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May 6, 1994

To: Members of the Executive Board

From: The Secretary

Subject: Israel - Selected Economic Issues and Statistical Appendix

This paper provides background information to the staff report on the 1994 Article IV consultation discussions with Israel, which was circulated as SM/94/95 on April 14, 1994.

Mr. Claassen (ext. 37472), Mr. Gleizer (ext. 38845), or Mrs. Hansen (ext. 38417) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

ISRAEL

Selected Economic Issues and Statistical Appendix

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Approved by the European I and Middle East Departments

May 3, 1994

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1. Introduction

This chapter provides an overview of the economic structure of and recent economic developments in the West Bank and Gaza Strip (WBGS), as well as the economic aspects of the peace process as it is unfolding. It also describes the international assistance effort to date and a number of implementation issues relating to the interim Palestinian administration for the WBGS. The chapter is based on information provided in the context of discussions in Jerusalem with Israeli officials and Palestinian officials during the course of the 1994 Article IV consultation mission to Israel 2/ and on data on the WBGS as they are currently available, primarily from Israeli government sources and the World Bank. 3/

The analysis of economic developments in the WBGS is based on incomplete macroeconomic data. Such data exclude East Jerusalem and are particularly weak for the years since the beginning of the Intifada in late 1987, when data collection became less comprehensive. Monetary data are nonexistent and both fiscal and balance of payments data are very limited in coverage. Accordingly, the macroeconomic analysis included in this paper is tentative and the results should be interpreted with caution. As regards economic prospects for 1994 and subsequent years, these will depend heavily on the evolution of the peace process and its impact on the WBGS, as well as on the region as a whole. Achievement of early economic gains is highly contingent on rapid progress in the economic negotiations between Israel and the Palestinians, 4/ as well as on the setting up of the necessary institutions.

1/ Prepared by Mr. Kanesa-Thasan (Consultant, MED) and Ms. Hansen (MED).

2/ Discussions relating to the WBGS were held with officials of the Palestinian Economic Council for Development and Reconstruction (PECDAR), which included Dr. Muhammad Shtayyeh, Dr. Samir Hulleileh, Dr. Amin Haddad, and Dr. Sami Tarazi (all department directors). The Israeli officials included Budget Director David Brodet, Commissioner of State Revenue Yoram Gabai (both Ministry of Finance), Brig. Gen. Freddy Zach (Civil Administration), Dr. Avi Ben-Bassat, Senior Director, and Mrs. Miki Eran, Director, Foreign Exchange Control and Credit Department (both Bank of Israel), Oded Eran, Assistant Director General (Ministry of Foreign Affairs), and Dr. Ezra Hadar, Senior Director (Central Bureau of Statistics).

3/ See in particular World Bank, Developing the Occupied Territories: An Investment in Peace, Vols. 1-6, September 1993.

4/ This report reflects the status of the negotiations at the time of the Hebron events, based on information obtained from Israeli and PECDAR officials during the mission.

2. History, political situation, and population

a. Overview of historical developments

The WBGS was part of the Ottoman Empire until 1917 and came under British control in 1922 via the British mandate over Palestine established by the League of Nations. Attempts to mediate between Jewish and Palestinian interests concerning the future status of Palestine were unsuccessful and in 1947 Britain relinquished its mandate to the United Nations. After the declaration of the State of Israel in 1948 and the ensuing military conflict that year, the West Bank came under Jordanian control and the Gaza Strip under Egyptian control. At the same time, the city of Jerusalem was partitioned, with Israel controlling the western section and Jordan the eastern section. Since the Arab-Israeli war in 1967, the WBGS has been under the military occupation of Israel, and in July 1980 East Jerusalem was annexed by Israel. Since December 1987, there has been a Palestinian uprising--the Intifada--against the Israeli occupation, which has been accompanied by strikes, curfews, border closings, and civil disturbances.

b. Current political situation and institutional arrangements

At present, there are two area commanders appointed by the Israeli authorities, one for the West Bank and the other for the Gaza Strip, in whom nearly all powers of government concerning the WBGS are vested. The Israeli Civil Administration (CA), which administers nonsecurity related matters on behalf of the area commanders, is responsible for all economic matters, including collecting taxes, regulating trade, granting licenses and permits, organizing public infrastructure and services, and supervising the operations of local governments. At present, the CA has about 22,000 employees, of which some 95 percent are Palestinians. However, most policy-making and senior administrative positions in the CA are held by Israelis.

Local government in the WBGS consists of 29 municipalities and 96 village councils. Except in the case of three municipalities (Bethlehem, Tulkarm, and Rafah) where mayors elected in 1976 are still in place, all local government bodies are run by Israeli-appointed officials. Generally, local governments have responsibility for power, water, solid waste, and local road services within their jurisdictions. The CA is responsible for education, health, and inner city road services. There are also 27 refugee camps run by the United Nations Relief and Works Agency (UNRWA), which provides services in these camps.

c. Population

In 1991, the total population of the WBGS was estimated by the Israeli Central Bureau of Statistics (CBS) at 1.68 million. 1/ Out of the total population, 1.0 million resided in the 5,800 square kilometers comprising the West Bank (excluding East Jerusalem) and 0.68 million lived in the 400 square kilometers comprising the Gaza Strip. The World Bank has estimated that in 1991 the rates of natural population increase were 4.1 percent and 5.0 percent in the West Bank and the Gaza Strip, respectively, and that about half the population of the WBGS is now less than 15 years of age. Population density is high: about 170 per square kilometer in the West Bank and about 1,700 per square kilometer in the Gaza Strip. In addition, about 135,000 Israeli settlers are living in some 150 settlements that have been built in the WBGS since 1967. It is estimated that 3.0-3.5 million Palestinians are living outside the WBGS; some of them have maintained residency rights and are in principle free to return to the WBGS to take up residency there.

3. Structural features of the economy

The economy of the WBGS has a number of structural features which have affected economic performance to date. First, the WBGS is highly dependent on developments in Israel: in the period 1990-92, Israel accounted, on average, for about 87 percent of the WBGS's imports and 83 percent of its exports, and wage payments received by Palestinians working in Israel averaged about 27 percent of GNP. 2/

Second, the domestic economy is characterized by a very small agricultural and manufacturing base. As a result, the WBGS is also highly dependent on imports, which averaged 60 percent of GNP in the 1988-92

1/ It may be noted, however, that based on Palestinian research and other Israeli sources, these estimates may be underestimated by 10-15 percent, in which case the resident population may have exceeded 2 million in 1992. Possible factors explaining the discrepancy include inaccuracies in the 1967 census on which the CBS data are based and underreporting of Palestinian births to the Israeli authorities. Accordingly, officially available income per capita data may similarly be overstated.

2/ In earlier years, the WBGS had more diversified sources of foreign exchange earnings, including in particular substantial remittances from oil producing and exporting countries, which tended to provide some counter-cyclical support during downturns to the Israeli economy. However, with the decline in Palestinian employment in these countries following the end of the oil boom and the August 1990 regional crisis, the WBGS's dependence on developments in Israel--especially those affecting Palestinian employment--has increased substantially.

period, and its exports are low: only 12 percent of GNP over the same period. An additional consequence of the narrow production base is that GDP is affected by the two-year cycle in the West Bank's production of olives and olive-based manufactures. 1/

Third, due to the high level of net factor income--primarily workers' remittances from Israel in most recent years--and the narrow production base, GNP exceeds GDP by a substantial amount. Over the 1988-92 period, GNP averaged over 135 percent of GDP (Table 1). Similarly, when net transfers are taken into account, total national disposable income averaged 143 percent of GDP over the same period. Moreover, with the high level of imports noted above, expenditure has in some years exceeded national income, financed, apparently, by drawdowns of household savings.

Fourth, regulatory, institutional, political, and security features in the WBGS have been a major constraint on economic growth. These include in particular: (i) the lack of a conventional banking system and of the financial intermediation which banks normally provide; (ii) tenuous property rights; (iii) a combination of licensing, taxation, and trade procedures and practices which has increased the cost of private sector operations, created barriers to entry, distorted the allocation of resources, and discouraged the modernization of technology; and (iv) uncertainty over political developments and ensuing security measures.

Fifth, the quality of public services and physical infrastructure is considerably inferior to the levels achieved in neighboring countries which are at lower income per capita levels. 2/

1/ Except for 1988, the first year of the Intifada, GDP growth has been marked by a regular pattern of one year of expansion followed by one year of stagnation or contraction in every year since 1972, which mirrors the olive cycle.

2/ According to World Bank data, average urban water supply on a per capita basis in the WBGS is about half the level in Jordan and about one-quarter the level in Egypt, and water supplies are frequently contaminated. Electricity consumption per capita is also low--about 80 percent of the level in Egypt and 45 percent of that in Jordan--due to supply constraints and network deficiencies. Power outages are frequent and many villages have no electricity or only part-time supply from diesel generators. Solid waste collection and disposal is reportedly grossly inadequate, and poor waste water management has contributed to the contamination of groundwater, particularly in the Gaza Strip. Roads in the Palestinian areas are in a very deteriorated state, raising transportation costs, especially for perishable agricultural produce. The telephone service is also highly inadequate, with a backlog of 12,500 connections (about one third of existing connections), which has adversely affected business expansion, especially in the service sector.

Table 1. The West Bank and Gaza Strip: Gross Domestic Product and Gross National Product by Type of Expenditure, 1987–92

	1987	1988	1989	1990	1991	1992
			(In millions of new sheqalim; at current prices)			
GDP at market prices	2,831.1	3,025.5	3,444.8	4,425.5	4,803.5	6,395.7
Exports of goods and nonfactor services	688.1	304.0	376.0	544.7	672.4	871.3
Imports of goods and nonfactor services	2,234.4	1,584.5	1,887.2	2,454.3	3,418.7	4,122.0
Total expenditure	4,377.4	4,306.0	4,956.0	6,335.1	7,549.8	9,646.4
Gross domestic investment	862.0	890.0	904.9	1,222.5	1,256.9	1,946.0
Fixed capital formation	902.0	792.0	938.9	1,129.5	1,309.9	1,798.0
Change in stocks (olive oil)	–40.0	98.0	–34.0	93.0	–53.0	148.0
Total consumption	3,515.4	3,416.0	4,051.1	5,112.6	6,292.9	7,700.4
Government	313.6	323.0	395.1	510.6	592.8	703.0
Private	3,201.8	3,093.0	3,656.0	4,602.0	5,700.1	6,997.4
GDP at market prices	2,831.1	3,025.5	3,444.8	4,425.5	4,803.5	6,395.7
Factor income from abroad	1,155.4	1,122.7	1,319.7	1,550.8	1,626.3	2,195.3
GNP at market prices	3,986.5	4,148.2	4,764.5	5,976.3	6,429.8	8,591.0
Net transfers	259.8	216.1	236.8	306.3	425.7	577.3
National disposable income	4,246.3	4,364.3	5,001.3	6,282.6	6,855.5	9,168.3
			(As percent of GDP)			
GDP at market prices	100.0	100.0	100.0	100.0	100.0	100.0
Exports of goods and nonfactor services	24.3	10.0	10.9	12.3	14.0	13.6
Imports of goods and nonfactor services	78.9	52.4	54.8	55.5	71.2	64.4
Total expenditure	154.6	142.3	143.9	143.1	157.2	150.8
Gross domestic investment	30.4	29.4	26.3	27.6	26.2	30.4
Fixed capital formation	31.9	26.2	27.3	25.5	27.3	28.1
Change in stocks (olive oil)	–1.4	3.2	–1.0	2.1	–1.1	2.3
Total consumption	124.2	112.9	117.6	115.5	131.0	120.4
Government	11.1	10.7	11.5	11.5	12.3	11.0
Private	113.1	102.2	106.1	104.0	118.7	109.4
GDP at market prices	100.0	100.0	100.0	100.0	100.0	100.0
Factor income from abroad	40.8	37.1	38.3	35.0	33.9	34.3
GNP at market prices	140.8	137.1	138.3	135.0	133.9	134.3
Net transfers	9.2	7.1	6.9	6.9	8.9	9.0
National disposable income	150.0	144.3	145.2	142.0	142.7	143.4

Sources: Israeli Central Bureau of Statistics; and staff estimates.

Sixth, the declining availability of land and water resources, due to restrictions on access to water, increased salinity levels, and the loss of land to settlements, has constrained domestic production. 1/

Seventh, while the economies of the West Bank and the Gaza Strip share many common features, there are also a number of striking differences between the two economies. 2/ Levels of development to date are noticeably different, and economic and social problems tend to be more acute in the Gaza Strip than in the West Bank.

Among the more positive features characterizing these economies is the fact that the WBGS has no official external or domestic debt. With appropriate macroeconomic and external debt management, the WBGS should not have to contend with debt burdens and, hence, has a potentially larger scope for economic growth. Moreover, the quality of the workforce is relatively high: there is a strong entrepreneurial tradition in the WBGS, and Palestinians are among the most highly educated of any Arab group. 3/ With a more stable political and security situation, sizeable official external financial support is expected to be forthcoming (see below), and the potential exists for sizeable private capital inflows from the Palestinian community outside the WBGS.

1/ Annually renewable water resources in the WBGS amount to about 750 million cubic meters, but annual use by Palestinians has been capped at the pre-1973 level of about 200 million cubic meters. In some areas, notably in the Gaza Strip, increasing salinity in wells caused by excessive extraction has virtually halted agricultural production. Access of Palestinian sheep and goat farmers to grazing lands has been restricted by the establishment of military areas and nature reserves. In addition, security measures restrict the area in which Gaza fishermen can operate, limiting fish production to a fraction of the pre-1967 levels.

2/ GNP per capita in the Gaza Strip (US$1,134 in 1992) is less than half that of the West Bank (US$2,451 in the same year); investment per capita in the Gaza strip (US$313 in 1992) is less than 60 percent of that in the West Bank (US$558 in the same year); the physical infrastructure in the Gaza Strip is in a considerably greater state of disrepair than in the West Bank; and a significantly larger percentage of the Gaza Strip's work force has been employed in Israel (37 percent on average during 1990-92) than in the West Bank's (31 percent on average during the same period).

3/ According to the World Bank, much of the higher education has been received from European and North American institutions. However, primary and secondary education available in the WBGS is generally of poor quality, reflecting a lack of investment, the patchwork of outdated curricula in use, and the frequent strikes and curfews during the Intifada.

4. Macroeconomic performance

a. Overview of developments during 1969-90

Following the Israeli occupation, the economy of the WBGS grew rapidly, with annual GNP growth averaging 21 percent during 1969-72 (Table 2, Chart 1, and Table 3). 1/ Growth during this period was strong and was in large part driven by the WBGS's integration with the larger, higher income, and more technologically-advanced Israeli economy. This process drew unskilled labor from the agricultural sector in the WBGS into more remunerative employment in Israel. The opening of Israel's labor market to Palestinian workers, along with increasing demand from the regional oil producing and exporting countries for skilled Palestinian labor, led to an average annual increase of 226 percent in net factor income over 1969-72. The integration process also provided a new market in Israel for domestically-manufactured goods and contributed to the introduction of new technology in the WBGS. These latter factors led to an investment boom, with gross fixed capital formation (GFCF) growing at an average annual rate of 56 percent during the same period. Much of this investment appears to have been in housing, but there was also evidence of sizeable investment in agriculture and industry. 2/ As a proportion of GDP, GFCF rose from 9 percent in 1968 to 23 percent in 1972. Private consumption also showed strong growth, increasing at an annual average rate of 16 percent over the period; as a proportion of GDP, it rose from 107 percent in 1968 to 116 percent in 1972. At the same time, imports--composed largely of investment goods--grew by an average annual rate of 23 percent. After an initial two years of stagnation, the growth of exports--primarily for the Israeli market--also took off, averaging over 30 percent per year in 1971-72.

Thereafter, average annual GNP growth decelerated from 21 percent during 1969-72 to 6.5 percent during 1973-82, and further to 2.6 percent during 1983-89; in this latter period, per capita GNP also began to stagnate. This deceleration partly reflected developments in net factor income. Following the first years of the occupation, the pace at which labor was shifting out of low-productivity agriculture in the WBGS into higher wage employment in Israel began to slow down. Strong remittances from regional oil producing and exporting countries, however, kept the average growth in net factor income at a relatively buoyant 8.3 percent per annum during 1973-82.

1/ During the same period, GDP growth averaged 13.5 per year. The higher GNP growth reflected a faster growth in net factor income from abroad.

2/ As shown in Tables 4 and 5, the construction, industrial, and agricultural sectors expanded by an average of 38 percent, 22 percent, and 16 percent per year, respectively, during the 1969-72 period.

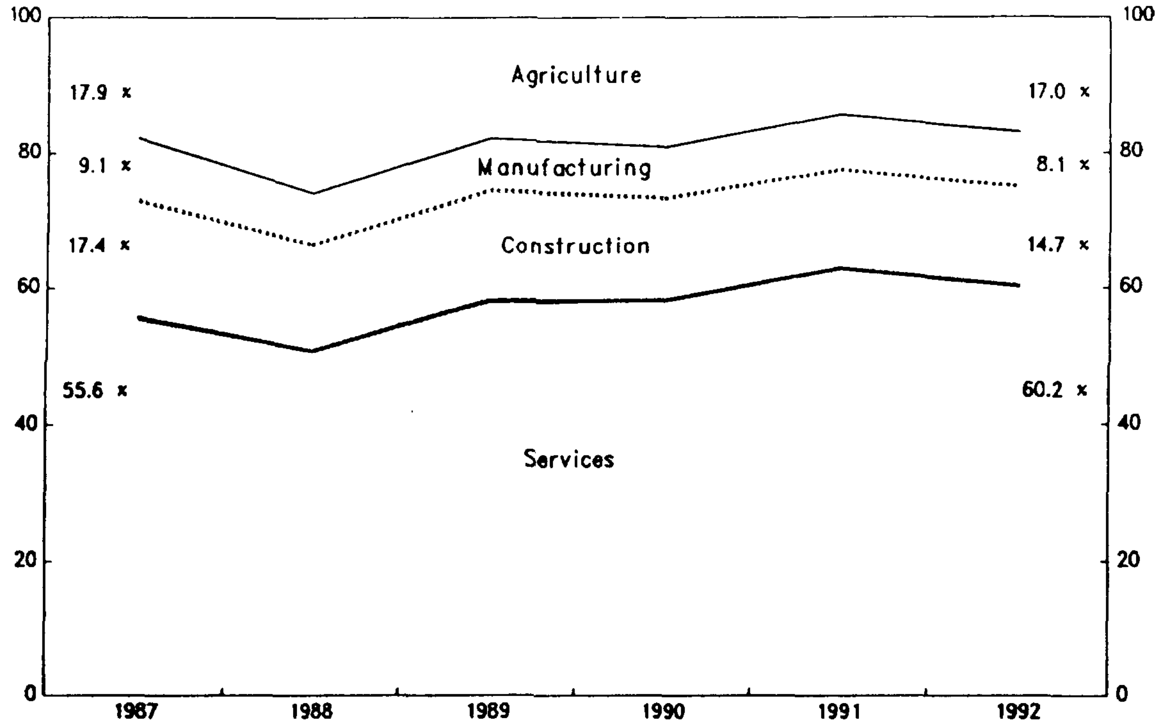
Table 2. West Bank and Gaza Strip: Real Gross Domestic Product and Gross National Product by Type of Expenditure, 1969–92

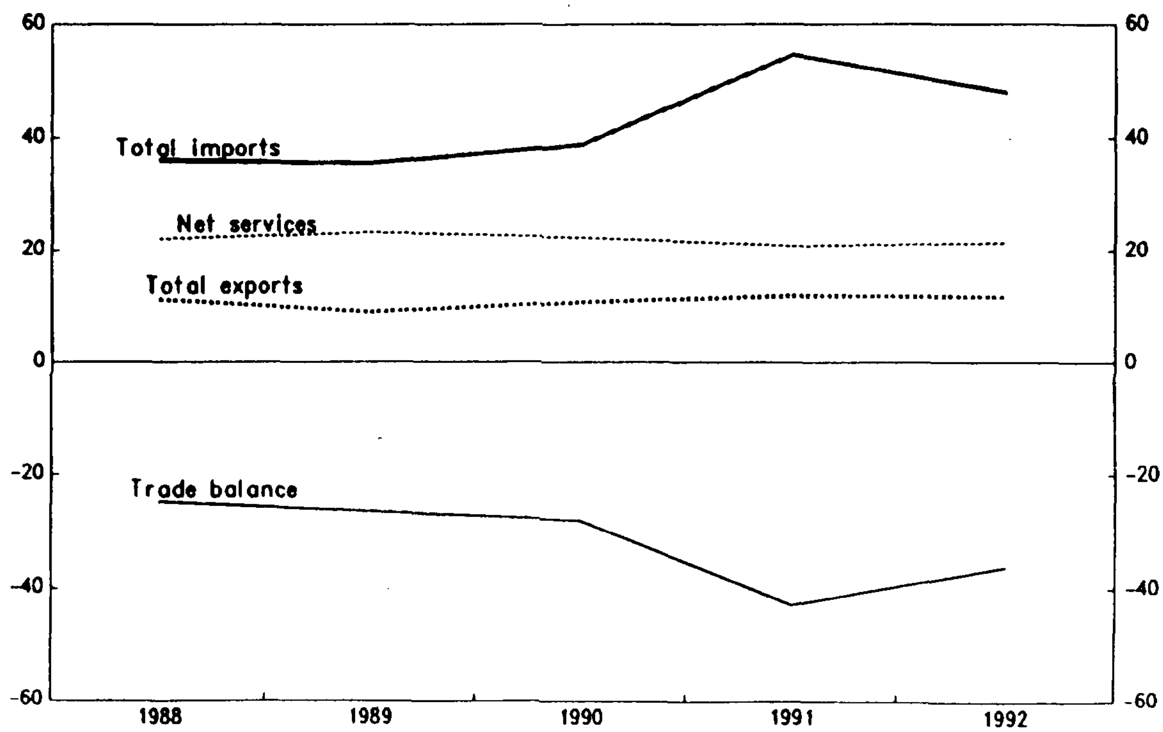
(Annual percentage changes)

	Private Final Consumption	General Government Expenditure	Gross Fixed Capital Formation	Exports of Goods and Services	Imports of Goods and Services	Total GDP	Net Factor Income	Gross National Product
1969	19.1	13.7	128.8	−5.5	29.7	12.1	634.3	18.1
1970	13.6	16.4	−23.1	4.2	5.3	11.0	114.6	17.2
1971	9.7	4.8	40.0	42.7	22.4	13.9	80.3	21.2
1972	21.0	6.2	80.0	19.9	33.4	16.9	75.1	26.4
1973	4.0	1.9	−3.1	−3.6	8.8	−4.0	5.3	−1.9
1974	9.0	1.8	61.0	21.3	9.7	22.1	0.7	16.9
1975	8.8	−2.0	−15.6	25.7	14.5	1.1	19.6	5.0
1976	6.6	2.8	24.3	15.1	4.8	15.3	0.6	11.8
1977	5.2	0.5	0.5	3.0	9.8	−1.0	1.6	−0.4
1978	1.7	2.1	26.1	12.5	0.8	12.9	12.1	12.7
1979	4.9	2.8	−3.2	−6.0	4.0	−1.6	16.1	2.3
1980	0.3	−2.0	31.0	8.8	−1.0	14.6	−7.7	9.1
1981	3.6	1.3	−19.9	15.4	10.9	−6.3	10.4	−2.8
1982	3.1	−0.1	15.0	−3.5	−2.2	8.6	23.8	12.2
1983	1.2	2.7	−6.8	−4.3	1.4	−3.8	6.3	−1.2
1984	3.8	3.2	−3.1	−7.3	−4.5	5.0	−10.1	0.8
1985	−0.1	0.4	6.8	−3.4	1.5	−0.7	−8.3	−2.6
1986	15.4	11.8	26.1	18.7	14.9	19.3	26.9	21.1
1987	7.3	8.2	−8.3	−4.2	10.1	−2.6	26.7	4.6
1988	−9.4	−11.6	0.6	−38.5	−26.5	0.2	−14.4	−4.2
1989	2.0	6.7	−13.6	−30.3	−10.9	0.6	−1.8	−0.0
1990	14.5	27.3	22.7	33.7	16.3	19.0	7.3	15.9
1991	10.0	−2.6	−7.4	13.2	26.4	−4.2	−6.5	−4.7
1992	11.8	21.0	46.5	18.4	10.4	23.7	25.8	24.2
Period averages								
1969–72	15.9	10.3	56.4	15.3	22.7	13.5	226.1	20.7
1973–82	4.7	0.9	11.6	8.9	6.0	6.2	8.3	6.5
1983–89	2.9	3.1	0.2	−9.9	−2.0	2.6	3.6	2.6

Source: Staff calculations based on data provided by the Israeli Central Bureau of Statistics (see Table 3).

CHART 1
WEST BANK AND GAZA STRIP
STRUCTURE OF THE ECONOMY
(In percent of GDP)





Sources: CBS; and IMF staff estimates.

Table 3. The West Bank and Gaza Strip: Gross Domestic Product and Gross National Product by Type of Expenditure, 1968–92

(In millions of new sheqalim; at 1986 market prices)

	Private Final Consumption	General Government Expenditure	Gross Fixed Capital Formation	Exports of Goods and Services	Imports of Goods and Services	Total GDP	Net Factor Income	Gross National Product
1968	740.1	121.7	58.3	162.1	394.7	689.3	6.7	696.0
1969	881.8	138.4	133.4	153.2	512.1	773.0	49.2	822.2
1970	1,001.5	161.0	102.6	159.6	539.1	857.9	105.6	963.5
1971	1,099.0	168.7	143.6	227.7	659.9	977.1	190.4	1,167.5
1972	1,329.7	179.2	258.5	272.9	880.0	1,142.7	333.3	1,476.0
1973	1,383.2	182.6	250.5	263.0	957.7	1,097.4	351.1	1,448.5
1974	1,507.8	185.9	403.2	319.1	1,050.8	1,340.1	353.6	1,693.7
1975	1,640.0	182.2	340.1	401.2	1,202.7	1,355.1	423.0	1,778.1
1976	1,748.7	187.3	422.9	461.6	1,260.4	1,562.1	425.4	1,987.5
1977	1,839.0	188.3	425.2	475.6	1,383.4	1,546.2	432.4	1,978.6
1978	1,870.2	192.2	536.3	535.2	1,394.1	1,744.9	484.9	2,229.8
1979	1,961.3	197.6	519.2	502.9	1,450.3	1,717.3	562.8	2,280.1
1980	1,966.6	193.7	680.4	547.2	1,435.7	1,968.0	519.7	2,487.7
1981	2,036.9	196.2	544.9	631.2	1,591.8	1,845.0	573.8	2,418.8
1982	2,100.9	196.1	626.7	609.1	1,557.2	2,003.6	710.3	2,713.9
1983	2,125.9	201.3	584.2	583.2	1,578.9	1,927.1	754.9	2,682.0
1984	2,206.2	207.7	565.8	540.8	1,507.1	2,024.4	678.4	2,702.8
1985	2,203.6	208.5	604.1	522.2	1,530.4	2,011.1	621.8	2,632.9
1986	2,543.1	233.1	761.5	620.1	1,758.1	2,399.6	788.9	3,188.5
1987	2,727.6	252.3	698.2	594.2	1,936.0	2,336.4	999.3	3,335.7
1988	2,471.6	223.0	702.2	365.7	1,422.4	2,340.0	855.3	3,195.3
1989	2,521.0	238.0	607.0	255.0	1,267.0	2,355.0	840.1	3,195.1
1990	2,886.0	303.0	745.0	341.0	1,473.5	2,801.5	901.6	3,703.1
1991	3,176.0	295.0	690.0	386.0	1,862.5	2,684.5	842.8	3,527.3
1992	3,552.0	357.0	1,011.0	457.0	2,057.0	3,320.0	1,060.0	4,380.0

Source: Israeli Central Bureau of Statistics.

Table 4. The West Bank and Gaza Strip: Real Gross Domestic Product by Major Sector (at Factor Costs), 1969–92

(Annual percentage changes)

	Gross Domestic Product	Agriculture Forestry and Fishing	Industry	Construction Building and Public Works	Public and Community Services	Other Services
1969	12.2	22.6	33.2	76.9	−42.9	−3.2
1970	10.9	−3.0	19.4	5.8	−19.6	23.3
1971	14.1	14.0	14.3	5.6	33.3	15.4
1972	17.1	30.8	20.3	63.9	30.0	−0.8
1973	−4.0	−19.7	10.6	8.6	43.6	3.1
1974	22.2	49.6	23.2	22.6	48.2	2.5
1975	1.1	−28.2	2.1	20.1	69.3	21.3
1976	7.6	23.6	2.7	13.7	94.7	−7.4
1977	6.1	−9.7	3.6	4.5	329.1	−12.5
1978	12.9	24.4	19.4	11.9	4.7	6.5
1979	−1.7	−24.2	−2.7	13.1	−5.0	13.7
1980	14.7	50.9	0.2	−8.5	−1.1	14.0
1981	−6.1	−14.0	−12.0	1.9	2.0	−4.4
1982	8.7	10.0	9.3	4.6	1.6	12.2
1983	6.6	−10.4	−0.5	−0.9	2.5	25.2
1984	−5.2	−0.5	9.8	−2.0	5.5	−13.9
1985	−0.7	−3.0	4.1	5.4	1.5	−3.2
1986	19.4	54.6	32.3	16.2	3.5	2.3
1987	−2.6	−24.6	10.0	3.9	1.9	10.0
1988	0.1	70.4	−13.0	−20.4	−22.0	−24.8
1989	0.7	−22.4	−2.7	9.4	12.5	26.9
1990	19.1	41.3	12.6	6.4	22.2	5.3
1991	−4.3	−23.0	3.5	−6.5	3.7	14.2
1992	23.6	54.2	17.7	12.3	14.3	7.1
Period Averages						
1969–72	13.6	16.1	21.8	38.1	0.2	8.7
1973–77	6.6	3.1	8.5	13.9	117.0	1.4
1978–82	5.7	9.4	2.8	4.6	0.4	8.4
1983–87	3.5	3.2	11.1	4.5	3.0	4.1
1988–92	7.8	24.1	3.6	0.2	6.1	5.7

Source: Staff calculations based on data provided by the Israeli Central Bureau of Statistics (see Table 5).

Table 5. The West Bank and Gaza Strip: Contribution of Main Economic Branches to GDP (at Factor Costs), 1968–92

(In millions of new sheqalim, at 1986 prices)

	Gross Domestic Product	Agriculture Forestry and Fishing	Industry	Construction Building and Public Works	Public & Community Services	Other Services 1/
1968	654.1	230.4	35.2	40.7	9.8	338.0
1969	734.0	282.4	46.9	72.0	5.6	327.1
1970	813.9	273.9	56.0	76.2	4.5	403.3
1971	928.3	312.3	64.0	80.5	6.0	465.5
1972	1,087.2	408.5	77.0	131.9	7.8	462.0
1973	1,044.2	328.1	85.2	143.2	11.2	476.5
1974	1,276.3	491.0	105.0	175.5	16.6	488.2
1975	1,290.4	352.3	107.2	210.8	28.1	592.0
1976	1,388.2	435.5	110.1	239.6	54.7	548.3
1977	1,472.4	393.4	114.1	250.4	234.7	479.8
1978	1,662.4	489.4	136.2	280.2	245.7	510.9
1979	1,634.9	371.0	132.5	317.0	233.4	581.0
1980	1,875.9	559.8	132.8	290.2	230.9	662.2
1981	1,762.3	481.4	116.8	295.7	235.6	632.8
1982	1,916.0	529.6	127.7	309.3	239.3	710.1
1983	2,042.6	474.7	127.1	306.6	245.4	888.8
1984	1,936.7	472.2	139.6	300.5	258.8	765.6
1985	1,923.5	457.8	145.3	316.7	262.7	741.0
1986	2,297.5	707.8	192.2	368.0	271.8	757.7
1987	2,237.4	533.5	211.4	382.4	277.0	833.1
1988	2,239.5	909.0	184.0	304.4	216.0	626.1
1989	2,254.5	705.0	179.0	333.1	243.0	794.4
1990	2,685.5	996.0	201.5	354.3	297.0	836.7
1991	2,570.5	767.0	208.5	331.3	308.0	955.7
1992	3,176.5	1,183.0	245.5	372.0	352.0	1,024.0

Source: Israeli Central Bureau of Statistics.

1/ Other Services include: Transport, Trade and other services (including ownership of Dwellings and errors & omissions).

From 1983 to 1989, however, the growth in net factor income declined to an average 3.6 percent per year, as remittances from regional oil producing and exporting countries dropped in the face of falling international oil prices. Moreover, remittances from Israel were adversely affected by unsettled conditions in the Israeli labor market following the onset of the Intifada.

Abstracting from the large annual swings associated with the olive cycle, average annual GDP growth also tended to decelerate from 1973 to the end of the 1980s. 1/ This was attributable to the fact that the initial boost to GDP growth afforded by integration with Israel had begun to dissipate; the multiplier effects of the decline in net factor income; and in the later years of the period, the onset of the Intifada. In particular, the pace of technological innovation slowed down after the early years of the occupation and, thereafter, the rate of GFCF decelerated sharply from 11.6 percent during 1973-82 to virtually a zero average annual growth during 1983-89; as a proportion of GDP, GFCF increased from 23 percent in 1973 to 26 percent in 1989.

With fewer new export opportunities in Israel and elsewhere and a precipitous drop in exports during the first two years of the Intifada, 2/ there was a marked reversal in export performance from an average annual increase of 8.9 percent during 1973-82 to an average annual decline of 10 percent during 1983-89. At the same time, average annual growth in private consumption decelerated from 4.7 percent during 1973-82 to about 3 percent during 1983-89, reflecting the deceleration in the growth of net factor income; as a proportion of GDP, it declined from 126 percent in 1973 to 107 percent in 1989. Nevertheless, the deceleration in consumption growth was less pronounced than that of GNP growth, suggesting that domestic savings may have helped maintain consumption levels. Over the same periods, import growth also decelerated from an average annual increase of 6 percent to an average annual decline of 2 percent.

b. Developments during 1990-93 and outlook for 1994

During the period 1990-93, economic growth continued to be uneven reflecting the effects of increased dependence on economic and political developments in Israel, which were exacerbated by swings in the biennial olive cycle. In 1990, strong increases in agricultural production and in Palestinian employment in Israel boosted GNP by nearly 16 percent. However, GNP declined by 4.7 percent in 1991, 3/ as a result of a number of reinforcing factors. First, due to curfews and a five-week border closure in the first quarter of the year, the average number of Palestinians working in Israel fell by 10 percent and wage receipts by 7 percent (in nominal

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1/ GDP declined from 13.5 percent on average during 1969-72 to 6.2 percent on average during 1973-82, and further to 2.6 percent on average during 1983-89.

2/ Exports dropped by a cumulative 69 percent over 1988-89.

3/ GDP declined by 4.2 percent.

terms), and the unemployment rate increased sharply. Second, although reliable data are lacking, it appears that remittances and official transfers from the regional oil producing and exporting countries collapsed in the wake of the August 1990 regional crisis. Third, there was a downswing in the olive cycle, which resulted in a 23 percent decline in agricultural production. Construction activity was also down, more than offsetting a moderate increase in industrial production. On the expenditure side, private consumption increased by 10 percent, while gross domestic capital formation declined by over 7 percent.

Economic growth recovered strongly in 1992, with GNP growing by 24.0 percent. 1/ With buoyant activity in the Israeli construction sector, the average number of Palestinians employed in Israel increased by nearly 20 percent and wage receipts were up by 15 percent (in nominal terms). Moreover, favorable weather, combined with an upswing in the olive cycle, resulted in a bumper harvest which contributed to a 54 percent increase in agricultural production. Over the 1990-92 period, GFCF averaged 27 percent and private consumption averaged 109 percent of GDP.

Although national accounts data are not yet available for 1993, macroeconomic performance is expected to have weakened considerably last year, due in large part to the adverse effects of Israel's closure of its border with the WBGS in April 1993. The border closure resulted in an immediate drop in Palestinian employment in Israel from an average 116,000 workers in the first quarter to virtually zero in late April. Shortly thereafter, Palestinian workers were allowed to return to work in Israel, due in part to pressure from the Israeli construction industry, which faced difficulties trying to replace the relatively well-skilled Palestinian construction workers. However, by the end of the third quarter of 1993, 2/ Palestinian employment in Israel had only risen to an average 68,000 workers for the quarter, or about 60 percent of their previous level. The border closure depressed domestic economic activity via the multiplier effects of the decline in workers' incomes and the disruption to internal trade. 3/ In addition, although the non-olive agricultural sector appears to have shown some growth, total agricultural output appears to have declined substantially, reflecting a downswing in the olive sector. The effects of the adverse factors listed above were only partially offset by a strong increase in the CA-sponsored public works program in the Gaza Strip to help absorb workers displaced from the Israeli market.

1/ GDP also rose by 24.0 percent.

2/ The last period for which data are available.

3/ The major north-south transportation routes in the West Bank pass through Jerusalem and links between the West Bank and the Gaza Strip pass through Israel.

At present, the outlook for 1994 is highly uncertain. Much will depend on the developments in the peace process which, in turn, will have a major effect on: (i) the economic arrangements for the transition period; (ii) the pace of disbursement of the US$578 million in external assistance pledged for 1994 (see below); and (iii) the prospects for Palestinian employment in Israel. With rapid progress in the negotiations and an early move to Palestinian self-rule, as originally envisioned in the Declaration of Principles (DOP), the prospects for the WBGS in 1994 would brighten considerably, relative to 1993. The disbursement of a substantial portion of the external assistance pledged for 1994 would result in a large expansion in the construction sector as the emergency reconstruction program started to be implemented. New employment opportunities in the construction sector, along with the hiring of Palestinians to replace departing Israeli officials and to staff the new Palestinian Interim Self-Governing Authority (PISGA), would help reduce unemployment in the WBGS. At the same time, favorable agreements on the specific political and economic arrangements for the transition period would be likely to lead to some initial private investment by residents and nonresidents of the WBGS, although the full effects on private investment would only be felt in 1995 and beyond. Peace would also be likely to enhance the prospects for Palestinian employment in Israel, raising the level of workers' remittances and net factor income. These first round effects of the peace process, along with an expected upturn in the agricultural production and the multiplier effects of the increase in national income, could mark the beginning of a period of strong growth in the WBGS.

However, the delays experienced in the peace process suggest serious downside risks to the scenario just described. As explained below, progress in the peace process has lagged behind the original timetable specified in the DOP, increasing the likelihood of delays in disbursing the external assistance pledged for 1994. In addition, Israel's recent decision to close its borders with the WBGS for an indefinite period of time does not augur well for the level of workers' remittances. If delays in external aid disbursements and the border closure were to persist, then the outlook for 1994 would increasingly become one of economic contraction and mounting unemployment.

5. Sectoral developments

a. Agriculture

Agriculture plays an important role in the economy of the WBGS, accounting on average for close to 20 percent of GDP in the West Bank and 17 percent of GDP in the Gaza Strip over the period 1988-92 (Tables 6, 7, and 8). The sector also employs a significant proportion of the workforce employed in the WBGS: 29 percent and 21 percent for the West Bank and the Gaza Strip, respectively, in 1992.

Table 6. The West Bank and Gaza Strip: Gross Domestic Product by Sector, 1987-92

	1987	1988	1989	1990	1991	1992
	(In millions of new sheqalim; at current prices)					
GDP at market prices	2,831.1	3,025.5	3,444.8	4,425.5	4,803.5	6,395.7
Agriculture	505.8	785.1	614.6	844.7	687.7	1,087.9
Olives	19.9	206.9	16.4	204.1	10.9	291.7
Other agriculture	485.9	578.2	598.2	640.6	676.8	796.2
Manufacturing	258.9	233.0	262.5	333.7	393.2	515.4
Construction	493.3	471.7	566.3	673.4	705.3	944.6
Services	1,573.1	1,535.7	2,001.4	2,573.7	3,017.3	3,847.8
Public and community	341.4	347.8	446.3	547.0	652.3	733.2
Other	1,231.7	1,187.9	1,555.1	2,026.7	2,365.0	3,114.6
	(As percent of GDP)					
GDP at market prices	100	100	100	100	100	100
Agriculture	18	26	18	19	14	17
Olives	1	7	0	5	0	5
Other agriculture	17	19	17	14	14	12
Manufacturing	9	8	8	8	8	8
Construction	17	16	16	15	15	15
Services	56	51	58	58	63	60
Public and community	12	11	13	12	14	11
Other	44	39	45	46	49	49

Sources: Israeli Central Bureau of Statistics; and staff estimates.

Table 7. The West Bank: Gross Domestic Product by Sector, 1987-92

	1987	1988	1989	1990	1991	1992
			(In millions of new sheqalim; at current prices)			
GDP at market prices	2,114.6	2,282.4	2,523.5	3,334.9	3,525.2	4,747.0
Agriculture	384.2	650.2	462.8	667.0	474.5	832.3
Olives	19.9	206.9	16.4	204.1	10.9	291.7
Other agriculture	364.3	443.3	446.4	462.9	463.6	540.6
Manufacturing	163.8	152.6	159.6	208.5	236.2	328.4
Construction	341.5	308.4	369.1	468.3	489.6	663.7
Services	1,225.1	1,171.2	1,532.0	1,991.1	2,324.9	2,922.6
Public and community	205.7	188.2	249.9	310.4	379.4	402.6
Other	1,019.4	983.0	1,282.1	1,680.7	1,945.5	2,520.0
			(As percent of GDP)			
GDP at market prices	100	100	100	100	100	100
Agriculture	18	28	18	20	13	18
Olives	1	9	1	6	0	6
Other agriculture	17	19	18	14	13	11
Manufacturing	8	7	6	6	7	7
Construction	16	14	15	14	14	14
Services	58	51	61	60	66	62
Public and community	10	8	10	9	11	8
Other	48	43	51	50	55	53

Sources: Israeli Bureau of Central Statistics; and staff estimates.

Table 8. The Gaza Strip: Gross Domestic Product by Sector, 1987–92

	1987	1988	1989	1990	1991	1992
	(In millions of new sheqalim; at current prices)					
GDP at market prices	716.5	743.1	921.3	1,090.6	1,278.3	1,648.7
Agriculture	121.6	134.9	151.8	177.7	213.2	255.6
Olives	...	...	...	...	...	...
Other agriculture	...	...	...	...	...	...
Manufacturing	95.1	80.4	102.9	125.2	157.0	187.0
Construction	151.8	163.3	197.2	205.1	215.7	280.9
Services	348.0	364.5	469.4	582.6	692.4	925.2
Public and community	135.7	159.6	196.4	236.6	272.9	330.6
Other	212.3	204.9	273.0	346.0	419.5	594.6
	(As percent of GDP)					
GDP at market prices	100	100	100	100	100	100
Agriculture	17	18	16	16	17	16
Olives						
Other agriculture						
Manufacturing	13	11	11	11	12	11
Construction	21	22	21	19	17	17
Services	49	49	51	53	54	56
Public and community	19	21	21	22	21	20
Other	30	28	30	32	33	36

Sources: Israeli Central Bureau of Statistics; and staff estimates.

Production in the West Bank consists primarily of livestock, olives, vegetables, and other fruits and in the Gaza Strip of vegetables, livestock, and citrus. Total agricultural output in the West Bank (but not in the Gaza Strip) is heavily influenced by the two-year olive cycle, causing dramatic large swings in output from one year to the next. 1/

Agricultural sector growth averaged 16 percent per year over the period 1969-72, in response to expanding export opportunities in Israel and a rapid transfer of technology from Israel in the years immediately following the occupation. During 1973-87, however, the average growth slowed to 5 percent annually as export markets declined in importance, the Israeli economy encountered difficulties, and the regulatory climate in the WBGS became more unfavorable. However, annual average growth in the agricultural sector increased markedly to 24 percent during 1988-92, reflecting in particular an influx of labor into the sector, some excellent olive harvests, and the changing preference of Palestinian consumers for locally-grown products.

Since 1967, most agricultural production in the WBGS has been for local consumption, although the Gaza Strip has exported citrus for many years. The WBGS also exported other fruits and vegetables in the past to other countries in the region, notably Jordan, and to Eastern European countries. However, such exports had declined or been lost altogether in the aftermath of the Iran-Iraq war, the August 1990 regional crisis, and the economic adjustments in Eastern Europe. Exports to Israel and Jordan, in particular, have been adversely affected by security considerations and increased import restrictions, while imports of Israeli agricultural products can enter the WBGS freely.

b. Industry

The industrial sector has historically accounted for a relatively small share of GDP in the WBGS, averaging 8 percent for the period 1987-92, reflecting low capacity utilization due both to the strikes and curfews

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1/ For example, in 1992, olives represented 35 percent of agricultural production in the West Bank and 6 percent of the West Bank's GDP, compared to only 3 percent of agricultural production and a minuscule contribution to GDP in 1991.

since the beginning of the Intifada and to a restrictive regulatory environment. 1/ Food processing--especially relating to olives in the West Bank--textiles, clothing, and leather account for a significant part of total industrial production.

Most industrial firms in the WBGS are quite small, with 60 percent employing fewer than 4 workers and less than 8 percent more than 10 workers. The generally small size of industrial establishments is attributable to several factors. First, small operations allow Palestinian entrepreneurs to work in a flexible and informal manner conducive to minimizing contact with the regulatory authorities. Second, the undeveloped state of the financial system and the restrictive regulatory system, among other factors, limit the ability to expand operations. Finally, the perception of high political risk has led entrepreneurs to postpone investment. However, subcontracting for Israeli firms, which has been providing market access to Israel via the Israeli firm and working capital, has become an important aspect of business activity.

c. Construction

Construction accounted for 16 percent of GDP on average during 1988-92, and was heavily concentrated in housing. This outcome partly reflects poor business incentives and may also be explained by the fact that, in the absence of a well-functioning banking system, housing has become the dominant investment vehicle for domestic savings. Moreover, in an environment of uncertainty about land tenure, housing construction is seen by Palestinians as a means of helping to maintain property rights. 2/

1/ As a point of comparison, the World Bank reports that the average share of industry in GDP for low- to middle-income countries increased from 30 percent in 1965 to 37 percent in 1990. Within the low- to middle-income group, the World Bank also cites the cases of Mauritius, a small, open economy with a significant agricultural sector, and Lesotho, a small, agricultural economy closely integrated with a larger, industrialized neighbor. In these countries, the industrial sector represents about 33 percent and 30 percent of GDP, respectively.

2/ The land tenure system as it existed in 1967 consisted of a patchwork of Ottoman, British, Jordanian, and Egyptian landholding and registration practices. In 1979, the Israeli authorities deemed that all land in the WBGS was state land unless previously registered or under continuous cultivation for the previous ten years, with the burden of proof placed on the Palestinians. The Israeli land survey conducted in 1979 concluded that about 40 percent of the land in the West Bank and 30 percent in the Gaza Strip was state land. By 1986, virtually all of this land had been transferred to the Israeli authorities.

d. Other services

By far the largest contribution to GDP in the WBGS comes from the service sector, which represented an average 58 percent of GDP during 1988-92; of this, public and community services averaged 12 percent of GDP and other services (excluding construction, building, and public works) 46 percent. Little additional information is available on the current composition of services. 1/

6. Fiscal institutional arrangements and developments

a. Institutional arrangements

Four main entities have been involved in public sector functions in the WBGS: (i) the Israeli Civil Administration (CA); (ii) municipalities and village councils; (iii) the United Nations Relief and Works Agency (UNRWA); and (iv) various local and international nongovernmental organizations (NGOs). The CA has been by far the leading fiscal agency in the WBGS, although the fiscal contribution of UNRWA has increased significantly in recent years. Historically, the budgets of these entities have not been consolidated to reflect the overall fiscal position of the WBGS. However, efforts have been made by the Palestinians, with World Bank assistance, to put together a somewhat more consolidated budget for the envisaged Palestinian central administration in 1994 (see below).

b. The CA budget 2/

The major sources of revenue are: a personal income tax at rates ranging from 8 percent to 48 percent; a corporate income tax at rates of 38.5 percent in the West Bank and 37.5 percent in the Gaza Strip; a uniform 17 percent value-added tax, the same rate as in Israel; customs and excise duties at various rates; health fees paid by employees of the CA and other WBGS residents who join the CA health system; and other fees and charges.

1/ Palestinian participation in the tourism sector, in particular, which is potentially a major source of foreign exchange and economic activity, has declined significantly since 1967.

2/ The CA budgets are based on the Israeli fiscal year, which until 1991 ran from April 1 to March 31; beginning in 1992, the fiscal year is the calendar year.

In addition, the deduction fund, which represents the portion of social security contributions that Palestinian employees in Israel are not entitled to draw, is transferred to the CA as general revenues. 1/ Over the 1987/88 to 1992 period, the revenue to GDP ratio in the CA budget was in the order of 12-13 percent (Tables 9 and 10).

Not all taxes paid by Palestinians are, however, reflected in the CA revenues. Import duties collected at Israeli ports on goods destined for the WBGS are retained by the Israeli Treasury, except when the goods (e.g., automobiles) can be clearly identified as being imported into the WBGS. In addition, taxes on trade between Israel and the WBGS are based on the "origin principle"; given the large trade deficit in Israel's favor, the preponderance of these trade taxes accrue to Israel. Revenue from fuel taxes, excise taxes (mainly on tobacco, beverages, and cement) and purchase taxes 2/ paid by WBGS residents also accrue to Israel. The World Bank has estimated that the loss to the CA budget in 1991 was about US$200 million (NIS 400 million) or 8.3 percent of GDP in 1991. The disposition of the deduction fund together with the sharing of trade and other taxes are among the issues currently under discussion in the negotiations on an interim agreement.

Over the period 1987-92, CA expenditure was generally equivalent to 12-13 percent of GDP. Current expenditures were in the order of 10 percent of GDP, of which roughly half has been for education and health; and development expenditure, about 2 percent of GDP. The CA budget does not include spending on security and outlays related to Israeli settlements.

Generally, the CA has run small surpluses on its current budget in order to finance a low level of development expenditure. From 1988/89 to 1992, the CA budget surplus was generally equivalent to less than 1 percent of GDP. In 1993, however, the CA administration sharply increased its development expenditures (including a relief works program), in large part to offset the effects of the April border closure, especially in the Gaza Strip. Thus, the CA's revised 1993 budget showed an overall deficit of NIS 451 million, or about 7 percent of GDP, compared with an overall surplus of NIS 40 million, or less than 1 percent of GDP, in 1992. The deficit was financed through a transfer from the Israeli Government.

1/ The total social security contribution is 12.7 percent of salary, of which employers contribute 7.4 percent and employees 5.3 percent. Palestinian workers in Israel are entitled to benefits worth 0.9 percent of salary; the remaining 11.8 percent is remitted to the CA as the deduction fund.

2/ The Israeli purchase tax is levied mainly on consumer goods, such as televisions and washing machines, as well as on several raw materials and processed goods. Tax rates are based on the wholesale value and range from 5 percent to 95 percent, except for cigarettes which are subject to rates of up to 240 percent.

Table 9. The West Bank and Gaza Strip: Civil Administration Budget, 1987/88-1992 1/

(In percent of GDP)

	1987/88	1988/89	1989/90	1990/91	1991 2/	1992
Revenue	12.0	11.8	12.5	12.1	12.0	12.6
Income tax	1.9	2.3	3.0	3.0	2.6	2.9
VAT	1.8	1.8	1.7	2.0	2.2	2.5
Customs and excises	1.5	1.4	1.5	1.6	1.5	2.3
Health fees	0.6	0.7	0.8	0.6	0.8	1.1
Other fees and charges	4.7	3.9	4.3	4.2	4.0	2.5
Deduction fund	1.5	1.6	1.1	0.8	0.9	1.3
Current expenditure	9.9	10.4	10.3	10.4	8.5	9.7
Health	2.3	2.3	2.3	2.1	1.9	2.3
Education	3.6	3.0	3.1	3.2	2.6	2.9
Welfare	0.8	0.5	0.4	0.4	0.4	0.4
Other	3.2	4.6	4.5	4.7	3.7	4.0
Development expenditure	3.0	1.3	1.3	1.7	1.8	2.3
Total expenditure	12.9	11.7	11.7	12.1	10.3	12.0
Overall balance (deficit -)	-0.9	0.1	0.9	0.0	1.7	0.6

Source: Staff calculations based on Table 10.

1/ Because of rounding, numbers may not add to the totals shown.
2/ Annualized.

Table 10. The West Bank and Gaza Strip: Civil Administration Budget, 1987/88–1993

(In millions of new sheqalim)

	Actuals					Actual	Revised Budget	Jan.–Sep.
	1987/88	1988/89	1989/90	1990/91	1991 1/	1992	1993	1993
Revenue	345	368	462	546	577	806	825	537
Income tax	56	73	109	134	125	184	200	135
VAT	52	55	63	89	106	157	167	126
Customs and excises	44	43	55	73	72	146	143	101
Health fees	16	23	31	28	38	73	83	64
Other fees and charges	135	123	158	188	192	160	140	49
Deduction fund	42	51	40	34	44	86	92	62
Current expenditure	286	325	381	471	410	620	798	521
Health	67	73	84	96	91	150	170	125
Education	103	93	116	146	124	186	207	147
Welfare	23	15	14	17	18	25	68	39
Other	93	144	167	212	177	259	353	210
Development expenditure	86	41	49	75	87	146	478	232
Total expenditure	372	366	430	546	497	766	1,276	753
Overall balance (deficit –)	–27	2	32	--	80	40	–451	–216
Financing	27	–2	–32	--	–80	–40	451	216
Israeli treasury	27	--	--	--	--	--	451	216
Increase in cash balances	--	–2	–32	--	–80	–40	--	--
GDP at market prices 2/	2,880	3,130	3,690	4,520	4,804	6,396	...	...

Source: Israeli Civil Administration.

1/ Annualized.
2/ On fiscal year basis: April to March until 1990/91 and January to December beginning in 1991.

c. Municipal budgets

Municipal budgets cover the revenues and expenditures of the electricity and water utilities. Current revenues consist of taxes (property and fuel), fees, and water and electricity charges, while current expenditures are composed of expenditures on general services and expenditures by the utilities. In addition, there is a small amount of development expenditure (about 0.5 percent of GDP since 1988/89) financed in part by the CA.

d. UNRWA

UNRWA is a major provider of health, education, and other social services in the WBGS. About 40 percent of residents of the West Bank and 60 percent of the residents of the Gaza Strip have refugee status and are therefore entitled to benefits from UNRWA. Over the period 1988-92, average annual expenditures by UNRWA in the WBGS increased to about US$160 million per year, but declined as a share of GDP from 3.5 percent in 1988 to 2.5 percent in 1992; expenditures in the Gaza Strip represented about 60 percent of the total. About 50 percent of UNRWA expenditures have been on education, about 20 percent on health, and the remainder on other activities. Other sources of externally-financed services in the WBGS include: UNDP, the European Union, official bilateral sources, and various nongovernmental organizations.

7. Money and banking

a. Institutional arrangements

(1) A cash economy

The WBGS is primarily a cash economy. Large cash balances are maintained for various reasons, including in particular an underdeveloped banking system (see below) and political uncertainty. Moreover, investment is mostly self-financed, requiring an accumulation of savings, and most transactions are on a cash-in-advance basis. According to tentative staff estimates, the cash in circulation in the WBGS in Jordan dinar (JD) and the new Israeli sheqel (NIS) might be of the order of US$1 billion, which is a comparatively high level both in relation to the size of its population and to GDP. Deposits in NIS are negligible, and those in JDs are mainly held as a store of value. In the absence of a monetary authority and an active banking system, changes in money supply are primarily determined by inflows and outflows related to external trade, net factor income, and net transfers. Since these flows varied widely over the years, the money supply would have fluctuated as well.

(2) An undeveloped banking and financial system

The financial system in the WBGS consists primarily of: (i) an undeveloped banking system, which has not encouraged financial intermediation; and (ii) a relatively efficient network of moneychangers, which in many respects has developed into a parallel financial sector.

All Arab and foreign-owned banks operating in the WBGS were closed in 1967. Thereafter, only Israeli banks were licensed to operate in the area until the opening of the Bank of Palestine in 1981 and the re-opening of the Cairo-Amman Bank in 1986. Israeli banks expanded operations in the WBGS through the 1970s and early 1980s; in 1984, there were 31 Israeli bank branches in the area, of which 22 were located in Palestinian towns. However, for a variety of reasons, 1/ only limited amounts of credit were provided in the WBGS. Following the beginning of the Intifada in late 1987, most Israeli bank branches operating in Palestinian areas were closed.

At present, there are only two Arab banks operating in the area: the Cairo-Amman Bank based in Jordan, which has seven branches in the West Bank, and the Israeli-registered Bank of Palestine, which has three branches in the Gaza Strip. These two banks provide only limited financial services to the economy and their near-monopoly status is reportedly reflected in the prices and the quality of their services. Both banks follow very conservative lending practices, and at the end of 1992, they had only US$17 million in credit outstanding, or less than 1 percent of GDP. There are also 13 branches of Israeli banks operating in the WBGS, but these banks mainly serve customers in the Israeli settlements and generally are only used by Palestinians for specialized international transactions not otherwise available. Overall, by international standards, banking services in the WBGS are quite limited. 2/

Since 1967, moneychangers have expanded to provide a number of important financial services, against the background of an undeveloped banking system, two legal currencies (the NIS and the JD) in the West Bank, (see below) stringent Israeli exchange controls and, at times, rapid inflation. According to available information, there were 162 money-changers in the West Bank as of 1986, offering a number of traditional banking services, including foreign exchange, inward and outward transfers,

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1/ Such as high collateral requirements, due to the inadequate legal framework, and poor loan recovery, especially since the beginning of the Intifada.

2/ For example, measured by the number of branches in relation to the size of the population, the WBGS has roughly 6 (non-Israeli) branches per million inhabitants in the WBGS, compared to 190 in the United States, 477 in France, and 84 in Jordan. Similarly, measured by the number of branches in relation to the size of GDP, the WBGS has US$220 million per bank branch, compared to US$124 million in the United States, US$52 million for France, and US$12 million for Jordan.

and check cashing on external accounts. The larger moneychangers also accept deposits and, on a very selective basis, make some short-term loans. However, due to the capital required and risks involved, deposit-taking and credit extension are not preferred activities. Accordingly, moneychangers have played a very small role in the mobilization of savings or the extension of medium- to long-term credit. While authorized moneychangers in the West Bank are legally permitted to deal only in NIS and JDs, in practice they deal extensively in U.S. dollars and other currencies, which the Israeli authorities have generally tolerated.

As regards the rest of the financial sector, there are also more than 20 credit programs administered by Palestinian nonprofit organizations and foreign nongovernment organizations (NGOs) which have been established to channel official bilateral and multilateral aid to the WBGS. These programs provide small loans at subsidized interest rates, which totaled US$16 million as of the end of 1992. Repayment rates are low, reflecting the credit programs' soft lending practices. There are also two insurance companies functioning in the West Bank, but none in the Gaza Strip. These companies are subject to a mixture of Israeli and Jordanian laws and regulations and are under the supervision of the Israeli Controller of Insurance. Uncertainty about the nature and stability of the political arrangements and financial system has hindered the development of an insurance industry.

b. Currency arrangements

Since 1967, the JD and the NIS have been legal tender in the West Bank and the NIS has been legal tender in the Gaza Strip. The NIS is more heavily used for transactions purposes, inasmuch as Palestinians working in Israel are paid in NIS, transactions with the Israeli economy are conducted in NIS, and tax payments to the Israeli authorities are made in NIS. However, concerns about high inflation in Israel in the mid-1980s, prior to the 1985 Economic Stabilization Plan, 1/ the continuous depreciation of the NIS, and political factors, have all contributed to a preference for the JD (and other foreign currencies) as a store of value.

1/ Available price data (Table 11) suggest that inflationary developments in the WBGS have generally followed those in Israel, reflecting the fact that a large proportion of imports by the WBGS is from Israel and that labor costs are strongly influenced by labor market conditions in Israel. In more recent years, the inflation rate has tended to be lower than in Israel, reflecting weaker market conditions in the WBGS.

Table 11. The West Bank and Gaza Strip:
Consumer Price Index, 1978–93

(Average annual percentage changes)

	West Bank	Gaza Strip	Israel
1978	50.4	42.8	50.6
1979	68.1	72.4	78.5
1980	139.4	156.0	130.8
1981	114.0	109.5	116.8
1982	107.4	114.6	120.3
1983	139.8	151.2	145.7
1984	360.3	373.0	373.8
1985	320.9	337.6	304.6
1986	50.0	49.6	48.1
1987	13.1	11.0	19.9
1988	8.7	11.1	16.3
1989	14.5	15.7	21.8
1990	13.0	16.9	15.6
1991	11.5	7.0	19.0
1992	13.9	14.1	12.0
1993	6.8	5.7	11.0

c. The regulatory framework

The legal and regulatory framework for financial institutions in the WBGS is quite complex. In principle, institutions in the West Bank are subject to Jordanian law as it existed prior to 1967, and those in the Gaza Strip are subject to British mandate laws, while Israeli institutions are subject to Israeli laws. In practice, however, the Bank of Palestine operates under Israeli law, while the Cairo-Amman bank operates under a special agreement between the Jordanian and Israeli authorities. This agreement has been superseded by the Israel-Jordan memorandum of understanding concerning the opening of Jordanian bank branches in the West Bank, which was signed in December 1993 (see below) and is to remain in effect for the five-year transition period or until the Palestinian authorities establish their own banking authority, whichever is sooner.

8. External sector 1/

The external current account of the WBGS is characterized by a persistently large trade deficit, with imports generally about three to four times higher than exports--mostly reflecting sizeable trade deficits with Israel. 2/ The services account, however, has been in surplus, reflecting mainly the high level of workers' remittances and a growing amount of transfers from UNRWA. In addition, since 1990 there have been increasing amounts of transfers from the Government of Israel, although these remain

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1/ Information on the WBGS's external transactions is limited to those in the current account. It should be noted, however, that the amount of remittances from workers other than those employed in Israel is probably underreported due to controls on the amount of private capital that Palestinians residing outside the WBGS can legally transfer into the area. (During 1988-91 and part of 1992 the ceiling was reportedly US$200 per month per Palestinian worker residing outside the WBGS; during 1992, the amount was raised to US$2,000.) For Palestinians employed in Israel residing in the WBGS, remittances are not subject to this restriction. As regards the capital account, there are no data on private capital transactions. In addition, given the WBGS's status, there have been no official capital transactions (apart from some limited loans from Israel to municipal utility entities) to date and no official foreign exchange holdings. It may be surmised, however, that given current account movements, there have been substantial unreported private capital flows and changes in privately-held foreign exchange reserves.

2/ Given the absence of external debt and private foreign direct investment, the existence of persistent current account deficits is to be interpreted with caution. Such deficits may be overstated due to under-reporting of remittances and have, in any case, been fully financed by unreported inflows and changes in private foreign assets.

small (Tables 12, 13, and 14). 1/ Following surpluses during 1988-90, the current account shifted into a substantial deficit of US$271 million, or 13 percent of GDP in 1991. This outcome reflected a surge in imports and a decline in the surplus on net services. In 1992, the deficit narrowed to US$148 million, or about 6 percent of GDP, as smoother conditions in the Israeli employment market led to higher workers' remittances and improved economic conditions in the WBGS had a moderating effect on import growth.

Although full-year data are not yet available, indications are that the current account deficit expanded again in 1993. The current account deficit reached US$201 million for the first six months of 1993, exceeding the deficit recorded for 1992 as a whole. The most important factor in this deterioration appears to have been the closure of the border with Israel for Palestinian workers in April 1993, followed by a gradual reemployment of Palestinians in Israel, which sharply reduced service receipts. The border closure also led to some disruption in merchandise exports from an already small base. A further negative factor was the poor olive harvest, which resulted in sharply reduced olive-based exports.

As regards the outlook for 1994, if a substantial amount of the foreign assistance that has already been pledged is effectively disbursed in 1994, imports would increase strongly. Such a prospect, together with a prolongation of the current closure of the border with Israel or other adverse developments in Palestinian employment in Israel, could result in a substantial current account deficit this year. However, to the extent that external financing is provided in the form of grants, the current account deficit could be financed in a manner that would not give rise to large future interest payment obligations.

9. Economic aspects of the peace process

On September 13, 1993, Israel and the Palestine Liberation Organization (PLO) signed the DOP on interim self-government arrangements for the WBGS. The DOP provides for the establishment of PISGA with an elected council for the WBGS for a transitional period not exceeding five years, which is to precede a permanent settlement based on Security Council Resolutions 242 and 338.

1/ Although the basic features of the current account for the West Bank and the Gaza Strip are similar, the Gaza Strip's external current account position has consistently been in a stronger position throughout the 1988-92 period due to a higher surplus on services in relation to the size of the trade deficit and to larger receipts on net transfers (in relation to GDP, as well as, in most years, in absolute terms).

Table 12. The West Bank and Gaza Strip: Balance of Payments, 1988–93

(In millions of current U.S. dollars)

	1988	1989	1990	1991	1992	QI–II 1993
Merchandise exports	209	159	231	247	300	135
Merchandise imports	676	632	843	1,139	1,232	547
Trade balance	−467	−473	−612	−892	−932	−412
Net services	413	412	483	434	549	82
Service receipts, of which:	742	728	844	794	996	306
Wages	692	682	794	737	930	273
Service payments	329	316	361	360	447	224
Net transfers, of which:	136	124	153	187	235	129
UNRWA	103	117	126	145	163	81
Government of Israel	15	−2	24	36	61	41
Current account balance	82	63	24	−271	−148	−201
As percent of GDP	4	4	1	−13	−6	...
As percent of GNP	3	3	1	−10	−4	...

Sources: Israeli Central Bureau of Statistics; and staff estimates.

Table 13. The West Bank: Balance of Payments, 1988–93

(In millions of current U.S. dollars)

	1988	1989	1990	1991	1992	QI–II 1993
Merchandise exports	142	125	180	173	217	99
Merchandise imports	453	432	574	777	867	382
Trade balance	–311	–307	–394	–604	–650	–283
Net services	242	268	279	263	366	53
Service receipts, of which:	451	482	520	491	664	202
Wages	422	456	492	459	627	183
Service payments	209	214	241	228	298	149
Net transfers, of which:	55	44	71	98	108	60
UNRWA	42	48	53	66	58	29
Government of Israel	6	–8	16	30	46	28
Current account balance	–14	5	–44	–243	–176	–170
As percent of GDP	–1.0	0.4	–2.7	–15.9	–9.2	...
As percent of GNP	–0.8	0.3	–2.1	–12.1	–7.0	...

Sources: Israeli Central Bureau of Statistics; and staff estimates.

Table 14. The Gaza Strip: Balance of Payments, 1988–93

(In millions of current U.S. dollars)

	1988	1989	1990	1991	1992	QI–II 1993
Merchandise exports	67	34	51	74	83	36
Merchandise imports	223	200	269	362	365	165
Trade balance	−156	−166	−218	−288	−282	−129
Net services	171	144	204	171	183	29
Service receipts, of which:	291	246	324	303	332	104
Wages	270	226	302	278	303	90
Service payments	120	102	120	132	149	75
Net transfers, of which:	81	80	82	89	127	69
UNRWA	61	69	73	79	105	52
Government of Israel	9	6	8	6	15	13
Current account balance	96	58	68	−28	28	−31
As percent of GDP	20.7	12.1	12.6	−5.0	4.2	...
As percent of GDP	13.0	8.2	8.1	−3.3	2.9	...

Sources: Israeli Central Bureau of Statistics; and staff estimates.

As a first step, the DOP provided for a "preparatory transfer of power" over the Gaza Strip and Jericho with respect to education and culture, health, social welfare, direct taxation, and tourism. This was to be followed soon by elections to the council and the establishment of PISGA, whose jurisdiction would cover the WBGS. A number of issues (including Jerusalem, refugees, settlements, security arrangements, borders, and relations and cooperation with other neighbors), were to be handled within permanent status negotiations. Those negotiations were to commence as soon as possible, but not later than the beginning of the third year of PISGA.

Under the DOP, the two sides were to negotiate an agreement on the political and economic aspects of PISGA. With regard to economic aspects, the DOP listed a number of economic agencies (such as a Palestinian Electricity Authority, a Palestinian Development Bank, a Gaza Sea Port Authority, etc.,) which would be established during the interim administration in order to promote economic growth in the WBGS. It also called for the immediate establishment of an Israeli-Palestinian Economic Cooperation Committee to develop programs in a number of key specified areas such as water, electricity, energy, finances, transport and communications, trade, industry, labor relations, the environment, and any other areas of mutual interest. The two sides were also to cooperate "in the context of the multilateral peace efforts in promoting a Development Program for the region, including the WBGS, to be initiated by the G-7". Such a development program was to consist of two elements--an Economic Development Program for the WBGS and a Regional Economic Development Program.

At the time the DOP was signed, it was expected that rapid progress would be made in the negotiations between the two sides on political and economic issues, leading to the preparatory transfer of power over the Gaza Strip and Jericho by mid-April 1994 and to the election of the Council for the WBGS and the establishment of PISGA by July 1994. However, both the political and economic negotiations were interrupted following the Hebron events; although they have apparently been resumed, they have fallen behind the envisaged schedule. No information has become available on the resumed negotiations.

The negotiations between Israel and the PLO on economic aspects of the transitional arrangements for WBGS were conducted on three principal areas--fiscal matters, including revenue sharing, trade and labor matters, and banking and finance matters. According to both Israeli and Palestinian sources, encouraging progress had been made in the negotiations prior to the Hebron events, but there were still some key points of difference outstanding. Understandings had been reached in principle on a fundamentally open economic relationship between the two entities and on a number of specific aspects of arrangements on trade, labor, taxation, and banking. At the same time, some important aspects still remained to be resolved, including the question of a possible Palestinian currency and the list of products on which separate external tariff could be applied by PISGA.

The following paragraphs summarize the main elements on which understandings had been reached in principle, prior to Hebron, and are based on information made available to the mission. There was agreement in principle on an open model of trade between Israel and WBGS, which would be equivalent in substance to a customs union, with two sets of exceptions--one with regard to the import of agricultural products and labor into Israel and the other with regard to different external tariffs which could be applied by PISGA on an agreed list of imports for use in the WBGS. With regard to agricultural products, the import of which into Israel is now completely restricted, there would be restrictions on five types of agricultural produce, all of which would be subject to quotas, but those quotas would be phased out by Israel over a five-year period. While all merchandise trade between Israel and the WBGS would thus be free, except for agricultural products over the five-year period, the Palestinian officials expressed concern about the possibility that Israel could, in practice, limit free trade through the invocation of product standards and security concerns.

With regard to employment of Palestinians in Israel, Israel would continue to restrict the number of workers through the application of its present system of employment permits. Israel would periodically fix a numerical ceiling, but no specific numbers had been discussed yet. While dependence on Israeli employment is expected by both sides to decline over time, the Palestinians emphasized that a large number would be important in the initial phase for the successful launching of PISGA.

With regard to external tariffs, reflecting the Palestinians' strong interest in developing their economic ties with their Arab neighbors and their concern that protective import tariffs in Israel not hamper the import of development-related items, there had been agreement, in principle, on two lists of products which would not be subject to the regular Israeli tariff schedule--one list consisting of specified imports from Arab countries, especially Jordan and Egypt, and a second "development list" which would include foreign aid-related imports and items such as capital goods for agriculture and industry and some basic food items. The products and quantities to be covered by the two lists are yet to be agreed. In this context, the Israeli officials noted that Israel's regular tariff schedule did not apply to countries or groups of countries with which it had preferential trade agreements--the United States, the European Union, and the European Free Trade Association--and that tariff levels vis-à-vis other countries were being progressively reduced.

With regard to taxation, it had been agreed that Israel and the WBGS would have independent policies on direct taxes and property taxes. For indirect taxes, it had been agreed that there could be marginal differences in the VAT rates for domestically-produced products. The same principles would apply for sales taxes and excise taxes on cigarettes and tobacco. As regards tax rates on gasoline and petroleum products, progress had also been made on the principles that would apply to taxes and consumer pricing. There had also been agreement in principle on a process for revenue clearing (sharing) based on the destination principle, but many practical modalities for revenue clearance at the microeconomic level had yet to be worked out.

With regard to banking matters, there was agreement in principle that the WBGS would be regarded as the "host country" under the Basle Concordat and be responsible for the licensing, regulation, inspection, and supervision of banks as well as being responsible for lender of last resort functions in the WBGS. There were two aspects on which differences between the two sides remained--namely, whether the liquidity requirements which would apply on NIS deposits should be the same in the WBGS as in Israel, and whether Israeli banks which had ceased operations in the WBGS should be allowed automatically to reopen. However, both sides were optimistic that these differences would be resolved.

In December 1993, Jordan and Israel signed a memorandum of understanding concerning the reopening of Jordanian bank branches in the West Bank. The agreement covered the period of Palestinian interim administration--under the September 1993 DOP or whenever banking responsibilities are transferred to the Palestinians. Under the Memorandum, the Central Bank of Jordan (CBJ) would authorize the operation of branches of Jordanian banks and issue a comfort letter required for the Israeli Supervisor of Bank (ISB) to issue an operating license. The CBJ would in principle be responsible for the supervision, regulation, and solvency of Jordanian banks and would be the lender of last resort for that purpose. In practice, overall banking supervision would be expected to be shared between the ISB and the CBJ. According to available information, the CBJ has approved the opening of eight branches to date, and operating licenses have been issued by the ISB for two branches.

In January 1994, an agreement was signed between Jordan and the Palestinians setting the basis for economic cooperation between the two sides. It provided for the reopening of Jordanian bank branches that were closed in 1967 and their supervision by the CBJ until the establishment of a Palestinian monetary authority. The JD was to continue as legal tender until a Palestinian currency was issued. A joint technical committee would be formed for the purpose of coordinating financial, monetary, and banking policies during that interim period. The agreement also called for cooperation in several other economic areas, such as trade, tourism, transport, labor, joint investment, and infrastructure.

10. <u>Mobilizing external support for the WBGS</u>

a. <u>External aid mobilization efforts</u>

Following the signing of the DOP, a Conference to Support Peace in the Middle East, chaired by the U.S. Secretary of State, was convened in Washington, D.C. on October 1, 1993. At this meeting, pledges totalling US$2.3 billion were made to assist the WBGS, including US$600 million by the

European Union to be available over five years, US$500 million by the United States, also available over five years, US$200 million by Japan, available over two years, US$100 million by Saudi Arabia, available over one year, and US$150 million by Norway, available over five years. The conference also created a High Level Ad-hoc Committee, with the World Bank to provide the Secretariat. It was also decided that the World Bank would chair a Consultative Group (CG) meeting for the WBGS.

In November 1993, the World Bank approved a US$30 million emergency rehabilitation program (ERP) for the Gaza Strip to be financed from the World Bank's surplus funds on IDA terms, with cofinancing from other sources. To date, US$88 million of cofinancing has been committed by the Saudi Fund for Development, the Arab Fund for Economic and Social Development, the Kuwait Fund, and the United Arab Emirates. The World Bank also established a Technical Assistance Trust Fund with a target of US$35 million to receive contributions from bilateral, multilateral, and other donors, for technical assistance for priority social and economic infrastructure projects and for other areas such as economic institution building in the WBGS. The target has been substantially realized. 1/

In December 1993, the World Bank convened a CG meeting for the WBGS in support of: (i) an Emergency Assistance Program (EAP) or the WBGS; and (ii) a Technical Assistance Program. In light of the pledges already made at the Washington meeting, the objective of the Consultative Group was not to obtain significant new pledges, but to match the pledges against the needs for 1994. A total of US$578 million in grants and highly concessional funds was pledged for use in 1994. 2/ The Palestinian officials indicated that such foreign assistance would be essential to enhance the prospects for renewed growth and ensuring the smooth transfer to self-government.

At the request of the Palestinian officials, particular focus was placed on the need for financing not only new investment, but also incremental current expenditures of the new Palestinian entity, especially the costs of transition. This was, however, a point of substantial concern to donors who wanted to ensure that any such financing should be on a declining basis and on an agreed timetable. For this reason, the donors requested that: (i) a detailed budget for 1994 for the WBGS be prepared (see below), which would enable donors to evaluate the need and nature of support for current expenditures; and (ii) a satisfactory mechanism be developed to monitor expenditures. Both the Palestinian officials and the donors emphasized the importance of speedy creation of appropriate Palestinian institutions, including not only the interim Palestinian

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1/ To date, Trust Fund agreements amounting to US$19.4 million have been signed with eight countries and agreements for another US$12 million with the European Union and five other countries are being finalized.

2/ This amount includes US$375 million for the EAP. So far, only US$15 million of this amount has been disbursed.

administration, but also institutions, such as an appropriate financial system, which would create a favorable environment for an expanded private sector role. They also stressed the importance of technical assistance in this context.

In late January 1994, a follow-up meeting on start-up and transitional costs was convened by the World Bank to deal with the financing of transitional budgeting expenditures for the WBGS and concurrently to cover the deficit projected in the budget for 1994. As proposed by the World Bank, transitional expenditures are to be financed through: (i) bilateral support for projects targeted as specific budget line items; and (ii) cash contributions to a Trust Fund established in the World Bank for expenditures which could not be "projectized". While most of the pledges were to be used through the bilateral approach, 1/ US$19.9 million of cash pledges to the Johan Jorgen Holst Peace Trust Fund have also been made. The latter was expected to be used for consumable health and education supplies and salaries of key Palestinian staff. The Trust Fund disbursements will be monitored by an "agent" appointed by the World Bank and audited by an internationally recruited accounting firm.

b. The 1994 budget for the Palestinian central administration

The Palestinian civil administration budget for 1994 (Table 15) covers a nine-month period through end-1994, based on the assumption that the Palestinians would take over the authority in the Gaza Strip and Jericho and have empowerment in five economic areas (direct taxation, education, health, welfare, and tourism) in the West Bank in April 1994, and will assume the remaining authority over the West Bank in July 1994. The budget does not cover expenditures on account of donor-financed development projects, since these have not been consolidated in the budget. The operations of UNRWA also remain outside the budget.

Revenue projections are largely indicative, assume no discretionary tax changes during the year, and are based on preliminary understandings on a revenue-sharing principle between the Israeli and Palestinian officials. As regards revenue projections, the Palestinian officials expressed concern about the likelihood of a temporary loss in revenue when the transfer of authority takes place due to anticipated administrative difficulties. They hoped, however, that timely provision of technical assistance in the area of taxation would help to minimize such a loss. Finally, they indicated that no tax holidays would be granted. In addition to maintaining current expenditures on health, education, and welfare, which are currently covered by the CA, the budget allows for start-up and transitory expenditures related to setting up the new Palestinian civil administration.

1/ In support of the following projects: support for the Central Administration and new agencies; investment in training for the police force; rehabilitation programs for ex-detainees; and community job creation.

Table 15. The West Bank and Gaza Strip: Public Sector Finances of the Palestinian Central Administration, 1994 1/

(In millions of current U.S. dollars)

	1994	Q1	Q2	Q3	Q4
Total revenue	282	--	67	97	118
Revenue	147	--	27	52	68
Income tax	43	--	11	15	17
VAT	24	--	3	8	13
Customs and excises	25	--	4	9	12
Health fees	19	--	3	8	8
Other fees and charges	36	--	6	12	18
Revenue clearance with Israel 3/	135	--	40	45	50
Total current expenditure	268	23	68	86	91
Current expenditure: base program 4/	154	--	43	55	56
New current expenditures	114	23	25	31	35
Police force: salaries 5/	68	15	15	18	20
Material and supplies for police 5/	27	6	6	7	8
Central administration 6/ 7/	11	--	2	4	5
Other 8/	8	2	2	2	2
Current balance	14	-23	-1	11	27
Start-up and transitory expenditures	157	20	48	49	40
Compensation for families of detainees 9/	8	5	2	1	--
Installation and moving	5	--	2	2	1
Early hiring	2	1	1	--	--
Preparations for elections	5	--	2	3	--
Liabilities arising from Jordanian disengagement 10/	20	5	5	5	5
Transfer to municipalities	12	--	2	3	7
Investment for Police force 5/	45	5	11	14	15
Investment for Central administration 11/	15	2	5	6	2
Relief Works Program 12/	25	--	10	10	5
Rehabilitation of detainees	20	2	8	5	5
Total expenditure	425	43	116	135	131
Overall balance 13/	-143	-43	-49	-38	-13
Financing	143	43	49	38	13
Domestic financing through deduction fund	35	--	9	13	13
Financing gap, Central Administration	108	43	40	25	--
Memorandum item:					
Transfers to the NOGs 14/	50	13	13	12	12
Financing gap, including transfers to the NGOs	158	56	53	37	12

1/ Prepared by the Palestinian authorities, in consultation with the World Bank. Revenues and current and set-up expenditures of the Palestinian Administration. Assumes Palestinians take over authority in Gaza and Jericho, and have empowerment in five economic areas in the West Bank in April 1994, and get remaining authority in the West Bank in July; revenue projections assume no discretionary tax changes. Current deficits of the NGOs are also added as a memorandum item in the presentation.

2/ Tax withheld by Israel on WBGS Palestinian workers in Israel will be used in 1994 as a financing item to the budget, but is to be returned later to the Palestinian workers in Israel.

3/ Figures are highly indicative. Based on understandings on revenue-sharing principles between Israel and Palestinian representatives.

4/ Excludes expenses associated with police after authority is transferred to the Palestinian Self-Government, but includes the expenses associated with the replacement of the Headquarters of the Civil Administration by the new Palestinian Administration.

5/ Based on police force growing to 15,000 by end-1994; man-year in 1994 is assumed to represent 80 percent of the total target. If target is 10,000 by year end, expenditures on police will decline from US$95 million to US$63 million. In addition, the investment costs for the police are likely to be lower by about one third.

6/ For 2,000 new employees, of which 1,500 man-years are employed in 1994. Includes staff for PECDAR.

7/ Includes materials and supplies.

8/ Compensation for families of deceased (US$3 million) and for injured or disabled (US$5 million).

9/ Support for families of detainees until their release.

10/ Pensions and supplementary salaries for civil service employees in 1994 to be merged with the public sector regular expenditures in 1995.

11/ Investments to accommodate 2,000 new employees plus additional furniture and equipment of non-recurrent nature.

12/ Includes initially a continuation of the works program, with a rapid transformation toward community-based investment.

13/ Excluding donor-financed capital outlays.

14/ Not explicitly included in the PCA budget. Current deficits of NGOs in the sectors of health (US$20 million), education (US$25 million), and youth and development of women (US$5 million).

The budget also allows for new current expenditures related to the establishment of a police force, including payments for salaries and supplies. The budget is projected to generate a current account surplus of US$49 million, which would be used to finance a part of the start-up and transitory expenditures projected at US$157 million. However, given the slower than expected developments in the negotiations, delays in the transfer of authority in the fiscal area could adversely affect revenue collection beyond the projection level, while expenditures would probably remain as projected.

The deficit for the operations of the Palestinian central administration is projected at US$108 million. The fiscal operations of the municipalities, including transfers from the budget (US$12 million), is projected to remain in balance. However, the overall current deficit of the NGOs on account of their ongoing operations in health, education, and other human resource development activities is projected to be US$50 million, which is incorporated in the budget as transfers. Accordingly, the consolidated fiscal deficit--including the operations of the NGOs--for 1994 is projected to be US$158. This deficit is expected to be fully financed from foreign grants and loans from multilateral and bilateral donors. The main thrust of the budget for 1994 has already been endorsed by the donors, who have already pledged to allocate more than US$120 million of their previous pledges to cover the transitional and start up expenditures; further possible reallocations may be made later. The World Bank, in consultation with the Fund, will review the budgetary situation periodically.

c. Implementation issues

The Palestinian officials indicated that several key immediate tasks remain in making the 1994 budget into an effective operational reality. First, the matching of the committed foreign aid with expenditure programs, both investment and current, as envisaged in the budget for 1994; second, ensuring that the funds are used with appropriate "accountability and transparency"; and third, effective mobilization of the domestic revenue resources assumed in the budget.

For all these areas, the critical need is the rapid emergence of Palestinian governmental institutions, which would effectively handle the expanded responsibilities envisaged in the budget. PECDAR was established in December 1993 as the key agency for aid coordination and implementation of the public investment program. 1/ However, while its by-laws have been approved and key officials and some supporting staff have been appointed, it is still considerably short of being fully operational. The World Bank staff are currently actively engaged in assisting PECDAR in the process of donor-project identification and project preparation, including projects to

1/ PECDAR is expected eventually to spin off into separate ministries in the Palestinian administration.

be financed under the World Bank's own Emergency Rehabilitation Project for the Gaza Strip. It will continue to provide substantial technical support for PECDAR, including an extended mission in the WBGS, on various aspects of project preparation and implementation. It has also made progress in mobilizing the targeted support for its Technical Assistance Trust Fund, and in the launching of activities to be supported from that Fund.

11. Technical assistance

The Palestinian officials have indicated that building up Palestinian institutional capacity is among their highest priorities and have welcomed technical assistance from the Fund in its area of expertise. With the cooperation of Israeli authorities, the Fund's Fiscal Affairs Department (FAD) has assumed the central technical assistance role in the key areas of expenditure control and revenue mobilization. Beginning from November 1993, FAD has mounted three technical assistance missions to date. The first mission in November 1993 underscored the need to set up a transition team swiftly to oversee, in particular, the establishment of budgetary and treasury systems, and the smooth takeover of the direct taxation system from the Israeli authorities. It emphasized the importance of maintaining the continuity of the existing budgets, treasury, and tax administration structures and procedures. 1/ It also recommended the establishment as soon as possible of a new budget office along with a central treasury to manage public funds, and that a linkage be set up with PECDAR so that the latter could be eventually folded into the budget and treasury systems.

Two FAD missions visited the WBGS in January 1994, focussing in depth on tax administration and on treasury and budgetary controls, respectively. The first mission, after examining the existing tax systems in the WBGS and taking into account the primacy of enhancing tax revenue during the transition, recommended that the Palestinian authorities adopt the direct tax system currently in place and minimize any differences with Israel in the area of VAT. The mission also recommended the adoption of a Palestinian Central Tax Administration, and advised on the structure of such an administration and on the need for immediate recruitment of Palestinian personnel to replace key Israelis in the current tax administration. The public expenditure management mission recommended, in the interest of an

1/ Alongside the Palestinian central administration, three other layers of public entities will function as before--viz., municipalities and village councils, UNRWA, and international and national NGOs. The operations of the local bodies have been largely balanced in financial terms; UNRWA is financed from grants from donors, and NGOs, which until the August 1990 regional crisis were self-supporting, is budgeted to receive about US$50 million from the Palestinian central administration in 1994. The budget projections for 1994 also assume that the Palestinian administration will take over authority over direct taxation, education, health, welfare, and tourism in April 1994 in the Gaza Strip and Jericho, and over the whole of the West Bank by July 1994.

orderly fiscal transition, the establishment of a Financial Management Authority, and also advised on its structure and the immediate recruitment of senior staff. In addition, the mission made detailed recommendations on budget formulation and implementation, and on the future of the computer system. Both missions also stressed the importance, for the efficient transfer of fiscal functions, of an early agreement being reached between Israel and the Palestinians on many related economic issues under negotiation, such as taxation of international trade, computer systems development and support, revenue sharing arrangements, and currency and banking arrangements. Upon the recommendations of the two FAD technical assistance missions, the Palestinian officials promptly initiated a search to recruit senior staff for the fiscal administration. Moreover, two training missions from FAD have already been approved, and are expected to take place once the senior Palestinian officials have been appointed.

Another area of major Fund technical assistance involvement has been in the development of economic and financial statistics relating to the WBGS, which are presently handled by the Israeli authorities. A mission from the Fund's Statistics Department (STA) visited Israel and the WBGS in December 1993 for this purpose, and a further multitopic technical assistance mission from the STA is currently under way. The primary purpose of the mission is to undertake an in-depth evaluation of the sources and methods underlying data compilation in the major areas of macroeconomic statistics (national accounts, balance of payments, prices, and government finance). It is envisaged that the findings of the mission will be contained in a status report on the scope and availability of statistics in these areas and their underlying methodology. The findings and recommendations of this mission will be used as a key input in the formulation of the master plan for the organizational and developmental functions of the Palestinian Bureau of Statistics, as agreed during the United Nations' sponsored meeting of international/national statistical experts that was held in New York in January 1994.

The Palestinian officials also place high priority on Fund technical assistance in regard to bank supervision and the development of financial institutions and more generally in the training of their economic officials. The coordination of all technical assistance operations on the Palestinian side is now being handled in a special department of PECDAR.

II. Israel: Financial Liberalization 1/

In the period since the Economic Stabilization Plan (ESP) of 1985, Israel has undertaken a substantial liberalization of its domestic financial markets. Moreover, Israel has introduced measures to reduce the degree of foreign exchange control and to promote the integration of domestic and international financial markets. Benefiting from the experience of other countries in similar circumstances, the Israeli authorities recognized that for a program of financial sector liberalization to succeed, the public sector must first reduce its use of inflationary finance to sustainable levels. 2/ As regards the sequencing of the liberalization program itself, the authorities operated on the premise that it was best first to remove domestic distortions and to reduce restrictions on external current account transactions, before finally liberalizing the capital account.

Under the 1985 ESP, the general government's balance improved from a deficit of 13.9 percent of GNP in 1984 to a surplus of 4.0 percent of GNP in 1986, while consumer price inflation was reduced from 374 percent to 48 percent over the same period. With the fiscal accounts in a more sustainable position, in September 1986 the authorities began to implement some financial liberalization measures, which eventually became part of a larger program. 3/ Over time the authorities' program has included, inter alia, minimizing and where possible abolishing government involvement in the functioning of financial markets; replacing administrative monetary policy instruments with market-based ones; reducing reserve requirements toward international levels; enhancing competition in the banking sector; addressing concerns about conflicts of interest in the operation of provident and mutual funds; removing restrictions on external current account transactions; abolishing restrictions on borrowing from abroad; and progressively liberalizing restrictions on outward capital flows.

This chapter briefly describes the structure of Israel's financial system and reviews Israel's financial liberalization program. The first section covers the liberalization of the domestic markets, while the second reviews the integration of domestic and international markets.

1/ Prepared by Mr. E. Clifton.

2/ See Mathieson and Rojas-Suárez (1993), McKinnon (1991), Edwards (1989) and Frenkel (1982 and 1983).

3/ Israel previously attempted an ambitious capital account liberalization in October 1977 but, given the imbalances in the economy at the time, the liberalization measures were quickly reversed. See Sussman (1992) for a discussion of that episode.

1. The liberalization of domestic financial markets

a. Financial system structure

The financial system in Israel is dominated by a few large banking groups through the banks they own and the other financial institutions they control. There are five major banking groups: Bank Hapoalim, Bank Leumi, Israel Discount Bank, United Mizrahi Bank, and the First International Bank of Israel. Except for First International, all of these banks--which at end-1992 accounted for 90 percent of bank assets--became majority-owned by the public sector as a result of the 1983 bank share crisis.

During 1977-83, banks in Israel had difficulties in raising capital because of competition from indexed government securities. In response to this problem, many banks began to support the prices of their shares on the Tel Aviv Stock Exchange to ensure that shareholders received high rates of return. In mid-1983, market participants concluded that these shares had become overvalued and that a currency devaluation was imminent and they started to sell off domestic currency assets including bank shares. In October 1983, the price of bank shares collapsed threatening the solvency of the banking system. To ameliorate the crisis, the Government stepped in and, in effect, exchanged the bank shares for state-guaranteed bonds. 1/ According to a report by the State Comptroller's office, the cost to the Government of rescuing the banks was over US$9 billion.

Public ownership of the banking system has, nevertheless, not implied government control. By October 1988, the Government had obtained most of the equity of the four largest banking groups. However, because of historical characteristics of the ownership structures of the banks, the Government did not obtain a majority of the voting rights and the banks' original managements were largely left with control. After protracted negotiations between the Government and the owners of the majority of voting rights, compacts to equalize the voting rights of the shares were agreed upon during 1990-91. But even then the Government did not assume control of the banks because, as part of the original rescue operation, the Government had agreed for its shares to be held--until October 1993--by trust companies established by the banks' managements. Finally, as described below, in May 1993 the Government made a decision to ensure that the banking system would remain independent of government interference even after October 1993.

The second important characteristic of the Israeli financial system is its high degree of concentration. 2/ At end-December 1992, the three major banking groups' share of assets was 81.6 percent, while the five largest groups' share was 96.2 percent. These shares implied a Herfindahl

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1/ The process by which the Government obtained the actual ownership of the shares involved several intermediate steps. See State Comptroller's Office (1993) for details.

2/ The rest of this subsection is largely based on Ruthenberg (1994).

Concentration Index (H Index) of 0.26 (the average for comparable countries is about 0.14). Since 1987, the H Index has been on a downward trend even though there has been no entry of new banks into the system. Rather the share of the three largest banks has decreased, while the share of the five largest has been stable. Studies suggest that economies of scale are exhausted at the level of intermediate-sized banks, which are considerably smaller than Israel's three largest banks.

In regard to the entry of new banks, while foreign banks have been permitted to operate in Israel for some time, none have chosen to do so. Foreign banks' operations in Israel are conducted through Israeli banks. There are a number of possible reasons why foreign banks have not entered Israel: geopolitical risk including the Arab boycott; foreign exchange controls; the past domination of the financial markets by the Government; and the strength and sophistication of the domestic banks. However, the role of many of these factors is diminishing and, in any case, the Bank of Israel encourages foreign banks to establish operations in Israel.

While in other countries the banking system may show somewhat similar degrees of concentration, in Israel there are fewer alternatives to the banking system. In Israel, banks are largely universal banks that are able to participate in all areas of the capital market and to control business sector activities. Furthermore, other important parts of the financial system, which are also highly concentrated, are controlled by the banks. For example, at end-1992 the banks managed NIS 66 billion out of the provident funds' total assets of NIS 82 billion.

There has been some trend toward disintermediation from the banking system. On the asset side, bank credit relative to overall credit from the banks and other financial companies decreased from 74.6 percent in 1988 to 69 percent in 1993. On the liability side, the public's assets at banks relative to the public's total assets decreased from 56 percent in 1989 to 37 percent in 1993. Because the banks are universal and not just involved in traditional commercial banking activities, the banks themselves have encouraged this trend. In particular, with the bull stock market banks have gained a larger share of their income from securities-related activities.

Another characteristic of the financial system is the high involvement of the Treasury and the central bank although, as explained below, the degree of official intervention has diminished in recent years. The Government's share of the market has decreased as the declining fiscal deficits have reduced the borrowing requirements of the Government. In addition, as described below, the authorities have reduced reserve requirements and liberalized banking system regulations. In response, intermediation which was directed in some way by official policy declined from 58.2 percent of the total in 1990 to 48.2 percent of the total in 1992.

b. The Government's reform program

The characteristics noted above have been the underlying motivation for the authorities' program of domestic financial sector liberalization which can be broken down into three inter-related parts for ease of exposition: deregulation measures to reduce public sector involvement in the financial system and to increase market efficiency; measures to enhance competition; and, measures to reduce potential conflicts of interest.

(1) Deregulation

The very large budget deficits and high public debt ratios prevailing prior to the 1985 economic stabilization plan resulted in a heavy dose of government intervention in the capital and foreign exchange markets. 1/ The basic purpose of this intervention was to mobilize the resources required for financing the budget deficit, to which end a set of administrative rules was imposed to ensure that a large portion of private sector savings was channeled to the public sector. A second role for intervention was to directly affect the allocation of resources within the private sector, to which end administrative measures were adopted to direct credit to investment and exports, which were defined as priority sectors.

The successful strengthening of the public finances in the context of the 1985 stabilization program allowed the authorities to start deregulating the financial system in April 1987. The two basic objectives of this reform were (a) to reduce the degree of government intervention and segmentation in the financial markets and (b) to stimulate competition and to introduce market-based mechanisms in capital market allocations. To this end, as an initial step, the mandatory investment requirement was reduced for institutions such as pension plans, provident funds, and insurance plans to invest in government securities. 2/ In addition, nonfinancial firms were

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1/ As noted by Leiderman and Bufman (1994), public intervention in the financial market took the following four forms: (a) the pension funds, provident funds, and the insurance plans, which held a substantial part of the private sector's savings, were required by law to hold almost all of their portfolio in the form of government-issued securities, most of which were non-negotiable and nontraded; (b) the Bank of Israel attempted to control the volume of financial assets by imposing heavy reserve requirements on deposits, which averaged 47 percent on domestic currency deposits and between 80-100 percent on foreign currency deposits; (c) with the objective of insulating the domestic financial market from potentially competing and destabilizing capital flows and to ensure that capital flight did not occur, international capital flows were severely restricted; and (d) in an attempt to promote exports and investment, special directed credit arrangements were introduced by the Bank of Israel.

2/ This section is based on Ben-Bassat (1993), Leiderman and Bufman (1994), and Klein (1994).

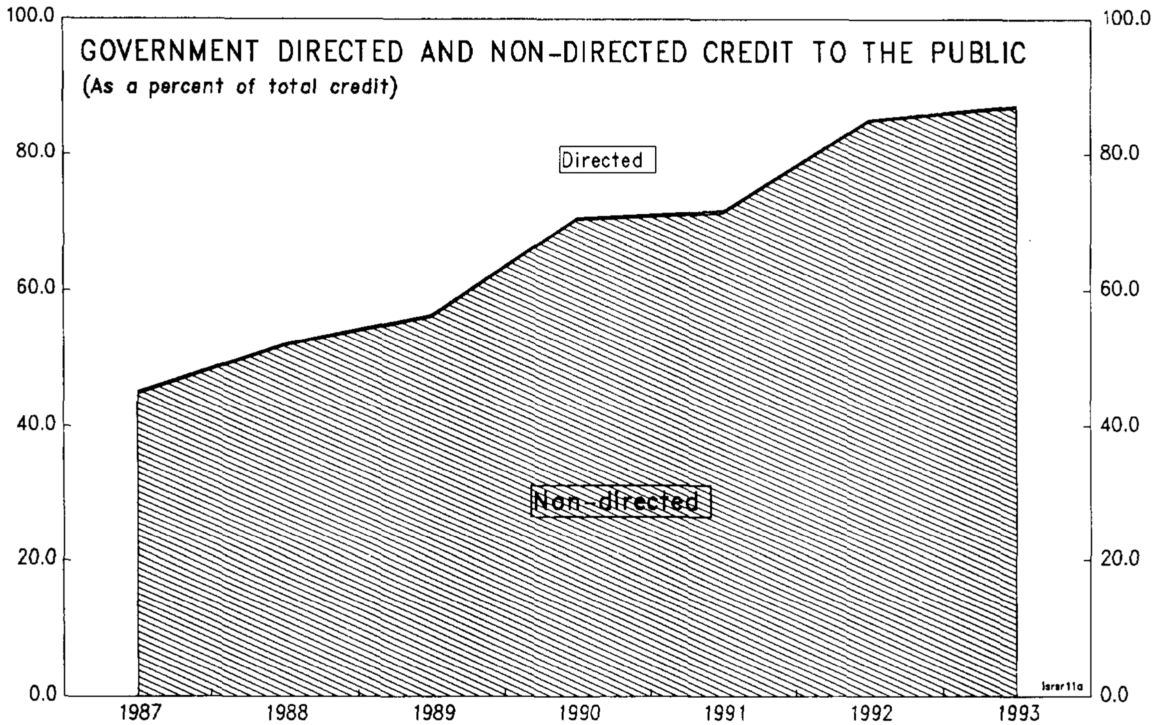
permitted to issue bonds, while commercial banks were allowed to sell bonds up to a specified ceiling.

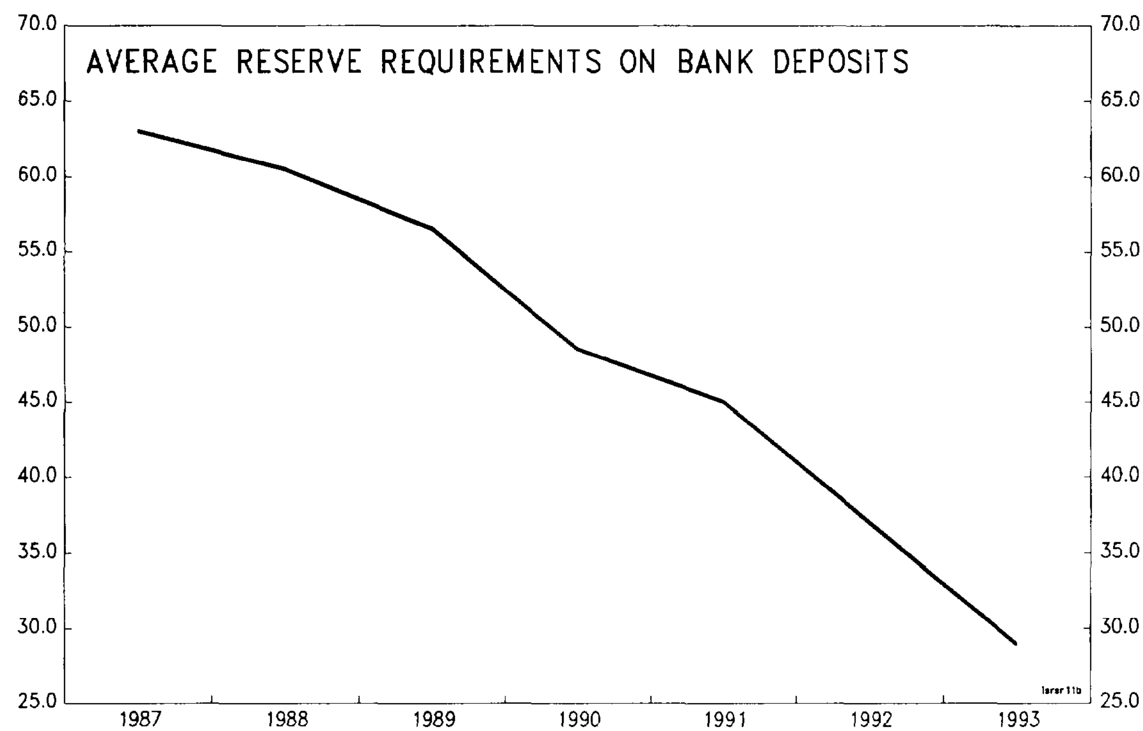
In the period after 1987, many other restrictions were eased. Ceilings on overall domestic foreign exchange loans to Israeli residents and ceilings on guarantees banks could issue on nonbank loans were abolished. Maturity constraints on loans were eliminated as well as on most deposits. Reserve requirements have been (and are still being) reduced to the level needed for prudential considerations. Special credit arrangements have been ended and the Bank of Israel has also reduced its involvement in determining the prices of financial services.

The scope and comprehensiveness of the aforementioned set of reforms can best be gauged by examining the various indicators of credit flows, changes in reserve requirements, and the narrowing of interest rate spreads since the start of the reform process. Among the more striking changes that have been induced by the reform program are the following: (a) whereas "directed" bank credits, whose terms are decided by the Government, whether or not the loan is financed from government sources, amounted to 55 percent of total bank credit to the public in 1987, the share of these credits declined to 13 percent of the total by end-1993 (Chart 2); (b) while average reserve requirements on bank deposits had reached 63 percent at the end of 1987, they had declined to 29 percent by end-1993 (Chart 2). Over the same period, the required reserve ratio on local currency deposits declined from 32 percent to 7 percent or to the same order of magnitude as in Western economies. Moreover, the necessary legislation is in place to ensure that over time the level of these requirements will automatically fall further toward levels more common in other developed economies; (c) the former mandatory requirement of pension funds, provident funds and insurance plans to hold practically their entire portfolio in government bonds has been reduced substantially, with the provident funds, for example, now only required to hold around 50 percent of their portfolio in government paper; (d) the spread between the domestic borrowing rate in U.S. dollars and Libor narrowed from 11.8 percentage points at end-1987 to 3.5 percentage points by end-1993 (Chart 3); (e) the spread between interest rates on local and foreign currency domestic loans declined from 16.4 percentage points at end of 1987 to 6.8 percentage points by the end of 1993 (Chart 3); and (f) the spread between the unindexed domestic currency borrowing and lending rates of the commercial banks declined dramatically from 34 percentage points at end-1987 to 7 percentage points by end-1993 (Chart 3).

An important by-product of reduced public sector deficits and government intervention in financial markets has been the increased effectiveness and autonomy of monetary policy. In particular, monetary policy has now begun to be conducted as in most developed economies through the use of market-based financial instruments. In Israel's case the primary monetary policy instruments are now the repurchase agreements between the commercial banks and the Bank of Israel and a version of the discount window where each bank has an allocation based on its relative size. These

CHART 2
ISRAEL
CREDIT AND RESERVE REQUIREMENTS
(In percent)



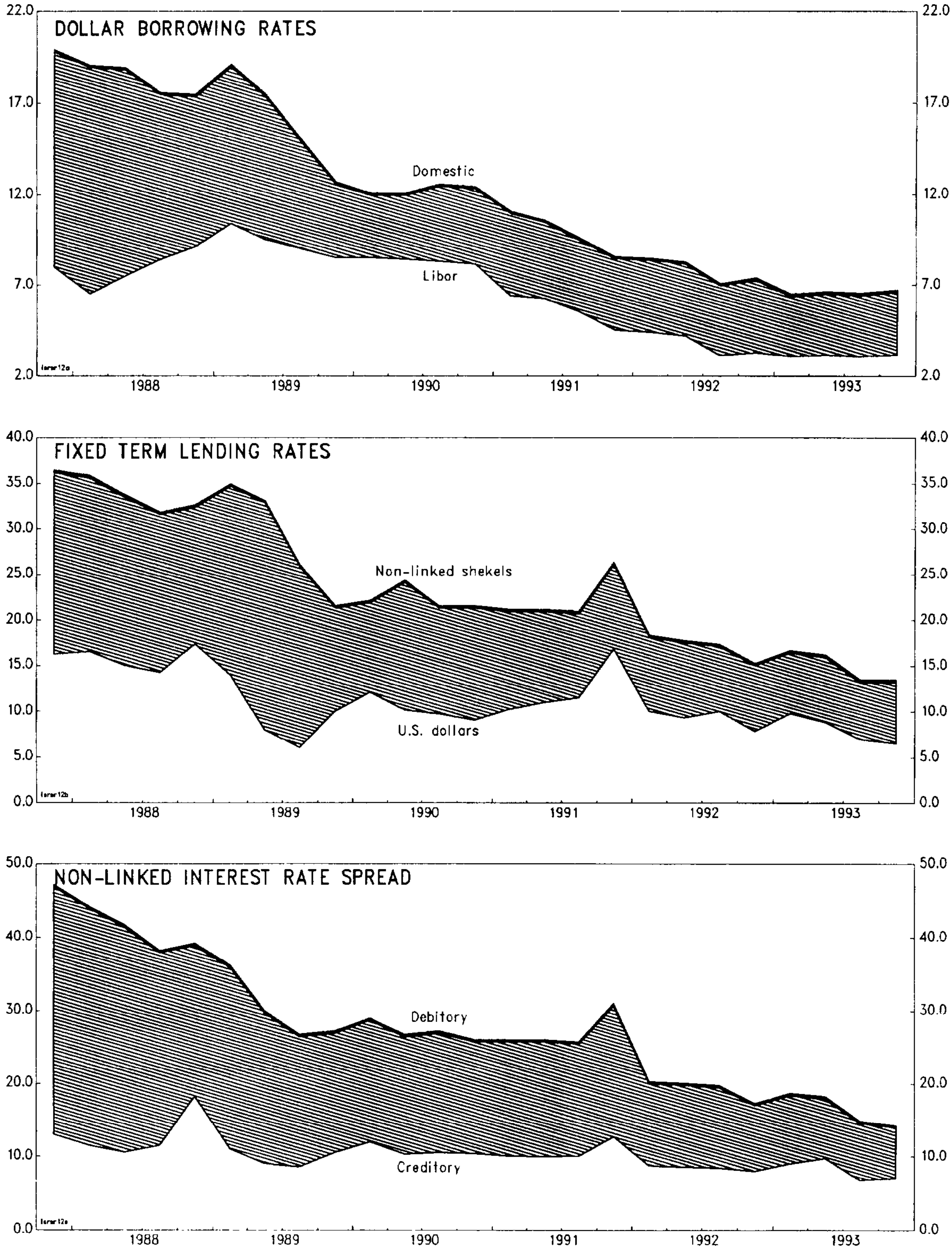


Source: Klein (1994).

CHART 3
ISRAEL

INTEREST RATES

(In percent)



Source: Klein (1994).

instruments allow the Bank of Israel to conduct monetary policy primarily through the cost of credit rather than through administrative controls.

(2) Enhancing competition in the banking system

As noted above, the Israeli financial system is highly concentrated and the authorities intend to reduce this concentration. As early as 1987, the Bank of Israel had hoped to begin restructuring the banking system so as to enhance competition. However, the discussions between the Government and the former owners of the banks became protracted. It came to be seen that a restructuring of the banking system would be easier to implement at the time of the expiration of the ten-year bank shares arrangement and thus this aspect of the authorities' reform program is only now underway.

One important reform measure to enhance competition in the authorities' program is the separation from some of the major banking groups of smaller units, which could be expected to survive as independent banks. The Government has already sold the Union Bank, which was part of Bank Leumi, and it is considering selling two other small banks. There are some difficulties in this process, however. For example, in some cases the existing subsidiaries are too small to survive independently and some must be combined before they can be sold. In other cases there are minority shareholders, which complicates the proposed sales. Moreover, the Bank of Israel does not believe it would be practical to further break apart the large banks because of the time the process would take and the technical difficulties involved.

The authorities are also seeking to increase competition by upgrading the licenses of some existing financial institutions so that they can compete as commercial banks. For example, the Industrial Development Bank, which is owned by the Government but controlled by three of the major bank groups, had its license changed so that it could compete as a commercial bank. Similarly, mortgage banks are now able to expand their lines of business into home equity-type lending.

The Government is also seeking to privatize the large banking groups. With the spin-offs from the large banks creating more competitors, encouraging more profit maximizing behavior within the large groups themselves should promote competition in the banking system. Recently, 23 percent of Bank Leumi was sold by the Government to the public and employees and about 18 percent of Bank Hapoalim was sold. The authorities' intention is to privatize all the banks over time, to which end further substantial bank share sales are envisaged in the Government's 1994 budget.

Even while the Government still remains the formal owner of banks, it will not have control over them as its shares are to be held by independent public trustees. 1/ In May 1993, the Government decided that after

1/ The previous trustees were chosen by the banks' managements.

October 1993, the Government's shares in each bank would be held by a board of trustees, which would exercise the Government's voting rights and would protect the interest of the public. The board of trustees of each bank is to be appointed by a public committee chosen by the Government. The Ministry of Finance will retain certain rights including the authority to sell the government's shares.

(3) Reducing conflicts of interest

Because of the concentration of the financial system, beyond wishing to enhance competition in the banking sector, the authorities are also concerned about potential conflicts of interest, particularly in regard to the provident funds whose assets total about US$30 billion. These provident funds, which require a minimum 15-year investment period and which are heavily favored by tax incentives to savings, have up to now been predominantly controlled by the three main bank groups. Moreover, information on the yields of the provident funds is not available on a timely basis. 1/

In a situation where about 80 percent of the provident funds are controlled by the banks, and information on the investments the funds are making is not readily available to the public, the authorities are endeavoring to eliminate the potential for conflicts of interest. To this end, the Government has decided to establish "corporate separateness" between the provident funds and other banking activities. For example, provident funds will not be able to invest in the shares of the bank group which controls the fund, while all of the funds that a given bank controls will not be able to own more than 10 percent of the capital of any other bank group. The authorities are also enacting limitations on the investment activities of the provident and mutual funds in order to disconnect the decision-making power in these funds from bank management. The majority of the members of the Board of Directors of provident funds must be outsiders and the provident funds' Investment Committees must be composed entirely of outsiders.

A further major focus of the current bank reform, which is aimed at promoting competitiveness within the economy as a whole, relates to the commercial banks' direct involvement in the nonfinancial enterprise sector of the economy. To that end, stricter limitations on the banks' control of nonfinancial enterprises are presently being enacted. Under the banking law of 1981, banks were forbidden to control nonbanking corporations and their holdings in these enterprises were limited to no more than 25 percent of the enterprise's capital. In addition, a banking corporation's total interest in nonbanking corporations could not exceed 25 percent of the bank's capital. However, because of interim provisions included when the 1981 banking law was passed, bank control of enterprises is still widespread in Israel. The decision has recently been taken to effectively require all

1/ In contrast, mutual funds--which in aggregate are only 1/3 the size of the provident funds--are negotiable instruments and information on their yields is available in the newspapers on a daily basis.

banks to reduce their holdings to no more than 25 percent of a company's capital within a two- to three-year period. Moreover, the banks' relationship with the nonfinancial corporations is to be subject to further review by the Bank of Israel and the Ministry of Finance in order to determine whether additional measures might be required in this area to promote competition.

2. The integration of domestic and international financial markets

The rationale for proceeding first with current account liberalization 1/ and secondly with the removal of capital controls is, in part, based on the assumption that goods markets adapt more slowly to external market conditions than financial markets. As discussed in Mathieson and Rojas-Suárez (1993), in many countries a premature opening of the capital account led to capital inflows, which caused an appreciation of the real exchange rate and the destabilization of the domestic economy. In the case of Israel, for the most part the authorities have had the opposite concern--that, with a liberalization of the capital account, Israeli residents might seek to diversify their portfolios by shifting large amounts of capital abroad at a faster pace than inward capital flows would result. For this reason, Israel has proceeded by moving more boldly with respect to inward capital restrictions, where by now all controls on foreign borrowing by residents have been eliminated, than on outward capital restrictions. While substantial progress has been made in the latter respect, important restrictions still remain, especially regarding the ability of the provident funds to invest abroad.

Prior to the recent current account reforms, restrictions on current account transactions included limits on foreign currency travel allowances, restrictions on wage payments abroad, and limitations on the rights of tourists to buy foreign exchange against proof of the prior conversion of foreign exchange into shekels. Two multiple currency practices were also in place, namely, a 4 percent tax on imports of tourist services levied at the time of the exchange transaction and an exchange rate insurance scheme for exporters. After 1987, the existing current account restrictions and multiple currency practices were gradually eliminated with the last, the exchange rate insurance scheme, being abolished on September 1, 1993. This process culminated in the acceptance of Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement on September 21, 1993.

Regarding the capital account, in general foreign currency transactions are forbidden unless explicitly permitted. 2/ While the eventual goal of the authorities is full capital account liberalization, the nearer-term goal is to move to a regime where all foreign currency transactions are permitted unless explicitly forbidden. Virtually all restrictions on the inward

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1/ See Chapter VII of this report for a description of Israel's exchange and trade system and the changes which took place during 1993.
2/ See Klein (1994) and Leiderman and Bufman (1994).

movement of capital have already been eliminated, as a result of which foreign borrowing by Israeli residents is not restricted. 1/

Regarding capital outflows, residents are now allowed to keep foreign exchange obtained through earnings or borrowing in foreign currency accounts in domestic banks, while exporters may maintain foreign bank accounts for amounts of up to 10 percent of their turnover during the previous year. At the same time, corporations can invest up to 40 percent of their capital in assets abroad, while mutual funds in general are now permitted to invest up to 10 percent of their assets in foreign securities and those specializing in foreign markets are allowed to invest 50 percent of their assets abroad. 2/ Moreover, individuals are currently not restricted in buying foreign securities provided that these are deposited in Israel with an authorized dealer.

As noted above, the liberalization measures reviewed in this chapter have led to a closer link between domestic and external interest rates. With a view to further using capital market liberalization as a means of fostering competition in the domestic financial system, the authorities are at present studying the issue of moving to full external convertibility of the shekel. Their intention is to proceed as rapidly as conditions permit, but they are yet to announce a timetable. In this regard, however, the authorities are actively considering measures such as permitting provident funds to hold at least a small part of their portfolio in foreign securities.

1/ Important elements of the liberalization program on inward capital movements included (a) the elimination of the minimal loan period and maximal loan limits; (b) the elimination in 1990 of the capital import tax; (c) the authorization to foreign residents to invest in traded private Israeli bonds in addition to their allowed bank transactions in foreign currencies and their investments in shares at the Tel Aviv Stock Exchange; and (d) allowing foreign residents to convert their capital gains into foreign currency. By the end of 1993, foreign residents were estimated to hold a portfolio of domestic securities, mainly shares, worth about US$1 billion and in addition they also held a controlling interest in Israeli companies, in term of shares traded, of around US$3 billion. The main financial asset of foreign residents in Israel, however, consists of foreign exchange deposits in domestic banks, totaling around US$11 billion by end-1993.

2/ In response to the easing of exchange controls, the Israeli corporate sector is estimated to have invested abroad around US$3 billion, or an average 14 percent of its capital, by end-1993. As of the same date mutual funds had a foreign financial portfolio of around US$0.7 billion. At the same time, Israeli corporations have been relatively successful in raising capital on foreign exchanges, as indicated by the estimated US$0.8 billion raised between 1991 and 1993.

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III. Privatization Policy 1/

1. Introduction

Public enterprises still occupy an important place in the Israeli economy, accounting for around 5 1/2 percent of the business sector labor force and close to 20 percent of total exports of goods and services in 1992 (Table 16). By-end 1993, there were about 170 state-owned companies, of which 82 were commercial enterprises and 62 were noncommercial enterprises that included the public utilities. In addition to having a virtual monopoly over public utilities, publicly controlled enterprises dominate many other sectors, including chemicals, raw material exploitation, banking, telecommunications, transportation, oil refineries, and the shipyards. 2/

While the extensive role of the public enterprises in the Israeli economy derives from Israel's specific historical and institutional evolution, since the implementation of the stabilization plan in 1985 it has been recognized as difficult to reconcile such a role with the basic objective of moving the economy in a more market-oriented direction. A program to redress this situation was initiated in 1988, while an attempt to accelerate this process was made in 1992. This chapter provides an assessment of the recent experience with the privatization of nonbank public enterprises in Israel. A first section presents the purpose of the initial privatization program and discusses the experience with that program from 1988 to 1991; a second section presents the changes made in privatization policy in 1992 and the results to date of that program; and a concluding section discusses some remaining difficulties with the program and prospects for the future.

2. The 1988-91 privatization experience

As part of the structural reform program initiated in the wake of the 1985 Economic Stabilization Plan, in 1987 the Ministry of Finance's Government Corporations Authority commissioned the First Boston Corporation to assist it in designing a program for the privatization of a selected group of public enterprises. In April 1988, a strategic master plan was submitted by First Boston, in which, the sale of a large group of government companies was proposed (Table 17). 3/ The basic objectives of this privatization program were as follows:

1/ Prepared by Mr. D. Gleizer.

2/ These public commercial enterprises include El-Al Israel Airlines, Bezeq (the telecommunications company), Batei Ha'zikuk (the oil refineries), Israel Aircraft Industries, Ta'as (the defense industry), Hevrat Ha'hashmal (the electricity company), KIL (Israel Chemicals), Mispenot Israel (shipyards), Zim Israel Navigation Company, and Shikun u'Pituakh (the Housing and Development Company).

3/ "Master Privatization Plan Recommendations For Selected Government Owned Companies", The First Boston Company, April 1988.

Table 16. Israel: State-Owned Enterprises - Net Worth, Percentage of State Ownership, Exports and Employment

Area of Activity	Net Worth 1992 1/	Percentage of State Ownership 2/	Exports		Employment	
			1992 3/	Percentage of Total Exports of Goods and Services	1992	Percentage of Business Sector
Total of commercial public enterprises	15,105.6	86.4	4,078.8	19.6	65,188	5.1
Chemicals and Non-metallic minerals	1,842.5	84.0	620.0	3.0	4,313	0.3
Water and Power	6,181.5	96.5	33.4	0.2	14,635	1.1
Research and Servicing for manufacturing and commerce	1,080.8	48.2	20.2	0.1	693	0.1
Transportation and communication	3,312.5	78.0	1,677.0	8.1	17,896	1.4
Oil and gas	1,487.6	81.2	200.0	1.0	1,999	0.2
Military industry (excl. Taas)	671.2	99.0	1,507.8 4/	7.2 4/	21,068	1.6
Taas	--	100.0	...	...	7,003	0.5
Agricultural R&D	18.3	90.4	...	...	1,036	0.1
Construction, land development and housing	256.3	100.0	...	...	1,283	0.1
Tourism services	83.9	100.0	...	...	230	--
Other	134.7	66.1	20.4 5/	0.1 5/	2,035	0.2

Source: Report on State-Owned Enterprises for 1992. Israel Government Corporations Authority, Ministry of Finance, June 1993.

1/ In millions of 1992 NIS. Net worth adjusted for inflation.
2/ December 1991.
3/ In Millions of current US dollars.
4/ Includes Taas.
5/ Includes agriculture.

a. to reduce the involvement of the Government in the provision of goods and services, by transferring such activities to the private sector;

b. to reduce the public sector debt;

c. to increase the role of market signals in the economy, so as to raise allocational and productive efficiency;

d. to permit a resumption of investment in privatized enterprises, by freeing potentially successful companies from the budgetary and borrowing constraints imposed by virtue of Government ownership.

e. to encourage the development of capital markets; and

f. to encourage and increase foreign investment in the economy.

The plan identified a large universe of state-owned enterprises that could be sold to the private sector (Table 17). Among those companies, the report elected a subset of around 25 companies, which could be sold within four years. The plan stressed that privatization should not be seen as a random sequence of transactions, but rather as a carefully monitored and thoroughly planned process. To that end, it suggested the following timetable to facilitate the privatization program: (a) companies considered for immediate privatization were those whose market values exceeded US$100 million and which had sustained profits under current market conditions, as well as those companies whose market values were below US$50 million, with an attractive profit record and with well-defined functions; (b) companies, which should not be sold in the first year of the program were to include the utilities, whose sale required changes in their concessions or regulatory frameworks and whose size required a gradual transfer of ownership via a public offering in several tranches, both domestically and internationally, (c) companies whose current legal, financial and market structures required some form of adjustment in order to make them suitable for a sale, should wait a period no longer than two years for those reforms to be put in place; and (d) enterprises in need of rehabilitation but which were affected by the privatization of subsidiary or associated companies which had higher priorities, such as the oil sector and aircraft manufacturing, should await their restructuring and the sale of the related enterprises.

Restructuring measures prior to sales were suggested in cases where these actions would facilitate the transfer of ownership, in order to deal with a variety of firm specific features of a financial, operational, legal, labor and regulatory related nature. At the same time, the suggested method of sale was to depend on the control structure envisaged for an enterprise, on the market conditions in which it operated, and on the type of activity involved. Two basic strategies for carrying out the sales were suggested: (a) direct sales in which an individual buyer could be identified to whom a controlling stake could be sold. The basic advantage of this method was seen to be its simplicity, its speed, and its greater likelihood of securing

Table 17. Israel: 1988 Master Plan for Privatization

Company	Area of Activity	Privatization Method	Other comments	Stock Exchange Quote	Earliest Timing
Israel Chemicals	Chemicals	Direct sale	50% initially	--	Immediately
Oil Refineries	Oil	Direct sale	74% (entire holding)	--	Immediately
Elta Electronics Ltd	Electronics	Direct sale	26% first	--	Immediately
Maman Cargo Terminals, Ltd.	Cargo	Direct sale	IPO as an alternative option	Domestic	Immediately
Tamam Food Services, Ltd.	Food	Direct sale of 77%	or El-Al buys 23% before selling all 100%	--	Immediately
Investment Co. of IDB	Industrial development	Direct sale	50% to be sold	--	Immediately
Foreign Trade Risks Insurance Corp.	Insurance	Direct sale	100%; or 51%, IPO for remainder	Domestic	Immediately
Israel Coins and Medals Corp.	Coins	Direct sale	51% initially	--	Immediately
Arim, Municipal Development Ltd.	Municipal development	Direct sale	100% to be sold	--	Immediately
Industrial Buildings Corporation	Manufacturing	Direct sale	At least 51% initially	--	Immediately
Jerusalem Economic Corporation	Industrial development	Direct sale	51% plus sale of shares in public market	--	Immediately
Karta, Central Jerusalem Development	Urban development	Direct sale	Or joint venture with developer	--	Immediately
Bezeq Corp.	Telecommunications	IPO 1/	Immediate debt offering followed by the IPO	Int'l/Dom	During Year 2
Israel Electric Corp.	Electronics	IPO 1/	Immediate debt offering followed by the IPO	Int'l/Dom	During Year 2
El Al Airlines	Air transportation	IPO 1/	Immediate cancellation of receivership followed by recapitalization	Int'l/Dom	During Year 3

Table 17. (continued) Israel: 1988 Master Plan for Privatization

Company	Area of Activity	Privatization Method	Other comments	Stock Exchange Quote	Earliest Timing
Shekem Ltd	Retailing	IPO 1/	Restructuring of subsidiaries	Int'l/Dom	During Year 3
Zim Israel Navigation Corporation	Sea transportation	IPO 1/	No immediate action	Int'l/Dom	During Year 3
Malam Systems Ltd.	Data processing	IPO 1/	Employee status change beforehand	Domestic	During Year 3
Tahal, Consulting Engineering	Engineering	Direct sale	After labor difficulties resolved	--	During Year 3
Bank of Agriculture	Banking	IPO 1/	Laon portfolio restructuring first	Domestic	During Year 3
Israel Aircraft Industries	Aircrafts	IPO 1/	Direct sale of position in Elta and issue of debt before IPO	Int'l/Dom	During Year 4
Petroleum Services	Oil	IPO 1/	Integration/oil refineries sale first	Domestic	During Year 4
Pi Gliloth, Ltd.	Oil	IPO 1/	Integration/oil refineries sale first	Domestic	During Year 4
Ashot Ashkelon Industries	Manufacturing (defense)	Hold	Restructuring of relationship with Israel Military Industries	--	During Year 4
Tourist Industry Development Corp.	Tourism	Liquidation	Return to government agency status	--	--

Source: Master Privatization Plan for Israel, The First Boston Corporation, April 1988.

1/ Initial public offering.

a core investor for the enterprise. The drawbacks were seen to be its possible lack of transparency, in the event that the sale was not accompanied by clearly defined competitive bidding procedures; and (b) the second sale method suggested was public share offerings through the stock market. While having the attractiveness of transparency and of creating a widespread investor base, this method was considered to be possibly cumbersome and to run the risk of giving rise to an excessively widespread ownership of the corporation for effective control.

In the event, the 1988 privatization plan remained largely unimplemented as suggested by an average annual rate of privatization of barely US$190 million between 1988 and 1991. In this regard, it would appear that the plan underestimated the severe political, structural, and institutional constraints facing the process. Lack of political will, in face of strong opposition from the staff and directorate of the corporations to be privatized, helped derail the program. Further contributing to its slow implementation was the ambitiousness of the program, the attempt to simultaneously achieve several goals, and the nondefinition of the order of priorities in which they should be accomplished. Moreover, in a number of important cases, including that of the telecommunication company, difficulties were encountered in framing and implementing the sectoral reforms required to precede the privatization process. While some of these problems were firm- or sector-specific, the lack of an overall framework to deal with issues of market structure and regulation created significant obstacles for the program.

3. Privatization after 1991

Against the background of the disappointing experience with the initial privatization program, in mid-1991 the authorities established a Cabinet Committee on Privatization consisting of the Prime Minister and the Ministers of Finance and Justice with a view to speeding up the process. This committee has proposed legislative changes that would enable the Government to dismiss directors of the public enterprises. Moreover, following the coming to power of a new government in 1992, the strength of the Government Corporations Authority was reinforced by means of a special law, which laid out for the first time a legal foundation for the privatization process. Within this institutional framework, the Ministry of Finance formulated the following six principal objectives for its privatization policy:

a. the elimination of the Government's responsibility for numerous business enterprises and the promotion of competition in the national economy;

b. the improvement in the efficiency of the public monopolies;

c. the attraction of foreign investors and the integration of the Israeli economy with the world economy;

d. the reduction of the Government's internal debt;

e. the promotion of labor market flexibility and employee ownership participation; and

f. the development and expansion of the domestic capital market.

While the stated objectives do not depart significantly from those pursued from 1988 to 1991, the extent of political support was given an important push by the fact that both the Minister of Finance and the Prime Minister showed both interest and support in pressing ahead with the program. That the revised policy yielded results is made clear by the fact that there has been a significant growth in the amount of assets sold. As indicated in the tabulation below, proceeds from the sales of nonbank public enterprises rose to US$900 million, or around 1 1/2 percent of GDP in 1993, while including the proceeds from the sale of banks, the Government's total privatization proceeds amounted to US$1.4 billion, or 2 1/2 percent of GDP in 1993.

Israel: Privatization Proceeds

(In millions of U.S. dollars)

Year	Nonbanking Companies	Banks	Total
1988	111.0	...	111.0
1989	185.8	...	185.8
1990	94.2	...	94.2
1991	229.7	149.4	379.1
1992	364.9	267.7	632.6
1993	905.0	560.7	1,465.7

Source: Government Corporations Authority.

Tables 18 and 19 further indicate the progress made in the privatization program by presenting the status of privatization sales initiated since 1986 and by indicating the concrete plans for privatization in 1994, respectively. In the latter respect, it might be noted that the 1994 budget envisages privatization proceeds from nonbank enterprise sales of around US$1.5 billion or around 2 1/2 percent of GDP in 1994.

4. Prospects for future acceleration of the program

In the Israeli context, two basic difficulties would appear to remain in the way of accelerating the pace of privatization. First, the proliferation of objectives raises the question of the mutual compatibility of these

Table 18. Israel: Implementation of Privatization

Type	Company 1/	Date	Description	Volume (in millions of U.S. dollars)
Complete privatization	Haifa Chemicals Ltd.	9/1986	Direct sale to a foreign investor the government share (26%)	14.7
	Zion Cables Ltd.	1/1988	Direct sale to domestic and foreign investors 65% of the stock and options for additional 35%	14.0
		10/1990	Realization of the option for 32.5% of the stock	
	Paz Ltd.	7/1988	Direct sale to a foreign investor the government shares (75%)	97.0
	Jerusalem Economic Corporation Ltd.	3/1987	Initial stock and option issue (17.5%) on the Tel Aviv stock market	12.5
		10/1989	Direct sale of the government shares (82.5%) to domestic and foreign investors	54.7
	Maman Cargo Terminals	11/1989	Stock offering of the government shares (32.5%)	10.9
			Stock offering of the shares of TESHET (15.6%)	5.2
		10/1991	Direct sale to a single investor the rest of the government shares (26%)	11.3
	Industrial Buildings Ltd.	3/1989	Initial issue of stocks, options and convertible bonds (20.2%)	28.3
		11/1989	Public offering of stocks and options (23.8%)	56.8
			Public issue of the government options (5%)	11.8
		3/1993	Direct sale the rest of the government shares (51%) to a single investor	201.0
	I.D.B. Bankholdings Ltd.	8/1991	Direct repurchase by a single investor (25%)	228.7
		11/1992	Public offering of shares	349.3
	Mizrahi Bank Ltd.	8/1992	Direct sale of 26% to a single investor and a right to obtain additional; 25% until September 1993.	
		12/1992	The deal was not permitted by the Bank of Israel	93.9
	SHEKEM	1993	Public offering of 65% of shares and convertible bonds on the Tel Aviv Stock Exchange	5.3
	M.G.N. Oil and Gas Ltd.	12/1993	Direct sale of 35.3% of capital	

Table 18. (continued) Israel: Implementation of Privatization

Type	Company 1/	Date	Description	Volume (in millions of U.S. dollars)
Direct Hybridization	Dead Sea Periclase	10/1986	Initial public stock and option issue (25%)	11.2
		6/1991	Issue for employees of shares and convertible bonds	14.5
	NAFTA	6/1989	Public option offering (28.8%)	18.1
	(Israel Co. for petrol)		Public sale and issue for employees of 56.6% of the shares	68.0
	BEZEK	9/1990	Public stock offering (8.7%)	76.7
	(Israel Co. for	5/1991	Public issue and stock and option offering	134.7
	Telecommunications)	1993	Public issue on the local and foreign stock markets	220-240
	Ashot Ashkelon Ltd.	5/92	Sale of 30% of shares	13.0
	Israel Chemicals	2/1992	Public offering of 20% of the government shares	235.2
		1993	Direct sale of 4.7% of the government shares to a single foreign investor	58.1
	Bank Hapoalim	5/1993	Public offering of 23% of the government shares	429.0
	Bank Leumi	8/1993	Public offering and issue for employees of 23% of shares	426.2
	Union Bank	1993	Direct sale of 60% of the stock	85.5
Sale out of government minority holdings	Israel General Bank	7/1992	Sale of 24.7%	16.0
	Koor Industries	9/1992	Sale of 2.4% of shares	19.5
		1993	Sale of 10.2% of shares	135.0

Source: Government Companies Authority.

1/ For area of activity, see Table 17.

Table 19. Israel: Planned Privatizations for 1994

Company 1/	Planned Privatization Method	Feasibility	Total Dilution Percent Planned
Housing and Development	Israeli stock market	High	100
Shekem	Private sale	High	35
El Al 2/	Israel/int'l stock markets	Medium	50
Bezeq 3/	Israel/int'l stock markets	High	25
Israel Shipyards	Private sale	High	100
Israel Chemicals	Int'l stock markets	High	26
Afridar (Construction)	Private sale	High	100
Zim	Int'l stock market or private sale	Medium	up to 48.5
Lepidot (Oil)	Israeli stock market	High	100
Tahal-Tami	Israeli stock market and private sale	High	51 49
Elta (Electronics)	Israeli stock market	Medium	25
Ramta (Electronics)	Private sale	Medium	100
Tourism development	Private sale	High	100
Industry Development Bank	Private sale	Medium	100
Malam-Data Processing	Private sale	High	100

Source: Government Companies Authority.

1/ For area of activity, see Table 17.
2/ The dilution is based on a combined move of capital raising by the company of 30 percent and shares sales by the Government of 20 percent.
3/ Directly or by debt that shall be financed by the company's capital to be raised.

objectives. The simultaneous attainment of all the goals set out may prove impossible, and the privatization program may yet again be slowed by the resulting dilemmas. Experience has shown that when governments want to pursue more than one objective at a time, they may have to subdivide the set of companies to be privatized, where for each group the goals and constraints are defined in different ways.

A second basic obstacle to the process is that the regulatory framework would appear to need substantial strengthening and reform. Given that in Israel most of the firms operating in monopolistic markets were owned by the Government and were thus expected to pursue the public interest, they were often not regulated. As a result Israel lacks a regulatory and supervisory tradition and framework. Indeed, Israel does not have an office such as the FTC in the United States, or the Monopolies and Mergers Commission in the United Kingdom, but it does have overlapping authorities supervising and regulating with diffused responsibilities and divergent purposes.

There are several reasons why focusing on regulation is fundamental for the success of the program. The first reason stems from the importance attached to efficiency gains and the establishment of a competitive environment in the revised directives for privatization. Given the very nature of the markets in which they operate, many of the privatized firms will retain some element of monopoly power. Under private ownership, there is no guarantee that economically or politically desired prices or quantities will be established. Additionally, if the absence of regulation is perceived to be temporary, the buyer will be encouraged to maximize profits over the short term in order to obtain an adequate rate of return on his capital, given the risk of re-regulation. The result may be high rates, poor service, low investment, and a decline in public support for the privatization program. This suggests that, for firms in such fields, the privatization process must be preceded by the definition of the sector's pricing and regulation policy. As has been noted by Vickers and Yarrow (1991), from an efficiency point of view, what matters is how the combination of ownership and regulation under private ownership compares with ownership and implicit or explicit regulation in the public sector.

A second reason for needing to focus on regulation is its impact on the determination of the firm's price. Prospective buyers can be expected to base the price they will bid for the company to an important degree on the regulatory framework that they expect to prevail. In an atmosphere of uncertainty as to future regulations, buyers can be expected to apply a discount factor to their estimates of the worth of public assets. Consequently, it is in the Government's interest to design a regulatory framework, structured on binding contracts, and to create a reputation as an "honest broker", in order to maximize the revenue flow from its privatization program. The challenge for the authorities is to devise regulations, which reduce variability in the post-sale firm management, without discouraging qualified buyers willing and able to pay a market price.

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IV. An Analysis of the Israeli Stock Market Boom 1/

Between 1988 and end-1993, the Israeli stock market experienced an unprecedented period of growth. Indications of this boom include a tenfold increase in stock market capitalization to US$51 billion between 1989 and end-1993 and the outperformance by the Tel Aviv Stock Market of world stock markets in terms of real rates of return in 1991 and 1992. During early 1994, however, share prices declined by around 30 percent, thereby approximately erasing the whole of their increase during 1993.

The rapid and prolonged runup in Israeli shares prices during the early 1990s, followed by their recent correction, raises questions as to the degree to which these developments might be explained by changes in economic and market fundamentals as well as to the significance that these developments might have for the economy. This chapter addresses these issues by reviewing the recent behavior of stock market prices; by analyzing the implications that these developments might have for aggregate demand; and by seeking to explain recent movements in stock market prices by Israel's improved growth prospects following the immigration wave that began in 1989, by reduced discount rates as inflation declined, by the improved peace prospects, and by regulatory changes that increased the possibility for institutional investors to participate in the share market. A basic conclusion of this analysis is that while it cannot be excluded that speculative phenomena might have had a role to play in the past runup of share prices, there have been far-reaching changes in economic and market fundamentals that can explain the major part of the past stock market boom.

1. The recent behavior of asset prices in Israel

After the implementation of the 1985 Economic Stabilization Plan (ESP), stock prices in real terms started to increase gradually as inflation declined and as the supply of government bonds contracted due to the reduction of the budget deficit. Beginning in 1989, as interest rates fell and the immigrant wave from the former Soviet Union began, stock prices rose to new heights, especially in 1991 and 1992. The general stock market price index increased by almost 750 percent from end-1988 to end-1993, while the real increase was above 315 percent (Chart 4) The real return on share holdings was 37 percent, 75 percent, and 27 percent, for the years 1991, 1992 and 1993, respectively, significantly outstripping the stock market performance in other developed countries (Table 20).

These stock price increases were accompanied by a substantial expansion of equity offerings and in the number of companies listed on the stock exchange. The number of equity issues increased from 37 in 1988 to 285 in 1993, with the amounts raised by issues of shares and convertible securities increasing by over 1600 percent in real terms over the same period (Table 20). As a result, since 1988 total stock market capitalization has

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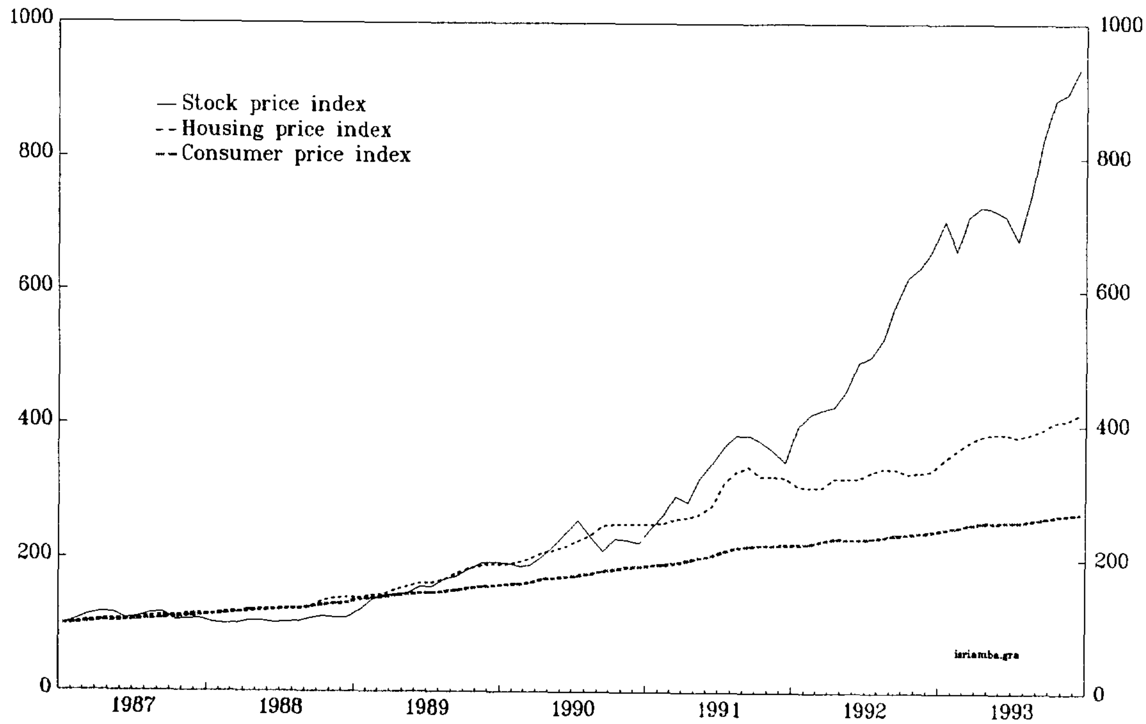
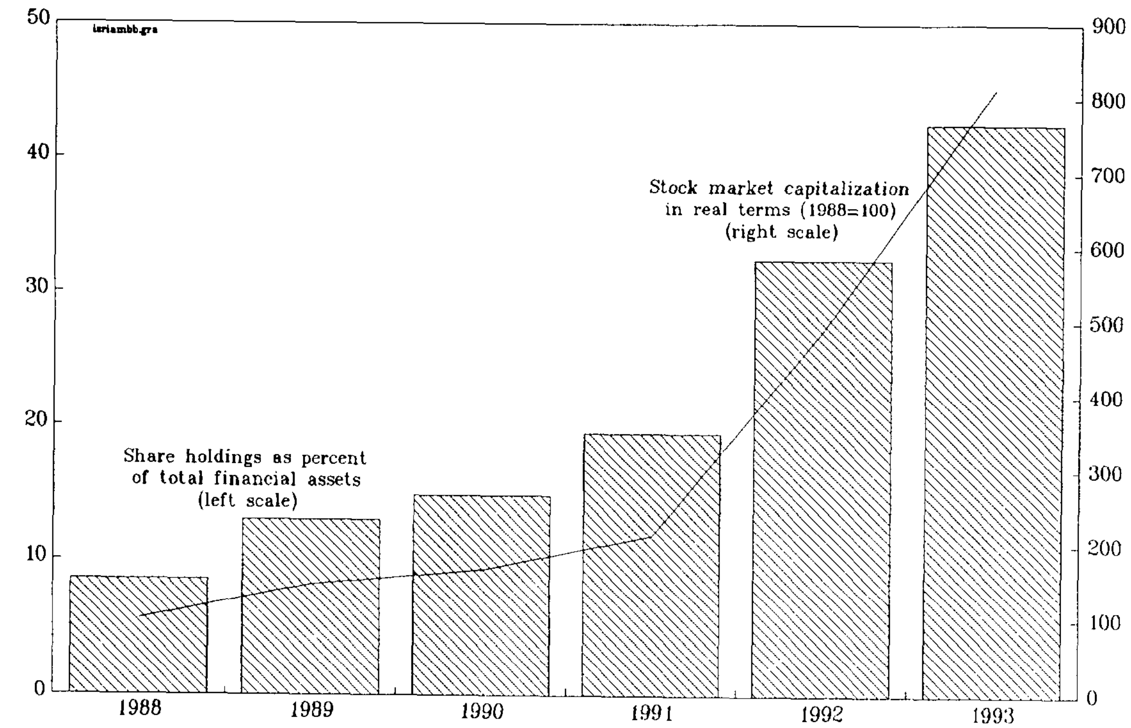
1/ Prepared by Mr. D. Gleizer.

CHART 4
ISRAEL
INDICATORS OF ASSET MARKET BEHAVIOR





Source: Bank of Israel.

increased by around 715 percent in real terms, reaching NIS 152 billion, or around US$51 billion, in December 1993 (Table 20).

Table 20. Israel: Principal Stock Market Indicators

(In millions of December 1993 new sheqalim)

	1988	1989	1990	1991	1992	1993
Total share market capitalization 1/	18,618.2	27,282.5	31,063.8	39,654.3	91,110.9	151,593.6
Volume of transactions 2/	8,321.0	13,044.5	17,365.9	27,070.8	40,974.3	89,633.9
Daily average volume of transactions	20.0	44.0	66.0	102.0	170.0	365.0
Annual turnover 3/	0.23	0.55	0.58	0.67	0.65	0.79
Capital raised						
Number of issues	37	56	54	68	166	285
Amount raised	534.0	1,278.0	1,490.0	2,271.0	5,407.0	9,232.0
New issues	379.1	1,214.2	1,120.5	1,755.6	4,696.1	8,545.5
Number of listed companies	266	264	271	286	378	558
Number of listed securities 4/	484.0	532.0	558.0	574.0	777.0	1147.0
General share index 5/	31.93	56.22	64.7	100	191.92	270.39
Real yield on shares and convertibles 6/						
General share index	-30.5	60.5	-1.5	37.1	75.2	26.7
"Mishtanim" share index 7/	-26.2	58.4	3.4	38.8	79.2	13.6

Source: Bank of Israel.

1/ At December 31.
2/ Total volume of transactions in shares and convertibles, including on-the-floor, offset and off-the-floor transactions.
3/ Ratio of monthly volume of trade to average market value.
4/ Shares and convertibles.
5/ Current December values (December 1991=100).
6/ Nominal changes deflated by CPI.
7/ Top 100 shares.

The sharp increases in stock market prices registered in 1992 led regulators to express concerns about the pace of increase. As a result of such statements, prices fell substantially during February 1993, but resumed a moderate growth path thereafter. Moreover, with the September 1993 breakthrough in the peace process, the index jumped by around 12 percent in September 1993 and it increased further by almost 20 percent through January 1994. Since February, however, the stock market fell some 30 percent in the wake of a growing investigation into various irregularities in stock market trading, of rising foreign and domestic interest rates, and of a setback in the peace process.

2. Economic implications of share price inflation

The impact of a sustained growth in stock market capitalization on the economy is often traced to its effects on consumption and investment spending. A stock market rally increases household's net worth, raising the ratio of wealth to disposable income above its steady-state desired level. This higher wealth motivates households to raise their consumption, at least to a limited extent, in order to reduce the ratio to a new steady-state level. In addition, a higher price-dividend ratio reduces the effective cost of raising funds through the issue of equity, while an increase in real stock prices, creates an excess of the market's valuation of existing business capital over the cost of that capital, thereby motivating firms to expand investment.

Recent research on asset price inflation in industrial countries provides additional insights on the implications of a considerable growth in stock market capitalization on macroeconomic developments and on the conduct of monetary policy. Such studies suggest that structural transformation, particularly that associated with the liberalization of financial systems, might have channeled liquidity and credit to agents particularly active in asset markets. This, in turn, might have generated an excess demand for assets rather than for goods and services, as a result of which measured inflation did not increase as sharply as it had in previous episodes of expansionary macroeconomic policies. With hindsight, it is recognized that the focus on income- or consumption-based measures of inflation to judge the appropriateness of money and credit policies did not provide a complete and accurate assessment of the inflationary pressures that were building up, leading the monetary authorities to follow what later proved to be an overly expansionary path of monetary and credit growth.

3. Determinants of asset prices

In an efficient asset market, the price of an asset should equal the present discounted value of the expected rents on that asset as expressed in the following equation:

$$P_t = E[(P_{t+1} + R_{t+1} + a.B_{t+1}):(W_t)]/(1 + r) \tag{1}$$

where P_t is the observed price of an asset in period t, E is the expectations operator, R_t is the income paid out to the holder of the asset, B_t is the bubble component of return, W_t is the information set, and r_t is the discount rate. In the absence of a bubble component, a recursive solution of this equation would imply that the present price of the asset would be the present value of the expected income payouts on holding this asset. However, if there were to be a bubble component (i.e., were a>0), the observed price, P_t, could be expressed as the sum of two components, the market fundamentals term, $P^f{}_t$, and a bubble component, B_t.

$$P_t = P^f{}_t + B_t \tag{2}$$

As Blanchard and Watson (1982) explained, deviations from fundamentals can occur without creating possibilities for arbitrage, thus precluding irrational behavior, since in any period there might be an exogenous probability that the bubble will persist or that the bubble will burst. In such an event, the asset price might increase by just enough to keep the risk neutral investor indifferent between holding the asset and selling it.

The recent runup in stock prices raises the question as to whether asset price behavior can be explained by 'fundamentals', such as improved expected future profits, cash flow and dividends, and a lower discount rate or by speculative-type behavior. In the following subsection the relevance of these alternatives is investigated.

a. Improved fundamentals

In the absence of bubbles, a share price could be viewed as the discounted value of an expected stream of future earnings. If the expected growth rate of earnings were constant, the share price could be expressed in the following manner:

$$P = D.R_t \tag{3}$$

where R_t is the current level of earnings and D a discount factor that equals the inverse of the rate of return on a riskless asset (r) corrected for a risk premium (rp) and adjusted for the expected constant growth rate of earnings (g). That is, $D=1/(r+rp-g)$. Viewed in this manner, an increase in the price-earnings ratio of a stock could stem from any combination of lower interest rates, a lower risk premium, or improved expectations of future earnings.

There are reasons to believe that much of the runup in Israeli asset prices can be explained by movements in the fundamentals. Some of these movements were policy induced, while others were the result of positive exogenous shocks. First, financial policy appears to have influenced the course of asset prices by substantially reducing the discount rate. Indeed, during the last several years, real interest rates declined in reflection of policy success in reducing the level and the variability of inflation and in bringing the budget under better control. In response to these developments, the long-term real interest rate as measured by the real yield to maturity on 5-year indexed bonds declined from around 4.1 percent in the late 1980s to 2.2 percent by end-1993. 1/ Second, since the 1985 Stabilization Program, the Israeli economy has undergone a significant process of adjustment, deregulation and structural change, which may have created widespread optimism about the growth prospects of the economy. In addition, the large scale immigration from the former U.S.S.R., that began in 1989, contributed to a substantial increase in the labor supply, a fall in real wages, an increase in productivity and a rise in profitability. This injection of human capital raises the possibility that the economy in general, and corporate profits in particular, might increase rapidly for several years. Finally, progress in the peace talks and prospects of a 'peace dividend' could have created expectations of permanently higher growth opportunities and contributed to higher stock prices.

1/ More recently, the easing of the stance of monetary policy in the second and third quarters of 1993 provided the backdrop for a significant increase in share prices during the course of that year.

The behavior of several profitability indicators, calculated from accounting data of the companies traded on the stock exchange, lends support to the view that a substantial part of the runup in Israeli asset prices can be explained by movements in fundamentals. Profitability, measured as the return on book equity, has risen from -1.9 percent in 1988 to 10.9 percent in 1992. For industrial companies the change was even more dramatic, from -14.5 percent in 1989 to 13.6 percent in 1992 (Table 21). Similarly, cash flow as a percentage of revenue increased from 6 percent in 1989 to 11.8 percent in 1992, and as a ratio of fixed assets from 18 percent to 22.4 percent, over the same period. As a result, while there was a substantial increase in share prices between 1990 and 1992, price earning ratios in 1992 were at around the same level as in 1990. Moreover, while the estimated 1993 price earnings ratio is high when compared to other developed countries, it is not excessively so once Israel's higher growth is taken into account.

Table 21. Israel: Selected Indicators of Companies Listed on the Stock Market

	1988	1989	1990	1991	1992
Price-earnings ratio	-31.0	-63.0	19.0	12.0	20.0
Price-cash flow ratio	...	6.4	6.3	6.7	11.5
Price (market value) to book ratio	0.6	1.05	1.01	1.31	2.14
Return on book equity					
All enterprises	-1.9	-1.7	5.2	10.7	10.9
Industrial enterprises	-7.3	-14.5	4.2	15.3	13.6
Net earnings as ratio of cash flow	...	-1.0	32.0	55.0	58.0
Net earnings as percentage of fixed assets	...	-1.9	6.0	11.0	13.1

Source: Blass 1994.

It is noteworthy, however, that while most of the earnings improvements occurred from 1988 through 1991, the largest increase in stock prices occurred in 1992 and 1993. Since prices in an efficient market should reflect future rather than current profitability, the behavior observed in the last two years requires that either expected growth prospects increased substantially, or that lower discount rates (due to a lower required real riskless return or a lower risk premium) are being used to discount future profits. Since both growth opportunities and required returns are unobservable, it is inherently difficult to evaluate these propositions.

Blass (1994) addresses the question by examining the changes in discount factors and growth expectations required to explain the increase in the price-earnings ratio from 12 in 1991 to 20 in 1992. Using an infinite-horizon constant dividend growth model, he finds that a drop of about 1 percentage point in the risk premium-adjusted discount rate could explain the increase in the price-earnings ratio. Similarly, an increase of 3/4 of a percentage point increase in the perpetual rate of growth could also explain the runup. Under the more realistic assumption that extraordinary investment opportunities are available for only 10 years, he finds that if the long-term growth rate of distributed earnings was 6 percent, the risk premium-adjusted discount rate would have had to decline by slightly more than 2 percentage points, from over 8 percent to slightly below 6 percent, to explain the observed change in the PE ratio (see tabulation below). If on the other hand, the risk premium-adjusted discount rate was and continued to equal 7 percent, annual growth rates in distributed earnings for the next 10 years would have had to increase from 3.7 percent to more than 9 percent in order to justify the observed increase in the price earnings ratio. While Israel's improved peace prospects and continued pursuit of structural reform could have resulted in both a decline in the risk premium-adjusted discount rate and an increase in expected earnings growth, it is not clear that these factors could have changed the discount rate and expected earnings by amounts sufficient to fully explain the observed change in the price earnings ratio.

Table 22. P-E Ratios as Functions of Required Returns and Growth Rates

(Ten-Year Horizon)

Growth in distributed earnings in percent per annum	Required percentage rate of return of stock holdings 5	6	7	8	9	10
2.25	17.0	12.9	10.0	7.8	6.1	4.8
3.00	18.5	14.2	11.1	8.8	6.9	5.5
3.75	20.0	15.4	12.1	9.7	7.8	6.3
4.50	21.5	16.7	13.2	10.6	8.6	7.0
5.25	23.0	17.9	14.3	11.6	9.4	7.8
6.00	24.5	19.2	15.4	12.5	10.3	8.5
6.75	26.0	20.4	16.4	13.4	11.1	9.3
7.50	27.5	21.7	17.5	14.4	11.9	10.0
8.25	29.0	22.9	18.6	15.3	12.8	10.8
9.00	30.5	24.2	19.6	16.3	13.6	11.5

Source: Blass 1994.

b. Institutional reasons

Until 1985, Israel had a tightly regulated financial system. Given its need to finance substantial budget deficits, the Government intervened in all aspects of financial intermediation, channeling a substantial portion of private savings to itself and to the Bank of Israel, either directly through the compulsory purchase of government bond issues by institutional investors or indirectly through the high reserve ratios set for saving schemes and private foreign currency deposits. In addition, the Government intervened in the allocation of private sector investment by administratively determining interest rates, subsidies, and credit volumes.

Following the 1985 Economic Stabilization Program, the Bank of Israel and the Ministry of Finance embarked on a gradual process of reforming the capital market with the objective of reducing government involvement in financial intermediation. Thus, restrictions were removed; interest rates were deregulated; new instruments were introduced; and market segmentation was reduced, while the market became more exposed to external competition. 1/ Moreover, as the supply of government bonds contracted due to the reduction of the budget deficit following the ESP, and as interest rates were lowered, there was a reshuffling in private portfolios, as institutional and other investors looked for alternative investment opportunities, such as the stock exchange.

The progressive reduction in the mandatory minimum rate of investment in government securities imposed on some institutional investors (provident funds and advanced training funds) allowed them to invest part of their portfolios in the stock market. Provident funds 2/, for example, more than doubled the proportion of shares in their portfolios during both 1991 and 1992, thereby raising the proportion of shares in their portfolios from 2 1/2 percent in 1990 to 13 percent in 1993. While much of the value rise results from higher share prices, the provident funds' demand for shares during 1992 amounted to more than NIS 1 billion or about a third of all new share issues. Similarly, the share of stock holdings in mutual funds' portfolios increased from 24.7 percent in 1990 to around 50 percent in 1993. This created a substantial increase in demand, which was partly responsible for the surge in share prices.

It is conceivable, moreover, that in addition to this direct impact on the demand for shares, provident funds might have had on indirect positive effect on the market, which stems from the long-term nature of their investments. Some argue, in fact, that this long-term investment horizon helps moderate short-term fluctuations in stock prices, reducing the risk involved in holding shares, and thereby expanding the stock market. However, the highly centralized nature of provident fund management, by which commercial banks determine investment policy, calls into question the funds' role as a stabilizing influence in the stock market. The major Israeli commercial banks handle around 80 percent of

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1/ For a discussion of capital market reform, see Chapter II, above.

2/ Provident funds are long-term (15 years) saving funds, which are heavily favored by tax exemptions to savers.

all share-trading volume in the Tel Aviv Stock Exchange, while the bigger five banks alone generate 63 percent of stock market activity. 1/

c. Rational bubbles

Bubbles are often proposed as another possible cause of asset price volatility and of persistent one-sided errors in stock markets, such as the ones that characterize bull market rallies. The problems with the theory is that it leaves open the question as to how a bubble gets started in the first place. Indeed, since the causes of the bubbles are never precisely identified, attributing stock price advances to bubbles is not very satisfying, while since fundamentals are not observable, testing stock markets for the presence of bubbles is a very difficult task. 2/ Nonetheless, there is evidence of a tendency for persistence in asset prices in a number of countries. 3/ However, the analysis of fundamentals above would suggest that not all of the runup in prices can be explained by their behavior. One is thus left with the possibility that while the initial increases in prices might have been underpinned by improved fundamentals, these might have been amplified by speculative type phenomena.

1/ Israeli banks also act as underwriters, stockbrokers and fund managers. Since the 1983 bank share collapse, following the manipulation of their own shares, the authorities have taken measures to change that state of affairs by increasing market regulation. The Securities Authority was given greater power, stricter legislation has been proposed to make banks set up separate subsidiaries for their brokerage, underwriting and mutual fund activities and a "one share, one vote" rule made corporate governance more democratic.

2/ The typical strategy is to test for the absence of bubbles. Rejection of the hypothesis of no bubbles would thus offer positive evidence. Testing usually involves checking if the time-series properties of stock prices and dividends are consistent with the implications of the fundamentals model. For example, if the price and dividend series have unit-roots, the fundamental's model implies that the two series are cointegrated. Alternatively, if bubbles are an important component of the actual price, the stock price should not be cointegrated with dividends. The data requirements are very exacting, since one needs to capture the lumpy pattern of dividends and earnings announcements.

3/ See, for example, Cutler, Poterba, and Summers (1990).

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V. Health Care Reform 1/

Israel has a comprehensive, quasi-public health care system, whose institutional and financial setup has its roots in the society's strong tradition of mutual support and solidarity. While the standard of health services in Israel compares favorably with other OECD countries, in more recent years, problems have surfaced that have brought to light that both the institutional and the financial framework need to be reformed to safeguard the system's equity, efficiency, and transparency. 2/ These problems include growing discontent by both consumers and providers about the system and the consequent trend toward more services being delivered outside the "public" sick funds; the emergence of serious financial problems in the largest sick fund, in part as a result of "cream skimming" by the smaller funds; and periodic labor unrest within the system.

The remainder of this chapter briefly describes the financial and institutional framework of the present system, including the problems that have emerged, and it outlines the basic reforms now under consideration to strengthen the system.

1. The current system

a. Some general parameters

Based on available indicators, Israel's present health care system would appear to have largely succeeded in improving the country's health care situation without raising the total cost of health care relative to GNP. By international comparison, the total cost of the system would not seem to be excessive at 7.5 percent of GNP, which is around the average for such expenditures in the OECD countries. 3/ Moreover, with almost 96 percent of the population insured through sick funds, 4/ and taking into account the high level of technology and the relatively large number of employees working in the health sector, the quality and accessibility of care would seem to compare favorably with most countries (see tabulation below).

1/ Prepared by Mr. H. Claassen.

2/ For an analysis of the Israeli health system in an international perspective, see Chernichovsky (1991).

3/ However, the figures for Israel benefit from the country's relatively young population as compared to most other OECD countries.

4/ About 3 percent reflects the insured indigent population, whose membership dues are subsidized by the Government.

Israel: Health Parameters

	1980-84	1992
Life expectancy: females	76.1	78.5 1/
males	72.7	75.1 1/
Infant mortality: (per thousands)	14.4	9.3
Health care employees: (in percent of employment)	5.5	5.7
Number of beds (per thousand capita)	6.5	5.9
Health care costs (in percent of GNP)	7.3	7.5

Source: Central Bureau of Statistics, Statistical Yearbook 1993.

1/ Levels in 1991.

Notwithstanding these relatively favorable overall parameters, the current system has a number of structural weaknesses. These weaknesses are particularly apparent in the financial area where the growing deficit of the largest sick fund could have negative effects on the Government's budget. 1/ Moreover, both providers and consumers appear to be increasingly dissatisfied with the system, which has been plagued by long queues for some services, while at the same time expensive equipment lies idle. There has also been periodic labor unrest in the health sector, reflecting relatively low wages and high wage disparities. Altogether, this has evoked forces that threaten to undermine the system's equity.

1/ By the end of 1993, Kupat Holim Clalit, the largest sick fund, had accumulated a debt of NIS 3.1 billion and it is expected to run an operational deficit of NIS 1 billion in 1994. An important part of Kupat Holim Clalit's problems stems from the aggressive competition from the other sick funds, which is aimed principally at the healthier, younger, and better-off part of the population.

b. The financial and institutional framework

The provision and the financing of health care are closely entangled, with an inadequate definition of the role and responsibilities of the different participants. Tables 23 and 24 provide an overview of the present system in terms of the provision of health and the financial flows.

(1) Provision of health care

The Government and the four sick funds are the main providers of health care services. Whereas government and local authorities provide directly about 22 percent of the value of care, the four sick funds account for about 42 percent. The remainder is made up of services provided by nonprofit organizations (13 percent) and the private sector (23 percent). Since 1980, the Government's share in the provision of health care has gradually declined, whereas that of the private sector has grown (Table 25).

The sick funds operate like Health Maintenance Organizations providing both insurance and health services to their members. The largest sick fund is Kupat Holim Clalit, which is part of the Histadrut (the General Federation of Labor). 1/ This fund (founded in 1911) insures over 70 percent of the Israeli population. In recent years there has been a shift of members from Kupat Holim Clalit to the other smaller sick funds, a development which has had negative financial implications for Kupat Holim Clalit.

The role of the Government, in particular the Ministry of Health (MOH), is not clearly defined. This role is being characterized by multiple responsibilities, which create the potential for conflicts of interest. On the one hand, the MOH is one of the main providers of health care, whereas, on the other hand, it also has the overall policy responsibility for the system. Indicative for the Government's involvement in the provision of health care is that almost 40 percent of the hospital beds are currently owned by the Government.

(2) Financing of health care

Currently, about 22 percent of health care expenditure is financed through the state budget (MOH) in the form of direct provision of services or by way of other contributions. Another 25 percent originates from the so-called parallel tax, which represents the employers' obligatory contributions to the sick funds. This contribution amounts to 4.95 percent of the individual wage and is being collected by the National Insurance Institute

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1/ The others are The National Employee Health Fund (Leovdim Leumim), Maccabi Health Fund, and Meuhedet Health Fund.

Table 23. Israel: General Entitlement to Direct Financial Responsibility for, and Principal Providers of Care, by Type

Type of Care	Entitlement	Direct Financial Responsibility	Principal Providers 1/
Preventive	Universal	Government	Government, Sick Funds, Municipalities
Early childhood (0-5) and maternal	Universal	Government	Government
Maternity	Universal	NII	Government, Sick Funds
Primary	96% of the population (excluding (armed forces)	Households, Employers 2/	Sick Funds
Secondary and tertiary	96% of the population (excluding (armed forces)	Households, Employers 2/	Government, Sick Funds, Nonprofit Organizations
Mental health	Universal	Government	Government, Sick Funds, Private and Nonprofit Organizations
Long-term for the elderly	Universal 3/	NII, Government, Households	Private and Nonprofit Organizations
Dental	Selective for children according to municipality	Households, Municipalities	Private Institutions

Source: Dov Chernichovsky - Economic Dimensions of the Crisis in the Israeli Health-Care System: Key Principles and Proposals for Reform.

1/ Most providers deliver virtually all types of services.
2/ The Government and the NII pay insurance premiums or membership fees for the economically disadvantaged, mainly the aged.
3/ In reality, this objective has yet to be met.

Table 24. Israel: Receipts and Disbursements 1/ in the Health Services of the General Government, 2/ and the Sick Funds 2/

1990

Receipts

Total	General Government 4,683	Sick Funds 4,633
Financing from the Government's budget and the deficit of the sick funds	1,704	343
Parallel tax	1,971	--
Earmarked receipts	1,008	4,290
Total		
Sales of services to:		
1. Government	--	483
2. Sick funds	817	--
3. Business sector	17	4
4. Households	169	1,671
Of which:		
sick funds membership fees		1,395
Current transfers from:		
1. Government	--	100
2. Government: parallel tax	--	1,973
3. Sick funds	--	--
4. Donations in Israel and abroad	1	33
Capital transfers to:		
1. Government	--	--
2. Donations in Israel and abroad	4	26

Disbursements

Total	General Government 4,683	Sick Funds 4,633
Current expenditure on goods and services		
1. On services produced by the sector	1,656	3,237
2. Purchased from Government	--	818
3. Purchased from sick funds	502	--
4. Purchased from other nonprofit health institutions	144	312
5. Purchased from business sector	166	65
Current transfers to:		
1. Government	--	--
2. Sick funds	80	--
3. Sick funds: parallel tax	1,975	--
4. Other nonprofit health institutions	52	6
5. Households	19	61
Fixed capital formation	94	134
Capital transfers to:		
1. Sick funds	--	--
2. Other nonprofit health institutions	6	--

Source: Central Bureau of Statistics.

1/ Not including provision and repayment of loans, interest (receipts and payments) and property income.
2/ The flows of disbursements and receipts between the Government, the sick funds, and other nonprofit health institutions are presented in this table as recorded in the financial reports of each of the above mentioned bodies, without adjustment; therefore, the parallel flows are not necessarily identical.

Table 25. Israel: National Health Expenditures by Source of Finance and by Operating Sector, 1980-92

(In percent)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	Est. 1992
					I. Source of Finance								
Government 1/	60.0	60.0	59.0	54.0	53.0	54.0	54.0	50.0	50.0	47.0	47.0	47.0	47.0
Of which:													
Parallel tax	...	...	...	...	22.0	27.0	30.0	29.0	30.0	27.0	26.0	26.0	25.0
Members' fees	12.0	--	--	--	15.0	14.0	18.0	19.0	19.0	20.0	18.0	19.0	19.0
Out-of-pocket payment	19.0	--	--	--	23.0	25.0	27.0	29.0	29.0	28.0	29.0	28.0	27.0
Other (unknown)	9.0	--	--	--	9.0	7.0	1.0	2.0	2.0	5.0	6.0	6.0	7.0
					II. Expenditure by Operating Sector								
Government	29.0	28.0	27.0	25.0	24.0	24.0	23.0	23.0	22.0	22.0	22.0	22.0	22.0
Nonprofit	52.0	51.0	51.0	52.0	57.0	55.0	54.0	53.0	54.0	54.0	55.0	55.0	55.0
Of which:													
Sick funds	...	...	...	...	45.0	43.0	42.0	41.0	42.0	43.0	42.0	42.0	42.0
Private	19.0	21.0	22.0	23.0	19.0	21.0	23.0	24.0	24.0	24.0	23.0	23.0	23.0

Source: Central Bureau of Statistics.

1/ Direct government finance and parallel tax.

that transfers the money to the sick funds. 1/ As the National Insurance Institute has legally not been able to transfer parallel taxes to any other than the four existing sick funds, new sick funds have been effectively precluded from entering the market.

The remainder of national health care expenditure is funded by the households directly in the form of membership fees and user charges. The workers' membership fees account for 19 percent of the expenditures. 2/ The contributions to the largest sick fund are part of the membership dues to the Histadrut, which uses part of these contributions for its own purposes (0.8 percentage points out of a premium of 5.6 percent). Officially, the membership fee for all sick funds is 4.8 percent of the individual wage and is being collected directly by the sick funds. 3/ User charges finance about 27 percent of national health care expenditure. Another 7 percent comes from other sources such as donations and loans (Table 25).

The relative importance of the ways of financing has changed since 1980. Reflecting the efforts to improve overall macroeconomic budgetary control, the share of government financing has been reduced, forcing an increase in households payments in the form of user charges and membership fees. More recently there also has been an increase in financing from other sources, including bank loans. The resulting increase in the share of "out-of-pocket" costs has brought this share to a relatively high level by European standards. It can also be observed that the decline in the Government's share of financing has been considerably larger than the decline in its share in health care provision. The latter development seems to reflect, at least partly, the Government's inability to divest itself from its hospitals because of labor union resistance.

1/ The maximum wage level on which employers pay their percentage contributions is three times the national average wage, as it is regularly determined by the National Insurance Institute.

2/ Although the employees' and employers' contributions are nominally almost the same, employers' contributions amount to 24 percent of national expenditure on health, compared with just 19 percent for employees' contributions. This reflects collection inefficiencies, problems related to under-reporting of income, and membership fee reductions granted by the smaller funds.

3/ It is interesting to observe that the redistribution of income, which is the result of the income-related premium, was implemented by the sick funds, not the Government. This illustrates the strong notion of mutual support in the society.

The value of care delivered by the sick funds and other nonprofit institutions amounts to 55 percent of total national health expenditure. 1/ Kupat Holim Clalit, the largest sick fund, has incurred growing debts, as its financial position deteriorated in the context of the Government's budgetary tightening and an increased tendency of other sick funds to become selective in accepting members. This "cream skimming" by smaller funds left Kupat Holim Clalit with a relatively larger share of older and low-income members. This put downward pressure on Kupat Holim Clalit's revenue base and increased pressure on expenditures (as low-income earners contribute less and elderly people need more care). Kupat Holim Clalit has remained committed to its ideology of providing health care on the basis of need and has refrained from increasing its premiums in order to remain competitive. 2/

2. Current reform proposals

Most of the reform proposals find expression in the Government's draft National Health Insurance Law. 3/ The guiding principle of this proposal is to find a solution to the problems in the present structure in a way that would not involve an additional burden on the public finances. The main points in the National Health Insurance Law proposal are:

a. By law every resident would be insured with one of the sick funds (residents would thus have the obligation to register in a sick fund). This would assure coverage for those 300,000 Israeli residents who currently are not insured.

1/ The Government would appear to be indirectly subsidizing the sick funds and nonprofit organizations to the extent of 4 percent of total national health expenditure. This indirect subsidy partly reflects the sale of services of state hospitals to sick funds at subsidized rates. This subsidy might be the implicit outcome of the agreement between the largest sick fund and the Government under which the Government sells a fixed amount of patient-days to this fund, at the official per diem rate set by the Government, for the hospitalization of this fund's members in state hospitals; the cost of hospitalization exceeding this fixed number is absorbed by the Government.

2/ Notwithstanding its financial problems, the sick fund's hospitals are paying their doctors significantly higher wages than the Government does. This is likely to reflect the lack of an effective budget constraint.

3/ The reform process was initiated in 1988, when an Investigative Committee was appointed to examine the performance and efficiency of the health care system in Israel and to make recommendations regarding the preferred policy and necessary changes in the structure of the system. The current proposal follows the committee's recommendation to introduce a National Health Insurance Law. At present, the proposal is being discussed in Parliament.

b. The law would specify the basket of health services any resident is entitled to. Kupat Holim Clalit's current basket of services has served as the basis for the health services basket. This basket has been supplemented by some additional services in the field of psychiatric and geriatric field, mostly services that are currently provided by the Government. 1/ In addition, the sick funds would be allowed to provide additional insurance for a supplementary fee, which will be under governmental supervision.

c. The law proposal clearly separates financial responsibilities from responsibilities regarding the provision of health services: the state would be responsible for the funding of the official Health Services Basket through the budget, whereas the sick funds would be responsible for providing this basket. The Government would disappear from the scene as a health service provider and focus its attention to the overall responsibility of the system. 2/

d. The collection of health contributions would be centralized with the National Insurance Institute. This Institute would also serve as pass-through for all government funding. Thus, after the reform, the National Insurance Institute will be collecting 75 percent of national health expenditure (except for out-of-pocket costs and additional insurance).

e. The proposal fixes the employee's premium at 4.8 percent of wage income, the same rate as is now collected officially by the sick funds. By unifying the rate, the sick funds would be deprived of the possibility of granting reductions as they see fit. Premium changes could only be enacted with both the approval of the Minister of Finance and the Knesset. The Minister of Health would also set out regulations regarding the amount of user charges.

f. The National Insurance Institute would transfer the funds collected to the health funds according to the principle of capitation. The capitation equation would take into account factors such as the age of the insured and the distance from his home to a population center. In this way, the distribution of financing to the health funds would be directly related to the medical needs of its members.

g. The insured's position would be strengthened by allowing him a wider choice of providers of medical services, on condition that these providers belong to the pool of contractual providers of a given sick fund; sick funds would thus no longer decide on the individual's provider. The

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1/ The draft law authorizes the Minister of Health with the approval of the Minister of Finance to add services to the official Health Services Basket. A reduction of the number of services in the Basket would need the approval of the Knesset.

2/ The reform plans foresee in a gradual divestment of the Government's hospitals.

proposal also stipulates that the basket of services be provided within a reasonable time and within a reasonable distance from the place of residence of the insured.

h. The sick funds' budgets would be approved and supervised by the Ministry of Health in order to prevent budgetary problems from developing. This will provide the Ministry the opportunity to oversee the funds' budgets and their implementation. The proposal also requires the funds to operate with a balanced operations budget.

In addition, reform proposals include a reorganization of the Ministry of Health so that it can effectively develop overall health policy; the decentralization of service provision and budgetary functions; a regulatory framework for major capital expenditure; the introduction of private medical services into public hospitals; and the unification of the wage structure.

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VI. International Competitiveness 1980-93 1/

In assessing the level of international competitiveness, the Bank of Israel favors the use of an indicator of relative price movements of tradable and nontradable goods over that of the real effective exchange rate indicators used more conventionally in other industrialized countries. This chapter compares different competitiveness indicators for Israel in the period 1980-1993. A first section reviews developments of the real exchange rate measured in terms of changes in the relative price of nontradable and tradable goods (the "internal" real exchange rate). A second section examines real effective exchange rate indicators, based on relative consumer prices, producer prices, unit labor costs, and export unit values. A final section compares and attempts to reconcile the basic differences that emerge from using these two different approaches to assessing competitiveness. The main conclusion of this chapter is that while the measure favored by the Israeli authorities points to a strong real appreciation of the currency, in particular since the implementation of the stabilization program in July 1985, the more conventional real effective exchange rate indicators suggest that competitiveness in 1993 was not much different from that in 1980.

1. The internal real exchange rate

The internal real exchange rate can be defined directly as the ratio between the consumer price index for nontradable and for tradable goods. More indirectly, the internal real exchange rate can be derived by comparing domestic product deflators with the prices of tradables. From Chart 5, it is clear that the secular pattern that these different indicators show over a long time period is broadly similar: a real appreciation in 1982-83, followed by some correction in 1984-85, and a strong and continuous real appreciation throughout the period 1986-93.

The real appreciation of nontradables vis-à-vis tradables observed in 1982-83 was the result of the authorities' attempt to reduce inflation by adhering to an exchange rate rule at a time when expansionary fiscal policies contributed to a very strong growth in domestic demand. 2/ In 1984-85, there was a depreciation in real terms because the authorities accelerated the pace of nominal depreciation and domestic demand had declined sharply in the aftermath of the October 1983 stock market collapse.

The internal exchange rate shows a strong real appreciation after the implementation of the 1985 stabilization program. This real appreciation happened notwithstanding a 19 percent devaluation of the shekel vis-à-vis

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1/ Prepared by Mr. H. Claassen.

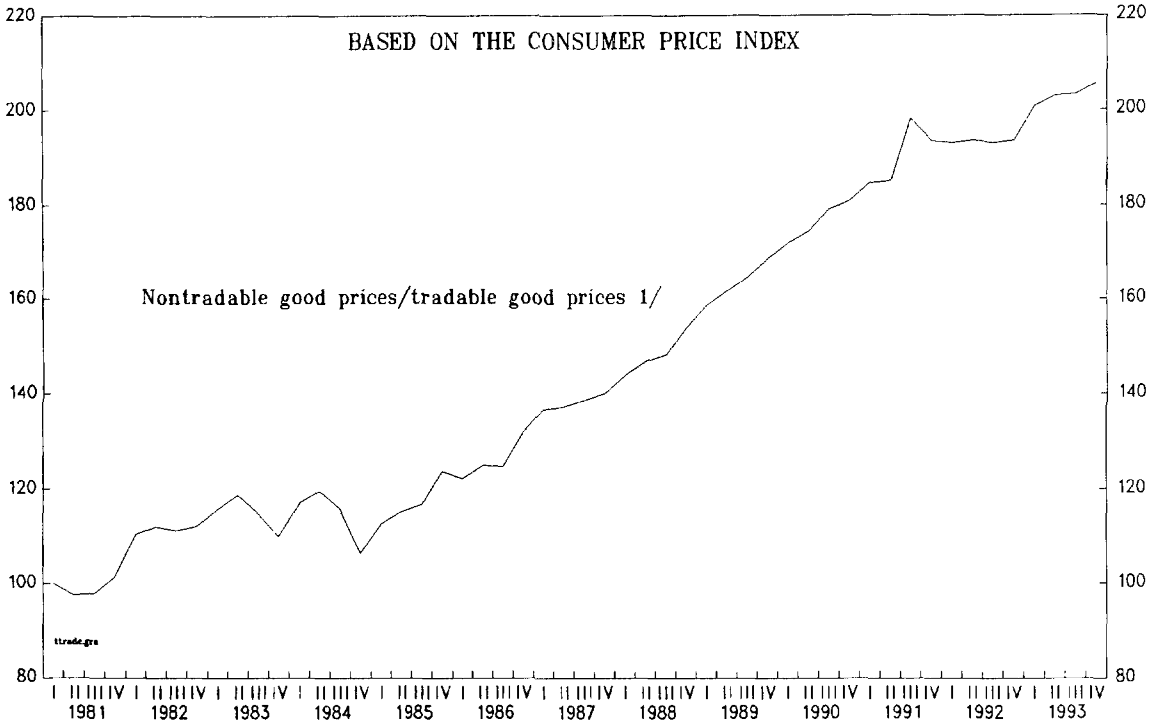
2/ As of September 1982, the authorities limited the rate of depreciation of the shekel against the U.S. dollar to 5 percent per month. During this period, the authorities protected the profitability of the producers of tradables by measures that included an exchange rate guarantee scheme, import deposit requirements, and increases in import taxes.

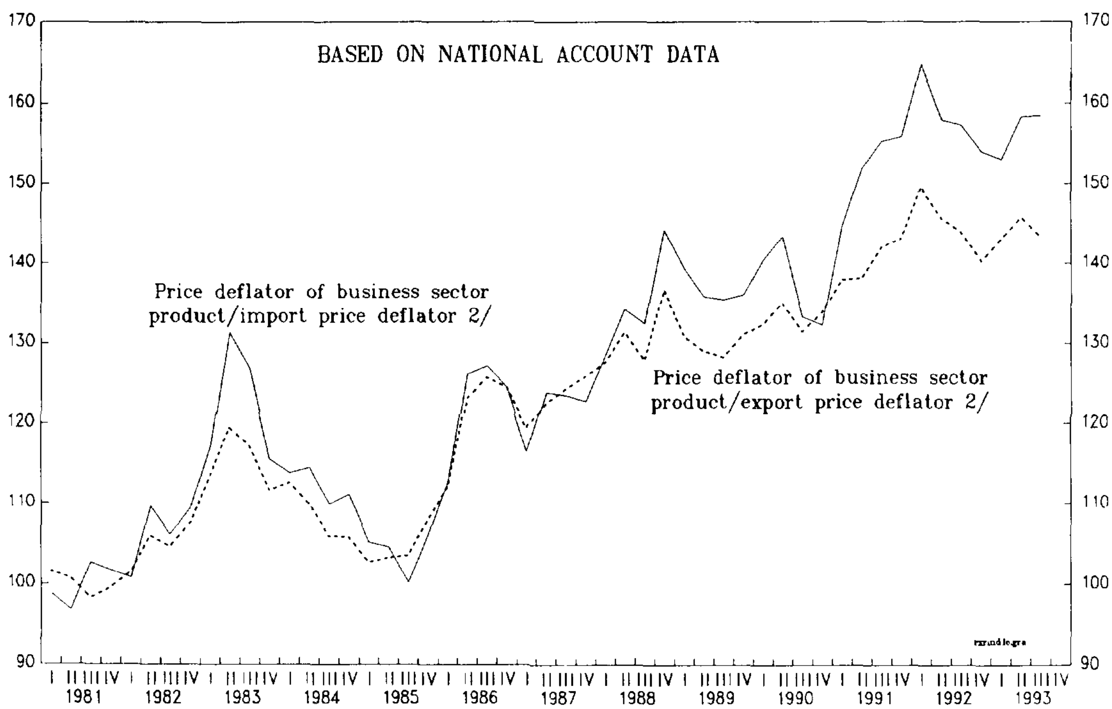
CHART 5

ISRAEL

REAL EXCHANGE RATE, 1981-1993

(1981=100)





Source: Bank of Israel

1/ Nontradables comprise services other than foreign travel, fruit and vegetables, butter and cheese, eggs, breads and bakery products, gas and electricity. Tradables are all other CPI items. The weights in the CPI are 58 and 42 for nontradables and tradables respectively.

2/ Excluding diamonds.

the U.S. dollar on the eve of the program's implementation, and the dollar's marked subsequent depreciation in international currency markets. Until 1990, when the current wave of immigration started, this process of real appreciation was mainly driven by cost factors, in particular real wage increases. 1/ Over the same period, the ability to increase prices in the tradable goods sector in response to developments in costs was limited because of foreign competition. Up until 1990 the process of real appreciation of nontradables continued despite efforts to partly restore relative prices through devaluations in January 1987, January 1989, and June 1989.

By 1990, when the current wave of immigration had started, the rate of unemployment had already risen to a relatively high level and substantial productivity gains had been obtained in the tradable goods sector. The increase in immigration led to a sharp increase in domestic demand, in particular for nontradables (e.g., housing), which put pressure on the trade balance. In the circumstances, the authorities' exchange rate policy became more focused on preventing a further real appreciation of the currency. This change in emphasis resulted in devaluations of 6 percent and 10 percent in March and September 1990, respectively, and another 6 percent in March 1991. Notwithstanding a deceleration in the rise of unit labor costs, mainly reflecting increases in unemployment, the increase in the relative price of nontradables continued in 1990 and 1991 at a fast pace under the influence of strong domestic demand, in particular for nontradables.

In 1992 and 1993, there was some levelling off in the internal real rate of exchange reflecting a slowdown in domestic demand growth. Over the same period, the new exchange rate regime (a preannounced crawling peg) introduced in December 1991 also contributed to a less pronounced real appreciation in the short term. 2/

2. Real effective exchange rate indicators

Real effective exchange rates over the period 1980-93 calculated on the basis of consumer prices, producer prices, unit labor costs in manufacturing, and export unit values are presented in Chart 6. To varying degrees these indicators suggest that Israel's competitiveness has moved in cycles since 1980. Thus, on the basis of these measures, competitiveness

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1/ Reductions in price subsidies and increases in taxes and fees for public services--measures that were taken in the context of the stabilization program--also contributed to a relative increase in nontradable prices.

2/ For 1993, the inflation target of 10 percent was considered to be consistent with an annual rate of depreciation of 8 percent and an expected increase of 2 percent in foreign prices. The 10 percent inflation target presupposed that prices of nontradables would also rise by 10 percent or, in other words, that there would be no change in the internal real exchange rate.

deteriorated in 1981-83, improved in 1984-85, deteriorated again in 1986-1989, and, since 1990, recovered most of the ground lost in the previous years. 1/ According to the real effective exchange rate indicators, competitiveness in 1993 was not much different from that in 1980. A further point to be noted is that both periods of real effective exchange rate appreciation--1981-83 and 1986-89--coincided with periods in which the authorities tried to fight inflation by reducing the rate of nominal exchange rate depreciation.

On the basis of export unit values, the real effective exchange rate has not displayed the same appreciation as on the basis of the other real effective exchange indicators, but rather it has maintained a relatively stable path. This observation would seem to be consistent with Israel being a price taker in world export markets. By contrast, the real effective rate based on unit labor costs generally indicates a stronger appreciation than the other indicators, indicating that the profitability in the tradable goods sector was indeed under strong downward pressure during periods of real effective appreciation. The real effective exchange rates based on producer prices and consumer prices have displayed a relatively similar pattern over the period under review.

3. A comparison

The strong internal real appreciation in Israel over the entire period was only paralleled by the other measures of real effective exchange rate in 1982-83 and 1986-89. While the internal real appreciation continued in 1989-93, the real effective exchange rate based on consumer prices has been depreciating slightly. The latter development would suggest that the process of internal appreciation, that has been found to be a fairly general phenomenon in many industrialized countries, was not much different in Israel than abroad in this latter period.

The development of the real effective exchange rate indicators would appear to be much more in line with the performance of Israeli exports in world markets than the calculated internal real exchange rates. Periods of losses and gains in market share coincided well, albeit with a lag, with periods of real effective appreciation and depreciation as measured by the

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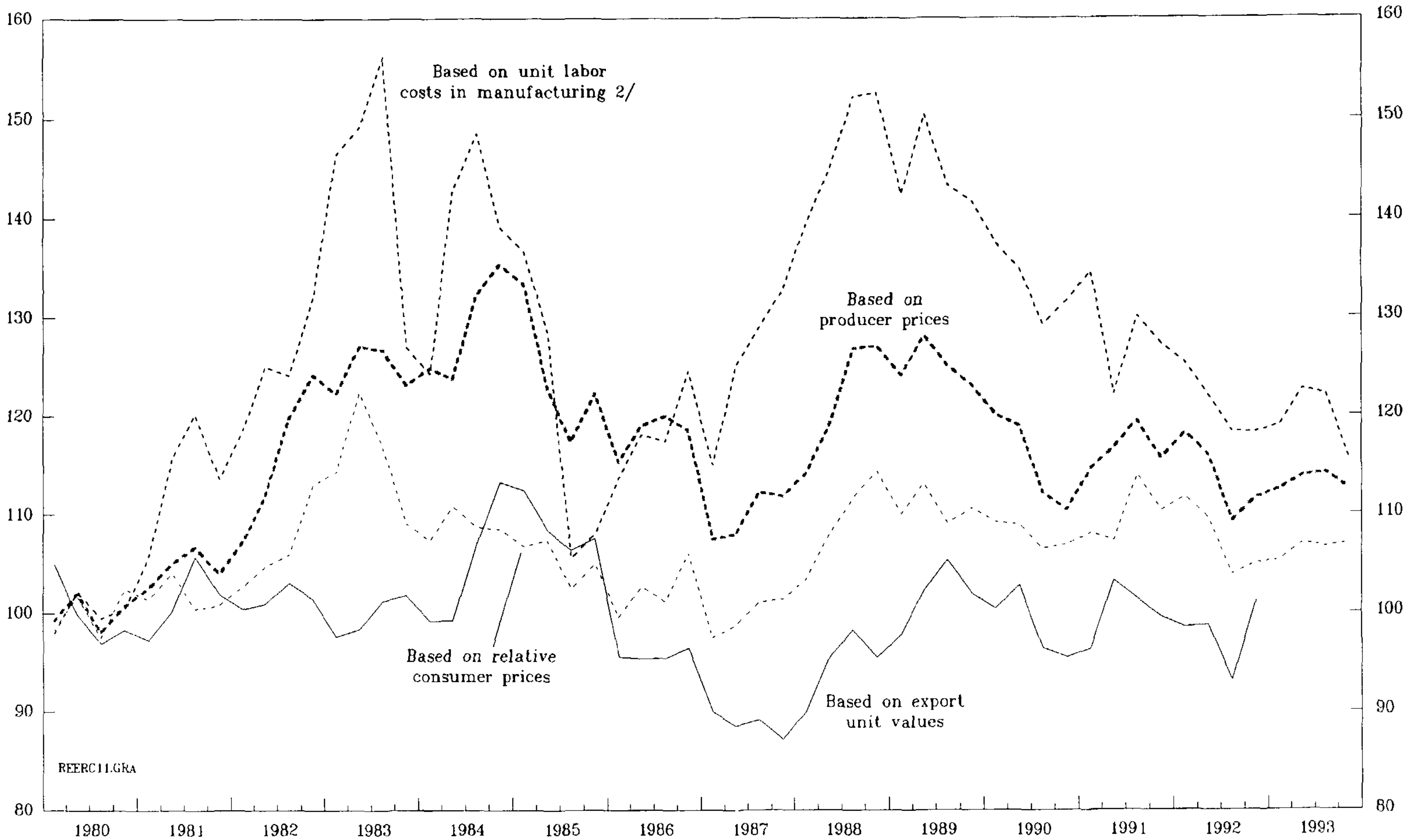
1/ A general point of caution needs to be made in interpreting these real effective exchange rate indicators, in that they exclude the impact of export subsidies or of import tariffs on relative competitiveness. From Chart 7, it can be seen that the protective measures that had been taken in 1981-1983 led to a widening in the difference between the relative ratios of the "implicit" exchange rate for exporters and importers to that of the official exchange rate. This difference tended to disappear after 1985, in particular for exporters. Thus, although real effective exchange rate indicators in 1982-1983 and 1988-1989 were at about the same level, exporters' competitiveness must have been more impaired in the latter period, since the various export subsidies had been eliminated.

CHART 6
ISRAEL

REAL EFFECTIVE EXCHANGE RATE DEVELOPMENTS, 1980-1993 1/

(1980 = 100)



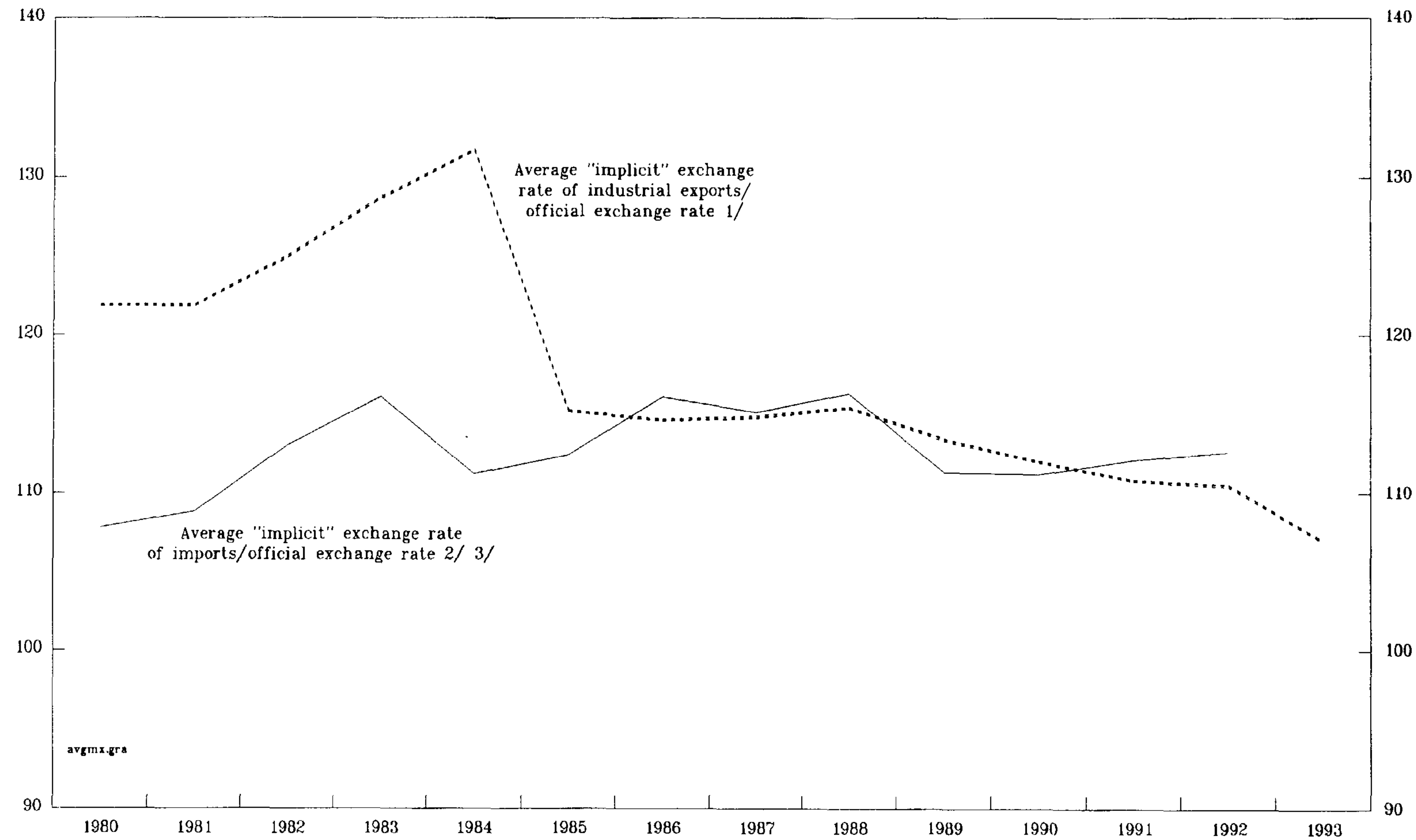
Source: International Financial Statistics.

1/ The indicators have been calculated using the IMF's Information Notice System weighting scheme and official exchange rates.
2/ For Israel the industrial sector excludes diamonds but includes mining, quarrying, food, beverages and tobacco, which together account for about 15 percent of total industrial output.

CHART 7

ISRAEL

AVERAGE "IMPLICIT" EXCHANGE RATE FOR IMPORTS AND EXPORTS, 1980-1993



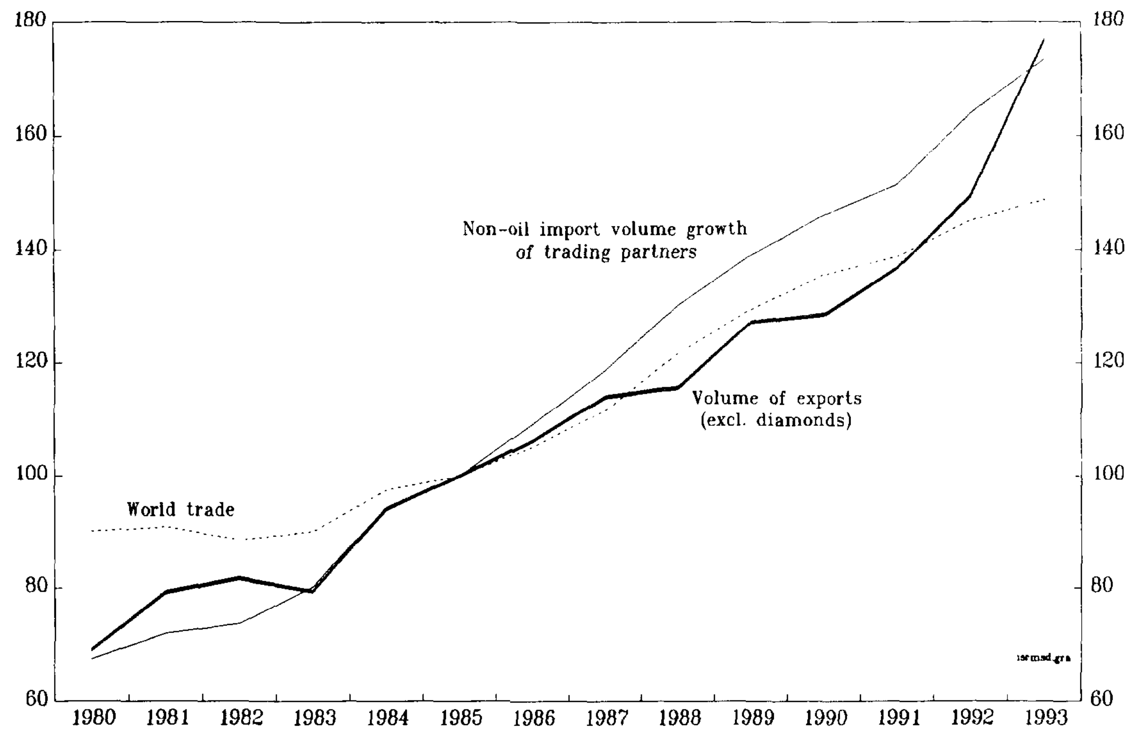
Source: Central Bureau of Statistics, Statistical Abstract.

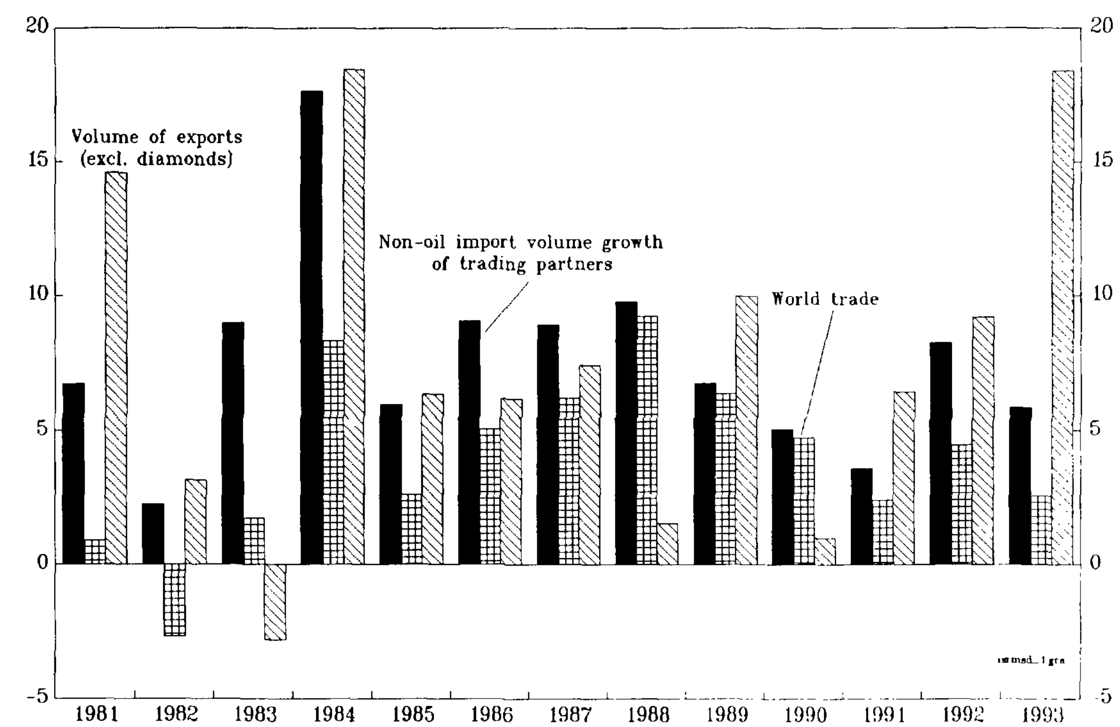
1/ The average "implicit" exchange rate for exports is calculated by dividing the national account data for industrial exports expressed in sheqels, which take into account the impact of subsidies to industrial exports, by the balance of payments data for industrial exports in dollars.

2/ The average "implicit" exchange rate for imports is calculated by dividing the national account data for imported goods expressed in sheqels, which include all import taxes except for VAT, by the balance of payments data for imported goods expressed in dollars.

3/ The gradual increase in 1991 and 1992 reflects a relatively strong growth of highly taxed consumer durables and the replacement of quantitative import restrictions vis-a-vis "third" countries by a system of import duties.

CHART 8
ISRAEL
MARKET SHARE OF EXPORTS, 1980-1993
(1985=100)





Sources: IMF and Bank of Israel.

more conventional exchange rate indicators (Chart 6). In particular, the real effective exchange rate based on unit labor costs would appear to be a useful indicator in the assessment of competitiveness. Used in combination with the other real effective exchange rate indicators, in particular those based on producer prices and export unit values, this indicator provides a reasonable indication of changes in the relative profitability of producing tradables.

The internal real appreciation in the period 1989-93 has not been accompanied by a real effective appreciation in terms of unit labor costs, but instead by a real effective depreciation. This would seem to reflect the fact that the internal real appreciation during this period was driven by demand factors (and to a large extent reflected increased housing costs) and not by cost factors as had been the case in 1982-83 and 1986-89. The internal real appreciation could thus coincide with improved external cost competitiveness.

An assessment of a country's competitiveness cannot be complete without looking at actual export developments and comparing actual export developments with the growth of the relevant market. Chart 8 shows that Israel's export market has grown faster than overall world trade. Moreover, in recent years Israeli exports have been growing at a rate higher than that of its relevant export market, which would appear to further confirm that the economy is currently competitive.

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VII. The Exchange and Trade System 1/

As a part of a broad program of market-oriented reform, Israel's financial sector and its exchange and trade system have been liberalized extensively since 1986. 2/ On September 21, 1993, the process of current account liberalization culminated in Israel's acceptance of the obligations of Article VIII, Sections 2, 3, and 4 of the IMF Articles of Agreement. The remainder of this chapter briefly describes Israel's exchange and trade regulations as of December 1993 and provides information on the most recent changes in the exchange and trade system.

1. Exchange arrangements

The currency of Israel is the New Sheqel (plural - Sheqalim). Its exchange rate is defined in relation to a currency basket consisting of five major currencies: the deutsche mark, the French franc, the Japanese yen, the pound sterling, and the U.S. dollar. The actual exchange rate fluctuates within a range of 5 percent above and below the midpoint rate. Since December 17, 1991, both the midpoint and the entire band are adjusted at a daily rate (the "slope" of the band) that reflects the difference between the domestic inflation target and projected inflation in the main trading partners. Since July 26, 1993 the slope of the band has been set at 6 percent on an annual basis. On December 31, 1993, the exchange rate of the new sheqel in terms of the U.S. dollar was NIS 2.9860 per US$1. Authorized banks are permitted to deal in foreign exchange; other institutions (e.g., securities brokers, foreign exchange dealers) are in possession of, or may obtain, a limited license to deal in foreign exchange.

Transactions in futures and options, including traded contracts, on foreign currencies, foreign interest rates, commodities and securities are allowed as well as forward exchange transactions. However, a juridical person may only enter such contracts in order to cover commercial risks arising from permitted transactions; transactions in commodities may only be entered into in order to cover risks; and, transactions, other than in traded contracts, must be done against an authorized dealer bank, or through it, against a foreign bank or broker.

2. Administration of control

Exchange control is the responsibility of the Controller of Foreign Exchange; it is administered by the Bank of Israel, in cooperation with the Ministry of Finance, and is carried out mostly through authorized banks.

1/ Prepared by Mr. E. Clifton

2/ See Chapter II for a fuller discussion of recent reforms in the Israeli financial sector.

3. Prescription of currency

Payments and receipts must be effected in the currency and manner prescribed by the exchange control authorities.

4. Nonresidents' accounts

Nonresidents' funds are held either in foreign currency accounts or in local currency accounts. The opening of nonresident foreign currency accounts does not require prior approval. Holders may freely effect transfers from their foreign currency accounts and may also convert funds held on the accounts into local currency at the market rate of exchange.

There are no restrictions on the opening of convertible local currency accounts by nonresidents; funds on these accounts may be used in permitted transactions, including for transfers between nonresidents. The sales proceeds of an investment in Israel, including real estate, may be transferred abroad in their entirety if the original investment was made through an authorized dealer with foreign currency.

5. Resident accounts in foreign currency

There are two main types of foreign currency accounts that Israeli residents may open and hold:

a. Foreign currency deposit accounts (PAMAH)

Export proceeds and unilateral transfers directly received from abroad, as well as unused travel allowances, may be deposited in these accounts. The liquidity requirements are 8 percent for a current account and 4 percent for a time deposit account. A noted subcategory is that of resident restitution deposit accounts. These accounts may be held only by recipients of restitution payments or certain disability pensions. The liquidity requirement on these accounts on December 31, 1993 was 61.5 percent, but this requirement is being gradually and automatically lowered at a given monthly rate from an initial 90 percent in November 1991. Funds deposited in these accounts are tax free and may be used up to a limit of US$1,800 for an additional travel allowance.

b. Exempt resident deposit accounts

Certain residents (mostly immigrants) may deposit funds brought from abroad in these accounts. Balances on these accounts may be transferred abroad freely. Certain regulations stipulate the types of funds that may be deposited in these accounts.

In addition, a resident may open a deposit account linked to the exchange rate of the sheqel (PATZAM) with a maturity period of not less than three months.

6. Imports and import payments

With the exception of agricultural products, imports are free of licensing and administrative or quantitative restrictions. A special regime applies to imports from countries that restrict or prohibit imports from Israel. The importation of meat is subject to government procurement.

Foreign exchange to pay for authorized imports is granted automatically by the banks upon presentation of relevant documents (import documents, bills of lading, and letters of credit). Foreign exchange is also provided automatically for repayment of suppliers' credits. Importers are allowed to use foreign currency proceeds of loans obtained abroad directly for import payments without first depositing the funds with an authorized Israeli bank. Advance payments for imports of goods to be supplied within one year are allowed.

A value-added tax of 17 percent is levied on almost all imported and domestically produced goods, other than fresh fruits and vegetables.

7. Payments for invisibles

Foreign exchange for payments abroad on account of invisibles, including expenses related to tourism, is provided automatically upon proof of the nature of the transaction. The exchange allowance for tourist travel, in addition to any payment executed from Israel, is the equivalent of US$3,000 a person for each journey. The business travel allowance is US$200 a day, up to a maximum of US$5,000 a trip (in addition to the standard allowance of US$3,000). The allowance may be taken out in the form of cash, traveler's checks, and banker's checks, or may be used with credit cards. Resident travelers may take out Israeli bank notes not exceeding the equivalent of US$200 a person a trip. Residents may make support or gift remittances abroad of up to US$2,000 a year. The exchange allowance for students studying at institutions of higher education abroad is US$1,000 a month in addition to tuition expenses. A resident going abroad for medical treatment who requires hospitalization is permitted to pay up to the equivalent of US$30,000 in advance. While abroad, he is permitted to pay the remainder of the fee against bills. Additional or subsequent payments may be authorized on request. Residents, while in Israel, are permitted to make credit card payments abroad, of up to US$1,500 a year.

Nonresident travelers leaving Israel are permitted to take out Israeli bank notes up to the equivalent of US$100, and to repurchase through an authorized dealer, at the port of departure, foreign currency up to the equivalent of US$500. Nonresidents may purchase foreign currency, on presentation of documents showing previous conversion of foreign currency into Israeli currency with a limit for each visit of US$5,000 for a person over 18 years and of US$2,000 for a person under 18 years (a temporary leave of less than two weeks during the visit does not affect the person's right). Commercial banks are authorized to sell Israeli currency abroad.

Remittances of earnings by foreign workers are not restricted. Remittances of profits and dividends from foreign direct investment are permitted after payment of local taxes.

8. Export and export proceeds

Most exports do not require licenses. Exports of oil and defense equipment to and the signing of defense contracts with South Africa are prohibited. Export proceeds in foreign currencies must be received within 12 months of the date of export; they may be held in a PAMAH account or surrendered. However, exporters may retain in a bank deposit abroad an amount equivalent to 10 percent of their turnover in the preceding year; this may be used in payment for imports and other permitted payments abroad. For inputs directly imported by an exporter, there is a system of rebates of customs duties, wharf charges, and other related charges.

9. Proceeds from invisibles

Exchange proceeds from invisibles may, in general, be kept in foreign exchange in PAMAH accounts or surrendered to an authorized dealer. Any resident is free to accept specified convertible currencies from tourists in payment for customary tourist services and commodities other than securities and real estate.

For 30 years after entering Israel, new immigrants are exempt from the requirement to surrender their foreign exchange to authorized dealers, and they may hold these foreign currencies freely with authorized banks in Israel or with banks abroad. There is no limit on the amount of Israeli bank notes or foreign currency that may be brought in by travelers.

10. Capital

Nonresidents are permitted to purchase real estate, traded securities, and units of mutual trust funds in Israel. In order to repatriate the principal or profits on these investments, nonresidents must prove to an authorized dealer that these were purchased with foreign currency through an authorized dealer. Direct loans from nonresidents to Israeli residents are not restricted.

Foreign exchange brought into Israel for the purpose of investment in the form of equity capital or shareholders' loans may be granted preferential tax treatment in accordance with the Law for the Encouragement of Capital Investment.

Capital transfers abroad by residents--other than new immigrants, of funds they brought in--require a special permit from the Controller of Foreign Exchange. Such permits are normally granted up to 40 percent of own capital to any active incorporated Israeli firm that is contemplating investment abroad. Emigrants are permitted to transfer their Israeli assets abroad up to the equivalent of US$4,000 a year.

Direct loans in any form from Israeli residents to nonresidents are subject to licensing. Domestic banks are permitted to lend to nonresidents; where collateral is required it has to be realizable in foreign currency. Individual residents may buy foreign securities traded abroad, provided that the securities are held in a safekeeping deposit with an authorized dealer. Israeli mutual trust funds are permitted to invest abroad up to 10 percent of their portfolio of financial assets (up to 50 percent in the case of funds specializing in foreign currency investments).

Resident exporters and airline and shipping companies may maintain foreign bank accounts. New immigrants may retain their foreign assets for 30 years. Otherwise, residents are not normally permitted to maintain abroad real estate, money, securities, or income from these assets.

Proceeds accruing from the repatriation or liquidation of foreign assets must be surrendered.

11. Gold

Residents are allowed to import and export gold, subject to the same regulations as those applied to merchandise trade, and to transact in gold bullion and coins. Gold certificates are treated as foreign securities.

12. Changes in the exchange and trade system during 1993

a. Exchange arrangement

January 1. The 4 percent tax on sales of foreign exchange to residents for purposes of tourism and for transfers abroad was abolished.

April 1. The maximum compensation provided under the export insurance facility for exchange rate risk was reduced to 2 percent of the valued added.

September 1. The export insurance facility for the exchange rate was discontinued.

September 21. Israel formally accepted the obligations of Article VIII, Sections 2, 3, and 4, of the Fund's Articles of Agreement.

b. Imports and import payments

January 1. The rate of value-added tax levied on all imported and domestically produced goods was reduced to 17 percent from 18 percent.

July 27. The 2 percent levy on imports of goods was abolished.

c. Payments for invisibles

January 1. The tax of NIS 250 on travel abroad by residents was abolished.

d. Capital

April 29. All nonresident heirs, irrespective of their domicile, were allowed to transfer inheritances abroad.

November 1. Nonresidents were allowed to deposit in nonresident accounts all incomes received from Israeli securities and real estate even if these were purchased from sources other than nonresident accounts.

e. Gold

April 19. Residents were allowed to import and export gold, subject to the same regulations as those applied to merchandise trade, and to transact in gold bullion and coins. Gold certificates would be treated as foreign securities.

Table A1. Israel: Industrial Production, 1990-93

	Weight in Index 1993	Percentage Change at Constant 1990 Prices 1990	1991	1992	1993
Mining, quarrying, and nonmetallic minerals	7.2	13.0	20.5	11.9	0.7
Food, beverages, and tobacco	11.4	1.1	1.7	2.8	7.6
Textiles, clothing, and leather products	8.7	8.5	6.9	7.1	5.2
Rubber, plastics, and chemicals	16.3	7.2	6.3	11.4	11.4
Electronics, transport equipment, optics	29.1	6.1	5.5	8.2	5.3
Metals and machinery	16.6	6.1	9.1	6.8	4.9
Wood, paper, publishing, and printing	10.6	5.6	3.0	9.8	12.8
Total industrial production excluding diamonds	100.0	6.3	6.7	8.2	6.5

Sources: Central Bureau of Statistics, Monthly Bulletin of Statistics; and data provided by the Bank of Israel.

Table A2. Israel: Investment, 1988-93

	In Millions of New Sheqalim	Percentage Change at Constant Prices					
	1993	1988	1989	1990	1991	1992	1993
Gross domestic investment	44,063	-1.9	-2.7	26.2	42.4	7.6	0.2
Gross fixed investment	39,495	-0.5	-5.5	22.4	40.1	4.9	-3.0
Machinery and transport equipment 1/	15,381	-6.6	-2.4	24.0	19.7	6.8	13.1
Of which:							
Transport equipment	4,763	13.3	-32.1	20.8	54.5	19.5	7.5
Construction:							
Residential	11,374	-0.1	6.2	19.1	74.2	-0.9	-27.3
Private	8,611	--	6.2	-0.7	-8.1	8.5	6.8
Public	2,762	-0.6	7.0	192.5	283.6	-9.3	-63.7
Nonresidential	7,657	6.1	0.4	11.7	16.1	11.0	12.8

Sources: Central Bureau of Statistics, Monthly Bulletin of Statistics; and data provided by the Bank of Israel.

1/ Including shipping and aircraft.

Table A3. Israel: Consumption, 1988-93

	In Millions of New Sheqalim	Percentage Change at Constant Prices					
	1993	1988	1989	1990	1991	1992	1993
Private consumption	116,952	3.8	-1.0	5.3	7.4	8.3	7.6
Food, beverages, and tobacco	27,614	5.8	0.5	5.4	5.9	4.8	7.5
Other nondurable goods 1/	16,997	-1.3	-1.8	4.2	5.8	14.1	11.0
Durable goods 2/	12,195	4.9	-13.8	17.1	21.6	24.1	2.2
Of which: passenger cars	4,252	13.0	-36.2	25.6	56.9	46.4	-10.5
Services 3/	31,360	1.8	1.8	2.4	4.9	10.5	7.5
Of which: Housing	25,899	2.1	2.3	2.5	2.7	5.2	4.4
Less: Consumption by nonresidents	6,414	-11.7	10.4	-6.0	-14.3	46.8	8.3
Plus: Consumption by Israelis abroad	6,313	6.0	10.1	-3.0	5.2	8.8	26.5
Public consumption (excluding net defense imports)	46,228	3.5	0.4	2.7	1.5	3.3	5.7
Civilian	31,410	3.9	4.2	3.4	4.6	5.2	4.1
Compensation of employees 4/	22,305	2.1	2.0	1.4	4.5	4.1	3.9
Consumption of fixed capital	2,570	4.8	3.5	3.1	3.3	3.2	3.2
Other current purchases (net)	6,535	11.4	13.4	10.7	5.3	9.4	5.0
Domestic defense	14,849	1.0	-1.9	0.8	-4.1	-0.6	-0.3
Compensation of employees 4/	7,393	8.3	-3.4	0.9	--	-2.7	-1.1
Other current purchases (net)	7,456	-5.5	-0.5	0.8	-8.1	1.7	0.5
Defense imports	7,214	17.4	-42.9	16.9	24.4	-24.6	36.7
Less: Sales	32	16.7	-11.9	2.7	-12.3	-33.3	-26.3
Public consumption (including defense imports)	53,441	-1.4	-5.8	4.0	4.2	-0.7	6.3

Sources: Central Bureau of Statistics, Monthly Bulletin of Statistics; and data provided by the Bank of Israel.

1/ Including clothing, footwear, personal effects, fuel and electricity, and other goods.
2/ Household equipment, furniture, and personal transport equipment.
3/ Including residential services and expenditures of private nonprofit institutions serving households.
4/ Including indirect taxes on salaries and imputations for government commitments to pay retirement pensions.

Table A4. Israel: Gross Private Income and Savings, 1989-93 1/

	1989	1990	1991	1992	1993
			(In millions of new sheqalim; at current prices)		
Gross national product at market prices	83,450	102,683	133,322	158,122	183,105
Plus: Subsidies on domestic production	1,470	1,741	2,459	3,702	3,627
Subsidies on government loans	568	569	578	517	405
Less: Indirect taxes on domestic production	11,417	14,671	19,741	24,281	26,695
Gross national product at factor cost	74,071	90,322	116,618	138,060	160,442
Less: Public sector's consumption of fixed capital	1,368	1,645	1,829	2,300	2,570
Public sector income from property and entrepreneurship 2/	1,203	2,100	2,366	3,047	3,886
Plus: Private transfers from abroad	3,398	3,815	4,682	6,231	7,670
Net transfer payments 2/	13,075	16,801	21,025	23,872	27,649
Private income	87,973	107,193	138,130	162,816	189,305
Less: Direct taxes 3/	16,575	19,430	23,289	28,207	34,104
Of which: Other property taxes	472	565	695	874	1,061
Gross private disposable income from all sources	71,398	87,763	114,841	134,609	155,201
Private consumption	53,234	65,051	82,177	98,513	116,952
Private savings	18,165	22,710	32,665	36,094	38,249
			(Percent of gross private disposable income)		
Private consumption	74.6	74.1	71.5	73.2	75.4
Private savings	25.4	25.9	28.4	26.8	24.6

Sources: Central Bureau of Statistics, Monthly Bulletin of Statistics; and data provided by the Bank of Israel.

1/ Excludes from incomes the subsidy component of government loans to the business sector is excluded from incomes.
2/ The interest on the domestic public debt is calculated in nominal terms. Includes also local authorities, national institutions, and nonprofit institutions financed mainly by the Government.
3/ Direct taxes on income and national insurance contributions.

Table A5. Israel: Labor Market Indicators, 1977-93 1/

	Average 1993	Average 1977-80	Average 1981-85	Average 1986-88	1988	1989	1990	1991	1992	1993
	(In thousands)	(Percentage change)								
Israeli population of working age	3,682.1	2.3	2.0	1.9	2.0	2.0	3.9	7.1	4.3	3.0
Israeli civilian labor force	1,946.1	3.0	2.2	2.4	3.9	3.2	2.9	7.3	4.9	4.8
Total Israelis employed	1,751.1	2.7	1.7	2.5	3.5	0.5	2.1	6.1	4.2	6.1
Public services	500.2	4.5	2.0	1.4	4.2	1.9	2.3	6.6	3.2	3.5
Business sector	1,250.9	1.9	1.7	2.9	3.2	--	2.0	5.9	4.7	7.2
Workers from Occupied Territories 2/	79.6	6.1	3.0	9.3	0.4	-4.1	2.7	-9.2	18.1	-31.1
Total employed	1,830.7	2.7	1.9	2.7	3.3	0.2	2.2	5.1	5.0	3.7
Memorandum items: 3/										
Participation rate	52.9	49.4	50.0	50.8	51.4	52.0	51.5	51.7	52.0	52.9
Unemployment rate	10.0	3.8	5.4	6.5	6.4	8.9	9.6	10.6	11.2	10.0

Sources: Bank of Israel, Annual Reports; Central Bureau of Statistics, Monthly Bulletin of Statistics; and data provided by the Bank of Israel.

1/ Beginning in 1985, the data are based on the 1983 census and correspond to the population aged 15 and over. Prior to 1985, the data correspond to the population aged 14 and over.
2/ Rate of change for 1988 and 1989 reflects hours actually worked and not number of workers from the territories, which declined only slightly.
3/ For Israeli population.

Table A6. Israel: Business Sector Employment and Labor Input by Industry, 1988-93 1/

	Employed Persons (in thousands)							
	Absolute Figures		Annual Percentage Change					
	1992	1993	1988	1989	1990	1991	1992	1993
Business sector	1,279.5	1,328.1	3.0	-0.4	2.1	4.7	5.8	3.8
Construction	193.5	175.1	8.9	-0.2	9.6	16.6	18.6	-9.5
Industry	355.7	375.9	-2.8	-3.2	1.8	4.1	2.4	5.7
Agriculture	68.2	70.8	-5.0	-1.9	-9.2	-9.6	1.5	3.9
Transport	104.1	106.1	3.5	-1.8	-0.6	4.4	7.8	1.9
Trade, personal services, business services 2/	466.2	504.3	12.3	3.3	2.6	5.1	5.1	8.2
Financial services	63.5	68.7	3.2	-3.2	-0.2	0.2	1.3	8.1
Public utilities	14.5	17.5	6.6	-0.7	15.3	1.2	-13.7	20.7
	Labor Input (in millions of man-hours)							
	Absolute Figures		Annual Percentage Change					
	1992	1993	1988	1989	1990	1991	1992	1993
Business sector	50.1	51.9	0.3	1.4	2.3	4.7	8.7	3.4
Construction	7.8	6.9	-4.6	5.1	11.8	17.1	21.6	-11.7
Industry	14.4	15.4	-4.3	-0.5	0.9	4.6	6.0	6.8
Agriculture	2.6	2.7	-8.4	-1.0	-10.5	-10.6	1.6	5.6
Transport	4.2	4.3	1.4	-2.3	2.7	2.9	8.3	4.2
Trade, personal services, business services 2/	17.9	19.0	14.8	5.1	1.9	3.6	8.6	6.4
Financial services	2.4	2.6	2.9	-1.4	0.4	0.2	4.0	7.6
Public utilities	0.6	0.7	14.5	-1.4	15.0	-1.8	-10.6	16.8

Source: Bank of Israel.

1/ Employment figures are annual averages; labor input figures are weekly averages.
2/ Includes other employees from the administered areas except for those employed in public services.

Table A7. Israel: Real Wages, Labor Costs, and Productivity, 1987-93

(Percentage change)

	1987	1988	1989	1990	1991	1992	1993 1/
Real wages per employee post 2/							
Total economy	7.9	6.0	-1.3	-1.0	-3.0	1.3	0.2
Business sector							
Real consumption wages	7.9	4.7	-1.7	-1.6	-5.0	1.7	-0.1
Real production wages	9.0	1.4	0.4	4.8	-6.1	...	...
Public sector	7.1	9.8	0.3	0.2	1.6	-0.4	1.3
Labor costs and productivity in the business sector							
Real compensation 3/	9.0	1.9	-1.1	3.2	-3.0	-0.6	2.3
Labor productivity 4/	4.8	1.9	-0.8	5.8	3.1	-0.8	0.3
Real unit labor costs 5/	4.0	--	-0.3	-2.5	-5.9	0.2	2.0

Sources: Bank of Israel, Annual Reports; Institute for Research on Output and Productivity; and data provided by the Bank of Israel.

1/ Preliminary estimates.
2/ Real wages in the public sector and real consumption wages in the business sector are deflated by the consumer price index; real production wages are deflated by the implicit price index of business sector net domestic product at factor cost.
3/ Measured on an hourly basis; deflated by the implicit price index of business sector net domestic product at factor cost.
4/ Business sector net domestic product per man-hour estimated from the expenditure side.
5/ The ratio of real labor cost per man-hour to labor productivity.

Table A8. Israel: Real Wages, 1980-93 1/

(Average 1982 = 100)

		Public Services	Business Sector	Total
1980		95.0	89.1	90.9
1981		105.0	98.3	100.3
1982		100.0	100.0	100.0
1983		109.4	104.4	106.1
1984		111.1	103.3	105.7
1985		95.3	96.6	96.2
1986		99.2	105.4	103.7
1987		106.2	113.7	111.9
1988		116.6	119.1	118.6
1989		116.9	117.1	117.1
1990		117.2	115.2	115.9
1991		119.1	109.5	112.4
1992		118.6	111.4	113.8
1993 2/		120.1	111.3	114.0
1991:	I	115.9	108.6	110.7
	II	125.7	110.6	115.1
	III	121.5	108.3	112.4
	IV	112.9	110.2	111.3
1992:	I	111.9	108.1	109.3
	II	122.0	110.7	114.1
	III	125.0	112.4	116.4
	IV	115.4	114.4	115.1
1993:	I	113.5	110.2	111.3
	II	124.4	110.4	114.6
	III	124.1	112.0	116.0
	IV	118.4	112.6	114.6

Source: Data provided by the Bank of Israel.

1/ Average monthly wage per employee post at constant prices: Central Bureau of Statistics data based on employers' returns to the National Insurance Institute, deflated by consumer price index.

2/ Preliminary estimates.

Table A9. Israel: Consumer Price Index by Economic Sector, 1991-93

	Weight in Index	Percentage Change Annual Average 1991	Percentage Change During Year 1991	Percentage Change Annual Average 1992	Percentage Change During Year 1992	Percentage Change Annual Average 1993	Percentage Change During Year 1993
General index	1,000.0	19.0	18.0	11.9	9.4	10.9	11.2
General index excluding agricultural products	933.5	19.2	18.2	11.6	9.1	11.5	11.1
Agricultural products	66.5	15.5	14.5	19.1	16.0	1.4	-1.6
Fruits, vegetables and field crops	58.5	12.6	15.1	18.1	14.9	0.3	-1.7
Fish and animal products	8.0	30.3	11.6	23.2	21.0	6.5	-1.4
Industrial products	430.0	13.6	13.2	9.6	7.2	6.5	6.5
Food, beverages, and toabacco	149.2	14.6	13.6	11.3	8.3	6.5	6.6
Wood and wood products	26.1	12.5	15.5	8.2	4.8	7.3	7.2
Clothing and textile products	66.6	7.8	11.4	7.9	6.0	6.1	3.9
Footwear, leather products, rubber, and plastic	20.4	11.8	15.7	10.7	7.1	5.5	4.5
Chemical and fuel products	41.8	15.8	11.7	7.7	6.4	5.3	2.4
Metals, machinery, transport, and electronic equipment	86.3	14.7	12.7	8.4	6.9	7.1	6.1
Miscellaneous	39.0	13.7	13.8	9.3	7.8	8.0	7.3
Building and housing services	168.1	30.7	27.4	11.0	5.4	18.5	22.5
Electricity and water	24.0	22.8	13.8	11.1	10.5	7.7	5.7
Transportation and communications	63.4	22.1	24.7	10.1	9.2	11.6	10.9
Services	248.0	17.2	16.9	15.2	14.6	12.3	11.0
Municipal taxes and insurance	54.9	18.1	17.9	17.0	14.6	12.9	14.0
Public sector services	82.5	19.6	19.3	18.5	19.3	13.8	10.0
Education	35.9	19.8	17.9	15.0	15.3	14.5	13.7
Health	46.6	19.4	20.4	21.2	22.5	13.3	7.3
Personal services	62.5	13.4	12.5	11.0	8.8	8.6	8.1
Entertainment	16.6	14.9	15.5	15.1	12.3	13.8	13.9
Other	45.9	12.8	11.5	9.5	7.5	6.5	5.9
Hotels, guest accommodation	43.3	15.1	15.4	11.7	13.4	13.0	12.1
Business services	4.8	27.6	28.8	15.4	7.8	14.1	16.8

Source: Data provided by the Bank of Israel.

Table A10. Israel: Selected Price Indexes, 1989-93

(Percent increase during the period, at annual rates)

	Weights	1989	1990	1991	1992	1993	1993 I	1993 II	1993 III	1993 IV
Consumer price index										
General index	100	21	18	18	9	11	16	8	9	13
Controlled prices 1/	34	24	22	18	13	9	14	4	10	8
Uncontrolled prices 2/	66	19	16	18	8	11	17	9	8	13
Tradables 3/	58	14	12	14	9	6	1	10	4	11
Nontradables 3/	42	26	22	20	7	16	32	11	8	15
Of which: Housing	16	35	32	28	5	24	53	13	8	25
Wholesale price index of industrial output		20	13	15	9	7	10	6	4	8
Official exchange rate 4/										
Against the U.S. dollar		22	4	14	17	10	14	-3	13	17
Against the foreign currency basket 5/		20	11	12	15	8	8	--	16	9

Sources: Central Bureau of Statistics, Monthly Bulletin of Statistics; IFS; and data provided by the Bank of Israel.

1/ The index of controlled prices comprises the following items: flour, eggs, frozen meat and poultry, edible oils and margarine, milk and milk products, property tax, municipal rates, electricity, water and gas for household use, school fees (kindergarten, elementary, and secondary), cigarettes and other tobacco products, public urban and interurban transport, mail and telephone, and gasoline, oils, and licenses for private cars. The weight of these items in the consumer price index is about 18.5 percent.

2/ The index of uncontrolled prices comprises items not listed in the preceding footnote.

3/ Excluding fruit, vegetables, and controlled prices.

4/ Change during the period, quarterly changes are at actual rates.

5/ A new five-currency basket was introduced in August 1986: U.S. dollar, deutsche mark, pound sterling, French franc, and Japanese yen.

Table A11. Israel: Bank of Israel Accounts, 1988-93

(In millions of new sheqalim, end of period)

	1990	1991	1992	1993			
				I	II	III	Nov.
Net foreign assets	12,876	14,313	13,400	15,122	13,664	15,586	19,540
Assets	12,935	14,379	14,185	15,912	14,470	16,419	20,388
Liabilities	59	66	785	790	806	833	848
Net domestic assets	5,939	6,522	8,906	10,675	12,206	12,480	10,930
Net claims on government	4,192	1,902	-1,275	-5,696	-2,456	-5,088	-6,986
Gross claims	10,300	10,285	10,419	10,513	10,642	10,561	10,562
Long-term debt	(8,968)	(8,809)	(8,644)	(8,644)	(8,645)	(8,647)	(8,651)
Government securities	(1,332)	(1,476)	(1,775)	(1,869)	(1,997)	(1,914)	(1,911)
Government deposits	6,108	8,383	11,694	16,209	13,098	15,649	17,548
Claims on deposit Money banks	3,066	5,475	11,053	17,791	16,376	19,091	19,213
In NIS	2,562	5,175	10,613	17,345	16,002	18,715	18,837
In foreign currency	504	300	440	446	374	376	376
Other items, net	-1,319	-855	-872	-1,420	-1,714	-1,523	-1,297
Reserve money	18,815	20,488	21,797	25,278	25,350	27,528	29,925
Currency in circulation	3,271	3,784	4,793	5,004	5,016	5,491	5,504
Deposits at Bank of Israel	15,472	16,624	17,004	20,274	20,334	22,037	24,421
In NIS	(1,030)	(1,260)	(1,111)	(2,342)	(2,202)	(3,998)	(3,522)
In foreign currency	(14,442)	(15,364)	(15,893)	(17,932)	(18,132)	(18,039)	(20,899)
Private sector demand deposits	72	80	104	110	104	107	108

Sources: IMF Data Fund; and Bank of Israel.

Table A12. Israel: Monetary Survey, 1989-93
(In millions of new sheqalim; at end of period)

	1989	1990	1991	1992 1/	1993			
					I	II	III	IV
Net foreign assets	5,253	7,329	8,415	9,505	9,470	7,810	10,891	12,339
Bank of Israel	10,399	12,874	14,314	13,400	15,122	13,663	15,586	18,214
DMBs	-5,146	-5,546	-5,898	-3,895	-5,652	-5,853	-4,695	-5,875
Net domestic assets	90,376	103,104	121,894	138,125	140,491	146,512	149,163	160,078
Domestic credit	97,590	112,423	133,781	145,253	147,648	154,298	156,868	168,622
Claims on:								
Government, net	42,838	45,861	50,797	52,117	48,196	50,702	49,757	47,935
Total gross claims	56,946	60,114	67,121	72,513	74,197	75,012	76,589	75,573
Bank of Israel	10,087	10,300	10,285	10,419	10,513	10,642	10,561	10,338
DMB claims	46,860	49,814	56,836	62,094	63,684	64,370	66,027	65,235
Government bonds	7,958	9,006	13,081	16,976	18,204	19,207	21,262	21,758
From bank resources	13,837	13,524	13,790	14,744	14,724	14,507	16,617	15,654
Foreign currency credit	1,644	1,473	1,943	2,883	2,813	2,733	2,827	2,818
From earmarked deposits	23,420	25,910	28,022	27,491	27,943	27,922	25,322	25,005
Less: Government deposits	14,108	14,253	16,324	20,396	26,000	24,310	26,832	27,638
Bank of Israel	7,503	6,108	4,175	5,249	9,442	6,144	8,322	7,945
DMBs	6,606	8,145	12,149	15,147	16,558	18,165	18,510	19,692
Mortgage banks	5,289	5,605	7,515	8,627	9,224	9,559	9,687	10,259
Private sector	49,464	60,957	75,468	84,509	90,227	94,037	97,424	110,427
Nondirected sheqalim	28,032	36,550	47,351	55,633	61,036	64,740	68,204	83,781
Nondirected foreign currency	3,266	8,259	10,082	12,447	12,355	12,471	12,601	12,617
Directed sheqalim	4	1	0	0	0	0	0	0
Directed foreign currency	3,566	417	300	441	445	405	425	403
From earmarked deposits	13,564	14,495	16,255	15,000	15,386	15,341	15,120	12,564
Securities	1,032	1,234	1,481	987	1,005	1,079	1,073	1,062
Other items, net	-7,214	9,318	-11,887	-7,128	-7,156	-7,787	-7,706	-8,544
Monetary liabilities	62,029	74,070	87,239	110,105	111,203	115,512	124,209	136,708
M1	5,304	6,951	7,908	10,432	10,109	10,653	12,118	13,364
Quasi-money 2/	56,725	67,119	79,331	99,673	101,094	104,858	112,091	123,345
Time and saving	52,064	60,486	71,326	89,152	91,392	94,444	100,489	106,589
Time deposits	5,346	8,049	9,934	11,532	11,828	13,949	15,110	17,489
Saving schemes	24,997	28,435	34,101	36,888	37,859	39,116	40,292	42,904
Long-term linked deposits	5,408	5,249	4,785	10,926	10,922	11,399	13,924	13,616
Foreign currency deposits	16,234	18,744	22,506	29,805	30,783	29,979	31,162	32,580
Mortgage banks deposits	79	8	1	0	0	0	0	0
CDs	4,569	6,500	7,842	10,521	9,702	10,414	11,602	16,755
Earmarked deposits	32,445	35,086	37,416	30,157	30,594	30,246	27,320	26,746

Source: Bank of Israel Research Department.
1/ From December 1992 New Report.
2/ Quasi-Money consists of time and savings deposits, CDs and other deposits.

Table A13. Israel: Financial Assets of the Public, 1989-93 1/

	1989	1990	1991	1992	1993	1993 I	1993 II	1993 III	1993 IV
	(In millions of new sheqalim; end of period)								
Broad monetary assets 2/	63,374	75,991	90,810	112,348	139,392	114,132	118,333	126,503	139,389
Liquid assets (M3)	25,396	33,735	41,872	52,638	69,944	53,048	55,616	59,346	69,944
M2	16,336	23,549	29,409	35,523	50,350	34,631	37,896	41,184	50,350
M2*	15,310	21,813	25,846	32,455	47,791	31,736	35,108	38,959	47,791
M1	5,304	6,951	7,908	10,390	13,364	10,109	10,653	12,118	13,364
Time deposits and negotiable CDs	10,006	14,862	17,938	22,065	34,427	21,627	24,455	26,841	34,427
Treasury bills	1,026	1,736	3,563	3,068	2,559	2,895	2,788	2,225	2,559
Resident foreign currency deposits	9,060	10,186	12,463	17,115	19,594	18,417	17,720	18,162	19,594
Medium-term assets	37,978	42,256	48,938	59,710	69,448	61,084	62,717	67,157	69,445
Restitution deposits	7,153	8,572	10,052	12,103	12,989	12,366	12,259	13,000	12,986
Saving schemes 3/	25,417	28,435	34,101	36,876	42,843	37,796	39,059	40,233	42,843
Long-term linked deposits	5,408	5,249	4,785	10,731	13,616	10,922	11,399	13,924	13,616
Tradable linked government bonds 4/	28,551	33,253	44,402	58,176	65,319	58,938	58,475	62,144	65,319
Total assets in banks and government bonds	91,925	109,244	135,212	170,524	204,711	173,070	176,808	188,647	204,708
Stocks	13,704	18,931	32,564	81,907	151,607	90,216	100,554	125,684	151,607
Total Financial Assets	105,629	128,175	167,776	252,431	356,318	263,286	277,362	314,331	356,315
	(In percent of total financial assets)								
Broad monetary assets 2/	60.0	59.3	54.1	44.5	39.1	43.3	42.7	40.2	39.1
Liquid assets (M3)	24.0	26.3	25.0	20.9	19.6	20.1	20.1	18.9	19.6
M2	15.5	18.4	17.5	14.1	14.1	13.2	13.7	13.1	14.1
M2*	14.5	17.0	15.4	12.9	13.4	12.1	12.7	12.4	13.4
M1	5.0	5.4	4.7	4.1	3.8	3.8	3.8	3.9	3.8
Time deposits and negotiable CDs	9.5	11.6	10.7	8.7	9.7	8.2	8.8	8.5	9.7
Treasury bills	1.0	1.4	2.1	1.2	0.7	1.1	1.0	0.7	0.7
Resident foreign currency deposits	8.6	7.9	7.4	6.8	5.5	7.0	6.4	5.8	5.5
Medium-term assets	36.0	33.0	29.2	23.7	19.5	23.2	22.6	21.4	19.5
Restitution deposits	6.8	6.7	6.0	4.8	3.6	4.7	4.4	4.1	3.6
Saving schemes 3/	24.1	22.2	20.3	14.6	12.0	14.4	14.1	12.8	12.0
Long-term linked deposits	5.1	4.1	2.9	4.3	3.8	4.1	4.1	4.4	3.8
Tradable linked government bonds 4/	27.0	25.9	26.5	23.0	18.3	22.4	21.1	19.8	18.3
Total assets in banks and government bonds	87.0	85.2	80.6	67.6	57.5	65.7	63.7	60.0	57.5
Stocks	13.0	14.8	19.4	32.4	42.5	34.3	36.3	40.0	42.5
Total Financial Assets	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
	(Nominal percentage change)								
Broad monetary assets 2/	22.1	19.9	19.5	23.7	24.1				
Liquid assets (M3)	28.1	32.8	24.1	25.7	32.9				
M2	40.9	44.2	24.9	20.8	41.7				
M2*	37.1	42.5	18.5	25.6	47.3				
M1	45.1	31.0	13.8	31.4	28.6				
Time deposits and negotiable CDs	33.2	48.5	20.7	23.0	56.0				
Treasury bills	139.2	69.2	105.2	-13.9	-16.6				
Resident foreign currency deposits	10.0	12.4	22.4	37.3	14.5				
Medium-term assets	18.3	11.3	15.8	22.0	16.3				
Restitution deposits	12.8	19.8	17.3	20.4	7.3				
Saving schemes 3/	22.8	11.9	19.9	8.1	16.2				
Long-term linked deposits	7.0	-2.9	-8.8	124.3	26.9				
Tradable linked government bonds 4/	53.8	16.5	33.5	31.0	12.3				
Total assets in banks and government bonds	30.4	18.8	23.8	26.1	20.0				
Stocks	108.3	38.1	72.0	151.5	85.1				
Total Financial Assets	37.1	21.3	30.9	50.5	41.2				

Sources: Bank of Israel, Research Department. Recent Economic Developments; and data provided by Bank of Israel.

1/ The public consists of individuals and corporations excluding the Government, Bank of Israel, ordinary banking corporations, and banks abroad. It includes social and life insurance funds but does not include the assets of these funds held out of the ordinary banking system.

2/ Consists of liquid financial assets (M3) and medium-term assets as defined above.

3/ Since February 1984, bank shares that were converted into savings schemes are included under "Savings schemes" instead of "Bank deposits."

4/ Defined to exclude bond holdings of pension funds and insurance companies.

Table A14. Israel: Commercial Bank Credit to the Private Sector, 1990-93 1/

	1989	1990	1991	1992 2/	1993	1993 I	1993 II	1993 III	1993 IV
	(End of period, millions of NIS)								
Total	65,316.0	65,327.9	81,503.0	92,175.3	119,610.0	98,394.0	102,511.0	106,030.0	119,610.0
Short-term credit	37,167.0	32,763.4	40,373.1	49,969.3	67,560.0	52,796.1	55,500.4	57,301.3	67,560.0
(a) Nondirected	33,639.0	32,345.3	40,073.0	49,528.6	67,156.8	52,351.1	55,094.9	56,876.3	67,156.8
in NIS 3/	28,745.0	24,085.6	29,990.0	36,407.9	53,574.7	39,448.3	42,132.8	43,834.8	53,574.7
in foreign currency	4,894.0	8,259.7	10,083.0	13,120.7	13,582.1	12,902.8	12,962.1	13,041.5	13,582.1
Directed	3,528.0	418.1	300.1	440.7	403.2	445.0	405.5	425.0	403.2
(b) Unlinked NIS Credit	10,012.0	24,085.6	29,990.0	36,407.9	53,574.7	39,488.3	42,132.8	43,834.8	53,574.7
Indexed NIS Credit	8,422.0	13,916.3	19,273.2	22,178.0	39,415.1	30,121.4	31,549.9	33,517.9	39,415.1
Medium and long term credit	28,149.0	32,564.5	41,129.9	42,206.0	52,049.9	45,597.9	47,010.6	48,729.0	52,049.9
	(In percent of total)								
Short-term credit	56.9	50.2	49.5	54.2	56.5	53.7	54.1	54.0	56.5
(a) Nondirected	51.5	49.5	49.2	53.7	56.1	53.2	53.7	53.6	56.1
in NIS 3/	44.0	36.9	36.8	39.5	44.8	40.1	41.1	41.3	44.8
in foreign currency	7.5	12.6	12.4	14.2	11.4	13.1	12.6	12.3	11.4
Directed	5.4	0.6	0.4	0.5	0.3	0.5	0.4	0.4	0.3
(b) Unlinked NIS Credit	15.3	36.9	36.8	39.5	44.8	40.1	41.1	41.3	44.8
Indexed NIS Credit	12.9	21.3	23.6	24.1	33.0	30.6	30.8	31.6	33.0
Medium and long term credit	43.1	49.8	50.5	45.8	43.5	46.3	45.9	46.0	43.5
	(Nominal percentage change)								
Total	24.9	21.3	24.8	23.6	29.8				
Short-term credit	32.3	25.6	23.2	28.5	35.2				
(a) Nondirected	35.6	37.5	23.9	28.3	35.6				
in NIS 3/	34.1	32.2	24.5	31.6	47.2				
in foreign currency	45.7	68.8	22.1	18.5	3.5				
Directed	7.2	-88.1	-28.2	46.9	-8.5				
(b) Unlinked NIS Credit	26.6	28.6	24.5	31.6	47.2				
Indexed NIS Credit	50.7	39.0	38.5	76.3	77.7				
Medium and long term credit	16.3	15.7	26.3	18.9	23.3				

Source: Bank of Israel, Research Department.
1/ Commercial banks and their overseas offices. Includes credit to local authorities.
2/ Starting 1992, new reporting system.
3/ Includes indexation increments on NIS credit linked to the CPI.

Table A15. Israel: Interest Rates, 1988-93

		Lending Rates 1/				Deposit Rates 1/					
		Bank of Israel Auction Facility 2/	Discount Window Loan (Maximum Bracket) 3/	Marginal Overdraft	Total Bank Credit 4/	Interest on Commercial Banks' Reserve Requirements at Bank of Israel	CD's 5/	Two-Week Time Deposits 6/	Treasury Bill Yield to Maturity (Shortest Term 1 Month)	Government Bond Yield to Maturity Five Yrs.	Ten Yrs.
		(Nominal rates in percent per annum)									
1988	December	31.4	28.3	52.9	40.1	11.4	23.9	22.4	22.4	...	...
1989	December	15.0	15.4	36.8	27.4	6.1	12.2	13.3	16.7	...	...
1990	December	13.0	14.0	34.4	25.1	4.2	12.1	13.8	13.4	2.1	3.0
1991	December	16.1	17.8	40.2	30.3	2.2	15.4	16.5	18.5	2.8	3.2
1992	December	10 2	10.6	20.5	16.7	1.0	9.2	10.1	11.0	1.6	2.0
1993	December	9 7	10 0	18.5	14.6	1.0	9.0	9.4	10.3	2.2	2.5
1992	January	14.0	14.9	36.2	26.7	2.3	13.5	14.5	15.7	2.9	3.2
	February	12 2	12.6	31.6	23.8	1.6	11.7	13.0	13.9	2.7	3.2
	March	10.8	11.2	25.9	20.2	1.4	9.9	11.1	12.1	2.8	3.1
	April	11.1	11.2	25.1	19.4	1.9	10.0	11.0	12.2	2.8	3.1
	May	11.1	11.2	25.4	19.5	1.7	10.0	11.0	13.1	2.5	2.8
	June	10.8	11.2	25.1	19.3	1.4	10.1	10.8	12.1	2.1	2.4
	July	11.0	11.2	25.3	19.2	2.3	10.3	11.0	11.7	1.9	2.1
	August	11.0	11.1	25.3	19.1	1.7	10.0	11.0	11.3	2.1	2.5
	September	10.9	11.2	25.0	19.0	1.3	10.0	11.0	11.0	1.9	2.1
	October	11.0	11.3	25.1	18.8	1.9	10.0	10.8	11.0	2.1	2.2
	November	10.2	10 6	21.4	17.4	1.1	9.0	10.2	11.0	1.9	2.1
	December	10.2	10.6	20.5	16.7	1.0	9.2	10.1	11.0	1.6	2.0
1993	January	10 8	11.4	21.3	17.5	1.2	10.3	11.0	12.5	1.6	1.9
	February	12.0	12.4	21.3	17.5	1.2	10.3	11.0	12.5	2.1	2.3
	March	11.9	12.5	21.9	17.9	1.4	10.5	11.3	12.2	2.5	2.5
	April	11 9	12.6	21.8	17.7	1.6	10.6	11.3	12.0	3.0	3.0
	May	12.2	12.9	12.2	17.7	1.0	11.0	11.6	12.8	3.3	3.4
	June	12 0	12.4	21.7	17.6	1.5	11.1	11.6	12.7	3.4	3.4
	July	11.1	11.4	20.7	16.7	1.3	10.2	11.0	10.4	3.4	3.5
	August	9 6	9.9	19.0	15.6	1.0	9.4	9.7	10.0	3.4	3.5
	September	9 0	9.7	18.4	14.9	0.9	8.1	9.1	10.7	3.0	3.1
	October	9.1	9.8	18.3	14.7	0.3	8.1	9.0	10.2	2.9	3.1
	November	9.4	10.4	18.5	14.7	0.4	8.2	9.0	10.3	2.5	2.8
	December	9.7	10.0	18.5	14.6	1.0	9.0	9.4	10.3	2.2	2.5

Source: Information provided by the Bank of Israel

1/ All interest rates converted to monthly terms at compound interest.
2/ In October 1987, the Bank of Israel started using auctions on monetary loans The interest specified is the weighted average of these loans.
3/ Commercial banks' monetary loans from the Bank of Israel (maximum bracket)
4/ Weighted average of rates on mostly short-term sheqel, including directed and nondirected credits.
5/ Deposits of NIS 10,000 and over From September 1988 it represents the weighted average interest for all deposits.
7/ Banking system mean interest and exchange rate differentials on 12-month deposits of $50,000 and over (see also footnote 5).
8/ Annual average.

Table A16. Israel: Real Actual Interest Rates on Various Types of Credit and the Public's Assets, 1989-93

(Annual rates in percent, before tax)

	1991	1992	1993	1992 I	1992 II	1992 III	1992 IV	1993 I	1993 II	1993 III	1993 IV
Short-term bank credit											
to the private sector 1/	6.3	10.0	4.1	13.3	7.3	8.8	11.2	6.0	0.1	11.1	1.6
Nondirected credit	6.5	10.2	4.2	13.5	7.5	9.0	11.5	6.2	0.2	11.2	1.8
In NIS	7.1	9.6	4.7	19.9	7.1	11.9	7.6	2.4	4.8	10.5	1.3
Overdraft facilities	10.0	11.5	6.2	23.0	8.7	13.7	9.3	3.8	6.4	12.1	2.7
Fixed-term credit	3.7	7.5	3.3	16.2	5.2	9.8	5.6	1.1	3.4	9.1	0.2
In foreign currency (Euro) 2/	4.3	2.9	2.2	11.5	9.2	9.0	7.7	6.3	6.3	8.1	6.4
Bank of Israel auction facility		1.8	-0.4	8.2	-0.8	4.1	0.7	-3.0	-0.2	5.1	-3.6
CDs	-4.3	0.9	-1.4	7.4	-1.7	3.3	-0.3	-4.1	-1.4	4.3	-4.4
Time deposits 3/	-3.5	1.8	-0.7	8.4	-0.8	4.1	0.6	-3.4	-0.8	5.0	-3.7
One-month Treasury bills	-2.6	2.6	0.1	9.6	0.4	4.9	0.9	-2.3	--	5.3	-2.7
Indexed 3-5 year government bonds	2.1	2.3	2.8	8.4	8.1	6.3	6.0	5.7	8.9	10.4	8.7
Interest rate spread 4/	15.2	10.7	7.7	14.6	10.7	10.2	9.7	8.2	8.0	7.5	7.5

Source: Data provided by the Bank of Israel.

1/ Includes directed credit and nondirected foreign currency linked credit.
2/ Euro in dollar terms for three months is the base for interest on dollar loans, excluding public companies.
3/ Average for all time deposits.
4/ Interest rate differential 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.

Table A17. Israel: Intermediation Structure (Asset Side) of Ordinary Banks, 1988-92 1/

	1988	1989	1990	1991	1992
			(Percent of total)		
Intermediation subject to control	65.3	65.2	58.2	53.3	48.2
With or on behalf of government or central bank	46.8	48.1	43.6	41.0	36.5
Controlled by government or central bank	18.5	17.1	14.7	12.3	11.7
Unrestricted intermediation	34.7	34.8	41.8	46.7	51.8
With the public 2/	20.4	22.3	26.3	31.5	34.1
Other unrestricted intermediation 3/	14.3	12.5	15.2	15.2	17.7
Total assets	100.0	100.0	100.0	100.0	100.0

Source: Annual Report, Supervisor of Banks, 1992.

1/ Israeli offices; end-of-period data at December 1991 prices; not including contingent accounts.
2/ Comprising credit to the public and acceptances.
3/ Comprising deposits with banks, and investments in securities and fixed assets.

Table A18. Israel: Reserve Requirements on Deposits 1/ and the Interest Rate Brackets, 1987-93

(In percent of deposits)

Date of Change	Demand Deposits			Time Deposits: 1 Week			Time Deposits: 2 Weeks			Time Deposits: 1 Month			Time Deposits: 2 Months			Time Deposits: 6 Months			CDs		
	Non-interest-Bearing	Interest-Bearing 2/	Total	Non-interest-Bearing	Interest-Bearing 2/	Total	Non-interest-Bearing	Interest-Bearing 2/	Total	Non-interest-Bearing	Interest-Bearing 2/	Total	Non-interest-Bearing	Interest-Bearing 2/	Total	Non-interest-Bearing	Interest-Bearing 2/	Total	Non-interest-Bearing	Interest-Bearing 2/	Total
1987																					
February 12	10	20	30	10	20	30	7	23	30	2	18	20	2	13	15	2	8	10	10	20	30
April 9	10	24	34	10	24	34	7	23	30	2	18	20	2	13	15	2	8	10	10	24	34
May 1	10	28	38	10	28	38	7	23	30	2	18	20	2	13	15	2	8	10	10	28	38
August 6	10	28	38	10	28	38	7	23	30	2	18	20	2	13	15	2	8	10	7	31	38
1988																					
February 25	8	25	33	4	16	20	4	16	20	4	16	20	4 3/	16 3/	20 3/	2 4/	8 4/	10 4/	8	25	33

Date of Change	Demand Deposits			1 Week - 3 Months			3 Months - 1 Year			1 Year Plus			CDs		
	Non-interest-Bearing	Interest-Bearing 2/	Total	Noninterest Bearing	Interest-Bearing	Total	Noninterest Bearing	Interest-Bearing	Total	Noninterest Bearing	Interest-Bearing	Total	Non-interest-Bearing	Interest-Bearing 2/	Total
1988															
September 29	8	18	26	4	12	16	2	7	9	1	6.5	7.5	8	18	26
1989															
February 23	8	13	21	4	8	12	2	7	9	1	6.5	7.5	8	13	21
August 31	8	7	15	4	6	10	2	5.5	7.5	1	4	5	8	7	15
1990															
April 26	8	2	10	4	3.5	7.5	2	3	5	1	2.5	3.5	8	2	10
1991															
November 28	8	--	8	4	2	6	2 5/	2 5/	4 5/	2 5/	2 5/	4 5/	8	--	8

Source: Information provided by the Bank of Israel.

1/ Net of permitted deficit.
2/ Currently a remuneration of 9.3 percent per year is paid on the interest-bearing portion of reserves held against deposits.
3/ As of February 25, 1988 the same reserve requirements also apply to deposits of up to three months.
4/ As of February 25, 1988 the same reserve requirements also apply to all deposits of longer than three-month maturity.
5/ As of November 28, 1991 the same reserve requirements apply to all deposits of longer than three months.

Table A19. Israel: Public Sector Injection and Sources of Nonrevaluation Increments to the M3 Base, 1990-93 1/

	1990	1991	1992	1993	1992 I	1992 II	1992 III	1992 IV	1993 I	1993 II	1993 III	1993 IV
	(In millions of new sheqalim; end of period balances)											
1. Total public sector domestic deficit	5,150	8,801	8,003	7,049	549	1,928	2,859	2,667	-17	2,267	2,745	2,054
2. Of which: Absorbed by net borrowing 2/	1,572	4,239	2,856	4,425	1,361	-52	138	1,409	2,169	199	1,780	277
3. Public injection 3/ to M3 base (1 - 2)	3,578	4,563	5,147	2,624	-812	1,980	2,721	1,258	-2,186	2,068	965	1,777
4. Bank of Israel injection	-2,754	304	2,884	3,800	650	743	-569	2,060	6,127	-1,824	1,877	-2,381
Monetary loans	-1,671	2,575	5,370	5,994	1,539	1,001	-201	3,032	6,728	-1,347	2,714	-2,102
Open market operations	277	-917	-109	996	-386	224	275	-223	177	272	41	507
Other factors 4/	-1,360	-1,354	-2,376	-3,190	-504	-482	-642	-749	-777	-750	-878	-785
5. Total liquidity injection (3 + 4)	824	4,867	8,031	6,424	-162	2,723	2,152	3,318	3,942	244	2,842	-604
6. Net foreign currency purchases by private sector	282	4,122	7,180	4,591	-131	1,825	2,169	3,317	2,499	373	574	1,146
7. Additions to M3 base (5 - 6)	541	745	851	1,833	-31	898	-17	1	1,443	-129	2,268	-1,750
Memorandum items:												
A. Government expenditure (excluding credit)	42,076	55,753	66,977	75,315	15,040	15,523	17,654	18,760	17,588	17,943	19,690	20,094
B. Government revenue	38,188	48,149	60,473	69,638	14,325	14,386	15,426	16,336	17,871	16,007	17,497	18,263
C. Deficit on real activity (A - B)	3,888	7,603	6,504	5,677	715	1,137	2,228	2,424	-283	1,936	2,193	1,831
D. Net credit by government	293	2,707	3,486	2,032	444	1,092	846	1,104	946	990	15	81
	(In percent of total injection)											
Absorbed by net borrowing	66.0	47.0	26.0	41.0	114.0	-2.0	6.0	30.0	35.0	45.0	39.0	-85.0
Net foreign currency purchases	12.0	45.0	66.0	42.0	-11.0	68.0	95.0	70.0	41.0	84.0	12.0	-350.0
Additions to M3 base	23.0	8.0	8.0	17.0	-3.0	34.0	-1.0	--	24.0	-29.0	49.0	535.0

Source: Data provided by the Bank of Israel.

1/ Excluding changes resulting from the revaluation of government bonds and PATAM deposits.
2/ Net government borrowing from the private sector less the early redemption of the State of Israel bonds.
3/ Includes the injection of the Jewish agency. Sale of tradable bonds is not considered as absorption. Includes interest payments on internal debt.
4/ Consists mostly of absorption/injection generated by various items in the Bank of Israel's balance sheet. (Such as interest paid on liquid assets in local and foreign currency).

Table A20. Israel: Factors Affecting M3 Base, 1989-92

	1990	1991	1992	1993 I	1993 II	1993 III	1993 IV
	(In millions of new sheqalim; end of period balances)						
1. Narrow money base 1/	4,301	5,044	5,904	7,347	7,219	9,489	7,740
2. Reserve requirements on PATAM deposits	3,918	3,308	3,236	2,367	2,393	2,639	2,694
3. M3 base (1 + 2)	8,219	8,352	9,140	9,713	9,612	12,128	10,434
	(As percent of M3 base)						
Narrow monetary base 1/	52.3	60.4	64.6	75.6	75.1	78.2	74.2
Reserve requirements on PATAM deposits	47.7	39.1	35.4	24.4	24.9	21.8	25.8
Ratio M3 base/M3	21.5	16.8	13.6	19.4	18.2	21.2	15.5
	(Real percentage change during period) 2/						
1. Narrow money base 1/	-2.7	-0.6	7.0	19.9	-3.6	28.8	-20.8
2. Reservice requirements on PATAM deposits	-18.7	-28.5	-10.5	-29.6	-0.8	8.0	-0.8
3. M3 base (1 + 2)	-11.0	-13.1	0.1	2.4	-2.9	23.6	-16.4
	(In millions of new sheqalim)						
Memorandum items (flows):							
Increase in M3 base	363.4	133.4	788.4	...	...	...	...
Of which:							
Revaluation increments on PATAM deposits' reserve requirements	467.3	159.8	814.1	...	...	...	...
Nonrevaluation increments	-104.0	-26.4	-25.7	...	...	...	...
Percentage of increase in M3 base due to:							
Revaluation increments	128.6	119.8	103.3	...	...	...	...
Nonrevaluation increments	-28.6	-19.8	-3.3	...	...	...	...

Source: Information provided by the Bank of Israel.

1/ Currency held by public and liquid assets of banking institutions.
2/ Nominal increase deflated by rise in consumer price index.

Table A21. Israel: Principal Stock Market Indicators, 1989-93

	1989	1990	1991	1992	1993
New issues 1/ (NIS millions) 2/	998	921	1,443	3,860	7,024
Of which:					
Shares					
Public sector corporations	28	194	240	554	1,933
Private firms	866	532	748	2,907	5,248
Market value (NIS millions) 2/	22,425	25,533	32,594	74,889	124,603
Arrangement bank shares (in percent)	15	12	--	--	--
Other shares (in percent)	85	88	100	100	100
Volume of stock exchange trade (NIS millions) 2/	10,722	14,274	22,251	33,679	73,675
Arrangement bank shares (in percent)	20	11	10	--	--
Other shares (in percent)	80	89	90	100	--
Annual turnover 3/					
Arrangement bank shares	0.49	0.50	0.73	--	0.79
Other shares	0.56	0.60	0.65	0.65	--
All shares	0.55	0.58	0.67	0.65	--
Real overall rate of return 4/ (in percent)					
Arrangement bank shares	5.9	-5.9	1.5	--	--
Other shares	64.7	-1.4	37.3	73.8	--
All shares	48.5	-2.3	31.8	74.4	27.1

Sources: Bank of Israel and Central Bureau of Statistics.

1/ Shares, convertible securities, and exercised options.

2/ At December 1991 prices (monthly inflation). Market value--end-of-year figures; volume of trade--on and off the floor.

3/ Ratio of monthly volume of trade (on and off the floor) to average monthly market value of the stock of shares.

4/ Deflated by end-of-month CPI.

Table A22. Israel: Principal Bond Market Indicators, 1989-93

	1989	1990	1991	1992	1993
Market value of listed bonds					
(NIS millions) 1/					
Government	48,876	48,627	58,479	68,125	67,216
Private 2/	8,688	9,312	9,489	9,866	9,453
Total	57,564	57,939	67,968	77,992	76,669
Of which: Held by					
(in percent)					
Public	22	22	26	25	25
Commercial banks	21	20	20	19	20
Social insurance funds	54	55	52	54	52
Bank of Israel	3	3	2	2	2
Volume of stock exchange trade					
(NIS millions) 1/					
Government	6,840	6,863	8,089	10,898	12,590
Private 2/	1,411	1,675	1,680	1,137	730
Total	8,251	8,538	9,769	12,035	13,319
Bank of Israel intervention 3/					
(in percent)	--	0.54	0.02	2.04	2.20
Issues of tradable bonds					
(NIS millions) 1/					
Government	3,768	1,196	8,951	3,014	1,237
Private 2/	1,333	1,423	337	298	317
Total	5,101	2,619	9,289	3,312	1,554
Annual turnover 4/					
Government	0.16	0.14	0.15	0.17	0.19
Private 2/	0.18	0.18	0.18	0.12	0.08
Total	0.16	0.15	0.15	0.17	0.18
Real overall rate of return					
(in percent)					
CPI-indexed bonds					
Government	14.1	-6.0	-1.2	5.3	-1.4
Private 2/	29.7	-2.7	6.6	8.1	-0.4
Total	17.4	-5.6	1.5	6.1	-1.5
Exchange-rate indexed bonds					
Government	9.6	-12.8	-1.4	19.4	-5.3
Private 2/	15.1	-6.9	0.6	26.0	-1.2
Total	12.7	-10.8	-1.7	20.4	

Sources: Bank of Israel and Central Bureau of Statistics.

1/ At December 1991 prices.

2/ Including public sector corporations.

3/ Ratio of the central bank's sales and purchases in the secondary market to total volume of stock exchange trade in bonds.

4/ Ratio of monthly volume of trade (on and off the floor) to market value of the stock of bonds. Calculated from monthly ratios.

Table A23. Israel: Summary Budgetary Transactions on Cash Basis, 1988/89–1994

	1988/89	1989/90	1990/91	1991 1/	Budget 1992	Actual 1992	Budget 1993	Estimate 1993	Budget 1994
					(In millions of new sheqalim)				
Total revenue	27,756	31,620	39,938	37,521	65,054	59,471	67,368	70,063	81,249
Total expenditure and net lending	35,250	41,431	51,927	51,658	87,064	78,958	85,096	86,800	100,167
Budget deficit (excl. grants)	−7,494	−9,811	−11,989	−14,137	−22,010	−19,487	−17,729	−16,737	−18,918
Foreign grants	5,020	5,816	6,595	6,351	7,673	9,063	8,475	8,236	9,210
Overall deficit 2/	−2,474	−3,995	−5,394	−7,786	−14,337	−10,424	−9,254	−8,501	−9,708
Foreign financing	−884	−209	450	825	6,107	1,959	1,500	965	1,800
Loans	10,677	3,389	2,962	3,789	9,471	5,145	5,576	5,203	7,610
Repayments	−11,561	−3,598	−2,512	−2,964	−3,364	−3,186	−4,076	−4,238	−5,810
Domestic financing	2,995	4,024	3,655	5,976	5,910	7,226	5,454	4,290	3,159
Net bond issue 3/	5,815	6,129	3,806	7,596	5,910	7,445	5,454	3,885	3,159
Gross bond issue	14,808	14,839	13,940	14,133	22,387	21,996	18,450	17,134	26,039
of which: to NII 4/	1,926	1,199	1,370	1,026	2,535	3,250	2,980	3,100	4,256
Repayments	−8,994	−8,711	−10,134	−6,537	−16,477	−14,551	−12,995	−13,249	−22,880
of which: to NII	−761	−907	−987	−292	−1,512	−1,388	−1,823	−1,785	−2,347
Bank share redemption 5/	−2,551	−857	--	−2,806	--	--	--	--	--
Net credit from banking system	−1,043	0	0	0	0	0	0	435	0
Gross borrowing	0	158	597	377	2,035	1,978	1,600	...	1,500
Repayments	−1,043	−158	−597	−377	−2,035	−1,978	−1,600	...	−1,500
Adjustment	775	−1,247	−151	1,186	--	−219	--	−30	--
Capital revenue (privatization)	363	180	1,289	984	2,320	1,202	2,300	3,246	4,600
					(In percent of GDP)				
Total revenue 6/	38.7	35.4	36.4	35.3	40.7	36.9	36.7	37.8	36.7
Total expenditure and net lending	49.2	46.4	47.3	48.6	54.4	49.0	46.4	46.8	45.3
Budget deficit (excl. grants)	−10.5	−11.0	−10.9	−13.3	−13.8	−12.1	−9.7	−9.0	−8.5
Foreign grants	7.0	6.5	6.0	6.0	4.8	5.6	4.6	4.4	4.2
Overall deficit 2/	−3.5	−4.5	−4.9	−7.3	−9.0	−6.5	−5.0	−4.6	−4.4
Foreign financing	−1.2	−0.2	0.4	0.8	3.8	1.2	0.8	0.5	0.8
Domestic financing	4.2	4.5	3.3	5.6	3.7	4.5	3.0	2.3	1.4
Net bond issue	8.1	6.9	3.5	7.1	3.7	4.6	3.0	2.1	1.4
Bank share redemption	−3.6	−1.0	--	−2.6	--	--	--	--	--
Net credit from banking system	−1.5	--	--	--	--	--	--	0.2	--
Adjustment	1.1	−1.4	−0.1	1.1	--	--	--	--	0.0
Capital revenue (privatization)	0.5	0.2	1.2	0.9	1.5	0.7	1.3	1.8	2.1

Source: Fund staff calculations from data provided by the Ministry of Finance.

1/ The 1991 budget only covered nine months, as the Government shifted the budgetary year from financial years to calendar years.
2/ The overall deficit as calculated by the staff differs from that of the authorities in that it does not include loans from and repayments to the National Insurance Institute as, respectively, revenue and expenditure. Instead the staff considers these to be financing items.
3/ Includes (net) borrowing through saving schemes.
4/ Under a special investment agreement, the assets of the National Insurance Institute are invested in CPI–linked government bonds.
5/ The last redemption under the Bank share arrangement took place in 1991.
6/ Government revenue is seasonally strong in the first quarter of a calendar year. Taking this into account, revenue in the 1991 would would have been about 1.5 percentage points of GDP higher.

Table A24. Israel: Central Government Revenues, 1988/89–1994

	1988/89	1989/90	1990/91	1991 1/	Budget 1992	Actual 1992	Budget 1993	Estimate 1993	Budget 1994
	(In millions of new sheqalim)								
Total revenue	27,756	31,620	39,938	37,521	65,054	59,471	67,368	70,063	81,249
Tax revenue	24,723	27,512	33,578	32,427	57,350	51,611	59,557	60,412	70,178
Tax on income, profits, gains	11,117	12,381	14,339	12,738	22,920	20,452	25,380	25,560	29,960
Individuals	8,034	9,562	11,322	10,028	16,600	15,875	18,280	19,520	22,840
Corporate	3,077	2,819	3,017	2,710	6,320	4,577	7,100	6,040	7,120
Other	6	0	0	0	0	0	0	0	0
Payroll and employers tax	1,390	1,612	2,094	2,141	3,500	3,165	2,960	3,180	3,800
Property taxes	647	760	1,073	997	1,630	1,338	1,690	1,960	2,280
Domestic tax on goods, services	8,172	9,413	12,131	12,544	22,616	20,050	22,067	22,007	25,788
Value-added tax 2/	6,374	7,535	9,874	10,128	18,326	16,101	17,847	17,937	21,088
Purchase tax	420	429	439	402	750	654	840	710	800
Excises and other	1,378	1,449	1,818	2,015	3,540	3,295	3,380	3,360	3,900
Import duties	837	640	795	842	1,665	1,403	1,840	1,355	970
Purchase tax on imports	2,109	2,093	2,421	2,507	3,860	4,118	4,500	5,020	5,800
Other taxes	451	613	727	658	1,160	1,085	1,120	1,330	1,580
Nontax revenue	3,033	4,109	6,360	5,094	7,703	7,860	7,811	9,651	11,071
Income from enterprises	701	791	1,914	1,673	1,920	2,546	2,331	2,656	2,822
Interest income	761	1,025	1,408	1,027	1,350	1,482	1,248	1,600	1,892
Other 3/	1,571	2,293	3,038	2,393	4,433	3,832	4,232	5,200	6,357
(balancing item)								195	
Memorandum item:									
Gross Domestic Product	71,671	89,325	109,710	106.328	160,000	161,279	183,481	185,285	221,264
CPI-Index (1987=100)	121.8	145.1	170.7	199.9	...	218.2	240.0	242.1	261.5

Source: Fund staff calculations from data provided by the Ministry of Finance.

1/ See footnote 1 to Table A23.
2/ Includes value-added tax on imported goods and services.
3/ Mainly earmarked income. As from 1992, this item also includes revenue from apartment sales.

Table A24 (continued). Central Government Revenues, 1988/89 – 1994

	1988/89	1989/90	1990/91	1991 1/	Budget 1992	Actual 1992	Budget 1993	Estimate 1993	Budget 1994
				(In percent of GDP)					
Total revenue	38.7	35.4	36.4	35.3	40.7	36.9	36.7	37.8	36.7
Tax revenue	34.5	30.8	30.6	30.5	35.8	32.0	32.5	32.6	31.7
Tax on income, profits, gains	15.5	13.9	13.1	12.0	14.3	12.7	13.8	13.8	13.5
Individuals	11.2	10.7	10.3	9.4	10.4	9.8	10.0	10.5	10.3
Corporate	4.3	3.2	2.7	2.5	4.0	2.8	3.9	3.3	3.2
Payroll and employers tax	1.9	1.8	1.9	2.0	2.2	2.0	1.6	1.7	1.7
Property taxes	0.9	0.9	1.0	0.9	1.0	0.8	0.9	1.1	1.0
Domestic tax on goods, services	11.4	10.5	11.1	11.8	14.1	12.4	12.0	11.9	11.7
Value–added tax	8.9	8.4	9.0	9.5	11.5	10.0	9.7	9.7	9.5
Purchase tax	*0.6*	*0.5*	*0.4*	*0.4*	*0.5*	*0.4*	*0.5*	*0.4*	*0.4*
Excises and other	1.9	1.6	1.7	1.9	2.2	2.0	1.8	1.8	1.8
Import duties	1.2	0.7	0.7	0.8	1.0	0.9	1.0	0.7	0.4
Purchase tax on imports	2.9	2.3	2.2	2.4	2.4	2.6	2.5	2.7	2.6
Other taxes	0.6	0.7	0.7	0.6	0.7	0.7	0.6	0.7	0.7
Nontax revenue	4.2	4.6	5.8	4.8	4.8	4.9	4.3	5.2	5.0
Income from enterprises	1.0	0.9	1.7	1.6	1.2	1.6	1.3	1.4	1.3
Interest income	1.1	1.1	1.3	1.0	0.8	0.9	0.7	0.9	0.9
Other	2.2	2.6	2.8	2.3	2.8	2.4	2.3	2.8	2.9
				(Real changes, in percent) 2/ 3/ 4/ 5/					
Total revenue	–3.5	–4.3	7.4	6.9	...	8.9	...	6.2	7.4
Tax revenue	–3.2	–6.6	3.7	9.9	...	9.4	...	5.5	7.6
Tax on income, profits, gains	0.3	–6.5	–1.6	1.1	...	10.3	...	12.6	8.5
Individuals	–1.3	–0.1	0.6	0.8	...	8.8	...	10.8	8.3
Corporate	4.8	–23.1	–9.0	2.2	...	16.0	...	18.9	9.1
Payroll and employers tax	6.0	–2.7	10.4	16.4	...	1.6	...	–9.4	10.6
Property taxes	–2.6	–1.4	19.9	5.8	...	–7.8	...	32.0	7.7
Domestic tax on goods, services	–1.4	–3.3	9.5	17.7	...	9.8	...	–1.1	8.5
Value added tax	–2.9	–0.7	11.4	16.8	...	9.2	...	0.4	8.9
Purchase tax	–9.4	–14.2	–13.0	4.2	...	11.8	...	–2.2	4.3
Excises and other	9.7	–11.7	6.6	26.1	...	12.4	...	–8.1	7.5
Import duties	–23.2	–35.7	5.5	20.6	...	14.5	...	–13.0	–33.7
Purchase tax on imports	–20.0	–16.7	–1.7	17.9	...	12.9	...	9.9	7.0
Other taxes	–1.1	14.1	0.8	3.1	...	13.3	...	10.5	10.0
Nontax revenue	–5.8	13.8	31.6	–8.8	...	6.0	...	10.7	6.2
Income from enterprises	14.9	–5.3	105.8	–0.5	...	4.6	...	–6.0	–1.6
Interest income	9.6	13.0	16.8	–16.9	...	–0.9	...	–2.7	9.5
Other	–18.1	22.6	12.6	–10.3	...	10.0	...	22.3	13.2

1 See footnote 1 to Table A23.
2/ Nominal changes deflated by CPI changes.
3/ The real increase in 1991 is calculated by comparing the annualized 1991 figures (not seasonally adjusted) to the 1990/91 figures.
4/ The real increase in 1992 is calculated by comparing the 1992 figures to the annualized 1991 figures.
5/ The real change in the 1994 budget is calculated by comparing the 1994 budget figures to the 1993 estimates using the CPI–inflation target of 8 percent as deflator.

Table A25. Israel: Budget Expenditure 1988/89–1994

	1988/89	1989/90	1990/91	1991 1/	Budget 1992	Actual 1993	Budget 1993	Estimate 1993	Budget 1994
					(In millions of new sheqalim)				
Current expenditure	32,936	39,123	47,658	43,961	72,591	69,347	74,470	78,048	91,600
Civilian expenditure	23,002	27,436	33,280	31,504	55,050	50,869	56,182	59,760	69,590
Domestic wages	3,113	2,790	4,975	4,504	7,021	6,950	7,724	...	9,996
Domestic purchases	1,920	2,328	3,084	3,579	4,956	5,049	5,378	...	6,913
Wages and purchases abroad	250	361	341	309	517	479	703	...	833
Transfer payments	7,925	10,576	11,664	11,330	23,780	21,968	24,678	27,153	31,517
Local authorities	1,182	1,467	1,856	1,919	2,771	2,791	2,970	...	4,161
National Insurance Inst.	3,789	4,357	4,410	4,490	8,965	8,139	9,051	9,680	12,023
Other transfers	2,954	4,752	5,398	4,921	12,044	11,038	12,657	...	15,333
Interest subsidies	560	535	593	475	533	534	441	445	406
Subsidies	2,397	2,345	2,745	2,061	4,119	3,476	3,448	...	3,583
Basic products and services	1,229	856	1,075	785	844	960	860	1,463	1,072
Export market development	845	1,054	946	605	835	675	483	...	0
Other subsidies	323	435	724	671	2,439	1,841	2,105	...	2,510
Interest payments 2/	6,837	8,501	9,879	9,247	14,125	12,414	13,811	13,683	16,342
Domestic	4,384	5,523	6,761	6,329	9,946	8,811	9,744	9,970	11,403
Abroad	2,453	2,978	3,117	2,918	4,179	3,603	4,066	3,713	4,939
Defense expenditure	9,934	11,688	14,377	12,456	17,541	18,478	18,288	18,288	22,010
wages	2,483	3,026	4,725	4,090	5,819	6,100	5,871	...	6,634
domestic purchases	3,527	4,011	4,456	3,431	5,269	5,550	5,265	...	7,351
purchases abroad	3,130	3,640	3,690	3,724	4,511	4,750	5,006	...	5,645
transfer payments	464	626	937	776	1,160	1,287	1,245	...	1,406
construction	216	290	383	318	480	500	534	...	587
other expenditure	114	95	187	118	302	290	367	...	387
Capital expenditure and net lending	2,314	2,308	4,269	7,697	10,350	9,611	7,737	8,752	5,498
Direct investment	650	1,087	1,744	3,886	7,318	7,332	5,080	6,066	4,973
of which: housing	251	345	1,081	3,353	5,064	5,311	2,457	2,427	1,345
net loans	524	136	1,093	2,057	3,031	2,277	2,657	2,686	514
loans	1,781	1,659	2,669	3,552	5,581	4,686	5,139	5,086	3,504
of which: housing	1,091	1,190	1,682	2,148	2,724	2,631	2,864	3,001	3,055
repayments	−1,257	−1,524	−1,576	−1,495	−2,550	−2,409	−2,482	−2,400	−2,990
Grants for investment 3/	991	1,073	1,397	1,755	--	2	--	--	--
Other	149	12	36	0	0	0	0	0	10
Unallocated expenditure	--	--	--	--	4,123	--	2,890	--	3,069
(of which: absorption reserve)					(1800)		(700)		(700)
Total expenditure	35,250	41,431	51,927	51,658	87,064	78,958	85,096	86,800	100,167

Source: Fund staff calculations from data provided by the Ministry of Finance.

1/ See footnote 1 to Table A23.
2/ Excludes interest payments to Bank of Israel.
3/ Starting in 1992, investment grants are classified as "other current transfers".

Table A25 (continued). Israel: Budget Expenditure 1988/89–1994

	1988/89	1989/90	1990/91	1991 1/	Budget 1992	Actual 1992	Budget 1993	Estimate 1993	Budget 1994
					(In percent of GDP)				
Current expenditure	46.0	43.8	43.4	41.3	45.4	43.0	40.6	42.1	41.4
Civilian expenditure	32.1	30.7	30.3	29.6	34.4	31.5	30.6	32.3	31.5
Domestic wages	4.3	3.1	4.5	4.2	4.4	4.3	4.2	0.0	4.5
Domestic purchases	2.7	2.6	2.8	3.4	3.1	3.1	2.9	0.0	3.1
Wages and purchases abroad	0.3	0.4	0.3	0.3	0.3	0.3	0.4	0.0	0.4
Transfer payments	11.1	11.8	10.6	10.7	14.9	13.6	13.4	14.7	14.2
Local authorities	1.6	1.6	1.7	1.8	1.7	1.7	1.6	0.0	1.9
National Insurance Inst.	5.3	4.9	4.0	4.2	5.6	5.0	4.9	5.2	5.4
Other transfers	4.1	5.3	4.9	4.6	7.5	6.8	6.9	0.0	6.9
Interest subsidies	0.8	0.6	0.5	0.4	0.3	0.3	0.2	0.2	0.2
Subsidies	3.3	2.6	2.5	1.9	2.6	2.2	1.9	0.0	1.6
Basic products and services	1.7	1.0	1.0	0.7	0.5	0.6	0.5	0.8	0.5
Export market development	1.2	1.2	0.9	0.6	0.5	0.4	0.3	0.0	0.0
Other subsidies	0.5	0.5	0.7	0.6	1.5	1.1	1.1	0.0	1.1
Interest payments	9.5	9.5	9.0	8.7	8.8	7.7	7.5	7.4	7.4
Domestic	6.1	6.2	6.2	6.0	6.2	5.5	5.3	5.4	5.2
Abroad	3.4	3.3	2.8	2.7	2.6	2.2	2.2	2.0	2.2
Defense expenditure	13.9	13.1	13.1	11.7	11.0	11.5	10.0	9.9	9.9
Capital expenditure and net lending	3.2	2.6	3.9	7.2	6.5	6.0	4.2	4.7	2.5
Direct investment	0.9	1.2	1.6	3.7	4.6	4.5	2.8	3.3	2.2
of which: housing	0.4	0.4	1.0	3.2	3.2	3.3	1.3	1.3	0.6
net loans	0.7	0.2	1.0	1.9	1.9	1.4	1.4	1.4	0.2
loans	2.5	1.9	2.4	3.3	3.5	2.9	2.8	2.7	1.6
of which: housing	1.5	1.3	1.5	2.0	1.7	1.6	1.6	1.6	1.4
repayments	-1.8	-1.7	-1.4	-1.4	-1.6	-1.5	-1.4	-1.3	-1.4
Grants for investment	1.4	1.2	1.3	1.7	--	--	--	--	--
Other	0.2	--	--	--	--	--	--	--	--
Unallocated expenditure	--	--	--	--	2.6	--	1.6	--	1.4
Total expenditure	49.2	46.4	47.3	48.6	54.4	49.0	46.4	46.8	45.3
					(Real changes, in percent) 2/ 3/ 4/ 5/				
Current expenditure	-0.4	-0.3	3.5	5.0	...	8.4	...	1.4	8.7
Civilian expenditure	3.2	0.2	3.1	7.8	...	10.9	...	5.9	7.8
Domestic wages	6.8	-24.7	51.6	3.0	...	6.0	...	...	...
Domestic purchases	15.9	1.8	12.6	32.1	...	-3.1	...	...	...
Wages and purchases abroad	-18.1	21.2	-19.8	3.2	...	6.6	...	...	...
Transfer payments	7.9	12.1	-6.3	10.6	...	33.2	...	11.4	7.5
Interest subsidies	-46.5	-19.8	-5.9	-8.8	...	-22.7	...	-24.9	-15.5
Subsidies	1.4	-17.8	-0.5	-14.6	...	15.9	...	...	...
Interest payments	2.8	4.4	-1.2	6.6	...	-7.8	...	-0.7	10.6
Domestic	16.9	5.8	4.1	6.6	...	-4.3	...	2.0	5.9
Abroad	-15.5	1.9	-11.0	6.6	...	-15.2	...	-7.1	23.2
Defense expenditure	-7.9	-1.2	4.6	-1.4	...	1.9	...	-10.8	11.4
Capital expenditure and net lending	1.1	-16.3	57.2	105.2	...	-14.2	...	-17.9	-41.8
Direct investment	0.1	40.5	36.4	153.6	...	29.7	...	-25.4	-24.1
of which: housing	-8.1	15.4	166.4	253.2	...	8.8	...	-58.8	-48.7
net loans	-19.9	-78.3	585.5	114.2	...	-23.9	...	6.3	-82.3
loans	18.7	-21.8	36.7	51.5	...	-9.3	...	-2.2	-36.2
of which: housing	2.3	-8.5	20.2	45.4	...	-15.9	...	2.8	-5.7
repayments	48.6	1.8	-12.1	8.0	...	10.7	...	-10.2	15.4
Grants for investment	1.3	-9.1	10.6	43.0	...	-99.9	...	-100.0	...
Other	2256.1	-93.2	152.9	-99.7	...	-100.0	...	...	...
Unallocated expenditure									
(of which: absorption reserve)									
Total expenditure	-0.3	-1.3	6.5	13.2	...	5.0	...	-0.9	6.9

1/ See footnote 1 to Table A23.
2/ Nominal changes deflated by CPI changes.
3/ The real increase in 1991 is calculated by comparing the annualized 1991 figures (not seasonally corrected) to the 1990/91 figures.
4/ The real increase in 1992 is calculated by comparing the 1992 figures to the annualized 1991 figures.
5/ The real change in the 1994 budget is calculated by comparing the 1994 budget figures to the 1993 estimates, using the CPI–inflation target of 8 percent as deflator.

Table A26. Israel: Budget Expenditure 1988/89–1994
Functional Classification

	1988/89	1989/90	1990/91	1991 1/	Budget 1992	Actual 1992	Budget 1993	Budget 1994
	(In millions of new sheqalim)							
General public service	2,772	3,350	4,127	3,314	5,455	5,179	6,089	7,299
General administration	2,007	2,455	3,016	2,274	3,778	3,592	4,294	5,069
Public order	765	894	1,111	1,039	1,677	1,587	1,796	2,230
Defence	9,934	11,688	14,377	12,456	17,684	18,618	18,434	22,197
Education	3,346	4,125	5,265	5,128	8,448	8,218	9,560	13,345
Universities	598	746	919	917	1,502	1,524	1,742	2,172
Health	1,327	1,642	2,172	1,889	2,949	3,336	3,392	4,212
Labor and welfare	4,517	5,322	5,680	5,724	10,968	10,036	11,235	14,760
Other social services	1,769	2,192	4,469	7,814	14,101	13,008	10,999	11,286
Housing			3,123	6,071	11,095	10,959	9,009	8,921
Direct absorption			904	1,305	2,201	1,351	1,168	1,431
Economic services	2,590	2,610	3,715	4,549	7,379	6,245	7,263	6,468
General	125	113	136	161	264	246	329	499
Agriculture	671	759	1,549	1,959	3,221	2,538	2,726	621
Manufacturing	556	597	819	778	1,933	1,473	1,655	2,157
Water and energy	785	526	528	950	682	604	658	739
Transport and communication	244	314	580	531	962	968	1,352	1,708
Other	209	301	104	171	318	417	543	743
Unallocable and other purposes	8,996	10,403	12,126	10,790	20,080	14,326	18,124	20,601
Interest	6,837	8,501	9,879	9,247	14,125	12,414	13,811	16,342
Interest and loan subsidy	561	538	597	477	542	536	446	408
Subsidy for basic products	1,241	985	1,163	876	1,263	1,254	1,201	1,504
Export market development	845	1,054	946	605	835	675	483	0
General transfers	769	849	1,118	1,080	1,609	1,856	1,623	2,203
Reserves					4,257	0	3,043	3,134
(repayment of loans)	–1,257	–1,524	–1,576	–1,495	–2,550	–2,409	–2,482	–2,990
Total expenditure and net lending	35,250	41,331	51,932	51,663	87,063	78,966	85,096	100,167
	(In percent of total expenditure)							
General public service	7.9	8.1	7.9	6.4	6.3	6.6	7.2	7.3
General administration	5.7	5.9	5.8	4.4	4.3	4.5	5.0	5.1
Public order	2.2	2.2	2.1	2.0	1.9	2.0	2.1	2.2
Defense	28.2	28.3	27.7	24.1	20.3	23.6	21.7	22.2
Education	9.5	10.0	10.1	9.9	9.7	10.4	11.2	13.3
Universities	1.7	1.8	1.8	1.8	1.7	1.9	2.0	2.2
Health	3.8	4.0	4.2	3.7	3.4	4.2	4.0	4.2
Labor and welfare	12.8	12.9	10.9	11.1	12.6	12.7	13.2	14.7
Other social services	5.0	5.3	8.6	15.1	16.2	16.5	12.9	11.3
Housing	--	--	6.0	11.8	12.7	13.9	10.6	8.9
Direct absorption	--	--	1.7	2.5	2.5	1.7	1.4	1.4
Economic services	7.3	6.3	7.2	8.8	8.5	7.9	8.5	6.5
General	0.4	0.3	0.3	0.3	0.3	0.3	0.4	0.5
Agriculture	1.9	1.8	3.0	3.8	3.7	3.2	3.2	0.6
Manufacturing	1.6	1.4	1.6	1.5	2.2	1.9	1.9	2.2
Water and energy	2.2	1.3	1.0	1.8	0.8	0.8	0.8	0.7
Transport and communication	0.7	0.8	1.1	1.0	1.1	1.2	1.6	1.7
Other	0.6	0.7	0.2	0.3	0.4	0.5	0.6	0.7
Unallocable and other purposes	25.5	25.2	23.4	20.9	23.1	18.1	21.3	20.6
Interest	19.4	20.6	19.0	17.9	16.2	15.7	16.2	16.3
Interest and loan subsidy	1.6	1.3	1.1	0.9	0.6	0.7	0.5	0.4
Subsidy for basic products	3.5	2.4	2.2	1.7	1.5	1.6	1.4	1.5
Export market development	2.4	2.5	1.8	1.2	1.0	0.9	0.6	0.0
General transfers	2.2	2.1	2.2	2.1	1.8	2.4	1.9	2.2
Purchasing bank shares	--	--	--	--	--	--	--	--
Reserves	--	--	--	--	4.9	0.0	3.6	3.1
(repayment of loans)	–3.6	–3.7	–3.0	–2.9	–2.9	–3.1	–2.9	–3.0
Total expenditure and net lending	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Fund staff calculations from data provided by the Ministry of Finance.

1/ See footnote 1 to Table A23.

Table A27. Israel: Central Government Expenditures and Domestic and Foreign Debt Service

	1988/89	1989/90	1990/91	1991 1/	Budget 1992	Actual 1992	Budget 1993	Estimate 1993	Budget 1994
	(In millions of new sheqalim)								
Total budget expenditure incl. debt rep. and net lend.	59,399	54,755	65,169	64,342	108,939	98,673	103,768	104,287	130,357
of which: current expenditure	32,936	39,123	47,658	43,961	72,591	69,347	74,470	78,048	91,600
Debt service payments	31,610	23,204	24,672	23,418	36,000	32,129	32,483	32,770	46,532
Interest	7,714	9,461	10,853	10,204	15,095	13,306	14,631	14,503	17,132
Amortization	23,897	13,743	13,819	13,214	20,905	18,822	17,852	18,267	29,400
Domestic	17,596	16,628	19,043	17,536	28,457	25,340	24,340	24,819	35,782
To the public	15,928	15,091	16,895	15,672	26,422	23,362	22,740	23,219	34,282
Interest	4,384	5,523	6,761	6,329	9,946	8,811	9,744	9,970	11,403
Amortization	11,545	9,568	10,134	9,343	16,477	14,551	12,995	13,249	22,880
Bank of Israel	1,668	1,537	2,148	1,864	2,035	1,978	1,600	1,600	1,500
Interest	877	960	975	957	970	893	820	820	790
Amortization	791	577	1,173	908	1,065	1,085	780	780	710
Foreign	14,014	6,576	5,629	5,882	7,543	6,789	8,143	7,951	10,749
Interest	2,453	2,978	3,117	2,918	4,179	3,603	4,066	3,713	4,939
Amortization	11,561	3,598	2,512	2,964	3,364	3,186	4,076	4,238	5,810
	(In percent of total budget expenditure)								
Debt service 2/	53.2	42.4	37.9	36.4	33.0	32.6	31.3	31.4	35.7
Interest	13.0	17.3	16.7	15.9	13.9	13.5	14.1	13.9	13.1
Amortization	40.2	25.1	21.2	20.5	19.2	19.1	17.2	17.5	22.6
Domestic	29.6	30.4	29.2	27.3	26.1	25.7	23.5	23.8	27.4
To public	26.8	27.6	25.9	24.4	24.3	23.7	21.9	22.3	26.3
To Bank of Israel	2.8	2.8	3.3	2.9	1.9	2.0	1.5	1.5	1.2
Foreign	23.6	12.0	8.6	9.1	6.9	6.9	7.8	7.6	8.2
	(In percent of GDP)								
Debt service 3/	41.8	24.3	20.5	20.3	21.2	18.7	16.8	16.8	20.4
Interest	9.5	9.5	9.0	8.7	8.8	7.7	7.5	7.4	7.4
To domestic public	6.1	6.2	6.2	6.0	6.2	5.5	5.3	5.4	5.2
Abroad	3.4	3.3	2.8	2.7	2.6	2.2	2.2	2.0	2.2
Amortization	32.2	14.7	11.5	11.6	12.4	11.0	9.3	9.4	13.0
To domestic public	16.1	10.7	9.2	8.8	10.3	9.0	7.1	7.2	10.3
Abroad	16.1	4.0	2.3	2.8	2.1	2.0	2.2	2.3	2.6
Memorandum item: Interest/current expenditure	23.4	24.2	22.8	23.2	20.8	19.2	19.6	18.6	18.7

Source: Fund staff calculations from data provided by the Ministry of Finance.

1/ See footnote 1 to Table A23.
2/ Includes debt service payments to Bank of Israel.
3/ Excluding debt service payments to Bank of Israel.

Table A28. Israel: Consolidated Central Government Debt, 1988/89-93

	1988/89	1989/90	1990/91	1991	1992	1993
			(In millions of new sheqalim)			
Total debt	119,930.3	139,387	165,199	190,499	222,990	252,800
Domestic	87,275.3	103,729	123,837	147,861	168,248	191,500
By holder:						
Other general government	153.9	161.0	152.0	199.0	310.0	...
Money authorities	8,985.2	8,975.0	8,975.0	8.809.0	8,644.0	...
Deposit money banks	9,618.3	12,480.0	12,050.0	12,135.0	11,595	...
Other domestic	68,517.9	82,113.0	102,660.0	126,718.0	147,699	...
Of which: nonfinancial private sector	41,872.1	52,846.0	70,406.0	92,006.0	112,774.0	...
By type of instrument:						
Long-term bonds	35,888.6	48,090.0	64,367.0	84,513.0	102,583.0	...
Long-term loans NEC	47,633.2	52,411.0	55,022.0	57,387.0	...	...
Short-term loans NEC	1,863.3	1,350.0	1,570.0	1,665.0	...	...
Short-term bonds	1,890.2	1,878.0	2,878.0	4,247.0	...	...
Foreign	32,655.0	35,658.0	41,362.0	42,638.0	54,732.0	61,300 1/
By holder:						
International institutions	--	--	--	--	--	...
Foreign governments	13,294.1	12,951.0	14,026.0	15,099.0	17,553.0	...
Other foreign	19,360.9	22,707.0	27,336.0	27,539.0	37,189.0	...
Long-term bonds	12,975.0	15,897.0	18,381.0	18,775.0	24,975.0	...
Long-term loans NEC	19,208.5	19,553.0	22,329.0	23,686.0	29,632.0	...
Short-term loans and advances	471.5	208.0	652.0	177.0	135.0	...
			(In percent of GDP)			
Memorandum items:						
Average debt stock	150.3	145.2	138.8	133.6	128.2	128.4
Domestic debt	108.9	106.9	103.7	102.0	98.0	97.1
Foreign debt	41.4	38.3	35.1	31.6	30.2	31.3
Deficit before grants	-10.5	-11.0	-10.9	-13.3	-12.1	-9.0
Deficit after grants	-3.5	-4.5	-4.9	-7.3	-6.5	-4.6

Sources: IMF, Government Finance Statistics; and staff estimates.

1/ Excludes the part of the borrowing under the U.S. loan guarantee program that was not channeled through the budget (1993: US$1.4 billion).

Table A29. Israel: Immigration-Related Expenditure, 1990/91-94 1/

(In percent of GNP)

	1990/91	1991	1992	Budget 1993	Actual 1993	Budget 1994
Total	1.1	5.2	6.5	5.8	...	5.1
Construction	0.3	2.5	3.2	1.6	...	0.8
Mortgages	0.4	0.9	1.4	1.8	...	1.9
Direct absorption	0.3	1.0	0.8	0.8	...	0.8
Other transfer payments	--	0.1	0.2	0.6	...	0.5
Social services	0.1	0.4	0.5	0.7	...	0.8
Infrastructure	--	0.1	0.4	0.4	...	0.3
Memorandum item:						
Number of immigrants	40,000	144,000	76,000	120,000	77,000	100,000
Public construction plan (housing starts)	3,000	46,000	18,500	--	4,500	1,000
Of which:						
Direct construction	--	10,000	3,000	--	450	1,000
Temporary housing units	--	8,000	12,000	--	--	--
Number of mortgages for immigrants	4,600	15,000	19,000	30,000	37,000	35,000

Sources: Data provided by the Ministry of Finance; and staff calculations.

1/ The budget's absorption reserve has been distributed over the various expenditure items.

Table A30. Israel: Government Subsidies for Basic Products and Services, 1987/88-94

(In millions of U.S. dollars) 1/

	1987/88	1988/89	1989/90	1990/91	1991	1992	Budget 1993	Actual 1993	Budget 1994
Total subsidies	568	460	618	567	372	404	468	396	371
Food products	222	221	113	90	2	--	--	--	--
Milk	91	97	29	30	--	--	--	--	--
Eggs	35	35	26	22	--	--	9	7	--
Frozen poultry	81	74	45	33	2	--	--	--	--
Bread	15	15	13	6	--	--	--	--	--
Services	303	204	467	407	307	305	347	348	344
Public transportation	267	168	430	337	271	202	206	266	234
Water	36	36	36	70	36	103	141	82	110
Raw materials and commodities	4	7	--	--	--	--	--	--	--
Agriculture	27	7	31	58	49	62	56	41	27
Other	12	21	7	12	14	37	56	--	--

Source: Ministry of Finance.

1/ At average annual exchange rates.

Table A31. Israel: The Currency Basket of the Israeli Sheqel, 1985-93

	Absolute Amounts of Currencies in Basket as of December 1992	Percentage Distribution of Currencies on the Basis of Market Rates on: 1986 Dec. 31	1987 Dec. 31	1988 Dec. 31	1989 Dec. 31	1990 Dec. 31	1991 Dec. 31	1992 Dec. 31	1993 Dec. 31
Deutsche mark	0.4177	0.2120	0.2368	0.2199	0.2310	0.2462	0.2441	0.2387	0.2258
French franc	0.3394	0.0520	0.0568	0.0523	0.0549	0.0588	0.0581	0.0569	0.0540
Japanese yen	7.7	0.0475	0.0568	0.0577	0.0503	0.0501	0.0547	0.0570	0.0646
Pound sterling	0.067	0.0975	0.1123	0.1136	0.1008	0.1140	0.1112	0.0938	0.0929
U.S. dollar	0.6	0.5910	0.5373	0.5564	0.5631	0.5309	0.5320	0.5537	0.5627

Sources: IMF, International Financial Statistics; and data provided by the Israeli authorities.

Table A32. Israel: Exchange Rate Developments, 1985-93

(Index number 1985 = 100; period averages)

	U.S.Dollar/ Sheqel	Pound Sterling/ Sheqel	Deutsche Mark/ Sheqel	Yen/ Sheqel	French Franc/ Sheqel	Currency Basket
1985	100.0	100.0	100.0	100.0	100.0	No Basket
1986	126.2	139.1	166.7	175.1	159.1	139.7
1987	135.3	166.6	215.3	218.0	196.4	156.9
1988	135.6	181.6	221.1	239.6	198.9	160.7
1989	162.6	200.0	291.5	274.0	222.4	186.5
1990	171.0	229.6	303.1	275.8	274.6	206.3
1991	193.3	256.3	333.1	334.3	298.9	231.6
1992	208.6	276.3	382.4	383.2	344.3	255.4
1993	240.1	271.1	414.9	503.6	369.8	286.5
1990						
I	166.9	207.9	281.9	262.4	253.7	196.7
II	172.1	216.6	292.9	257.5	265.9	203.1
III	173.7	243.2	311.4	278.4	283.5	211.3
IV	171.5	250.7	326.2	305.0	295.5	214.4
1991						
I	175.3	251.7	327.6	304.8	294.0	217.2
II	198.6	254.8	327.0	337.3	294.6	233.8
III	199.3	252.1	326.2	339.4	292.9	234.1
IV	200.1	266.8	351.4	359.2	314.2	241.7
1992						
I	198.8	264.8	351.0	359.8	314.9	240.7
II	206.2	280.0	364.9	368.0	330.5	250.3
III	207.4	297.6	404.9	385.8	364.5	261.3
IV	221.9	262.8	408.6	419.1	367.4	269.5
1993						
I	236.8	263.1	414.0	455.4	372.5	281.7
II	233.1	269.1	411.9	492.9	372.7	280.9
III	241.4	273.0	411.2	531.4	361.8	287.6
IV	248.9	279.1	422.7	534.7	372.1	295.6

Sources: IMF, International Financial Statistics; and data provided by the Israeli authorities.

Table A33. Israel: Balance of Payments - Services, 1988-93

(In millions of U.S. dollars)

	1988	1989	1990	1991	1992	1993
Freight and transportation, net	-429	-407	-479	-599	-648	-549
Receipts	1,263	1,338	1,491	1,541	1,683	1,295
Payments	-1,692	-1,745	-1,970	-2,139	-2,331	-1,844
Travel, net	186	207	-46	-232	217	-99
Receipts	1,347	1,468	1,396	1,319	1,891	1,591
Payments	-1,161	-1,261	-1,442	-1,550	-1,674	-1,689
Insurance, net	-93	-155	-220	-157	-91	-76
Receipts	1	-21	-8	3	3	-6
Payments	-94	-134	-212	-160	-94	-69
Other, net	-98	-186	-272	-117	-58	51
Receipts	1,548	1,592	1,775	1,972	2,512	1,739
Payments	-1,646	-1,778	-2,047	-2,089	-2,570	-1,689
Government, n.e.s., net	-77	-82	-83	-97	-125	-118
Receipts	35	42	47	47	52	36
Payments	-111	-125	-130	-144	-177	-154
Total services, excl. investment income, net	-510	-623	-1,099	-1,201	-705	-791
Receipts	4,194	4,420	4,702	4,881	6,141	4,654
Payments	-4,704	-5,043	-5,801	-6,082	-6,846	-5,445
Investment income, net	-1,632	-1,393	-1,243	-878	-1,114	-792
Receipts	1,000	1,268	1,496	1,660	1,391	899
Payments	-2,632	-2,661	-2,740	-2,539	-2,505	-1,691
Total services, net	-2,142	-2,015	-2,342	-2,079	-1,820	-1,583
Receipts	5,194	5,688	6,198	6,542	7,532	5,554
Payments	-7,336	-7,704	-8,540	-8,621	-9,352	-7,137

Sources: Central Bureau of Statistics, Monthly Bulletin of Statistics; and data provided by the Bank of Israel.

Table A34. Israel: Civilian Import Volume and Price Indicators, 1987-93

(Percentage change from previous year)

	1987	1988	1989	1990	1991	1992	1993
Volume indicators 1/							
Consumer goods	13.5	12.7	-8.4	12.6	20.7	20.2	9.3
Nondurables	11.7	10.0	2.3	2.1	13.1	13.9	20.6
Durables	16.0	15.5	-19.7	27.1	29.2	26.9	-1.0
Input goods	11.2	0.3	-1.8	4.3	10.4	11.8	12.6
Diamonds	15.8	10.7	-14.3	-10.2	-11.1	5.5	12.7
Fuel	2.0	14.9	-3.9	1.4	16.9	21.6	16.9
Other	12.1	-7.9	1.9	12.4	19.0	11.8	11.7
Investment goods	9.9	-6.4	-13.9	22.0	37.0	7.9	13.0
Machinery and equipment	4.8	-8.4	-7.5	22.1	28.3	3.6	14.2
Total imports, net	11.2	0.6	-4.1	7.3	15.1	12.0	12.2
Total, excluding diamonds	10.4	-2.2	-3.3	12.3	21.8	13.1	12.2
Price indicators 2/							
Consumer goods	14.5	2.9	-0.8	7.0	-3.0	2.4	0.9
Nondurables	10.4	4.4	2.1	8.9	-0.6	0.9	0.4
Durables	19.1	1.5	-4.0	4.9	-5.3	3.7	2.4
Input goods	8.2	10.3	9.8	7.4	-5.5	-1.1	-4.2
Diamonds	3.8	20.3	24.2	13.7	-0.4	7.7	0.2
Fuel	21.7	-19.5	22.3	21.4	-17.8	-4.5	-11.9
Other	7.5	13.5	4.6	2.9	-4.2	-3.0	-4.0
Investment goods	15.3	4.1	-3.1	8.0	-0.1	2.4	0.1
Machinery and equipment	13.4	4.2	-2.0	8.6	1.3	2.3	-0.6
Total imports, net	10.1	8.3	6.6	7.4	-4.4	-0.1	-2.8
Total, excluding diamonds	11.3	5.9	4.6	6.1	-5.1	-1.3	-3.3

Sources: Central Bureau of Statistics, Foreign Trade Statistics Quarterly; data provided by the Bank of Israel; and Fund staff estimates.

1/ Value data deflated by Fisher type unit value indices.
2/ Based on U.S. dollar data.

Table A35. Israel: Commodity Composition of Civilian Imports (c.i.f), 1987-93 1/

	1987	1988	1989	1990	1991	1992	1993
				(In millions of U.S. dollars)			
Consumer goods	1,263	1,468	1,312	1,585	1,876	2,287	2,528
Nondurables	642	707	734	820	927	1,043	1,259
Durables	622	761	578	765	949	1,244	1,268
Input goods	8,169	9,151	10,174	11,373	11,793	13,163	14,203
Diamonds	1,901	2,415	2,869	2,895	2,558	2,910	3,352
Fuel	1,148	1,062	1,247	1,535	1,474	1,713	1,742
Other	5,120	5,675	6,058	6,943	7,761	8,540	9,109
Investment goods	2,044	1,929	1,585	2,194	2,996	3,180	3,577
Machinery and equipment	1,424	1,357	1,228	1,625	2,107	2,240	2,522
Other items 2/	-20	-260	-44	-45	32	-66	-58
Total imports, net	11,455	12,287	13,027	15,107	16,697	18,564	20,250
Total, excluding diamonds	9,554	9,872	10,159	12,212	14,139	15,654	16,898
				(In percent)			
Consumer goods	11.0	11.9	10.1	10.5	11.2	12.3	12.5
Nondurables	5.6	5.8	5.6	5.4	5.6	5.6	6.2
Durables	5.4	6.2	4.4	5.1	5.7	6.7	6.3
Input goods	71.3	74.5	78.1	75.3	70.6	70.9	70.1
Diamonds	16.6	19.7	22.0	19.2	15.3	15.7	16.6
Fuel	10.0	8.6	9.6	10.2	8.8	9.2	8.6
Other	44.7	46.2	46.5	46.0	46.5	46.0	45.0
Investment goods	17.8	15.7	12.2	14.5	17.9	17.1	17.7
Machinery and equipment	12.4	11.0	9.4	10.8	12.6	12.1	12.5
Other items 2/	-0.2	-2.1	-0.3	-0.3	0.2	-0.4	-0.3
Total imports, net	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Sources: Central Bureau of Statistics, Foreign Trade Statistics Quarterly; and Monthly Bulletin of Statistics.

1/ Excluding imports from occupied areas and direct imports of military goods. A revised classification of commodity categories applies in 1987 and thereafter.
2/ Returned and re-exported imports, and items not specified elsewhere.

Table A36. Israel: Origin of Imports, 1988-93

(Percent of total)

	1988	1989	1990	1991	1992	1993
Imports	100.0	100.0	100.0	100.0	100.0	100.0
European Community	51.9	50.5	49.3	47.7	50.2	49.0
Belgium-Luxembourg	15.1	15.2	13.2	11.1	12.7	12.2
Denmark	0.4	0.4	0.4	0.5	0.7	0.7
France	4.2	4.1	3.9	4.2	4.5	4.2
Germany	11.3	10.8	11.7	11.9	11.9	10.4
Greece	0.4	0.3	0.3	0.3	0.4	0.4
Ireland	0.3	0.3	0.3	0.3	0.3	0.3
Italy	6.1	5.8	6.1	6.5	7.0	7.3
Netherlands	3.5	3.5	3.5	3.4	3.3	3.4
Portugal	0.2	0.3	0.3	0.3	0.3	0.4
Spain	1.0	1.1	1.0	1.0	1.1	1.0
United Kingdom	9.3	8.8	8.6	8.3	8.0	8.6
Japan	3.7	2.7	3.6	4.3	5.3	5.1
United States	16.6	17.9	17.8	19.3	17.2	17.8
Canada	0.7	1.0	0.9	0.8	0.6	0.5
EFTA countries	11.6	11.5	11.5	10.9	9.5	10.1
Other countries	15.5	16.5	17.0	17.0	17.2	17.5

Sources: Central Bureau of Statistics, Monthly Bulletin of Statistics; and IMF, Direction of Trade Statistics.

Table A37. Israel: Commodity Composition of Exports, 1987-93 1/

	1987	1988	1989	1990	1991	1992	1993
			(In millions of U.S. dollars)				
Agricultural products	609	567	527	656	643	551	558
Citrus fruit	201	176	132	180	150	117	131
Other fruits and vegetables	151	115	118	177	183	162	171
Other	257	275	277	299	310	272	256
Industrial products (excl. diamonds)	5,488	6,294	7,034	7,849	7,846	8,823	10,183
Ores and minerals	252	275	311	294	300	304	298
Food (incl. beverages and tobacco)	436	526	567	657	538	558	543
Textiles (incl. clothing and leather)	592	641	635	787	850	964	932
Other light industry products	709	904	1,024	1,169	1,199	1,431	1,459
Chemicals	1,039	1,115	1,268	1,450	1,454	1,542	1,871
Metals, machinery and electronics	2,413	2,834	3,229	3,492	3,504	4,024	5,080
Diamonds, net 2/	2,070	2,547	3,027	3,054	2,690	3,046	3,332
Total 3/	8,201	9,445	10,669	11,603	11,219	12,429	14,070
			(In percent)				
Agricultural products	7.4	6.0	4.9	5.7	5.7	4.4	4.0
Citrus fruit	2.5	1.9	1.2	1.6	1.3	0.9	0.9
Other fruits and vegetables	1.8	1.2	1.1	1.5	1.6	1.3	1.2
Other	3.1	2.9	2.6	2.6	2.8	2.2	1.8
Industrial products (excl. diamonds)	66.9	66.6	65.9	67.6	69.9	71.0	72.4
Ores and minerals	3.1	2.9	2.9	2.5	2.7	2.4	2.1
Food (incl. beverages and tobacco)	5.3	5.6	5.3	5.7	4.8	4.5	3.9
Textiles (incl. clothing and leather)	7.2	6.8	6.0	6.8	7.6	7.8	6.6
Other light industry products	8.6	9.6	9.6	10.1	10.7	11.5	10.4
Chemicals	12.7	11.8	11.9	12.5	13.0	12.4	13.3
Metals, machinery and electronics	29.4	30.0	30.3	30.1	31.2	32.4	36.1
Diamonds, net 2/	25.2	27.0	28.4	26.3	24.0	24.5	23.7
Total 3/	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Sources: Central Bureau of Statistics, Foreign Trade Statistics Quarterly; and Monthly Bulletin of Statistics.

1/ Including returned exports (except diamonds): excluding exports to Occupied Territories.
2/ Unworked and worked diamonds. Beginning with the 1989 data, sales of unworked diamonds are recorded as exports instead of returned imports.
3/ Numbers do not add up because total includes "other exports," mainly scrap metal.

Table A38. Israel: Export Volume and Price Indices, 1987-93

(Percentage change from previous year)

	1987	1988	1989	1990	1991	1992	1993
Volume indicators 1/							
Agricultural products	-7.4	-20.1	3.5	11.6	-3.2	-2.9	-1.6
Citrus fruit	1.0	-22.2	-21.3	31.4	-25.7	-13.3	-1.6
Other fruits and vegetables	-8.5	-42.1	10.4	37.5	7.4	-0.2	-0.6
Other	-12.7	-5.1	16.6	-7.9	4.7	0.6	-1.4
Industrial products (excl. diamonds)	9.1	4.0	9.3	5.9	0.7	10.7	14.3
Ores and minerals	4.4	-5.4	--	-3.8	2.7	-3.3	6.2
Food	15.4	-8.7	11.0	6.9	-7.9	-4.3	6.2
Textiles	10.2	-10.3	1.3	13.4	4.1	12.5	-1.2
Metals, machinery and electronics	3.3	11.4	12.3	5.1	0.6	12.7	20.9
Chemicals	23.7	4.2	8.1	5.4	2.8	8.5	26.1
Other industrial products 2/	8.6	6.0	9.6	7.0	1.8	16.7	-0.9
Diamonds, net	20.5	1.4	-8.9	-7.3	-7.9	3.0	1.8
Total	10.7	1.2	5.8	1.2	-2.1	9.4	9.3
Total, excluding diamonds	7.2	1.4	9.7	5.6	0.4	9.6	12.7
Price indicators 3/							
Agricultural products	17.4	17.4	-10.2	11.6	1.2	-11.8	-5.7
Citrus fruit	13.9	11.7	-5.1	4.3	11.7	-10.2	12.7
Other fruits and vegetables	14.2	29.6	-7.2	8.9	-3.7	-11.4	-7.4
Other	22.2	15.6	-13.7	17.1	-0.8	-12.7	-10.5
Industrial products (excl. diamonds)	7.7	10.0	2.3	5.4	-0.7	1.6	-3.1
Ores and minerals	-3.3	15.8	13.3	-1.6	4.6	4.8	-7.5
Food	13.4	31.0	-2.9	8.3	-11.1	8.3	-9.9
Textiles	15.4	20.7	-2.2	9.4	3.7	0.8	-6.0
Metals, machinery and electronics	6.0	4.8	1.5	2.8	-0.3	1.9	-1.3
Chemicals	6.1	8.0	5.2	8.5	-2.4	-2.3	-4.4
Other industrial products	10.9	6.5	3.3	6.7	0.8	2.3	-0.9
Diamonds, net	1.6	21.5	19.1	13.3	3.2	1.4	8.6
Total	6.7	13.9	6.7	8.3	0.5	0.7	-0.1
Total, excluding diamonds	8.8	10.8	1.1	5.8	-0.5	0.5	-3.1

Sources: Central Bureau of Statistics, Foreign Trade Statistics Quarterly; and data provided by the Bank of Israel.

1/ Value data deflated by Fisher type unit value indices.
2/ "Other industrial products" includes rubber and plastic rubber and plastics through 1989; from 1990 rubber and plastics are included under chemicals.
3/ Based on data in U.S. dollars.

Table A39. Israel: Destination of Exports, 1988-93

(Percent of total)

	1988	1989	1990	1991	1992	1993
Exports	100.0	100.0	100.0	100.0	100.0	100.0
European Community	33.1	31.9	35.3	35.8	34.5	29.4
Belgium-Luxembourg	4.0	5.0	5.7	5.7	5.0	5.3
Denmark	0.3	0.2	0.3	0.3	0.3	0.3
France	4.0	4.0	4.8	4.8	4.7	3.9
Germany	5.3	4.8	5.9	6.7	5.8	5.3
Greece	1.3	1.2	0.9	1.1	0.8	0.7
Ireland	0.2	0.2	0.2	0.2	0.2	0.1
Italy	3.9	3.8	4.2	3.9	3.5	2.8
Netherlands	4.7	4.5	4.5	4.4	4.2	3.7
Portugal	0.2	0.2	0.3	0.3	0.3	0.3
Spain	1.3	1.4	1.4	1.7	1.9	1.3
United Kingdom	7.9	6.8	7.0	6.7	7.7	5.5
Japan	6.7	6.8	7.2	6.1	5.3	5.1
United States	30.7	29.9	28.8	30.3	30.5	30.9
Canada	1.0	1.0	0.8	0.8	0.7	0.7
EFTA countries	4.1	4.1	4.1	3.8	3.1	3.0
Other countries	24.5	26.2	23.7	23.2	25.9	30.9

Sources: Central Bureau of Statistics, Monthly Bulletin of Statistics; and IMF, Direction of Trade Statistics.

Table A40. Israel: Capital Account Transactions, 1988-93

(In millions of U.S. dollars)

	1989	1990	1991	1992	1993		
					I	II	III
Capital flows (net) 1/	-2,529	-1,215	-544	-1,432	666	1,115	10
Net capital flows (excl. by central monetary institutions)	-1,131	-700	-583	-2,767	1,289	471	556
Long-term capital	123	-24	25	-650	800	105	1,293
Government liabilities	65	-62	646	694	1,089	-81	1,058
Direct investment:							
In Israel	106	81	268	220	-44	155	87
Abroad	-38	-165	-414	-575	-166	-126	-41
Private liabilities	-7	109	-130	-145	60	-99	-40
Private assets (securities)	-3	14	-345	-844	-139	256	229
Short-term capital	-1,254	-676	-608	-2,118	489	366	-737
Government liabilities	-70	-25	-4	-14	-17	4	-11
Government assets	-222	-190	-180	78	47	251	-65
Private liabilities	103	149	-93	-165	-5	21	-84
Private assets	-396	-383	40	-433	-166	87	-47
Monetary sector							
Liabilities	-31	376	151	351	269	-89	-5
Assets	-637	-603	-521	-1,933	361	92	-525
Assets in foreign currency and liabilities of the central monetary institutions	-1,398	-515	38	1,335	-624	644	-546
Liabilities	--	--	--	245	--	--	--
Assets	-1,398	-515	38	1,090	-624	644	-546

Source: Central Bureau of Statistics, Monthly Bulletin of Statistics.

1/ Excluding errors and omissions.

Table A41. Israel: Indicators of External Indebtedness, 1987-93 1/

(In millions of U.S. dollars)

	1987	1988	1989	1990	1991	1992	1993 IIIQ
Gross external liabilities							
Amount	31,971	31,522	31,476	32,781	33,206	33,631	36,091
Percentage increase	3.8	-1.4	-0.1	4.1	1.3	1.3	7.3
Percent of GNP	92.5	73.7	72.3	61.7	56.8	52.3	56.9
Gross external liabilities minus foreign assets of commercial banks							
Amount	25,524	24,747	24,048	24,464	24,309	22,966	25,287
Percentage increase	5.3	-3.0	-2.8	1.7	-0.6	-5.5	10.1
Percent of GNP	73.9	57.8	55.3	46.1	41.6	35.7	39.9
Net external liabilities 2/							
Amount	17,839	18,104	15,789	15,198	15,108	14,741	16,436
Percentage increase	-0.4	1.5	-12.8	-3.7	-0.6	-2.4	11.5
Percent of GNP	51.6	42.3	36.3	28.6	25.9	22.9	25.9
Memorandum items:							
Foreign assets	14,131	13,418	15,687	17,583	18,098	18,890	19,655
of which:							
commercial banks	6,447	6,775	7,428	8,317	8,897	10,665	10,804

Sources: Central Bureau of Statistics, Monthly Bulletin of Statistics; data provided by the Bank of Israel; and the staff calculations.

1/ Data for 1993 are provisional.
2/ Net of foreign assets of commercial banks, Bank of Israel's reserves, holdings of other monetary institutions, and export credit.

Table A42. Israel: Indicators of Debt Service, 1988-93

	1988	1989	1990	1991	1992	1993
			(In millions of U.S. dollars)			
1. Gross interest payments	2,506	2,502	2,608	2,399	2,304	2,292
2. Interest receipts	968	1,235	1,587	1,615	1,405	1,181
3. Net interest payments	1,538	1,268	1,021	784	899	1,110
4. Principal repayments 1/	6,617	2,295	2,131	2,206	1,851	1,787
5. Debt service (1+4)	11,629	7,299	7,347	7,004	6,458	6,370
6. Net debt service (5-2) 2/	10,661	6,064	5,761	5,389	5,053	5,189
Ratio of gross interest payments to exports of goods and services	16	15	14	13	11	10
Ratio of gross debt service to exports of goods and services 2/	75	44	40	38	31	29
Ratio of net interest payments to exports of goods and services	10	8	6	4	4	5
Ratio of net debt service to exports of goods and services 2/	69	36	31	29	24	23
Memorandum items:						
GNP	42,793	43,524	53,120	58,414	64,327	63,700
Exports of goods and services	15,491	16,749	18,332	18,563	20,814	22,276

Sources: Central Bureau of Statistics, Monthly Bulletin of Statistics; and data provided by the Bank of Israel.

1/ Excludes short-term debt.
2/ Excludes prepayment in 1988 of debt of US$4.5 billion owed to the U.S. Government, the debt having been replaced with a corresponding liability in long-term bonds.

Table A43. Israel: Distribution of External Foreign Currency Liabilities

(In millions of U.S. dollars)

	September 1993			
	Long-Term 2/	Medium-Term 3/	Short-Term 4/	Total
1. Government sector	17,588	2,761	--	20,349
Credit from the U.S. Government	3,704	--	--	3,704
Credit from other governments and from international institutions	1,883	268	--	2,151
Negotiable bonds	6,732	553	--	7,285
State of Israel bonds				
Credit from abroad through Israeli banking system				
2. Private nonfinancial sector	1,890	771	959	3,620
Credit from abroad through Israeli banking system				
Supplier's credits				
Others 5/				
3. Net external liabilities of the banking system	-944	1,172	1,623	1,555
4. Total external liabilities (1+2+3)	18,534	4,704	2,582	25,524

Source: Bank of Israel, Controller of Foreign Exchange.

1/ Gross liabilities minus foreign assets of commercial banks. Provisional.
2/ More than five years.
3/ One to five years.
4/ Less than one year.
5/ Includes credit to mortgage and investment banks.

Table A44. Israel: Official Gold and Convertible Foreign Exchange Reserves, 1982-93

(In millions of U.S. dollars; end of period)

		Gold 1/	SDRs	Reserve Position in the Fund	Foreign Exchange	Total
1982		42.0	0.6	--	3,793	3,836
1983		37.2	4.1	--	3,653	3,694
1984		34.9	0.1	--	3,063	3,098
1985		39.0	--	--	3,680	3,719
1986		43.4	--	--	4,659	4,703
1987		50.0	0.1	--	5,874	5,924
1988		47.9	0.1	--	4,043	4,091
1989		47.0	--	--	5,283	5,329
1990		41.5	--	--	6,274	6,316
1991		21.0	0.4	--	6,277	6,298
1992		0.4	--	--	5,131	5,132
1991	I	38.9	0.6	--	7,160	7,200
	II	27.5	0.3	--	7,136	7,164
	III	20.0	0.3	--	6,612	6,632
	IV	21.0	0.4	--	6,277	6,298
1992	I	15.5	--	--	6,236	6,252
	II	10.6	0.5	--	6,240	6,251
	III	1.4	0.5	--	5,607	5,609
	IV	0.4	--	--	5,131	5,132
1993	I	0.4	--	--	5,748	5,749
	II	0.4	0.5	--	5,158	5,159
	III	0.4	0.2	--	5,733	5,734
	IV	...	...	...	6,304	...

Sources: IMF, International Financial Statistics; and data provided by the Bank of Israel.

1/ National value.