GENERAL AGREEMENT ON

TARIFFS AND TRADE

RESTRICTED

BOP/W/141
20 November 1991

Limited Distribution

Committee on Balance-of-Payments Restrictions

1991 CONSULTATION WITH ISRAEL

Background Paper by the Secretariat

1. This paper has been prepared in accordance with paragraph 7 of the Declaration on Trade Measures Taken for Balance-of-Payments Purposes adopted by the CONTRACTING PARTIES on 28 November 1979 (BISD 26S/205-209).

I. Previous consultations with Israel

2. Since its provisional accession to the GATT in 1959, Israel has consulted with the Committee on 19 occasions (in 1960-65, 1968-71, 1974, 1976, 1978, 1980, 1982, 1984, 1985, 1987 and 1989). At its last consultation with Israel, held on 22 November 1989 (BOP/R/187), the Committee noted with satisfaction the structural reforms undertaken by Israel. It encouraged the authorities to continue the process of macroeconomic adjustment, in particular by pursuing appropriate budgetary, monetary and incomes policies.

3. The Committee encouraged Israel to continue the liberalization of its trade and exchange régimes, and welcomed the measures taken to eliminate the import deposit scheme and reduce import duties.

4. The Committee noted that the use of import licensing remained widespread and that the import levy introduced for balance-of-payments reasons remained in force. In this context, it recalled the provisions of paragraph 1 of the 1979 Declaration on Trade Measures Taken for Balance-of-Payments Purposes.

5. The Committee encouraged Israel to reduce the use of import measures taken for balance-of-payments purposes, in view of the improvement in the economic situation, and to announce, as practicable, a timetable for the progressive phasing out of the measures in force. It expressed the hope that progress in this direction could be made by the time of its next consultation with Israel.

II. Main changes in Israel's trade system since the last consultation

(a) Import licensing

6. At its last consultation with the Committee, Israel notified a complete list of items subject to import licensing, classified according to the Harmonized System (BOP/295). Import licensing requirements affected goods originating in all countries except those which have signed Free Trade Agreements with Israel (i.e. the European Communities and the United States).

7. On 1 September 1991, the Government of Israel abolished all discretionary import licensing requirements applicable to imports of industrial goods and replaced them by an automatic licensing procedure. The automatic licenses are to be phased out in three years. Higher transitional ad valorem tariffs were established with a view to allowing domestic industry time to adapt gradually to increase international competition stemming from a lowering of border measures. Although imports from all sources are now freely permitted,[1] most imports from countries not covered by free trade arrangements are subject to the transitional tariffs. These range from 20 to 50 per cent on most products, and up to 75 per cent on "especially sensitive" products such as textiles, clothing, leather, and wood products.[2] (See also BOP/307, basic document by Israel).

8. The transitional rates are to be reduced gradually over a period of five to seven years, when the maximum rate will be 8 per cent on raw materials and 12 per cent on finished products. The seven-year period applies to the above-mentioned "especially sensitive" products.

9. Some imports on a "restricted" list are subject to approval. The list includes most agricultural products, beverages, certain textiles, explosives and inflammables, and specified items of machinery and metal products.[3]

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[1] However, restrictions on particularly sensitive imports, such as textiles, clothing and wood products, were lifted in September 1991.

[2] Under the free trade agreements, reductions and elimination of customs duties affected most of Israel's imports from the European Communities and 90 per cent of imports from the United States.

[3] International Monetary Fund, Exchange Arrangements and Exchange Restrictions, Annual Report 1991.

(b) Import levy

10. A temporary import levy of 3 per cent ad valorem was introduced by Israel in June 1982 with the purpose of reducing the balance-of-payments deficit and curbing inflation. The import levy, was reduced to 2 per cent in April 1983 and still applies to all imported goods subject to value added tax. The levy is applied over and above all tariffs.

(c) Customs valuation practices

11. In 1990, Israel amended its "TAMA" system under which declared import values were raised for taxation purposes; importers now declare the actual wholesale value of their products in the same way that domestic producers do. Another customs valuation system (HARAMA) remains in effect, allowing uplift adjustments of virtually all products imported into Israel by exclusive agents. The adjustments are made within a range of 2 to 10 per cent.

(d) Foreign exchange

12. The exchange rate of the currency of Israel, the New Shequel, is linked to the deutsche mark, the French franc, the Japanese yen, the pound sterling and the U.S. dollar. Since January 1989, daily rates for the New Shequel have been established by the Bank of Israel within margins of 3 per cent around the rate fixed in relation to the basket. In March 1990, the margins were increased to 5 per cent.

13. Foreign exchange for imports is granted automatically by the authorized banks upon presentation of relevant documents. The 1 per cent levy on the purchase of foreign exchange was abolished in March 1990 and purchase tax rates on many imported consumer goods were reduced. In June 1990, the tax base of the import levy on services was narrowed from all imported services to tourist services only. The tax rate was reduced from 7.5 per cent to 4 per cent in December 1990.

14. In June 1990, the maximum permitted advance payments for imports was increased from US$50,000 to US$200,000; and in September 1990, it was set at 35 per cent.

III. Economic and trade developments

(a) Introduction

15. Slow growth in 1989 was followed by a cyclical upswing in 1990, with a contributory rôle played by the stimulus given to demand by significantly higher immigration. Middle East developments dampened growth temporarily, leading to a decline in GDP in the first quarter of 1991; activity has since recovered quickly. Led by exports, Israel's balance-of-payments situation improved substantially in 1989 and has subsequently remained in surplus. International reserves at end 1990 amounted to some US$7 billion, an increase of 12 per cent from the previous year, and equivalent to some 3.6 months of 1990 imports. However, unemployment increased, with productivity gains largely fuelling the 1990 growth surge. Inflation remained in the 17 to 21 per cent range, partly consequent upon reductions in subsidies, exchange rate devaluations and a looser monetary stance. Cyclical revenue declines in 1989/90 and immigration-related expenses in 1990/91 contributed to a deterioration in the overall budget deficit in both years.

(b) Aggregate supply and demand

16. The growth of gross domestic product slowed to less than 2 per cent in 1989, with aggregate demand very sluggish (Table 1 and Graph 1). Both private and government consumption stagnated, the latter being affected by a 2 per cent decline in defence expenditures. Investment fell by nearly 5½ per cent, with initial interest rate reductions insufficient to overcome low levels of business confidence and profitability. In consequence, with private savings up by a sixth, increased exchange rate flexibility contributed to a recovery in exports of goods and services, which grew by nearly 4 per cent, significantly narrowing the trade deficit. Stagnant demand was reflected in a 2 per cent decline of industrial output. Construction recovered slightly, and agricultural production benefited from favourable climatic conditions to record a 5 per cent increase.

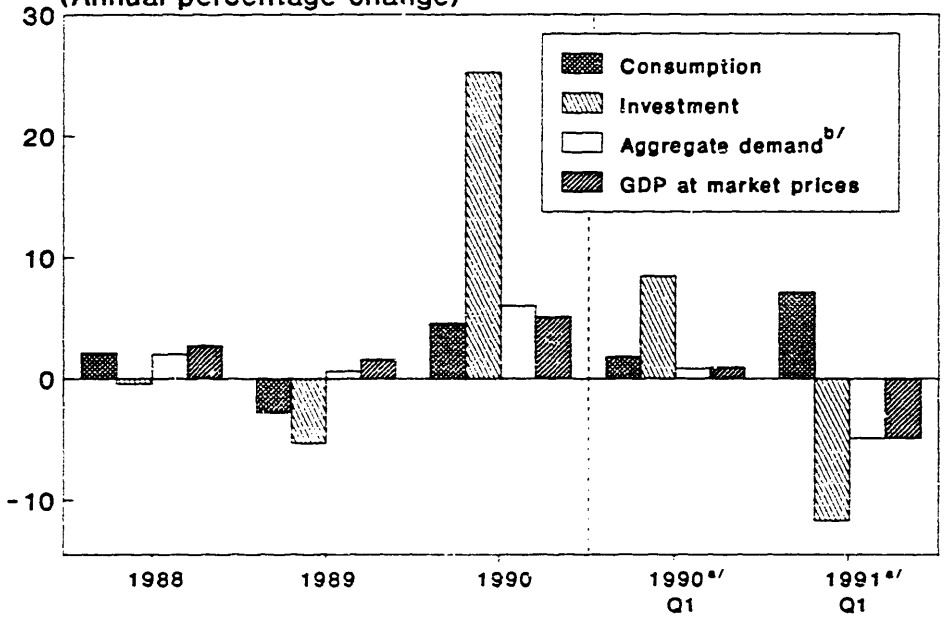
Table 1
GDP at factor cost by industry of origin, 1988-90
(Annual percentage change)

	Percent of GDP 1989	1988	1989	1990
Agriculture	8.0	-4.6	5.0	12.9
Industry[a/]	29.8	-2.5	-2.0	5.8
Construction	9.4	2.9	3.8	10.8
Public Utilities[b/]	3.9	2.0	--	6.0
Transportation and Communications	15.2	1.0	2.6	6.9
Trade, services and finance	33.7	4.0	4.0	4.0
GDP at factor cost	100.0	0.6	1.9	6.4

a/ Includes value added in diamond processing industry.
b/ Electricity and water.

Source: IMF.

Graph 1
GDP at constant market prices by expenditure components
(Annual percentage change)



a/ Estimates
b/ Excludes net defense imports
Source: IMF, Monthly Bulletin of Statistics, Central Bureau of Statistics, Israel, 1991

17. In 1990, total output of the Israeli economy recovered strongly, growing at more than 5 per cent, with gross domestic expenditure up by 7½ per cent. Immigration contributed significantly to this increase. Helped by expectations of immigration-related higher growth and a continuing fall in interest rates, private consumption and domestic investment grew briskly, at rates of 5 and over 25 per cent respectively. Government consumption grew by some 2 per cent, reflecting in part an increase in public housing construction in an effort to accommodate immigrants. Consequently, construction output rose by almost 11 per cent, with only agriculture, at 13 per cent, showing larger gains; with industrial output also up sharply, associated imports rose strongly, widening the trade deficit.

18. The expansion of the economy was slowed and then halted by the Gulf conflict, which gave rise to significant absenteeism, negative expectations and a sharp decline in domestic demand. Overall, the damage to the Israeli economy from the Gulf war is estimated by the authorities at around 2 per cent of GNP. During the first quarter of 1991, aggregate demand fell nearly 5 per cent and economic activity declined. In March 1991, recovery began, and during the second quarter of the year domestic demand, particularly private consumption and investment, increased rapidly. Public spending rose further, notably on construction, as efforts continued to house immigrants.[4] The negative foreign balance widened further during the first half of 1991 as imports were buoyant and exports of goods and services declined somewhat compared to the same period of 1990.

(c) Prices, wages, and employment

19. In 1989, consumer prices increased by almost 21 per cent (Graph 2). There were large price rises for housing and controlled products.[5] The former reflected low investment levels in immediately preceding years, when the Intifada reduced the availability of workers; in the latter case, subsidy reductions played a rôle as did higher fuel prices, an important component in some controlled products. Devaluations of the shequel during the year, put additional pressure on prices, a factor that was repeated in 1990 and 1991. Nevertheless it is notable that price increases for

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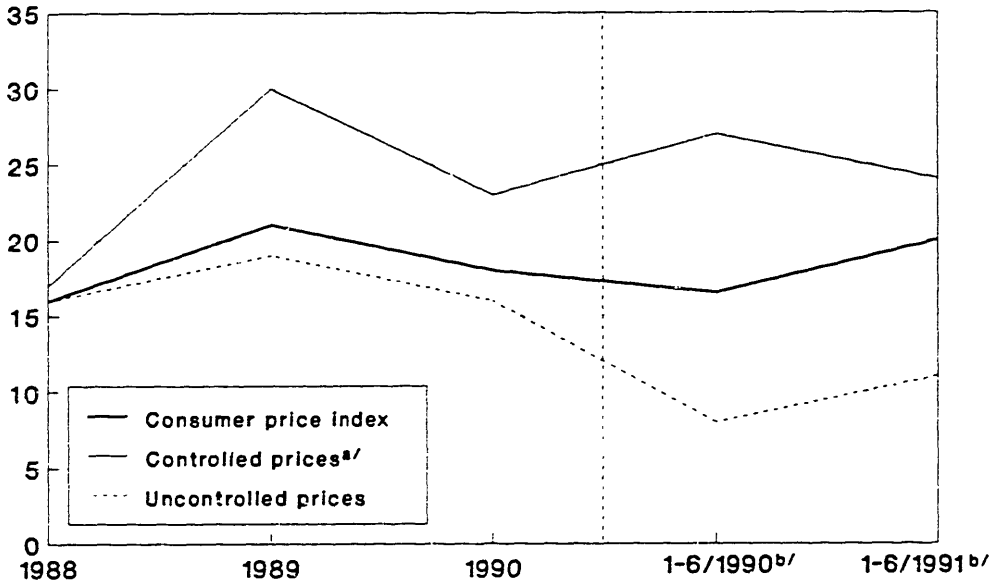
[4]The share of the private sector in the construction industry fell from 82 per cent in 1989 to 25 per cent in mid-1991.

[5]Commodities subject to price controls in Israel comprise about 18 per cent of the items in the CPI. They are mostly in the areas of health, education, basic foodstuffs, transportation services, and the products of monopolies and utilities. The monopolistic and oligopolistic structure of domestic markets has caused the prices of goods and services under government control to rise faster than general inflation.

tradeables were substantially less than those for non-tradeables, in both 1989 and 1990, with foreign competition imposing definite discipline.

Graph 2
Selected price indexes
(Annual percentage change; period average)



a/ The weight of items in the consumer price index is about 18.5 per cent
b/ Refers to the first quarter of the year for controlled and uncontrolled prices
Source: IMF

20. In 1990, inflation decelerated to 18 per cent, largely due to the fall-off in demand with the onset of the Gulf crisis. In the first half of 1991, inflation rebounded to 27 per cent at annual rates, with the consumer price index under pressure from renewed domestic demand - including strong immigration-related housing demand - and rises in controlled prices. Inflation excluding prices relating to housing was 16.7 per cent at an annual rate.

21. Average real wages decreased in both 1989 and 1990, by some 2.2 per cent on a cumulative basis. Concurrently, labour productivity rose during the period by some 4.5 per cent, supporting competitiveness gains from shequel devaluations. The rise in productivity largely reflected improved capacity utilization as economic activity picked-up in 1990. Unemployment increased in both years, to 9.6 per cent in 1990 compared to 6.4 per cent in 1998. The influx of immigrants puts further pressure on the unemployment rate, which with the fall-off in demand, rose to some 10½ per cent in the first quarter of 1991. Efforts are underway to reduce labour-market rigidities: in April 1991, private employment agencies were authorized, conditions on unemployment benefits were tightened and funding

for training programmes was increased; in May, Government, labour and employers agreed on a package to cut labour costs, but relatively high minimum - and entry-level wages remain in effect.

(d) Public finance

22. The public sector of Israel consists of the Central Government; the rest of the general Government; many large non-financial public enterprises; and some financial public institutions. The implementation of the 1985 stabilization programme brought a dramatic improvement in fiscal performance. The share of overall public sector expenditure in GNP fell from over 75 per cent in 1984/85 to under 50 per cent of GNP in 1988/89 (Table 2), with defence outlays, subsidies and government lending the main targets of expenditure reductions. In the year 1988/89 the general government deficit is estimated to have been some 3.2 per cent of GNP.

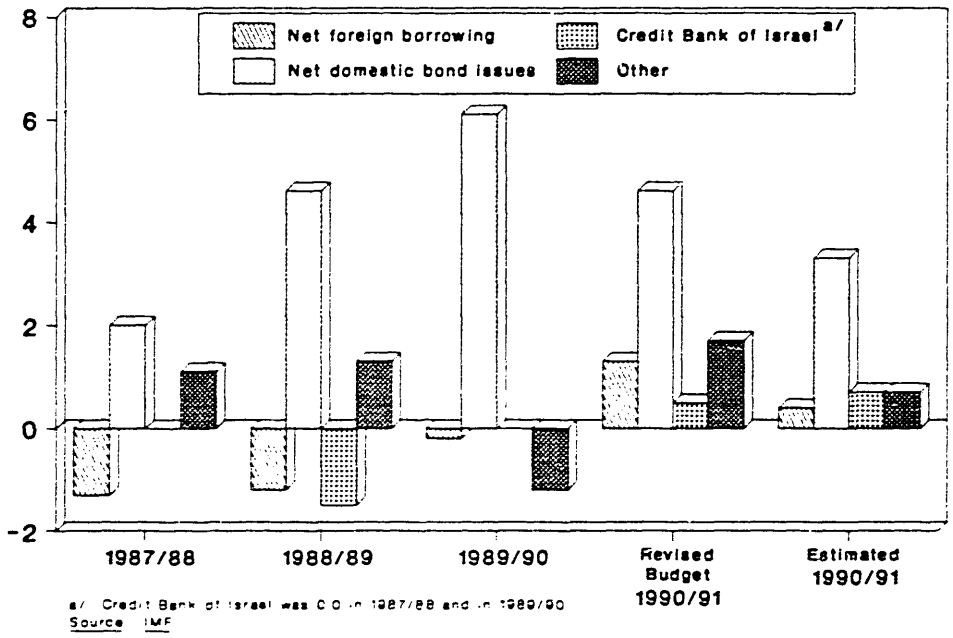
Table 2
Summary of general government finances, 1987/88 - 1990/91
(Percentage of GNP)

	1987/88	1988/89	1989/90	Revised Budget 1990/91	Estimated 1990/91
Total revenue	42.0	39.5	36.3	38.0	37.7
Tax revenue	37.3	34.9	31.6	32.7	32.3
Non-tax revenue	4.7	4.6	4.7	5.3	5.3
Total expenditure and net lending	52.8	49.8	47.6	52.0	48.7
Current expenditure	49.4	46.5	45.0	43.7	--
Civilian expenditure	33.7	32.5	31.5	31.5	--
Defence expenditure	15.8	14.0	13.4	12.2	--
Wages	7.6	7.9	8.0	7.6	--
Other goods and services	14.0	12.5	11.9	11.3	--
Transfers and subsidies	16.4	16.0	14.9	14.9	--
Interest payments	10.8	9.7	9.8	9.4	--
Other current expenditure	0.7	0.5	0.4	0.5	--
Capital expenditure	2.4	2.5	2.5	3.0	--
Net lending	1.0	0.7	0.2	1.7	--
Non-allocated expenditure	--	--	--	3.6	--
Deficit (before grants)	-10.8	-10.2	-11.3	-14.0	-11.0
Grants	8.9	7.1	6.7	5.9	5.9
Overall deficit	-1.9	-3.2	-4.6	-8.2	-5.1

Source: IMF.

23. In 1989/90, the overall deficit is estimated to have deteriorated to 4.6 per cent of GNP, due largely to a decline in revenue. This reflected a number of factors including: first, a cyclical decline in domestic tax receipts on goods and services; second, the elimination or lowering of tariffs on imports from the EC and the United States following the implementation of free trade agreements; and, third, a lowering of the tax rate on service imports. Expenditure reductions were effected in most areas, notably in transfers and subsidies, which fell from 16 per cent of GDP in 1988/89 to less than 15 per cent in 1989/90. The deficit was financed by sale of domestic bonds (Graph 3).

Graph 3
Sources of general government deficit financing
(Percentage of GNP)



24. According to IMF data, the revised 1990/91 budget showed a further deterioration of Government finances, with the deficit widening to 8.2 per cent of GNP. Revenue was expected to increase by nearly 2 percentage points to 38 per cent of GNP but with the housing needs of new immigrants and the Gulf war estimated to cause a surge in non-allocated outlays, total expenditure was anticipated to grow from 47.6 per cent of GNP in 1989/90 to some 52 per cent of GNP in 1990/91. The programmed financing of the deficit was to rely largely on the issuance of domestic bonds, together with some net foreign borrowing and credit from the Bank of

Israel (BOI). In the event, with the rebound of economic activity after the first quarter of 1991, estimated expenditures declined relative to the revised budget, with the estimated overall deficit in the order of 5 per cent of GNP for 1990/91.

25. Israel has continued to implement fiscal reform since the last consultation, particularly with the view to redistributing the tax burden toward indirect taxation with lower disincentives for saving and investment. Thus, the value added tax was gradually raised to 18 per cent, the maximum marginal personal income tax rate was reduced from 51 to 48 per cent and corporate income taxes have been reduced and depreciation allowances widened. However, Government efforts to encourage structural reform have proceeded slowly. The Government remains the largest single employer; State-owned enterprises exercise monopolistic or oligopolistic power over large sectors of the economy including oil refining, utilities, telecommunications, aviation, transport and banking; and from 1989, the pace of privatization decelerated.[6]

(e) Money and Credit

26. The Israeli financial system comprises the Bank of Israel (BOI), commercial banks subject to liquidity regulations, a number of mortgage and investment banks, financial institutions not fully subject to liquidity regulations, and joint service companies. The system is highly concentrated, with the two largest banks accounting for about 70 per cent of total commercial bank credit to the private sector. With some of three-quarters short-term and medium-term financial assets still indexed, following years of high inflation, control of the money supply hinges on non-indexed sheqalim. An added constraint is the share of bank credit denominated in foreign currency (nearly 30 per cent at the end-March 1991). The Central Bank's control of the cost of credit is limited to new lending in unlinked sheqalim, mainly short-term.

27. Monetary policy was expansionary in 1989, with interest rates reduced to stimulate sluggish economic activity (Table 3). Domestic credit expanded by some 15 per cent, led by a 21.5 per cent growth in private sector credit. However, with inflation moving to the top of its range, domestic credit fell by 5 per cent in real terms (Table 4). Concurrently, net real foreign assets of the banking system surged by 175 per cent, under the impact of shequel devaluations in 1988 in 1989, which both offset inflation differentials with the five countries in Israel's reference

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[6]Some 170 State-owned enterprises occupy about 65,000 workers and account for 12 per cent of [GDP]. The Government had planned to divest itself of 50 firms but since 1985, when the Economic Stabilisation Programmed started, 8 firms have been sold.

bracket and curbed speculative purchases of foreign assets.[7] Overall monetary growth (M3) was 6.4 per cent in real terms.[8]

Table 3
Real actual interest rates on various types of credit and the public's assets, 1988-1991 Q1

	Q1 1988	Q1 1989	1990	1990	1991
Short-term credit to the private sector	13.1	10.6	4.4	13.1	14.6
Non-directed credit	16.9	10.1	5.2	13.9	15.0
Overdraft facilities	25.6	11.3	10.2	17.3	13.5
Directed credit	-2.8	11.1	-7.3	7.8	-11.5
Indexed private capital issues	6.4	3.2	3.4	3.6	4.2
Time deposits for one month[a/]	-2.4	-6.7	-4.3	-0.9	-1.0
Indexed government bonds (5 years)	4.1	1.7	1.2	1.6	2.6
Interest rate spread[b/]	29.3	23.1	16.3	16.6	16.6

a/ From September 1988, on average for all time deposits.
b/ The spread is defined as the gap in nominal percentage points on an annual basis between the effective rate on overdrafts and the rate on certificates of deposit.

Source: IMF.

Table 4 Selected factors affecting changes in broad monetary liabilities, 1988-91 Q1
(Real annual percentage change)

	1988	1989	1990	March 1991
Net foreign assets	-60.7	175.3	19.0	18.6
Net domestic assets	1.5	-7.8	-2.7	1.0
Domestic credit	3.7	-5.1	-1.7	1.4
Net claims on government	-2.0	-11.6	-8.7	1.4
Claims on mortgage banks	0.9	1.9	-9.6	2.4
Claims on the private sector	10.4	0.6	5.1	1.3
Monetary liabilities	5.0	0.3	1.9	0.3
M1	-4.5	20.2	11.8	3.1
Quasi - money	5.8	-1.2	1.0	0.0
Earmarked deposits	-5.5	-9.1	-7.7	-2.5
Memorandum item:				
M3[a/]	-4.9	6.4	15.2	0.5

a/ M3 includes M1 plus short-term deposits, certificates of deposits and PATAM deposits.

Source: IMF.

[7] The basket reference for the shequel is the U.S. dollar, Deutsche mark, French franc, Yen and Pound sterling.

[8] M3 comprises currency, demand deposits, short-term deposits, CDs, and PATAM deposits.

28. Continuing the expansionary policy, domestic credit again grew by 15 per cent in 1990, with credit to the private sector growing at 23 per cent, more rapidly than in 1989. Net foreign assets of the banking system strengthened by a third, with a March 1990 devaluation of 6 per cent and a widening of the bands around the central pegged rate reversing the purchase of foreign assets that had followed renewed devaluation expectations in early 1990. These developments, with a further easing of interest rates, saw M3 grow at some 15 per cent in real terms in 1990. The BOI, with improved domestic growth, took a more restrictive monetary stance in the latter part of 1990 but, with the growth downturn consequent upon the Gulf war, again relaxed policy; real domestic credit grew by 1 per cent in the first quarter of 1991, although interest rates were up slightly as the Government's financing needs increased.

29. Since the stabilization programme in 1985, bank credit to the Government of Israel has declined in real terms. By contrast, credit to the private sector has grown steadily, both in nominal and real terms. Within this group, directed credit (mostly in foreign currency and for export activities) and non-directed credit in U.S. dollars (roughly 50 per cent of which is rationed, with the rest approved in most cases for export-related activities) have seen their shares in total bank credit fall significantly. Directed credit has been abolished since late 1990. Credit for domestic activities in sheqalim (unrestricted in price and quantity) is the category that has grown most in real terms. The share of medium- and long-term credit (mostly indexed) in total credit has increased.

30. After the stabilization programme of 1985, the high cost of capital was of concern. Efforts to reduce real rates of interest have generated a decline of rates on short-term credit and overdraft facilities, although short-term rates have also been subject to temporary increases to stem capital outflows at times of growing devaluation expectations. Overall, real lending rates have remained relatively high, while real rates on time deposits and certificates of deposits have been negative. The resultant high spreads between lending and deposit rates reflect the market power of major banks, the high reserve requirements, and significant operational costs for financial intermediaries. The decontrol of most service charges in April 1990, and the virtual abolition of directed credits in September 1990, has contributed to a decline in the spread, from some 29 per cent in 1988 to the present level of about 16 per cent.

(f) Balance of payments and current account

31. Israel's balance-of-payments position improved significantly in 1989, with surpluses on both current and capital accounts (Table 5); gross international reserves increased to just over 3 months of merchandise imports. In 1990, with the recovery of economic activity, the current account surplus declined and the capital account recorded a small deficit, limiting the growth in reserves.

Table 5
Balance of payments, 1988-1991 Q1 (Million U.S. dollars)

	1988	1989	1990	Q1 1990	Q1 1991
Current account balance	-657	1104	702	484	-49
Merchandise exports, f.o.b.	10355	11169	12260	3107	2969
Merchandise imports, f.o.b.	-13424	-12933	-15150	-3572	-4012
Military imports	(-2071)	(-1192)	(-1470)	(-323)	(-615)
Civilian imports	(-11353)	(-11741)	(-13680)	(-3249)	(-3397)
Merchandise trade balance	-3069	-1764	-2890	-465	-1044
Civilian trade balance	(-998)	(-572)	(-1420)	(-142)	(-428)
Services (net)	-2103	-1995	-2198	-259	-431
Net private receipts	1075	1286	1146	241	270
Net national institutions receipts	627	875	1455	316	418
Net intergovernmental receipts	2812	2702	3188	651	737
Capital account	-505	294	-142	-432	1283
Medium- and long-term capital (net)	-585	88	-207	-39	132
Commercial banks (net)	-521	-631	-79	-10	496
Private short-term capital (net)	-146	-217	-166	-144	-163
Government short-term capital (net)	589	-220	-172	-185	272
Errors and omissions	158	1274	482	-54	546
Overall balance[a]/	-1163	1397	560	53	1233

a/ Includes changes in the value of foreign currency reserves against the U.S. dollar.

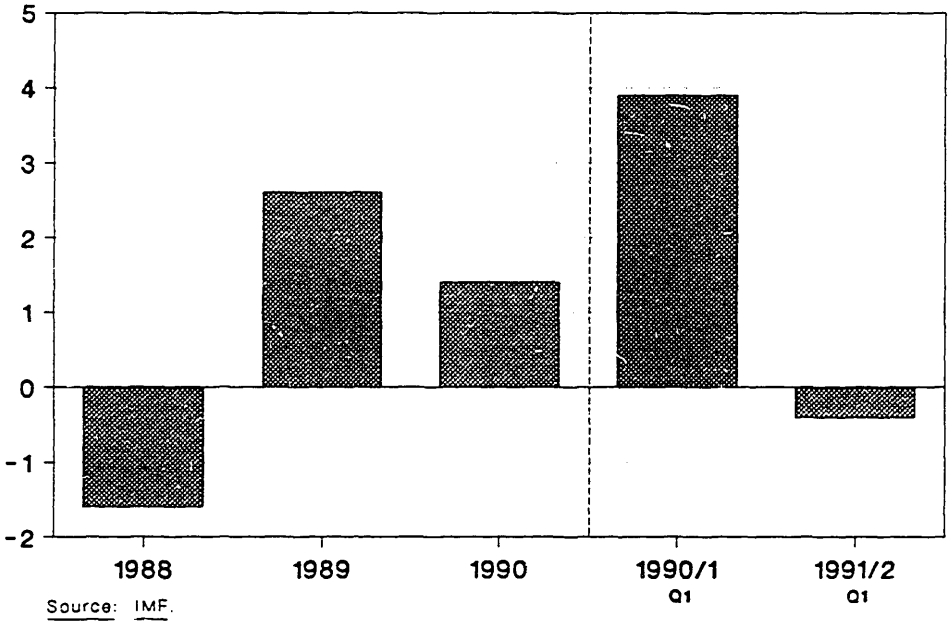
Source: IMF.

(g) The current account

32. In 1989, with national savings outpacing investment, the merchandise trade balance improved by almost 43 per cent and moved the current account into a surplus of US$1.1 billion, or 2.6 per cent of GNP (Graph 4). Merchandise imports grew more than 17 per cent in 1990 and the trade deficit widened. Terms of trade effects together with increased unilateral

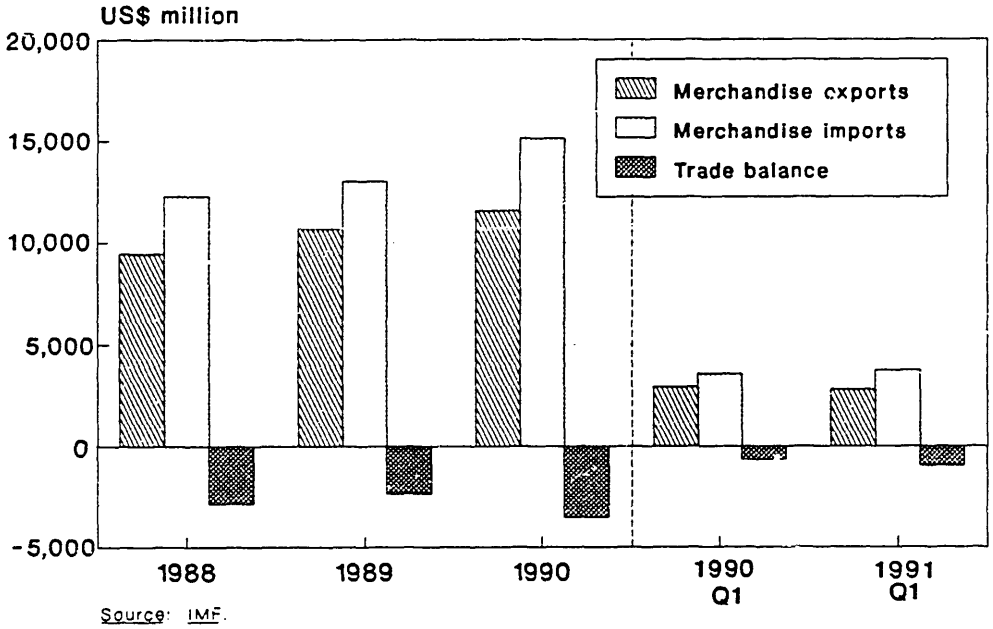
transfers partly offset the effect on the current account, which recorded a surplus of US$700 million, or nearly 1½ per cent of GNP. Events in the Middle East had a dampening effect on trade and tourism in late 1990 and early 1991, with the result that Israel's current account recorded a small deficit in the first quarter of 1991.

Graph 4
Current account balance
(Percentage of GNP)



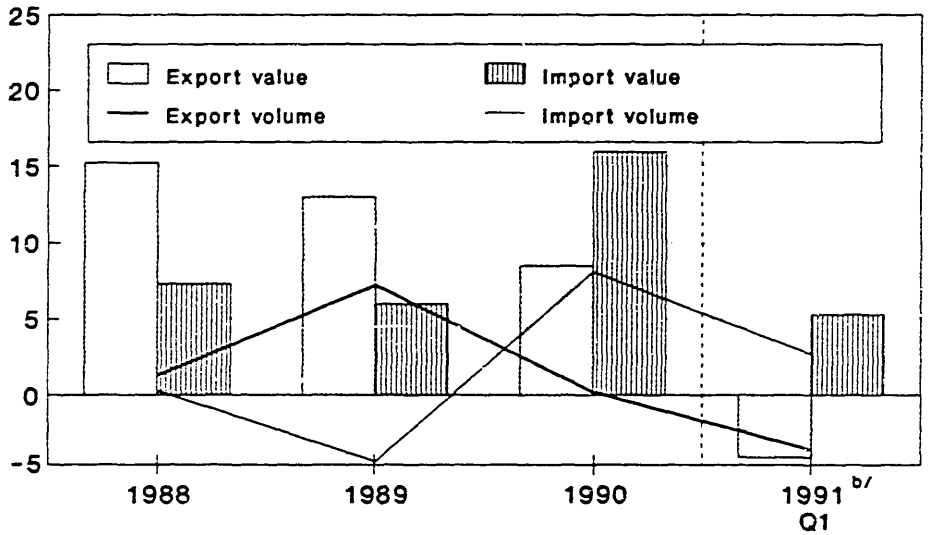
33. In 1989, the merchandise trade deficit (on a customs basis) narrowed by 17 per cent to US$2.4 billion (Graph 5), largely due to the relatively slow pace of economic recovery and despite a slight deterioration in the terms of trade. The value of merchandise exports grew 13 per cent while volume growth accelerated to 7 per cent (Graph 6), helped by three devaluations that roughly offset inflation differentials with trading partners. The growth of imports slowed to 6 per cent, equivalent to a volume decline of almost 4.5 per cent; military imports fell from 4.9 per cent of GNP in 1988 to 2.8 per cent of GNP in 1989.

Graph 5
Value of merchandise trade on a customs basis



Source: IMF.

Graph 6
Value and volume[a/] of merchandise trade (Annual percentage change)



a/ Value and volume data calculated according to the Fisher formula
b/ Calculated with respect to same period of previous year
Source: Foreign Trade Statistics Quarterly, Central Bureau of Statistics, Israel, Vol. XLII, 1, 1991.

34. In 1990, under the impetus of strong domestic demand, the merchandise trade deficit widened to US$3.5 billion, although the terms of trade improved modestly, by 1.2 per cent. The growth in the value of merchandise exports decelerated to 8½ per cent while export volume stagnated. Led by a 38 per cent increase in imports of investment goods, both the value and the volume of imports grew briskly, by about 16 per cent and 8 per cent, respectively. In the second half of 1990, the import bill rose as the Gulf conflict resulted in an increase in the price of oil. In 1990, military imports' share of GNP showed little change.

35. During the first ten months of 1991, the trade deficit widened to about US$4.7 billion, compared with US$2.8 billion in the same period of 1990. Sluggish export performance partly reflected growing domestic demand and is also partly ascribed to a decline in orders due to the Gulf war. Merchandise imports have grown rapidly.

36. High labour costs and competition in European markets have affected Israeli exports of agricultural products in recent years. In 1989, improved climatic conditions saw a recovery in Israeli agricultural output, and the volume of exports grew modestly. However, negative price developments more than offset the volume rise and, as a result, the total value of agricultural exports fell 7 per cent, reducing the share of agriculture in merchandise exports (Table 6). Weakening global demand led to a 6½ per cent decline in the volume of diamond exports, which account for about a quarter of total exports: nevertheless, price rises of 16 per cent yielded an increase in export value of 6 per cent. Among industrial products, accounting for two thirds of exports, volume growth generally recovered, but with only moderate price increase their value growth lagged that of total exports. In 1990, favourable weather and price developments saw agricultural exports grow by almost a quarter. As the diamond industry was affected early on in the Gulf crisis export values stagnated with price rises of some 8 per cent offset by volume declines. Except for the decline in the volume of exports of ores and minerals, industrial products performed well both in volume and prices. In the first half of 1991, industrial exports rose moderately, largely on the basis of price improvements, but the value of both agricultural and diamond exports weakened. The competitiveness of Israeli agricultural exports was damaged by a rise in the cost of irrigation.

Table 6
Composition of merchandise exports, 1988-1990[a/]

	1988	(Share) 1989	1990
Agricultural products	6.0	4.9	5.7
Citrus fruits	1.9	1.2	1.6
Other fruits and vegetables	1.2	1.1	1.5
Other	2.9	2.6	2.6
Industrial products	66.6	65.9	67.6
Ores and minerals	2.9	2.9	2.5
Food	5.6	5.3	5.6
Textiles	6.8	5.9	6.8
Other light industry	9.6	9.6	11.3
Chemicals	11.8	11.9	12.5
Metals, machinery and electronics	30.0	30.3	28.8
Diamonds (net)	27.0	25.3	24.0
Total[b/]	100.0	100.0	100.0

a/ Including returned exports (except diamonds); excluding exports to occupied territories.
b/ Numbers do not add up to 100 because total includes "other exports", mainly scrap metal.

Source: IMF.

37. In 1989 only the value of intermediate imports rose, temporarily raising their share in total imports to almost 78 per cent (Table 7). In the first three quarters of 1990, the rise in aggregate demand boosted imports mainly of machinery and equipment and consumer durables. For the year as a whole, the import volume of machines and equipment rose more than 22 per cent and that of consumer durables by 27 per cent. As prices in all categories of imports also increased between 7 and 8 per cent, the import bill rose significantly. Except for imports of diamonds, the same pattern has continued into 1991; in the first half of 1991, imports of production inputs (excluding diamonds) increased more than 14 per cent, of investment goods 35 per cent, and of consumer goods 21 per cent.

Table 7
Composition of civilian merchandise imports, 1988-1990[a/]

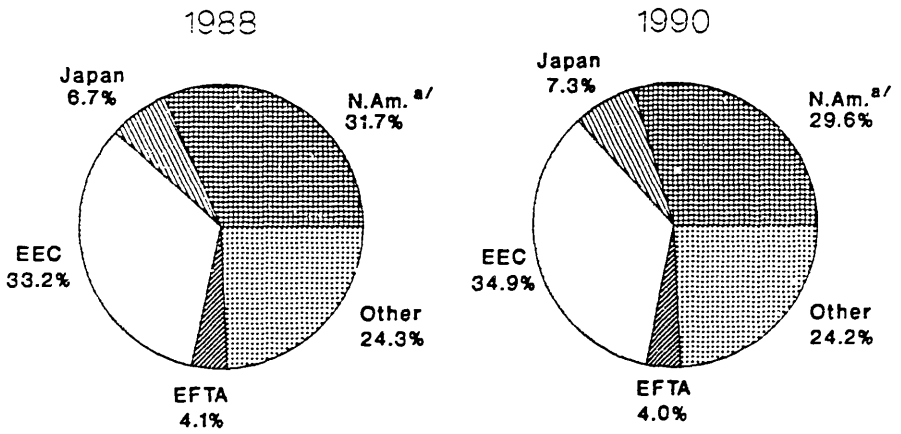
	(Share) 1988	1989	1990
Consumer goods	11.9	10.2	10.6
Non-durables	6.0	6.2	5.7
Durables	5.9	4.3	4.9
Intermediate goods	74.2	77.8	74.9
Diamonds	19.7	22.0	19.2
Fuel	8.6	9.6	10.2
Other	45.9	46.2	45.6
Investment goods	16.0	12.4	14.8
Machinery and equipment	11.1	9.5	10.8
Other items[b/]	-2.1	-0.3	-0.3
Total	100.0	100.0	100.0

a/ Excluding imports from administered areas.
b/ Returned and re-exported imports, and items not specified elsewhere.

Source: IMF.

38. In 1990 there was a slight shift in the direction of Israeli merchandise exports, toward the European Communities and Japan, away from the United States and developing countries (Graph 7). In 1990, the United States accounted for just under 29 per cent of Israeli exports, down from also 31 per cent in 1989. The share of the European Communities in exports of Israel was nearly 35 per cent in 1990, up from about 31.5 per cent in 1989. The United Kingdom had the largest share within the group with almost 7½ per cent in 1990. Japan's share of Israeli exports has risen steadily, to 7.3 per cent in 1990 (compared to 4.5 per cent in 1986). The share of the European Communities in total Israeli imports declined to about 49 per cent in 1990 from about 51 per cent in 1988 (Graph 8). Belgium-Luxembourg (13.2 per cent) followed by Germany (11.7 per cent) constitute the major single suppliers. The share of North America expanded by 1½ per cent to nearly 19 per cent in 1990.

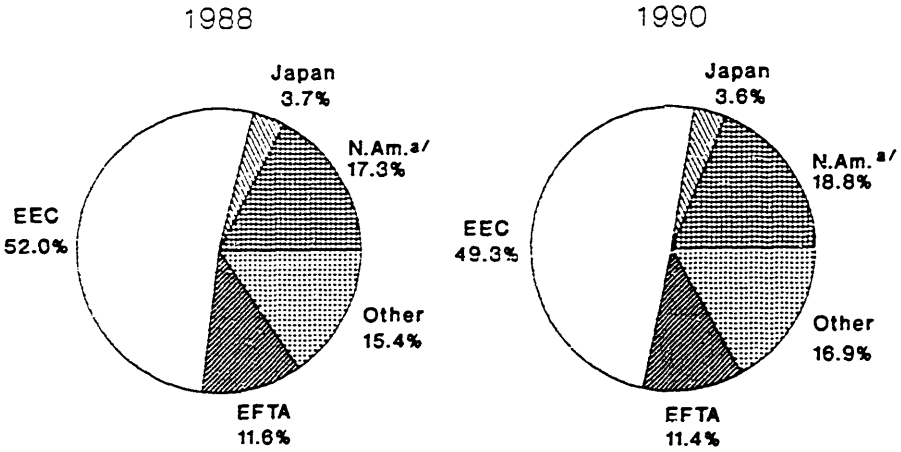
Graph 7
Regional pattern of merchandise exports



a/ Includes USA and Canada

Source: IMF.

Graph 8
Regional pattern of merchandise imports



a/ Includes USA and Canada

Source: IMF.

(h) The invisibles balance

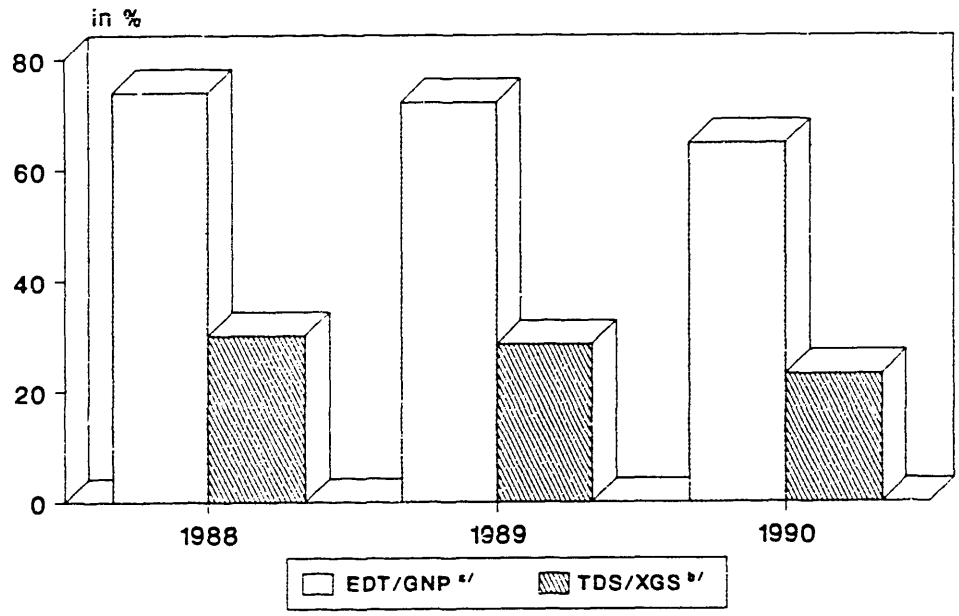
39. In 1989, the surplus on invisibles rose to US$2.9 billion as both the services account deficit declined and net transfer receipts from private and national institutions increased. The improvement in the services account was mostly due to a narrowing of the deficit on investment income. The invisibles surplus grew further in 1990, to nearly US$3.6 billion. Transfers by national institutions and foreign Governments rose but the services deficit widened as net payments in all categories, except investment income, rose. Largely due to the Gulf crisis, net travel recorded a deficit, with the number of tourist arrivals 10 per cent lower than in 1989. During the first quarter of 1991, the services deficit worsened by two-thirds relative to the same 1990 period, reflecting a sharp deterioration of the travel balance; in January-February 1991, the number of tourists arriving in Israel was only 20 per cent of that recorded in the same period a year earlier. Offsetting this decline, to improve the invisible balance marginally, was an increase in unilateral transfers.

(i) The capital account and the external indebtedness

40. Some reversal of the 1988 capital outflows took place after the devaluation of the shequel at the beginning of 1989, especially in private medium- and long-term capital. However, net outflows by commercial banks, private and Government sources, increased during 1989. There was considerable speculative movement of capital, centred on exchange rate uncertainty, reflected in large (positive) errors and omissions and moving the capital account balance into a surplus of some US$300 million. In 1990, there was a modest outflow of medium- and long-term capital, while short-term capital outflows decelerated and errors and omissions were reduced by some 60 per cent.

41. Gross external debt of Israel at the end of 1990 was about US$32.5 billion, 7 per cent higher than at the end of 1988 (Graph 9). However, the ratio of total external debt to GNP fell to less than 65 per cent in 1990 from 74 per cent at the end of 1988 and the ratio of debt service to exports of goods and services also improved, falling from about 30 per cent at end-1988 to 23 per cent at the end of 1990. About 70 per cent of total Israeli external debt is owed by the Government, 11 per cent by the banking sector, and the rest by the non-financial private sector.

Graph 9
External debt indicators



a/ EDT refers to total external debt
b/ TDS refers to gross total debt service.
XGS refers to total exports of goods and services
Source IMF

(j) Foreign exchange

42. The Government of Israel has continued its liberalization of foreign exchange transactions. The external value of the shequel is linked to a reference basket. In January 1989, the BOI began to set the representative rate flexibly on the basis of market conditions within a band of 3 per cent on either side of the central rate vis-a-vis the basket; the band was widened to +/- 5 per cent in March 1990. Recent devaluations of the shequel against the basket were effected in January 1989 (8 per cent), June 1989 (4.4 per cent), March 1990 (6 per cent), September 1990 (10 per cent) and March 1991 (6 per cent). The BOI has also initiated 3 month and 1-year foreign currency options and exchange controls were liberalized on business sector investments abroad. Measures to facilitate the use of foreign currency by the banking system were taken in April 1990, when forward transactions were authorized.