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DIRECTORATE OF
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Intelligence Memorandum

Israeli Export Prospects

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
October 1972

INTELLIGENCE MEMORANDUM

ISRAELI EXPORT PROSPECTS

Introduction

1. The economic development and prosperity of Israel, with its poor endowment of natural resources, has been derived primarily from human resources and imported capital. In 1971, gross national product (GNP) was approximately US $5.55 billion or about $1,825 per capita, and less than 10% of this was accounted for by branches of the economy directly dependent on natural resources – agriculture, forestry, fishing, mining, and quarrying.

2. International commerce is vital to Israel's economic life. Imports of goods and services are equivalent to about 55% of GNP and exports to one-third.[1] Therefore, raising exports of goods and services to a level close to that of imports has been a prime long-run objective of successive Israeli cabinets. This memorandum examines the Israeli export picture and prospects for export growth in 1972-76.

Discussion

The Record

3. Israel's exports of goods and services have increased faster than imports and much faster than GNP since the early 1950s. Nevertheless,

1. Substantially less than one-third of Israel's production, however, is exported, as many exports – polished diamonds being a notable example – have a substantial import content.

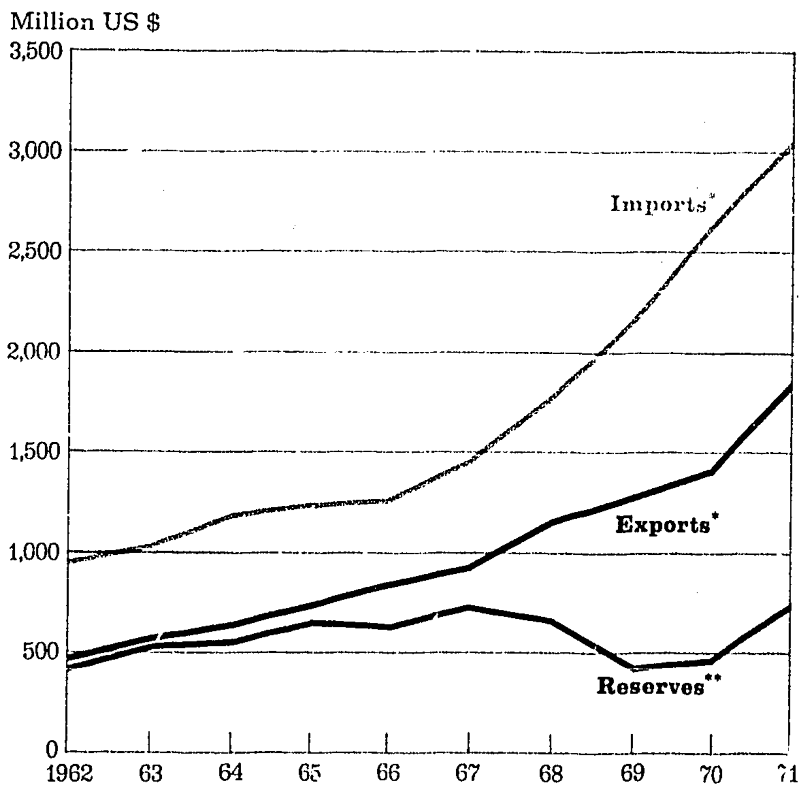
Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

trade in goods and services has always been in deficit. Supported by heavy government assistance and aggressive sales procedures, exports of goods and services increased by about 15% a year between 1952 and 1971 while GNP increased 9% annually. In 1971 the deficit in goods and services was $1.17 billion, or about one-third the value of all imports. Throughout Israel's history, chronic deficits on goods and services transactions have been covered by massive inflows of transfer payments and capital. Israel has benefited from reparation and restitution payments from West Germany, bilateral and multilateral aid, and private assistance through purchases of development bonds and donations to the Jewish Agency. Immigrants have brought in a good deal of money, and Israelis have received sizable remittances from relatives in other countries. Capital has flowed in through direct investment and commercial credit.

4. In its efforts to improve the balance of payments (see Figure 1), the government of Israel has devalued its currency seven times (from $4.03

Figure 1

Israel: Balance-of-Payments Indicators



*Goods and services on a balance-of-payments basis (f.o.b.); includes transactions with residents of territories occupied in 1967 but not annexed.
**End of year, International Monetary Fund accounting of Bank of Israel assets.

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in 1948 to $0.24 today), subsidized exports, taxed imports, and employed controls including import licenses, import deposits, multiple exchange rates, and restrictions on the conversion of Israeli pounds. It has also solicited aid from foreign governments, international organizations, and private individuals. However, efforts to improve the balance of payments have had to overcome the deleterious effect of continuing inflation resulting in large measure from the government's domestic policies. The consumer price index increased 5.5% annually on the average during 1956-71. Israel's precarious political situation and the need for heavy defense expenditures have compounded the balance-of-payments problem, especially since the 1967 war. Imports of military equipment jumped from about $150 million in 1965 to $625 million in 1970 and have since continued at a high level.

Marketing of Exports

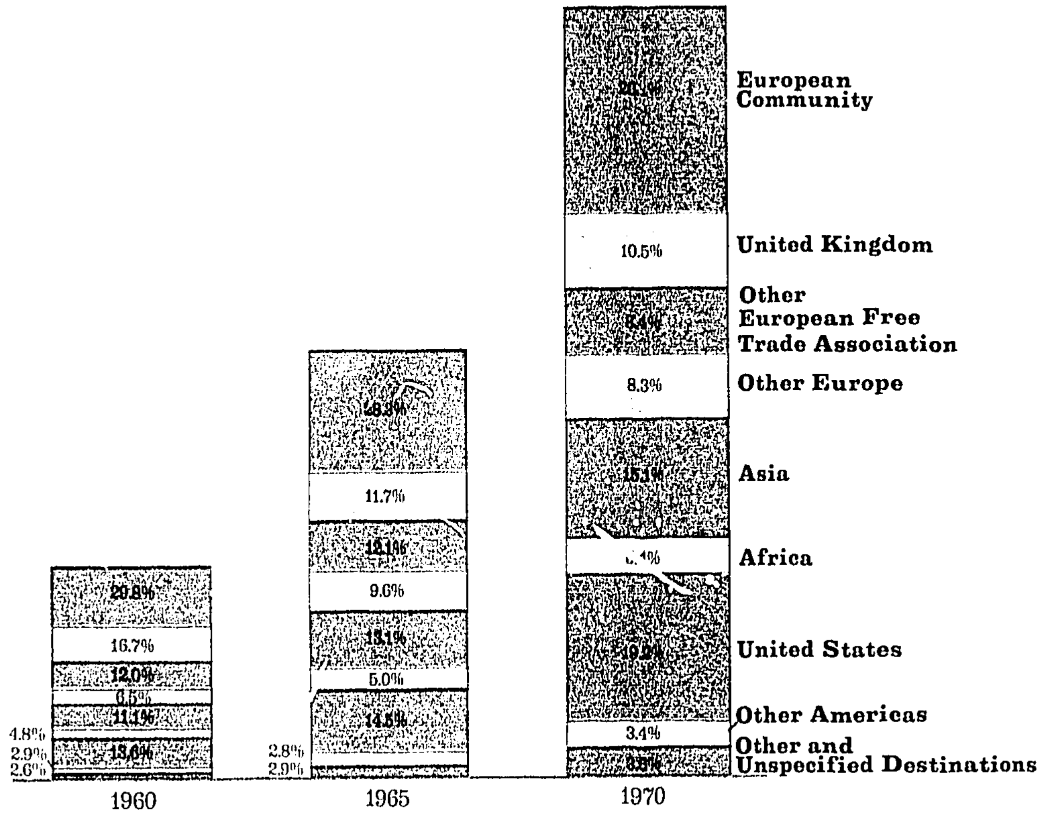
5. Israel conducts most of its trade with other developed countries. In 1971, half of Israeli commodity exports went to non-Communist Europe, a fifth to the United States, and nearly 8% to Japan, Canada, Australia, and New Zealand. Less than 3% went to European Communist countries – most of this to Romania and Yugoslavia. The developing countries of Asia, Africa, and Latin America received about one-fifth of Israel's exports. Export flows have changed somewhat since 1960, when 17% of Israel's products went to less developed countries. The proportion of exports now going to the United States also has increased at the expense of that going to Communist and non-Communist countries of Europe (see Figure 2). Had the political situation permitted trade between Israel and the Arab states, a larger share of Israeli exports would be going to less developed countries because of the complementarities of the economies. Israel would be the most competitive source for many types of machinery for Arab states, and this trade would reduce Israel's heavy dependence on exports of diamonds and agricultural products to the United States and Western Europe.

6. Israel's exports to the developed countries are dominated by diamonds, agricultural products, and processed foods, but increasingly Israel is selling manufactures in these markets. Exports to the United States are made up largely of diamonds and clothing, particularly knitwear, whereas sales in Western Europe are heavily oriented toward citrus fruit and other agricultural products and processed foods. Exports to less developed countries include a wide range of manufactures such as communications equipment, agricultural machinery, agricultural chemicals, pharmaceuticals, plastics, textiles, and air conditioning equipment.

7. Israeli exporters of industrial products compete successfully with producers in other developed countries by offering specialized good-quality merchandise at competitive prices. Devaluations and subsidies have been

Figure 2

Israel: Commodity Exports, by Destination*



* *Gross of returned exports; excluding trade with territories occupied in 1967.*

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instrumental in keeping Israeli prices competitive. Furthermore, many Israeli exporters are aggressive merchandisers, and some have ties with foreign firms that aid in the distribution of their products. In some instances, Israeli products no doubt have benefited from what might be called the "Jewish connection." In the words of a leading Israeli economic journalist, "The unique and invaluable asset at the disposal of Israeli industry is of course the assistance of Jewish business circles abroad, their readiness to cooperate in providing contacts, whether technological or commercial." Such assistance has been of special importance in the opening of new markets for Israeli products in developed countries and has included marketing advice and introductions, publicity (for example, on the Israeli fashion industry), and technical assistance in tailoring products to foreign standards – particularly American. In general, Jewish importers in other countries probably prefer to buy from Israel, although they are unlikely to purchase Israeli goods that are not competitive in quality and price.

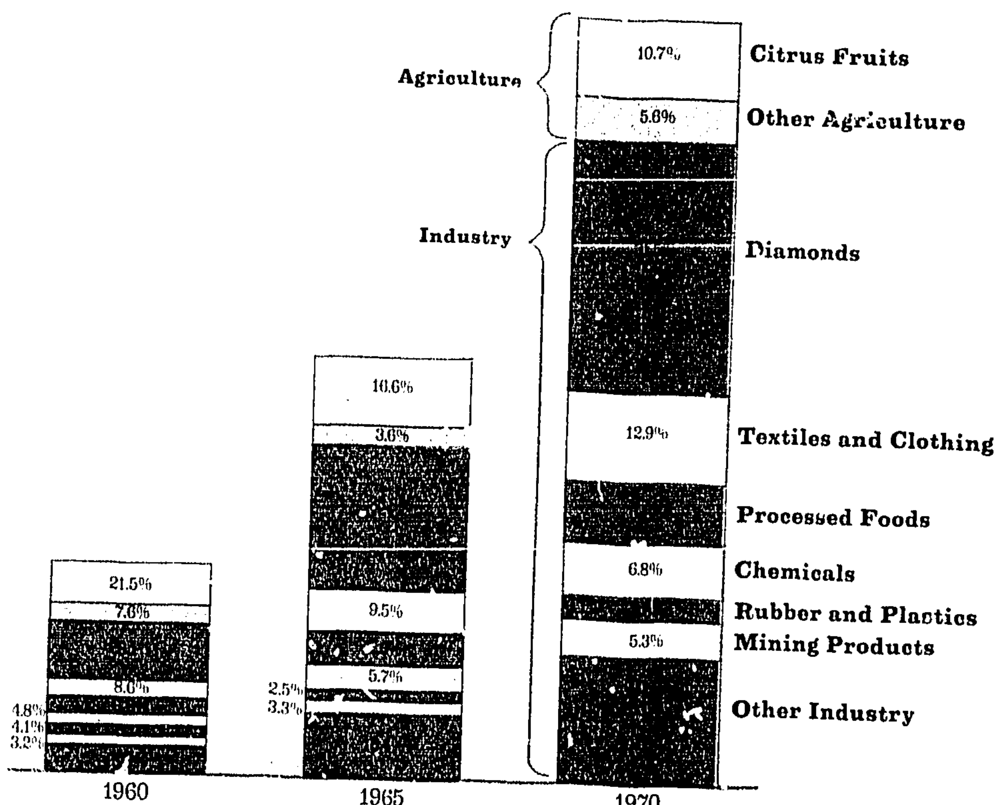
8. "Made in Israel" labels no doubt are attractive to Jewish customers for some consumer goods, but the influence of this factor on Israel's total exports is marginal. Although about two-thirds (by gross value) of all commodity exports are consumer goods, only some 15% of these are products for which the country of origin would be significant. Clothing accounts for the bulk of such items, and the remainder includes processed foods, wine, and miscellaneous manufactured goods.

Structure of Exports

9. The structure of exports has undergone a secular shift from agricultural to non-agricultural products, as a growing portion of citrus fruit and other agricultural products goes to Israel's food processing industry. Exports of fresh citrus fruit have been growing absolutely since pre-independence times, but in recent years they have declined in relative importance even among agricultural exports. Citrus fruit now accounts for somewhat more than 10% of merchandise exports, and other agricultural products account for about 5%. Processed foods, which are considered non-agricultural, account for nearly 10% of merchandise exports (see Figure 3 and Table 1).

Figure 3

Israel: Commodity Exports, by Group*



*Gross of returned exports; excluding trade with territories occupied in 1967.

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Table I

Israel: Merchandise Exports, by Main Category [a]

Million US $

	1970	1971
Agricultural	129.3	154.9
Citrus fruit	87.2	114.5
Other agricultural products	42.1	40.5
Industry	595.6	750.4
Diamonds	203.3	268.0
Mining and quarrying	40.8	41.9
Processed food	65.5	81.2
Textiles	42.7	49.4
Clothing	53.6	69.8
Wood and furniture	9.6	9.6
Paper and cardboard products	3.2	2.5
Printing and publishing	5.9	11.2
Leather and leather products	3.5	4.8
Rubber and plastic products	23.5	27.4
Chemicals	58.3	63.7
Nonmetallic minerals	3.0	3.7
Basic metals	10.1	9.1
Metal products	28.5	44.6
Machinery	10.5	9.2
Electric and electronic equipment	12.8	25.3
Transport equipment	9.1	13.9
Miscellaneous	11.7	15.2
Total merchandise	**724.9**	**905.3**
Adjustments to balance-of-payments definitions [b]	-1.5	-5.4
Total merchandise, according to balance-of-payments definitions	**723.4**	**899.9**
Exports to occupied territories	78.5	77.0
Total merchandise, including occupied territories	**801.9**	**976.9**

a. Because of rounding, components may not add to the totals shown.
b. Adjustments include the deduction of articles removed from the country by diplomats and tourists as personal belongings and the deduction of trade samples, gold, leased equipment, and movies sent out of Israel.

10. Of the non-agricultural exports, polished diamonds long have been the largest single commodity by value, accounting for one-fourth to one-third of all merchandise exports. Diamonds, however, are much less important to Israel's trade balance than the export figures indicate, because the finished product has an unusually high import content – over 80% of the value of finished gems. A wide variety of other non-agricultural products, ranging from electronic equipment to potash, make up an increasing share of exports. Over the last decade exports of textiles and clothing, chemicals, and products of the extractive industries have grown significantly. Textiles and clothing surpassed citrus fruit in 1970 to become the second largest merchandise export and maintained this position in 1971. Among the most rapidly growing exports in recent years have been clothing, certain chemicals, plastics, electronic equipment, machinery and other metal products, and products of the printing and publishing industry.

11. Exports of services are large and growing. They reached a value of more than $870 million in 1971[2] (see Table 2). Tourism brought in

Table 2

Israel: Services Exports, by Main Category

Million US $

	1970	1971
Freight	91.6	131.0
Merchandise insurance	5.4	5.9
Passenger fares	54.1	74.1
Charter hires	18.1	40.2
Port disbursements	15.6	22.3
Other transport	15.0	23.1
Other insurance	100.2	110.0
Travel	105.9	181.4
Investment income	64.8	122.8
Government, not elsewhere specified	28.0	33.7
Other services	96.7	127.0
Total services (balance-of-payments definitions; including occupied territories)	**595.4**	**871.5**

2. Including exports to the occupied territories, which cannot be broken out.

more than $180 million, and an additional $75 million was taken in by Israeli passenger carriers. Over 650,000 tourists visited Israel in 1971, four times the number of visitors received 10 years earlier and over 50% more than in 1970. In addition, nearly 110,000 residents of Arab countries visited the West Bank and Israel under a special new program. Hotel space is being increased rapidly, but a shortage of accommodations constrains the tourist flow at peak periods. Israel's sizable fleet of merchant ships, including some container ships and a number of tankers, together with the Trans-Israel Pipeline, earned more than $130 million on freight transport in 1970, and insurance services brought in more than $115 million.

Export Strategy

12. The government of Israel has striven constantly to encourage export industries that would make the maximum use of available manpower and the country's limited natural resources. Among the first important exports developed from Israel's natural endowment were citrus fruit and potash. Diamond polishing was started by skilled craftsmen who had migrated to Palestine from the Netherlands in the 1930s and the 1940s. Food processing was a natural outgrowth of increasing agricultural production. The textile industry, processing some domestic cotton and wool, was at first developed to provide employment for unskilled immigrants as well as to reduce imports. The extractive industries were expanded to capitalize on the availability of phosphates, bromine, and copper. Available minerals also were the basis for the chemical industry, which came to provide exports of fertilizer, basic chemicals, and more sophisticated products. Facilities for oil refining were developed to reduce imports and to process small quantities of crude oil being extracted domestically. Refined petroleum products soon became available for export, and by-products of the refining became inputs for the chemical, plastics, and rubber industries, all of which have become important exporters. Military needs dictated the establishment of an electronics industry, which has been successful in exporting a growing quantity of equipment, much of it defense related.

13. Despite a policy of diversification, diamonds and citrus fruit, which account for about 40% of merchandise exports, still make or break annual export performance. Thus, in 1970, commodity exports increased only 6% when diamond sales declined because of recession in the US market and earnings from citrus fruit fell because of a drop in European prices. Conversely, in 1971, exports rose by 22% when sales of diamonds and citrus fruit jumped more than 30%. In recent years, more emphasis has been placed on the development of exports of products such as clothing, pharmaceuticals, plastics, specialized instruments, and electronics. These products have low shipping costs, a relatively high input of skilled or semi-skilled labor, and a low import content.

14. The Israeli government generally has tried to encourage exports by raising their profitability through devaluation and subsidization. The most recent devaluation was effected in August 1971, when the pound was reduced by 17% to a par value of $0.24. Subsequent adjustments in the relationships between other currencies and the dollar have boosted the devaluation of the Israeli pound to the order of 25% relative to currencies of Western Europe and Japan. Even so, the Israeli pound is overvalued, as it always has been.

15. Export subsidies last were given a big boost in August 1970. Some 5.5% of government budget expenditure for the fiscal year that began on 1 April 1972 is earmarked for direct export subsidies. Exporters are given subsidies varying from 0.84 to 0.89 pounds per export dollar received, depending upon the percentage of product value that is added in Israel. A rate of 0.50 pounds per dollar of value added in Israel is in effect for diamond exports. In addition to direct export subsidies, exporters receive a rebate of import duties (other than the surcharge in effect since August 1970) and of Israeli purchase taxes paid on raw materials and intermediate products. Moreover, a portion of the property tax levied on exporters' equipment and inventory is waived, and under specified conditions travel outside the country by exporters is exempted from the travel tax. Clothing and textile exporters also have received special subsidies averaging 0.60 pounds per export dollar, but these now are being phased out. All agricultural production is heavily subsidized.(3)

16. The government also subsidizes transportation and insurance costs for exports and pays part of the cost of market research and sales promotion in foreign countries. Low cost loans are provided to cover working capital needs. In addition to all this, the Law for the Encouragement of Capital Investment provides for low cost loans, tax concessions, and outright grants to defray part of the cost of investment in export industries as well as in other favored ventures.

17. In the last two years resurging inflation has pushed up the costs of Israel's producers, partly offsetting renewed government efforts to raise the profitability of exports. Prices, as measured by the GNP deflator, rose 9% in 1970 and 13% in 1971.

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3. It is difficult to determine the effective exchange rate for exports, considering all direct and indirect subsidies. On the average, direct subsidies on exports -- including agricultural subsidies and special subsidies on textiles and clothing -- amount to about IS£ 2.10 per dollar of value added in Israel. Subsidies on textile products, however, are about IS£ 3.65 per dollar of value added, whereas subsidies on agricultural products are about IS£ 1.65 and those on diamonds only IS£ 0.50. Elimination of the special subsidies on textiles will reduce the total payment on these products to IS£ 2.15 per dollar of value added.

18. The government exerts control over exports in a number of other ways. In some instances – for example, the extraction of minerals from the Dead Sea basin – it controls both production and exports through outright ownership of operating companies. In the citrus industry, the Citrus Control and Marketing Boards seek to maximize earnings from citrus fruit by influencing plantings, improving growing techniques, and monopolizing disposal of the crop. The Marketing Board divides output between export and processing and decides the timing and destination of exports.

19. The government has simultaneously restrained imports and stimulated exports by taking deflationary measures that reduce domestic demand and free labor and other resources for employment in export industries. In 1966 this course was followed with undesirable and severe side effects – slower economic expansion and a sharp rise in unemployment. When a high level of employment had again been reached in 1969, efforts were made to restrain the growth of demand sufficiently to keep consumer imports within bounds and to prevent a diversion of resources from export production to production for the domestic market. Taxes and compulsory loans were increased, credit was restricted, incomes policy measures were adopted, and government spending was restrained. Fiscal measures have not been sufficiently restrictive, however, to bring domestic revenues into line with domestic expenditures. The budget for the fiscal year beginning 1 April 1972 called for $155 million in borrowing from the central bank and $145 million in borrowing from other banks.

20. Israel has tried to expand its export market in Europe by securing preferential treatment in the European Community (the EC or Common Market). An agreement concluded in 1970 provided for the halving of EC duties on Israeli industrial products in progressive stages; 80% of the reduction was to be effected by 1 January 1972. The six-member Community buys about one-fourth of Israel's commodity exports. Through 1971 the impact of the preferential agreement on trade flows was not great.

Prospects for Further Increases in Exports

Overall Outlook

21. Considering anticipated growth of productive capacity, present plans and programs, and recent performance, Israel seems capable of

increasing exports by 15% annually for the five-year period beginning 1 January 1972.[4] Economic output has grown rapidly ever since the 1967 war, notwithstanding the existence of a full employment constraint since 1969, and continued expansion clearly is achievable. In 1971 the Ministry of Finance published an economic plan that foresaw a 14.9% annual rate of increase for exports during the five years beginning 1 January 1971.[5] The government of Israel is not committed to the goals or policies incorporated in the plan, but the plan is significant as an Israeli appraisal of economic prospects. Our projection assumes that Israeli commerce will not be disrupted by war or international monetary difficulties, that immigration will continue at a relatively high rate, and that the government will pursue policies that will encourage investment, maintain full employment, and keep exports profitable. A continuation of rapid inflation -- which seems likely -- will mean a continuing need for additional subsidization and devaluation; nevertheless, the process probably can be continued successfully for the next several years. Given the uncertainties involved, export growth could vary several percentage points in either direction from the projected 15% annual rate, but variation on the high side seems more probable than variation on the low.

The Israeli Economy

22. Growing ability to export will have to be grounded on growing capacity to produce. Present capacity is fully committed, and domestic demand is increasing inexorably. We expect real gross national product to increase through 1976 at an average annual rate of about 8% per year, extending the trend in effect since the attainment of full employment in 1969. The Israeli economic plan foresaw GNP growth of 7.7% during 1971-75; however, growth of 8.8% was realized in 1971. We assume the government will continue monetary and fiscal policies that maximize

4. Confidence in this estimate is reinforced by a regression analysis of export growth over the past 20 years. Two regression equations were estimated for exports from 1952 through 1971. The first is as follows: $\log X(t)=4.36+0.157T(t)$, where $X(t)$ signifies exports in current dollars in year t and T is a time variable. The R^2 for the equation is 0.995. The result indicates that exports in current dollars tend to increase 15.7% per year. The second equation is the following: $\log Z(t)=5.55+0.147T(t)$, where $Z(t)$ signifies exports in year t valued in constant Israeli pounds including export subsidies. The R^2 is 0.986. This result indicates that exports in constant pounds tend to increase 14.7% per year. Export performance does not lend itself to forecasting by more elaborate mathematical modeling, because most determinants of exports -- for example, demand in customer countries, supply from rival sources, currency exchange rates, subsidies in Israel, and taxes in customer countries -- are exogenous to the Israeli economy.

5. An annual rate of increase of 15.2% was foreseen if trade with the occupied territories is excluded from consideration.

expansion at the cost of accelerated inflation. We expect that future growth will result from an increase in civilian employment of 3.5% to 4% per year and an increase of 4% per year in output per worker, or labor productivity. The estimate of employment growth assumes continued full employment and continuation of current trends in immigration and natural growth of the population. In recent years labor productivity has been increased by 5% per year chiefly by increasing the average amount of capital employed with each worker and by modernizing equipment and techniques. Despite vast gains already made, output per worker still is less than half that in the United States. Considerable scope remains for raising labor productivity by increasing and modernizing the capital stock and introducing new techniques. However, as Israel approaches the contemporary frontier of technology and raises its capital-labor ratio, benefits can be expected to come more slowly. Hence the slowing of productivity growth to a still respectable 4% per year is expected.

23. The civilian labor force of just over a million is relatively skilled and educated; the educational level of the Jewish component, some 90% of the total, is comparable to that of the Italian labor force. In general, the Jews who have migrated to Israel from North Africa and the Middle East have been less well endowed with education and skills than those from Europe and the Americas. Somewhat more than half the growth in the labor force through 1976 should result from natural increase and less than half from net immigration, even assuming a continuation of the current heavy influx from the Soviet Union.

24. More than 40,000 residents of the occupied territories now work in Israel. The number probably will increase slowly because unemployment in the territories has been greatly reduced. However, underemployment remains, particularly in Gaza. The wages earned in Israel by territory residents contribute to the GNP of the territories rather than that of Israel. Manpower from across the "green line," however, raises the return on Israeli capital and adds flexibility to the economy. The employment of territory residents can be varied by individual firms and by the economy as a whole with little interference from the powerful labor unions.

25. Investment will continue to grow more rapidly than production, probably increasing by more than 10% annually through 1976. Businessmen have poured funds into investment since the 1967 war, encouraged by prospects of rising aggregate demand. The 1967 war triggered an influx of foreign exchange in the form of private assistance and signaled an end to restrictive policies that had protected the Israeli foreign exchange position at the expense of a painful recession. Government spending, led by a surge in defense outlays, has increased sharply in the post-war period. Economic expansion and the uptrend in investment have continued to date and are

expected to go on for several more years. Although relatively mild restraints have been imposed in an effort to retard inflation, the government has made plain its determination to avoid a repetition of the pre-war recession. Moreover, this determination is firmly and credibly based on an absence of balance-of-payments pressure, thanks largely to heavy private assistance and official US aid.

26. The government will continue to stimulate investment and to guide much of it into export industries and import substitution industries. The crucial factor in stimulating investment is the maintenance of favorable prospects for sales and profits, and these prospects in turn depend heavily on expected government policies Potential investors seem confident that the government will maintain domestic demand with appropriate fiscal and monetary policies and international competitiveness with subsidies and devaluations. In recent years, substantial investment has been made in metal products industries, the cement products industry, textiles, chemicals, food processing, printing and publishing, petroleum transportation and processing, passenger transportation and tourism, and the aircraft industry. Considerable investment, much of it from foreign sources, also has gone into the electronics and plastics industries. Most of these industries will continue to attract investment of expansion and modernization over the next several years.

International Factors

27. Export prospects depend in part on economic conditions in customer nations, which for Israel means primarily the United States and the nations of Western Europe. The economic expansion now in progress in the United States benefits Israeli exports. Economic slowdowns recently have dampened demand for imports in several West European countries, but it is likely that these slowdowns will soon be overcome.

28. Expansion of the European Community to include the United Kingdom and other countries will affect Israel's exports in a mixed fashion. Britain takes about 10% of Israel's commodity exports, while the other prospective members in combination buy only 1%. Britain will align its duties with the EC Common External Tariff in stages, with 40% of the adjustment to be effected on 1 January 1974 and full alignment to be achieved on 1 July 1977. British entry into the Community will raise problems because present UK duties on citrus fruit, citrus juices, plywood, and bromides -- which together account for half of Britain's purchases from Israel -- are lower than the duties levied on Israeli products by the Community. Furthermore, under the EC system of tariffs and preferences some Israeli products will enter Britain on less advantageous terms than competing products from certain other countries. For example, the UK duty on Israeli oranges will increase from 5% ad valorem to 12% when Britain

imposes EC tariffs, while the rate on oranges from Morocco and Tunisia will decline to 4%, and oranges from Italy and Greece will be given duty-free entry. On the other hand, EC tariffs on some items are lower than present British duties. Thus British tariffs on knitwear now range from 18% to 25%, whereas the EC rate is only 8%. Such important Israeli exports as chemicals, textiles, apparel, and electronic products generally will gain from British accession to the European Community. Moreover, Israel is pressing for concessions from the Community that would limit the negative effects of EC expansion, and London has promised its support in this effort.

Product Trends

Diamonds

29. Diamond exports rose rapidly in 1971 and have continued to surge upward in 1972, but a slowdown to about 15% annual growth is likely during the next few years. Future gains will depend heavily on the ability of Israeli firms to expand their modest share in the market for large stones. Israelis have already achieved a dominant position in the market for the small to medium size "melee" brilliant cut diamond, accounting for 80% to 85% of the world's supply. The availability of rough stones also may be a constraining factor as production of roughs is limited and the DeBeers Central Selling Organization dominates distribution, rationing supplies among processors in various countries. Israeli firms now obtain about half their rough diamonds directly from DeBeers, 15% to 20% from independent sources, and the remainder from processing firms in other countries that are willing to sell a portion of their consignments from DeBeers.

Other Industrial Products

30. Industrial products other than diamonds hold the key to Israel's export success over the longer term. Israel should be able to increase exports of such products by 15% to 20% annually through 1976. Textile and clothing exports will expand less rapidly than in the recent past because a glut of doubleknits and pantyhose in the United States and Western Europe has depressed prices and blunted the Israeli export drive. Moreover, the textile industry is in the process of shifting from natural to synthetic fibers and from yarn and fabrics to apparel, including high fashion women's clothing. Recognizing that Israel cannot compete successfully in producing intermediate mill products with India and Far Eastern countries having lower labor costs, the government has begun to encourage restructuring of the industry by reducing restraints on imports of yarn and fabrics, reducing special export subsidies, and refusing to grant subsidies for investment in new yarn and fabric facilities. The government will continue to sponsor vocational training and applied research for the industry because many

textile and apparel firms are too small to provide such services for themselves. Efforts by the industry to obtain assistance from Diaspora Jews having expertise in textile and clothing production will continue, as will aggressive marketing. A substantial increase in exports of clothing is likely, particularly exports to the United States and Western Europe.

31. Exports of processed foods, including juices and other citrus products, will continue to grow. An increasing proportion of the citrus crop probably will be processed in Israel rather than exported fresh. The principal market for Israel's processed foods is in Western Europe.

32. Exports of basic chemicals, pesticides, and pharmaceuticals should grow rapidly. The petrochemical industry will benefit from the start-up of a new refinery at Ashdod in 1973. Much of the increase in exports of fertilizer, pesticides, herbicides, and veterinary pharmaceuticals will go to the rapidly expanding markets of developing areas, while basic chemicals will continue to go primarily to developed countries for industrial use. Most pharmaceutical chemicals requiring further processing likewise will continue to be sold to producers in developed countries, but finished pharmaceutical preparations for human use are winning growing acceptance in Africa and other less developed areas.

33. Metal products exports will continue to expand briskly. Among the fastest growing exports in this heterogeneous category will be irrigation equipment and other machinery for agriculture, machinery for the food and chemical industries, air conditioning and cooling apparatus, and military equipment. Under the pressure of circumstances, Israel initially developed and perfected these products for its own use. Subsequently, Israeli successes in agriculture, the food and chemical industries, the cooling field, and military operations have won admiration and created receptive markets in many countries. Other metal products include steel pipe and pipe fittings; copper tube and pipe fittings; copper sanitary ware; aluminum profiles, plates, and strips; and a variety of tools and other items. Israeli metal products go to the United States, Western Europe, Eastern Europe, and less developed countries.

34. Transportation equipment is another expanding export field. Parts and accessories for motor vehicles already are being marketed successfully in the United States and many other countries, and increasing quantities of aircraft parts are being sold to a long list of customers. Parts are manufactured for foreign-built planes under license arrangments. Israel also buys, renovates, and re-exports used aircraft. Manufacture of two types of aircraft for export – an executive jet and a transport designed for short take-off and landing capability – has got under way after painful delays; however, Israel Aircraft Industries is having difficulty finding buyers, and

it is doubtful whether the manufacture of complete aircraft will prove to be economically viable. Ships and boats are built to special order, and export sales are expected to grow irregularly.

35. Plastics exports probably will continue to expand rapidly. Exports of finished products will rise less rapidly than exports of intermediate products such as polyethylene, polyvinyl chloride, polyester, and molding powders. A number of plastics firms already have joint ventures or other forms of liaison with American and European firms, and such cooperation will be an important factor in the future expansion of Israel's production and export of plastics. Among the best customers for Israeli plastic materials and products are the United States, the United Kingdom, Canada, Iran, and sub-Saharan Africa.

36. Exports of rubber products will rise, but less rapidly than exports of plastics. Tires are the principal rubber export, and the United States and West Germany are the biggest customers. Israel's rubber industry is monopolized by the Alliance Tire and Rubber Company, which recently concluded Israel's largest export contract ever -- a $40 million deal - with a US distributor. As the principal materials used in tires are produced domestically and labor is available at wages that compare favorably with those prevailing in Western Europe, Israel's tires can compete on international markets without special subsidies.

37. Exports of electric and electronic equipment will continue to grow rapidly. Israel's chief advantage in the electronics field is the availability of relatively inexpensive skilled manpower in both top and middle-grade jobs. Many Israelis with electronics skills have foreign as well as domestic education and experience. Israeli firms turn their small size to their advantage by responding quickly to demands for small series or custom-made equipment. Most Israeli electronics firms have tie-ins with foreign firms through know-how agreements or partnership arrangements or as outright subsidiaries. Thus foreign technology, capital, and marketing facilities can be exploited. Among foreign firms involved are General Telephone and Electronics, Xerox Data Systems, Control Data, Motorola, Gerber Instruments, and American Electronic Laboratories. Israeli products include radio transmitters, receivers, and parts; telecommunication equipment; transformers and motors; small computers and peripheral equipment; and electronic laboratory and medical equipment. A large share of the exported products have military end uses. Israeli firms offer less developed countries complete communication systems from design through maintenance, and at least one company builds stations for satellite communication.

38. Exports from the printing and publishing industry, although still small, are growing fast. The United States is the principal customer. Israeli publishers are capitalizing on their expertise in the Hebrew language by producing an increasing quantity of religious books for export. Similarly, they are capitalizing on their considerable experience with foreign languages and with scientific materials and on the wage differential between Israel and the United States to print growing quantities of secular material for American consumers.

Products of Mining and Quarrying

39. Exports by the extractive industries will increase less rapidly than commodity exports as a whole. The output of potash, which accounts for 60% of extractive exports, now is nearly at full capacity, and additional capacity will not be available until 1974. Although Israeli copper mining is under pressure from depressed world prices, considerable preliminary work is going into the development of a second mine. Opening of the new mine should reduce unit costs and might encourage the building of facilities to refine ore into copper metal. Bromine production and export are increasing, spurred by a favorable price situation. An increasing proportion of bromine probably will be processed into compounds in Israel rather than exported in elemental form. Phosphate exports are unprofitable and are likely to be cut back further unless there is an increase in prices. A plant now is being built to extract magnesium oxide and salicylic acid from Dead Sea water. Annual capacity levels of 55,000 tons of the oxide and 80,000 tons of the acid are to be reached in mid-1973, with the entire output being exported initially.

Agricultural Products

40. Agricultural exports probably will increase by only about 5% per year through 1976. Exports of citrus fruit are not likely to grow rapidly or regularly, but they will remain important. Competition in the European market from other Mediterranean producers is becoming very strong, and fruit from Italy, Greece, Morocco, and Tunisia will enjoy tariff advantages in the expanded European Community. Israel will continue to respond to market demands by changing the mix of citrus exports and will strive also for qualitative improvement.

41. Exports of agricultural products other than citrus fruit, which were only 5% of commodity exports in 1971, should grow by 10% to 15% per year. Fastest growing exports in this category will be specialty products for the European market -- for example, flowers, artichokes, lettuce, celery, carrots, melons, strawberries, bananas, avocados, and mangos. Some of these products cannot be grown successfully in Europe, and others can be raised

only for marketing in a restricted season. Plantings of these items already are being expanded in response to favorable market conditions. Exports of raw cotton, peanuts, chicks, and hatching eggs will increase unevenly and less rapidly than the specialty products.

Services

42. Earnings from services should increase by about 15% annually, reaching a value of $1.75 billion in 1976 including exports to the occupied territories. Tourism, the biggest single service category, should continue to expand briskly unless repeated acts of terrorism foster continuing fear. The number of tourists visiting Israel jumped 50% in 1971 and continued to increase very fast until the summer of 1972, when terrorist acts caused some curtailment. Recent moves by Jordan relaxing restrictions on the two-way movement of tourists across the Jordan River could benefit tourism in both countries if continued and broadened. If terrorism subsides, the growth of tourism in Israel will be constrained primarily by the rate of expansion of hotel accommodations. As the number of visitors to Israel increases, the earnings of Israeli passenger carriers will increase commensurately.

43. Israel's fleet of ocean freight carriers has been expanded sharply in the last few years, and capacity will continue to be added through the mid-1970s. The merchant fleet totals more than 3 million deadweight tons of shipping, including all fully Israeli-owned ships, of which half sail under the Israeli flag. Vessels now being acquired are mainly tankers and container ships.

44. The Trans-Israel Pipeline is carrying increasing quantities of oil, and capacity of the line is being expanded from the present 30 million tons a year to 40 million. The pipeline operation is not profitable, however, because the pipeline company services the line with tankers acquired on multi-year leases before the recent big drop in tanker charges. The drop in tanker rates has reduced the cost of bypassing the pipeline by shipping Persian Gulf oil around Africa, thus putting downward pressure on pipeline charges. The company is pinning its hopes for profitability on an increase in its scale of operation.

45. Exports of other services will continue to grow. Israel sells a sizable amount of engineering and construction services, primarily to less developed countries. In the communications field, Israeli firms not only sell equipment but design, install, and service nationwide systems. Israel Aircraft Industries sells maintenance and overhaul services to foreign airlines and air forces. In all these areas, Israel is in a favorable position because it can sell the services of skilled people at relatively low prices. Also in the service sector, Israeli insurance earnings are large and expanding.

Conclusions

46. Israel's exports of goods and services (including exports to occupied territories) have been increased by about 15% per year over the last two decades and probably can be increased at a similar rate for the next several years. Earnings of $1.85 billion in 1971 were 2.2 times the 1966 level, making Israel's exports on a per capita basis 10 times as great as those of Egypt and comparable to those of the United Kingdom. Recent export growth has been concentrated in the industrial sector. Polished diamonds long have been the biggest single industrial export, but exports of clothing, processed foods, chemicals, machinery, metal products, tires, plastics, and electronic equipment are growing rapidly. Although citrus fruit has been a key export since before independence, it is not keeping pace with export growth in industrial goods. Currently agricultural exports are trending toward non-citrus fruits, vegetables, and flowers. The value of services exported is nearly as great as commodity exports, the most important services being tourism, transportation of passengers and freight, and insurance.

47. Israel's principal markets are Western Europe and the United States, the latter having increased considerably in relative importance in recent years. Taken together, all less developed countries account for about one-fifth of Israeli sales, and exports to such countries are increasing. The denial to Israel of Arab markets has limited exports to less developed countries but probably has not seriously affected overall export growth.

48. Export gains have resulted largely from government stimulation. Export industries have been kept profitable despite domestic inflation by periodic devaluations and heavy subsidization. The government of Israel probably will continue to push export growth pragmatically with subsidization and devaluation. If annual growth in exports of 15% is maintained, exports of goods and services will exceed $3.7 billion in 1976 (including exports to the occupied territories). Quality apparel, selected chemicals, machinery and other metal products, plastics, and electronic items are expected to lead future growth in commodity exports. Growth in services exports will be greatest in tourism, transportation, and engineering and technology.

49. Israel is capable of stabilizing or reducing its deficit on trade in goods and services in the coming years, but complete elimination of the deficit is unlikely. The growth of civilian imports might be held to 12% per year by firm measures, and it might prove feasible to keep defense-related imports near the present level for the next several years. While total defense-related imports would remain stable in this scenario,

their composition would change with growing self-sufficiency in defense production. Thus an increase in imports of materials for defense industries would offset a decline in imports of finished military equipment. If exports do in fact grow 15% per year and civilian imports 12% while defense-related imports are limited to $800 million per year, the deficit will be slightly lower in 1976 than in 1971. Projecting the growth of exports and civilian imports still further at the same rates would erase the deficit in 1984 even if defense-related imports were allowed to reach $1.3 billion a year.

50. Exports could grow by as much as 18% per year, particularly if diamond sales continue to zoom, but this more rapid growth probably would lead to a relaxation in restraints on imports. Moreover, increases in diamond exports would be largely offset by increases in imports of rough diamonds. Hence the deficit on goods and services transactions probably would persist very much as in the first scenario. A flareup of international hostilities could cause defense-related imports to rise sufficiently to offset any likely increase in export earnings. If the annual growth of exports should slip much below 15%, the government would be hard pressed to effect any reduction in the deficit on goods and services transactions, barring the imposition of harsh restrictions that would trigger a major economic recession.

51. In reality, there is little pressure on the government to eliminate the deficit in goods and services. Israel now receives about $1.5 billion annually in US government loans and grants, private donations and bond purchases, personal restitution payments by the West German government, and personal transfers (including immigrants' remittances). There also is a substantial, though fluctuating, inflow of commercial capital. So long as these inflows of foreign exchange continue, the government has no reason to impose painful and unpopular measures that would restrain imports sufficiently to eliminate the deficit. Elimination of the deficit would only lead to accumulation of foreign exchange reserves or diminution of that aid that makes life easier for the people of Israel.