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Supplement: The Structure of Gross Domestic Product and Gross Capital Formation in the West Bank and the Gaza Strip in 2011[1]

Investment is of outmost importance to an economy as it helps expand productive capacity and increase potential output, thus stimulating future economic growth, employment creation and a rise in living standards. Gross capital formation is one of the expenditure components of Gross Domestic Product (GDP), together with final consumption and net exports, and serves as an indicator of the level of investment in an economy.

$$\text{GDP} = \text{final consumption} + \text{gross capital formation} + \text{net exports of goods and services}$$

Investment is made possible through saved income, which implies the sacrifice of consumption today in the expectation that the saved and invested income will yield an increased flow of income and consumption tomorrow. Poorer countries and territories typically face a dilemma whereby little income may be available for saving and investment if a large proportion of income is spent only to meet the essentials of life, thus limiting the expectations of growth in the future.

The Composition of Gross Domestic Product in the West Bank and Gaza

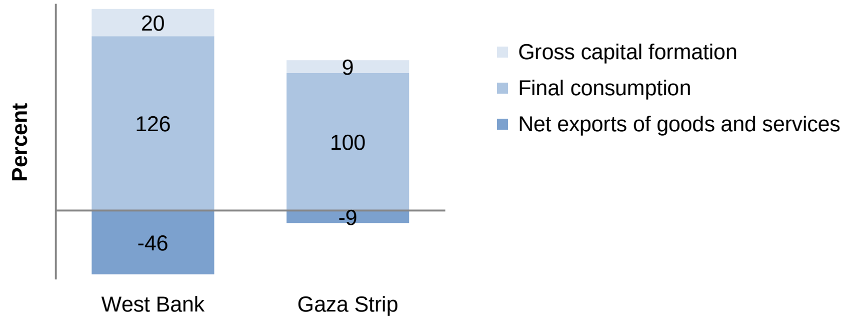
GDP reached US$8,768.6 million in nominal terms in the oPt in 2011. Total final consumption (encompassing the final consumption of households, government and non-profit institutions serving households, or NPISH) was the largest component of GDP, surpassing the value of GDP by about 20% and reaching a level seven times greater than that of gross capital formation.[2]

The composition of GDP reveals significant differences between the West Bank and the Gaza Strip, however. In particular, whereas gross capital formation reached 20% of GDP in the West Bank, it was a low 9% of GDP in Gaza. At the same time, final consumption was equal to GDP in Gaza but it was equivalent to 126% of GDP in the West Bank. These levels of consumption and gross capital formation were possible in both regions through import levels that exceeded exports, that is, through a trade deficit or negative net exports. The deficit in the registered trade of goods and services was equivalent to 9% of GDP in Gaza and 46% of GDP in the West Bank. (See Graph 1 below.)

[1] Data for this supplement are from PCBS's *Preliminary Estimates of Quarterly National Accounts (Fourth Quarter 2011)*

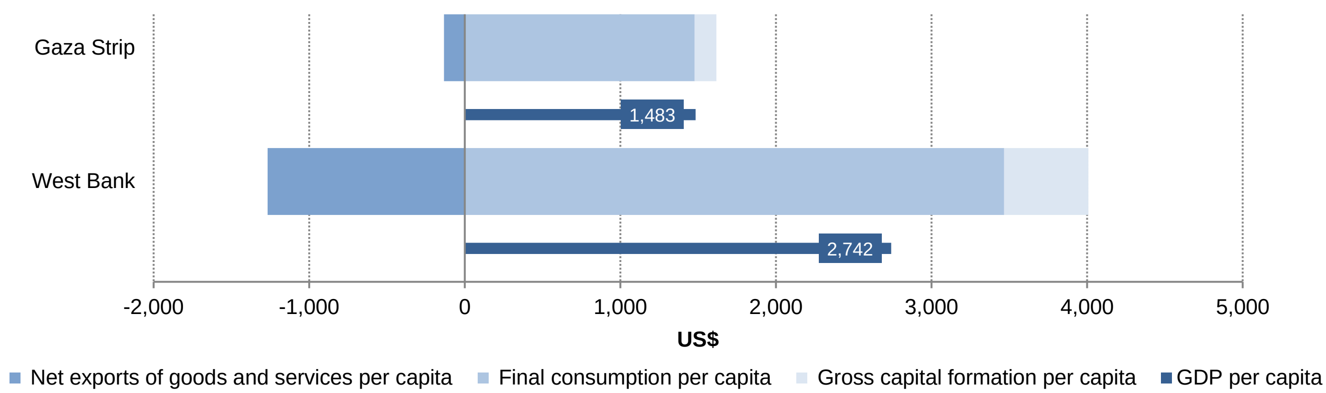
[2] Most of this consumption is household and NPISH final consumption. Very high proportions of GDP spent on private consumption are often characteristic of low levels of income.

GRAPH 1
Composition of gross domestic product, 2011



The differences between the two regions in per capita terms are striking. Whereas final consumption per capita in the West Bank was more than twice the level as in the Gaza Strip, gross capital formation per capita was almost four times higher in the West Bank than in Gaza. These higher levels of consumption and investment per capita in the West Bank were realized through a registered trade deficit that was almost ten times greater in per capita terms in the West Bank than in Gaza. (See Graph 2 below.)

GRAPH 2
GDP and its components per capita, 2011



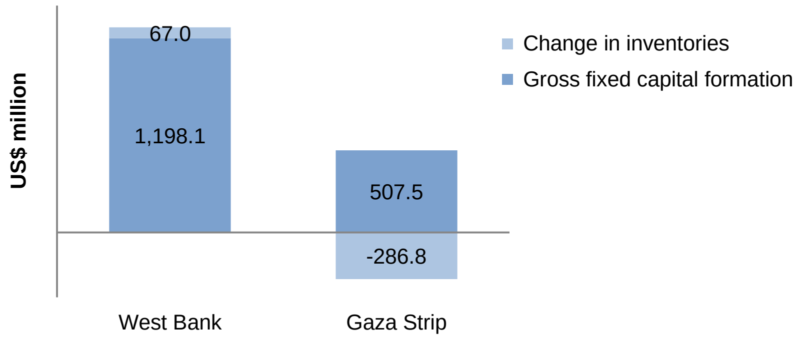
Gross Capital Formation in the West Bank and Gaza

Gross capital formation consists of expenditures by the private and public sectors on additions to the fixed assets of the economy, such as equipment, machinery and buildings, plus net changes in the level of inventories, and acquisitions less disposals of valuables, such as precious metals and works of art.

$$\text{gross capital formation} = \text{gross fixed capital formation} + \text{change in inventories} + \text{net acquisition of valuables}$$

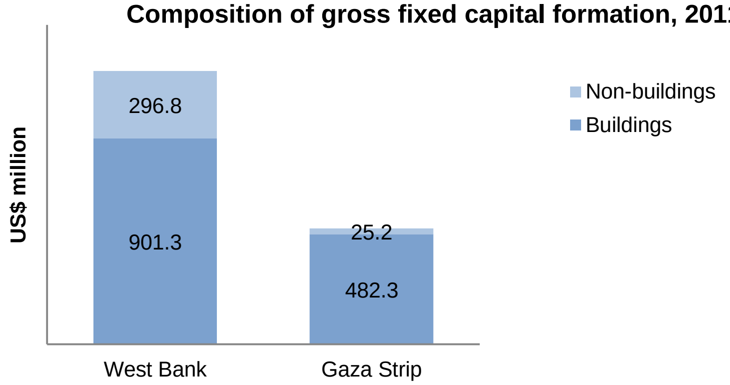
Gross capital formation displays different structures in the West Bank and Gaza, partially explaining the low levels of investment observed in Gaza. Although gross fixed capital formation (e.g. investments in machinery and buildings) was more than twice as high in absolute terms in the West Bank as in Gaza in 2011 (US$1,198.1 vs. US$507.5), it played a more important role in Gaza than in the West Bank relative to GDP (22% vs. 19%) and relative to total gross capital formation (230% vs. 95%). Change in inventories, which are stocks of goods held by firms or government often to meet temporary or unexpected fluctuations in production or sales, was 1% of GDP and 5% of gross capital formation in the West Bank, but was negative, equal to -12% of GDP and -130% of gross capital formation, in Gaza. This implies that Gaza "disinvested" by tapping into its existing inventories and/or by the decreasing value of its inventories in 2011, partially explaining the lower level of total investment discussed above. The net acquisition of valuables was equal to zero in both regions. (See Graph 3 below.)

GRAPH 3
Composition of gross capital formation, 2011



Gross fixed capital formation, composed of fixed capital formation on buildings and on non-buildings (e.g. equipment and machinery), also displays important differences between the two regions. Specifically, whereas gross fixed capital formation on buildings was almost twice as high in absolute terms in the West Bank as in the Gaza Strip, buildings represented 75% of gross fixed capital formation and 71% of gross capital formation in the West Bank, but in the Gaza Strip they represented 95% of gross fixed capital formation and 218% of gross capital formation. This reveals the dominance of buildings in total investment in Gaza in 2011. (See Graph 4 below.)

GRAPH 4
Composition of gross fixed capital formation, 2011



In sum, overall investment in Gaza was low in 2011 as a proportion of GDP and also compared to investment levels in the West Bank. Inventories experienced a significant reduction during the year, offsetting some of the investment made through fixed capital formation and thus contributing to this low level of total investment. Furthermore, almost the totality of gross fixed capital formation in Gaza was in the form of buildings. Building, in particular residential building, may have a more modest impact on productive capacity than other types of productive investment, such as capital formation in the form of machinery. Increasing future income flows in Gaza through investment would require an increase in current savings and the investment of savings in the most productive use. As mentioned in the introduction, however, increasing savings is not an easy option if consumption levels are low and close to covering only the essentials of life.