

APR 8 1977



UNITED NATIONS
GENERAL
ASSEMBLY



UN/SA COLLECTION

Distr.
RESTRICTEDA/CN.2/R.387
5 April 1977

ORIGINAL: ENGLISH

COMMITTEE ON CONTRIBUTIONS
Thirty-seventh session
New York

REPRESENTATION BY ISRAEL

The following communication dated 5 April 1977 from the Minister Plenipotentiary of the Permanent Mission of Israel to the United Nations addressed to the Chairman of the Committee on Contributions is submitted to the Committee for its consideration.

"Referring to the Secretary-General's note No. FI313/1 (1) of 22 February 1977, with regard to the meeting of the Committee on Contributions, my Government has requested that the attached aide-mémoire be considered by the Committee, in addition to the normal statistics provided by the Bank of Israel.

As you remember, Mr. Ambassador, Israel's assessment, last year, was raised from 0.21 per cent to 0.24 per cent, in spite of the adverse effects of our economy.

The Government of Israel would highly appreciate it, if the Committee, under your Excellency's able guidance, would find it possible, taking into consideration the enclosed aide-mémoire, to make a downward adjustment in the rate of our assessment in the next scale."

Israel - A developing country

The purpose of this short paper is to present data relevant to the position of Israel in the array of countries classified according to their degree of development.

One of the most widely used criteria for such a classification is the "GNP per capita" criterion. 1/ If the dollar value of this measure is estimated at the

1/ See World Bank Atlas 1974, pp. 23-24. The Atlas recognizes the deficiencies inherent in the official exchange rate approach to intercountry comparisons of per capita GNP. It recommends, that such comparisons should be based on purchasing power parities which include price comparisons of non-tradeable outputs as well as those of tradeable ones. Such estimates are not available for Israel.

official exchange rate, Israel's rank, in the last three years, is in the \$3,000 range. (See table 1 below.) But given the overvaluation of the Israeli pound, one should value the per capita GNP (in dollars) at an exchange rate which includes this element of overvaluation. One can arrive at an approximation of this overvaluation on the basis of effective protection rates. ^{2/} These rates are defined as the percentage by which the tradeable component of GNP (value added generated in the production of import substitutes and exports) valued at domestic prices exceed the value of that component at world prices. If we value per capita GNP (in dollars) at this corrected rate, Israel is placed, in the last three years, in the \$2,000 range.

It should be noted that the exchange rate including the effects of the protective structure is not an "equilibrium" rate in the sense that it does not equate imports with exports (goods and services). As can be seen from table 1, the yearly import surplus in the post Yom-Kippur war period was in the 3 to 4 billion dollar range. It is obvious that the "equilibrium" rate would be a much higher rate than the one we used to translate GNP in Israeli pounds to GNP in dollars.

One of the most important causal factors in the size of Israel's import surplus is this country's defence expenditures. The share of these expenditures in GNP which was 21 per cent in 1972, rose to 42 per cent in 1973 and remained in the 30-35 per cent range in the 1974-1976 period.* Given that in most countries defence expenditures comprise about 3 to 4 per cent of GNP, the much higher share of Israel should be considered as an excess burden.

It cannot be said that this excess defence expenditure, arising from special political circumstances, adds to the welfare of the Israeli people, in the same sense that other elements of the GNP do. This excess expenditure should therefore be subtracted from Israel's gross national product, when the size of the latter is compared to the size of the products of other countries on a per capita basis.

Here below are the estimates of the excessive defence burden translated into dollars at the effective exchange rates used earlier. United States grants-in-aid which financed part of the burden were netted out.

As can be seen from the table below, the per capita GNP, corrected for excess defence expenditures, amounts, in the 1974-1976 period, to some \$1,600.

^{2/} For an analysis of the protective system in Israel in 1965 and 1968 see J. Baruh - Structure of Protection in Israel, 1965 and 1968 - Bank of Israel, Research Department, August 1976. The effective protection estimates in this study have been updated for the 1972-1974 period (forthcoming in Bank of Israel Bulletin).

* It should be pointed out that these defence expenditure figures are underestimates - given the nearly "free" services given to the state by army conscripts for periods of two to three years.

Table 1. Data for the conversion of the values of
GNP into \$ values, 1972-1975

	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>
1. <u>GNP per capita</u> (Israeli pounds)	9 307	11 455	16 058	21 668
2. Official exchange rate (IL per \$)	4.20	4.20	4.46 <u>1/</u>	6.00 <u>2/</u>
3. <u>GNP per capita</u> (in \$s at official exchange rate)	2 216	2 727	3 600	3 423
4. Exchange rate including element of effective protection <u>3/</u>	7.66	6.96	8.00	10.34
5. <u>GNP per capita</u> (in \$, at effective protection rates)	1 215	1 646	2 005	2 096
6. Import surplus (in \$)	1 101	2 642	3 387	4 037
7. Foreign indebtedness (in \$s)	4 081	5 093	6 250	7 617

1/ Average for two periods with different official exchange rates:
4.20 IL per \$ up to 9 November 1974 and 6.00 IL per \$ till the end of the year.

2/ Average of six different official exchange rates ranging from 6 IL
per \$ at the beginning of 1975 to 7.10 IL per \$ at the end of 1975 (creeping
devaluation).

3/ The latest estimate of effective protection rate on import substitutes
refers to 1974. We assumed that the rate remained unchanged in 1975.

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Table 2. Excess defence burden of Israel, 1972 to 1975

	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>
1. Defence expenditure as per cent of GNP	21	42	30	35
2. Excess defence burden <u>1/</u> (per cent)	17	38	26	31
3. Net excess defence burden (M.\$)	596	1 262	1 069	1 580
4. Net excess defence burden <u>per capita</u> (\$)	188	385	316	457
5. GNP <u>per capita</u> corrected for net defence burden (\$)	1 027	1 261	1.689	1 639

1/ Excess defence burden (per cent of GNP) equals to total defence expenditure minus "normal" defence expenditure (4 per cent of GNP).

The sharp difference between the pre- and post- 1973 periods arising from the drastic increase in defence expenditures was reinforced by the deterioration of Israel's terms of trade in 1974. 3/ This deterioration, which was due to the sharp increases in the world prices of primary products specially can be regarded as a real reduction in the resources available to the world economy. This is due to the fact that in order to offset the effect of the terms of trade deterioration on this country's capacity to import, in the 1973 period, one needed, each year, resources in the form of additional and/or capital imports of a size equal to about 9 per cent of current use.

It should be pointed out that the impact of the terms of trade deterioration on Israel was relatively severe, given its high imports/GNP ratio.

The impact of the increased defence expenditures and of the worsening terms of trade on the current account, led to a sharp increase in the external indebtedness of Israel, with a marked increase in the share of short-term debt within total debt. (See table 3 below.) These changes will constitute, for the years to come, a heavy burden on the productive capacity of Israel's economy.

3/ The terms of trade deteriorated in the 1973-1975 period by the following percentages:

1973 - 4 per cent 1974 - 23 per cent 1975 - 2 per cent

Source of data for the above section: Bank of Israel Annual Report 1975
Table VI-11 - p. 132.

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Table 3. Israel's foreign indebtedness 1972-1975

	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>
Total debt (million dollars)	4 081	5 093	6 250	7 617
Cumulative percentage distribution of total debt				
(a) up to one year	11	11	16	19
(b) one to two years	17	17	24	25
(c) two to three years	23	24	30	32
(d) three to four years	30	31	37	40
(e) four to five years	35	38	45	47
(f) five years or more	100	100	100	100
(Five years or more non-cumulated)	(65)	(62)	(55)	(53)

As a foot-note we would like to cite from an OECD study by Dr. Wilfred Beckerman (International Comparisons of Real Incomes, Paris 1966) which has developed non-monetary real consumption indicators. These indicators which are highly correlated with various national accounts aggregates are used by Beckerman for the estimation of relative real per capita GNP levels in countries whose exchange rates are unfit for such comparisons. On the basis of these indicators, Beckerman arrives at the conclusion that in 1960, real GNP per head in Israel was about 24 per cent of real per capita GNP in the United States of America. (See table 6 - p. 42 in the study cited above.) If we assume that this ratio has remained constant over the years - then Beckerman indices yield a \$1,500 per capita GNP estimate for Israel in 1973 (\$6,200 x 0.24), an estimate which is not much different from the one arrived at in our table 1, line 5.
