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UNITED NATIONS PALESTINE COMMISSION

Memorandum dated 17 March from the Advance Party
concerning the general economic situation in
Palestine with special reference to Inflationary
Forces.

The following Memorandum by Mr. Ghosh was received in Advance Party

Air Pouch Number 2 on 21 March.

PALESTINE COMMISSION ADVANCE GROUP

A SURVEY OF THE GENERAL ECONOMIC SITUATION IN
PALESTINE WITH SPECIAL REFERENCE TO INFLATIONARY
FORCES

(Memorandum by D. Ghosh)

The price situation in Palestine today is determined by a complexity of factors whose strength can be only broadly estimated. Externally, the most important forces have been (a) the import surplus, (b) the military expenditure, and (c) the import of Capital. Imports during the current financial year have flowed in at an average rate of roughly LP8,000,000 a month, and the total for the year is expected to amount to about LP.90,000,000. Exports have not increased much so that the net import surplus of the year is likely to be between LP.50 and LP.60 million. Military expenditure has been falling for some time and is expected to fall further. No estimate has yet been available to me, but it may amount to half its level of last year. Imports of capital and/or draft on the sterling resources of Palestine will have to be on a larger scale to meet the deficit that will remain after military expenditure has been deducted from the import surplus. It is likely that a part of the import surplus has been paid out of the sterling assets of the country. Up to November 1947 both currency in circulation and the volume of bank demand deposits declined appreciably. This was accompanied by similar falls in the holding of foreign balances and foreign investments by the Palestinian banks.

The movement of the Palestinian price level, however, does not show the net deflationary effect of these factors. The wholesale price index rose from 337.9 in March 1947 to 366.0 in October 1947, though there was a dip in November to 356.5. The cost of living index, however, remained fairly steady. The Wage Committee Index which, I am told, is used widely in adjusting wages of industrial and commercial workers in Palestine, followed closely the behaviour of the Cost of Living Index. It would seem, therefore, that the higher wholesale prices during the period were due to factors other than monetary supply. One of the explanations given is that the international prices of many of the commodities which figure in the wholesale Prices Index moved up during the period. Some rise of the wholesale prices was also made possible by the expansion of bank

credit which importers have made use of to pay for imports. According to the Currency Officer, the volume of currency in actual circulation was probably augmented by the issue out of hoards. The rising prices induced farmers and others who had built up hoards out of the war-time high receipts for their products to draw on them to meet their current expenditure. Evidently movements into and out of private currency hoards can take place to some degree without affecting the officially recorded volume of currency in circulation. The wholesale price index has also been pushed up by the rise in price per unit of particular commodities, e.g. meat, which has been very much in short supply.

From about the beginning of last December the situation changed somewhat. The amount of currency in circulation increased in December and January. The increase is attributed to rising prices which was caused, in the main, by higher transport costs due to the spread of disturbance over the country, though industrial production, it is said, was hardly affected. A large addition to the currency in circulation was made shortly before the issue of the Currency Ordinances. At least in one centre, in Tel-Aviv, there was a big run on one of the larger banks and all banks in the City were closed on Monday 23 February. The panic died down soon after, but the cash taken out does not seem to have returned from circulation. One explanation is that people in Palestine have been for some time rather suspicious of the value of the pound sterling. It is also probable that some people had got scent, in a vague way, of the Currency Ordinances some time before they were enacted. The Ordinances, too, created temporarily a confusion in public mind. These factors are supposed to have played an important part in the recent expansion of currency in circulation, which represents, in some measure, a drive towards liquidity on the part of the public. Some contribution, though not a major one, to the increase of currency in circulation has been made by the recent upward revision of grades in government service on the basis of the Mill's report.

In using the wholesale and retail price indices it is necessary to remember that (a) some of the commodities whose prices are included in them have ceased to be available today at any price, (b) there has been an increasing decontrol by the Government so that recorded prices reflect more faithfully current supply and demand conditions; (c) the links between the Jewish and Arab markets have now almost completely broken up in many areas. For some time past the two markets have been behaving differently; while prices in the Jewish market have been on the upgrade, those in the Arab market have either kept steady or moved down slightly. This has induced the Statistical Department recently to discontinue the practice of combining the indices of price movement in the two markets to constitute a single index for the whole country.

Both indices are, however, dominated by the movement of food prices, which have allotted to them sixty per cent of the total weight and which have risen much more than others.

Industrial production, too, has suffered more and more since the increase of disturbances in the country. The difficulties have been connected mainly with the clearance of raw materials from the ports, the transport and safe storage of materials and finished products and the movement of workers. Up to now industrial activity does not seem to have been handicapped by lack of imported raw material, except in the case of textiles, which have been affected by the unwillingness of Egypt to export raw cotton to Jews in Palestine. It is probable that the shortage and uncertainty of supply of fuel oil has interfered with the full working of some factories. Industrialists have also experienced in recent months some difficulty in getting bank credit. In the absence of a central bank to which other banks in Palestine can turn for new money, the Palestinian banks have been obliged to maintain high cash reserves and conventionally to limit their advances to fifty per cent of their deposits. This limit seems to have been reached by most banks, which can now increase their advances only against the influx of fresh funds from abroad. I am, however, told that the influx of funds into the country has been hindered by the formalities that have to be gone through since Palestine was put outside the sterling area. On the other hand, the decision of the administration to reduce the extent of bulk purchases on government trading account and pass on the immediate financial responsibility to private parties has increased the latter's

need for funds. It is probable, finally, that the liquidity position of banks has been somewhat affected by the recent run for cash on some of them. On the other hand, there has been a certain contraction of total demand for some industrial goods, mainly textiles. This is due, in part, to the increasing cost of foodstuffs especially in the Jewish sector of the economy and the levy of taxes on its members by the Community to raise funds for defence purposes.

The volume of employment and the total wages bill have both decreased somewhat, but the decrease has been much less than one would think from official indices. A good proportion of the workers thrown out of productive work have been re-employed on defence work, including repair of buildings and other property damaged by bombs. The Jewish part of the economy would seem to be on a war basis with the familiar features of full employment, rising prices, etc.

It is the opinion of the officials concerned with economic affairs and of others that the rise of prices has not been accompanied by profit inflation except in limited instances. Wages have broadly kept up with prices, while prices of raw materials and costs of transport, etc. have gone up. In some cases, especially those of shopkeepers, the volume of business done has contracted as a result of disturbances. The total demand for the products of some industries, e.g. the textiles, has suffered a decline. Within the Jewish community, again, the Vaad Leumi is said to be exercising some check on profiteering.

The restriction of current industrial production has not, however, according to the Registrar of Joint Stock Companies, influenced the volume of investment activity in the country. Floating of new companies and extension of old ones are proceeding as before. Applications for patents and trade marks are on the increase. In some measure, the uncertainty regarding the future has stimulated the tendency to invest in land and buildings. Building construction is proceeding as before, in spite of high costs.

The general conclusion would be that the Palestinian economy retains its expansionary features in spite of disturbances, but inflationary forces are still fairly under control. Whether the situation would change in the near future would depend upon (a) security conditions, (b) on public finance operations, and (c) on currency and foreign exchange measures. With further deterioration of security

conditions, the economy will disintegrate further and prices will rise in the Jewish sector though they may remain steady or rise less in the more self-sufficient and primitive Arab sector. So far as the ordinary budget of the Administration is concerned, there has been a surplus of revenue over expenditure. But the accumulated surplus would be exceeded by extraordinary expenditure on account of abolition benefits. The inflationary effect of the abolition payments would, however, depend on the extent to which they are made in Palestine itself and on their spread over time. The effect would be greatly reduced if a good proportion of the non-expatriate staff is reabsorbed by the new administration on the termination of the Mandate and if payments to expatriates are made outside Palestine, and, finally, if payments are distributed over a fair length of time by conversion of lump sums due into annuities or otherwise. Similarly, if Cyprus expenses are met out of the accumulated funds or for the time being, out of money borrowed from the United Kingdom Government, they should exercise no inflationary effect on the Palestine economy. Summing up, the net addition to inflationary pressure exerted by finance operations of the present administration would be defined by the size of accumulated revenue surplus plus the amount of funds it borrows from the United Kingdom to meet its extraordinary expenditure within Palestine. From about the end of the period of the Mandate, the financial operations of the present Administration would be supplemented by the import of funds to meet the expenses of the United Nations Commission. This would be a definitely inflationary factor.

The effect of the recent currency measures may be, finally, noted. One of the important methods by which inflationary forces in Palestine could be checked would be to allow an import surplus to develop and be paid for out of the reserves of the Currency Board. This outlet has been closed by the recent measures which blocked Palestine sterling balances, including those of the Currency Board. On the other hand, exclusion of Palestine from the sterling area would hinder the inflow of funds into this country from sterling area countries. The Jewish Agency people hold that if a large import surplus does develop, it has at its disposal sufficient foreign resources to meet the emergency.

The anti-inflationary measures that will be necessary in the period of United Nations Commission responsibility would seem to comprise (a) arrangement for adequate import of food (b) retention of price control, (c) some control or at least direction of capital investment until the supply of consumer goods within the country is adequate, (d) restriction of import of capital to amounts necessary to provide for current consumption and insistence on foreign capital entering the country in the form of goods, raw materials and machinery, and (e) release by negotiation with the United Kingdom of sufficient sterling from the currency to build up an international margin that can be used to support a large import surplus. Finally, it is needless to say the greatest contribution to anti-inflation would be made by the maintenance of adequate security conditions in the country.

**STATEMENT OF APPROXIMATE REVENUE AND EXPENDITURE
TO 31st JANUARY, 1948**

1947-48		R E V E N U E					To Rev
		Customs	Licences, Taxes, etc.	Other Sources	Total Ordinary Revenue	Grants	
		£P.	£P.	£P.	£P.	£P.	
April,	1947	1,086,450	480,918	338,904	1,886,267	-	1,8
May,	"	1,168,382	641,435	389,614	2,199,429	-	2,1
June,	"	1,118,667	584,068	1,278,286	2,981,015	-	2,9
July,	"	1,101,623	697,224	892,702	2,191,549	-	2,1
August,	"	1,057,827	646,849	316,302	2,020,985	-	2,0
September,	"	1,179,828	811,070	401,859	2,392,757	-	2,3
October,	"	1,150,984	658,702	453,652	2,263,338	-	2,2
November,	"	1,111,000	650,000	411,000	2,182,000	-	2,1
December,	"	940,000	825,000	279,000	1,744,000	-	1,7
January,	1948	910,000	546,000	479,000	1,935,000	-	1,9
Total		10,804,698	6,251,260 ^(a)	4,740,830	21,796,788	-	21,7
Estimates 1947-48		10,800,000	7,503,700	5,411,691	23,415,391	144,290	23,4
Actual Revenue and Expenditure from 1st April, 1946, to 31st January, 1947		9,113,333	6,572,833	4,541,584	20,228,750	48,205	20,2
Actual Revenue and Expenditure 1946-47		11,140,860	8,225,845	6,272,396	25,640,101	76,535	25,7

NOTE: All figures are final, except those for the last three months. The figures in red are approximate and are subject to change.

- (a) Includes £P. 2,070,000.- Income Tax.
 (b) Includes £P. 650,000.- Contribution from Palestine.
 (c) Includes:
 (i) £P. 570,000.- Public Debt.
 (ii) £P. 5,070,000.- Compensatory Allowance.
 (iii) £P. 480,353.- Assistance to the City.
 (iv) £P. 5,000,000.- Reserve Fund.
 (v) £P. 1,980,000.- Maintenance of Jewish Community.
 (vi) £P. 185,000.- Evacuation of British Subjects.
 (vii) £P. 84,000.- Security Moves.
 (d) Includes £P. 1,863,000.- Government Trading Account.

STATE REVENUE AND EXPENDITURE FOR THE PERIOD 1ST APRIL, 1947,
TO 31ST JANUARY, 1948.

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R E V E N U E				E X P E N D I T U R E				
	Total Ordinary Revenue	Grants	Total Revenue	Ordinary (Recurrent & Special)	Temporary Services	Extra- ordinary	Customs Draw- backs	Total Expenditure
	EP.	EP.	EP.	EP.	EP.	EP.	EP.	EP.
01	1,886,267	-	1,886,267	1,381,556	21,145	13,051	3,593	1,419,345
14	2,199,429	-	2,199,429	1,817,156	39,123	69,722	9,229	1,935,232
b)	2,981,015	-	2,981,015	1,788,523	700,622	92,619	14,569	2,596,368
02	2,191,549	-	2,191,549	1,611,486	17,974	62,791	6,893	1,699,144
09	2,020,985	-	2,020,985	1,407,600	38,757	100,739	30,456	1,577,562
59	2,392,754	-	2,392,754	1,527,971	789,917	89,114	3,116	2,410,118
62	2,263,289	-	2,263,289	6,443,498	16,200	112,068	4,749	6,576,535
00	2,182,000	-	2,182,000	1,934,000	20,000	96,000	7,000	2,057,000
00	1,744,000	-	1,744,000	2,073,000	341,000	84,000	6,000	2,504,000
00	1,935,000	-	1,935,000	1,708,000	29,000	93,000	3,000	1,833,000
30	21,796,288	-	21,796,288	21,692,827 ^(c)	2,013,756 ^(d)	815,124	88,615	24,608,304
91	23,415,391	144,290	23,559,681	20,282,085	2,069,276	2,203,705	80,000	24,635,065
54	20,222,750	48,205	20,276,955	14,082,288	1,405,656	822,940	47,198	16,358,082
28	25,640,101	76,535	25,716,636	19,172,919	2,061,707	1,245,677	65,723	22,547,026

except those for the last three months in the table and the total for the ten months.
~~approximate and are subject to revision. The figures in black are final.~~

0,000.- Income Tax.

0,000.- Contribution from Palestine Currency Board.

0,000.- Public Debt.

0,000.- Compensatory Allowances (Figures supplied by Departments).

0,353.- Assistance to the Citrus Industry.

0,000.- Reserve Fund.

0,000.- Maintenance of Jewish Illegal Immigrants.

5,000.- Evacuation of British Civilians.

1,000.- Security Moves.

3,000.- Government Trading Account.

Shin
ACCOUNTANT-GENERAL.