURAL EXPORTS

(Million dollars)

	1981	First half of 1981	First half of 1982
<u>Total</u>	600	400	366
Citrus	250	200	163
Field crops	157	80	80
Vegetables	53	38	38
Chicken and other animals	13	6	6
Fruits	41	7	25
Other	88	67	52

13. One member asked the Israeli delegation to quantify the balance-of-payments impact of the war in Lebanon. The Israeli representative replied that the war had only had a marginal impact on export performance; a negative impact had occurred only in two sectors of minor importance: leather products and meat preparations. As regards imports he could not give precise indications at this stage.

System, method and effect of the restrictive import measures

14. One delegation asked whether the introduction of the surcharge had in fact been worthwhile since, levied at the rate of 3 per cent, it could hardly have a significant impact on the balance-of-payments. The Israeli representative replied that one reason for including the surcharge in the package of stabilization policies was the need to respond to the public expectation that the government impose not only restrictive fiscal and monetary policies but also measures directly attacking the balance-of-payments problem.

15. One member expressed concern about reports according to which the state enterprises in Israel were instructed to conclude compensation agreements under which at least 25 per cent of their foreign exchange expenditures were to be covered by export earnings. The Israeli representative said that his authorities did not attempt to promote exports through the required compensation agreements but rather to stimulate a transfer of technology. In reply to another question, the Israeli representative stated that the planned removal of the surcharge in April 1983 would in no way affect the timely implementation of the Tokyo Round and other tariff commitments.

16. One member asked why printed books in Hebrew were subject to licensing and what criteria applied for the issuing of licenses. The Israeli representative replied that the authorities would not allow the import of books in Hebrew if these could be produced in Israel. This was however only a theoretical constraint since Israel had an obvious comparative advantage in the production of Hebrew books.

17. Asked to explain the method of valuation of importers' profit margins under the TAMA, the Israeli representative said that the information was given at the last consultation and was contained in BOP/R/113, paragraph 23.

Conclusions

18. The Committee welcomed the fact that Israel had terminated in November 1980 the import deposit scheme introduced in November 1979.

19. The Committee noted that, during the course of 1981 and thus far in 1982, the Israeli currency had appreciated in real effective terms while the competitiveness of Israel's exports had declined and the current account deficit widened. The Committee further noted that the Israeli government, to reduce this deficit, had added 28 import categories to the list of quantitative restrictions and introduced a 3 per cent surcharge on all imports.

20. The Committee recognized that the effect of the additional restrictive measures on imports was relatively small. However, it believed that the increase in the restrictiveness of the import regime could have been avoided through a strengthening of the other, more fundamental, adjustment policies which the Israeli authorities are pursuing. For this reason the Committee welcomed the temporary nature of the surcharge and expressed the hope that it would not be extended beyond 1 April 1983, when the present legislation expires, and that the authorities, as a result of further adjustment efforts, would place themselves in a better position to shorten the list of quantitative restrictions.

ANNEX

Statement by the Representative of the International Monetary Fund

Following a strong expansion in economic activity in 1981, the pace of growth of the Israel economy appears to have eased in recent months. For 1982 as a whole, real growth is likely to be less than the 4 1/2 per cent estimated for the previous year.

A major problem facing the Israel economy continues to be a very high rate of inflation. After some easing in 1981, the rate of increase in prices has recently reaccelerated, reaching an annual rate of about 135 per cent during the first eight months of 1982. Expansionary fiscal policy contributed importantly to the deterioration in price performance; a reduction in government subsidies in 1982 was also a factor. Furthermore, expectations and the indexation mechanisms have helped make the inflationary process a persistent one. Real wages, after increasing considerably in 1981, declined modestly in the first half of 1982 as a result of restraint on public sector wages.

The budgetary situation has been under considerable strain. The attempt over much of 1981 to hold prices down by cuts in indirect taxes and increases in subsidies was abandoned when the related liquidity injections became large. In the face of rising expenditures, new revenue measures were introduced in mid-1982, with a view to containing the fiscal deficit. Monetary policy has been geared principally toward tight control over credit to the private sector. However, the financial

injection stemming from the budget has been a dominant influence, with total financial assets rising considerably faster than the rate of inflation over the 12 months to June 1982.

The deficit in the current account of the balance of payments rose to 16 per cent of GDP in 1981, and the situation does not appear to have improved in 1982. Net private and official transfers have leveled off in the past two years, and the widening current account deficit has been covered by substantially higher net short-term capital inflows. At end-August 1982, official reserves amounted to \$3.6 billion; while this represents a relatively high proportion of imports, Israel's level of reserves must be seen against the background of some special factors of uncertainty, considerable dependence on short-term capital inflows, and a relatively large amount of external debt.

The Israel authorities have allowed the value of the shekel to be determined on the basis of demand and supply conditions in the market, intervening when necessary to maintain orderly conditions. During the course of 1981 and thus far in 1982, there has been an appreciation of the shekel in real effective terms. The Israel authorities have recently taken measures to relax the regulations with respect to capital inflows from abroad.

The comprehensive reform of the exchange and trade system undertaken in 1977 eliminated most restrictions on payments and transfers for current international transactions and multiple currency practices. A further liberalizing step was taken in November 1980 with

the abolition of the import deposit requirement. However, the restrictiveness of the exchange and trade system has been intensified since June 1982. In particular, an import levy of 3 per cent was introduced in June 1982, with an understanding that it would be terminated by April 1, 1983. During the period mid-June through September 1982, residents of Israel traveling abroad were required to pay a travel surcharge. Also from June, residents of Israel selling domestic and foreign traded securities, as well as foreign residents selling domestic traded securities, have to pay a 2 per cent surcharge on the sale proceeds; this measure is expected to be terminated in March 1983. The Fund hopes that the authorities, by strengthening the adjustment effort, will be better placed to further liberalize the exchange and trade system.