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Statement by the Hon. MOSHE NISSIM,
Minister of Finance and Governor of the Fund for ISRAEL,
at the Joint Annual Discussion

This is my first opportunity to take part in the Annual Meetings of the World Bank and the International Monetary Fund. I would like to commend the President of the World Bank and the Managing Director of the Fund for the effort and thought they and their staffs are investing in resolving the economic and financial problems of the world. They rightly emphasize the problems that disturb us all, and, in particular, disturb the developing countries and the countries laboring under a heavy burden of servicing an external debt.

In 1986 and 1987, there were some encouraging developments in a number of less developed countries, such as the renewal of growth and the lowering of inflation rates. The slowdown in growth and demand for imports in some industrial countries and the debt service burden of many developing countries have, however, cast a shadow over the positive developments. Postponement in finding a solution for these problems can only perpetuate the situation. Lack of solutions may only aggravate such a process. This, therefore, is the main issue facing the international banking institutions and the banking system in the industrial world.

The long-term solution for the problems of balance of payments, external debt, and living standards is, first and foremost, the formation of conditions that will ensure continuous and sustainable growth.

Growth requires structural changes, mainly through the increase of exporting industries. Export-led growth, however, can only succeed if the demand for imports on the part of industrial countries grows.

Increasing demand for the products of developing countries depends, among other things, on removal of obstacles to international trade in all countries. Progress in this area in recent years leaves little room

for satisfaction. In the long term, the economic stability of industrial countries, as well as political stability of the whole world, depends on finding solutions for the problems of the developing world.

Growth needs investment. The problem is that in some developing countries living standards are so low that an adequate level of savings to provide the necessary investment cannot be attained. Thus, the only solution for the problems of these countries necessitates the import of capital. However, import of capital will not solve their problems unless a structural change takes place.

We in Israel have learned that problems of balance of payments and inflation cannot be solved without the introduction of a comprehensive and consistent policy which may also be painful.

In the first half of 1985, our inflation and balance of payments deteriorated. Inflation accelerated to a monthly rate of 20 percent, combined with depletion of our foreign currency reserves. In order to turn around these trends, Israel adopted in July 1985 a comprehensive policy which included a whole range of fiscal, monetary, wage policy, and exchange rate measures. Temporary use was made during the transition period of administrative price controls.

To date, this policy has had positive results. Inflation is down to 1.5 percent a month. This is still high by international standards, and we hope to bring it down yet further. In order to achieve this, we are restraining expenditures and have taken special measures to improve tax collection.

The main nominal anchor during the period of stabilization was a fixed exchange rate. At the beginning of the process we fixed the exchange rate to the U.S. dollar, allowing our currency to devalue relative to our basket of foreign currencies. Later on, we fixed the exchange rate to the basket of currencies. Ten months ago, we managed to devalue our currency by 10 percent without any noticeable effect on the rate of inflation.

We have also adopted a restraining monetary policy, resulting in high real interest rates which helped to support the stable exchange rate. These rates started to decline at the end of 1986.

Stabilization of the economy and the improvement of our financial situation have enabled us to focus our attention on finding long-term solutions and thus laying the foundation for renewed growth.

In order to create a suitable climate for growth, income tax as well as capital market reforms were introduced.

We believe that the income tax reform which brought the maximum marginal tax rate down from 60 percent to 48 percent, and the corporate tax from 61 percent to 45 percent, will encourage motivation to work and invest.

The noteworthy reduction in the budgetary deficit in 1986 permitted us to make considerable reduction in government involvement in the capital market. In the past, the business sector was crowded out by the Government. Now, business has room to raise money in the capital market.

There are clear indications that we have passed the low point of economic activity. Gross domestic product this year is expected to be 4-5 percent higher, and the product of the business sector will increase by 5-6 percent. The composition of this year's anticipated growth is well balanced. Particularly encouraging is the significant growth of investments in fixed assets.

The recovery in economic activity is also expressed in a decline of unemployment rates from 7.5 percent to approximately 5.5 percent. The rate of savings, which declined last year, is expected to rise again. The real increase in imports over the last two years was mainly caused by a growth in the import of inputs for manufacturing and fixed asset investments.

One of the main factors for the success of the economic policy is the public trust in this policy. Despite--or perhaps because of--the unpopular steps we have adopted, we have come to realize that one can win public and political popularity by courageously taking the right steps, however difficult they may be.

We realize that, despite these achievements, we are only halfway down the road in the process of economic recovery.

I often ponder how similar are the problems of a small-scale economy such as ours to those with which large countries struggle. The requisite solutions are also similar. Our experience in the last two years has served to strengthen our conviction and belief that, when the correct steps are taken, positive results can be achieved.

Our message to other countries which are in the situation in which we found ourselves two years ago is that a stabilization program can work. We will be glad to share our experience with all countries.

These days the Jewish people celebrate their High Holidays. In our prayers during these days we say: "Our Lord in Heaven: Grant peace unto thy land. Give prosperity to the world." What more can we all ask for, if not to live in a better world where peace and prosperity reign.

Let us hope that these prayers will be fulfilled in our days.