

CHAPTER V

DOMESTIC INVESTMENT

GROSS DOMESTIC investment amounted to IL. 840 million in 1957 at current prices, against IL. 655 million¹ in 1956. This rate of increase of 28.2 per cent partly reflects a price rise of 6 per cent. The increase in real terms amounts, therefore, to 21 per cent. Net investment for 1957 was estimated at IL. 664 million, representing a real increase of 23 per cent over that of the previous year (see Table V-1).

TABLE V-1
Domestic Investment, 1956-1957
(millions of 1957 IL.)

	1956 ^a	1957	Percentage increase
Gross investment	695	840	20.9
Depreciation ^b	157	176	12.1
Net investment	538	664	23.4

SOURCE: Bank of Israel.

^a Revised estimate.

^b As no data for depreciation are available, depreciation has been calculated at 7 per cent of the national income.

The increase in residential building construction accounted for about half of the increase in total investment in 1957. Imports of equipment—ships, aircraft, industrial and other—which had actually been ordered long before the period under review, accounted for another portion of the increase, while there was also a substantial increase in investment in services.

The share of investment within total resources available to the economy from the gross national product and the import surplus was 23 per cent in 1957 and 21 per cent in 1956. The Israel economy requires such a high rate of investment in order to ensure a high level of output in the future. This will render possible the maintenance of the standard of living of the rapidly growing population after capital imports have contracted following the completion of the reparations agreement with Germany. To attain a high level of output in the future, the

¹ Revised estimate.

channelling of investments is of major importance even now. This will enable development of those sectors which will be conducive to the solution of the economic problems likely to arise in the future.

In Israel, the channelling of investments assumes particular importance. The annual amount of investment represents a considerable share of the capital stock, thus changing the production pattern every year. Such changes are likely to transform investments which are profitable at present into non-profitable investments in the future. At present prices, the establishment of a new enterprise to produce a given commodity may appear desirable. Moreover, upon the beginning of operations and with the rise in marketed quantities, prices of this commodity are likely to fall. At the new price level, the profitability of the plant may turn out to be doubtful. Contrariwise, enterprises whose establishment may not appear to be a fruitful investment at the existing price level may become profitable investments in the future at changed relative prices. Obviously, a change in prices may be caused not only by expanded production, as a result of present investments, but also by other factors some of which can already now be foreseen. The coming decline in capital imports will undoubtedly change relative prices and will affect the profitability of present investment. Hence greater importance should be attached to investments devoted to the production of exportable commodities.

In view of the fact that private investors cannot foresee such price changes, they make only a minor allowance for these considerations when planning their investments. The Government, on the other hand, are more likely to foresee such changes. They take them into consideration both in planning their own investments as well as in channelling those of private investors.

In 1957, as in previous years, investment has been financed to a great extent by the Government, the Jewish Agency and the local authorities. Through their investments, these public institutions influenced both the overall volume and the distribution of investments between the different sectors. An analysis of investments shows that a considerable part went in 1957 to building and services. Investment in these sectors was made in response to the conditions which arose in 1957. It would, however, appear that, in view of the considerations outlined above, certain investments did not constitute first priorities in the light of long run developments.

It should, however, be borne in mind, that investment in construction cannot be easily replaced by investment in equipment that necessitates a large outlay in foreign exchange. More foreign exchange is required for a given amount of local currency invested in equipment than for an identical amount invested in construction. A decline in investment in construction and an increase in investment in equipment calls, therefore, for a greater use of foreign exchange. This leads to a reduction in imports for current production, causing in turn a considerable fall in output and in employment.

The analysis of investment by destination is shown in Table V-2 and in Diagram V-1.

1. FACTORS DETERMINING THE VOLUME AND THE CHANNELLING OF INVESTMENTS IN 1957

Following the Sinai campaign, there was a decline in defence expenditure in 1957, which rendered possible the diversion of a greater part of resources to investment.

TABLE V-2
Gross Fixed Investment by Industrial Use, 1956-1957
(millions of 1957 IL.)

<i>Industrial group</i>	1956 ^a	1957	<i>Increase or decrease (-)</i>	
			<i>Million IL.</i>	<i>Percentages</i>
Agriculture and irrigation	141.4	158.1	16.7	11.8
Industry	111.8	122.5	10.7	9.6
Mining and oil	34.0	34.9	0.9	2.6
Electricity	52.2	43.9	- 8.3	-15.9
Transport	68.5	99.7	31.2	45.5
Residential building construction	219.2	287.7	68.5	31.2
Services	68.3	93.5	25.2	36.9
<i>Total</i>	695.4	840.3	144.9	20.8

SOURCE: Bank of Israel.

^a Revised estimate.

The volume of investment, largely determined by the expenditure of the Development budget, was financed in the early part of the year by non-inflationary means. Towards the middle of the year, however, the Government was faced with the need to build housing at an accelerated pace. The Government did not raise tax collection, and thus did not reduce the expected rise in private consumption. An attempt was made to contract consumption through the encouragement of private saving in the form of Government bonds, of bank savings accounts, of provident funds, etc. Such savings, however, proved inadequate to cover the rise in additional investment expenditure, and part thereof was financed by inflationary means.

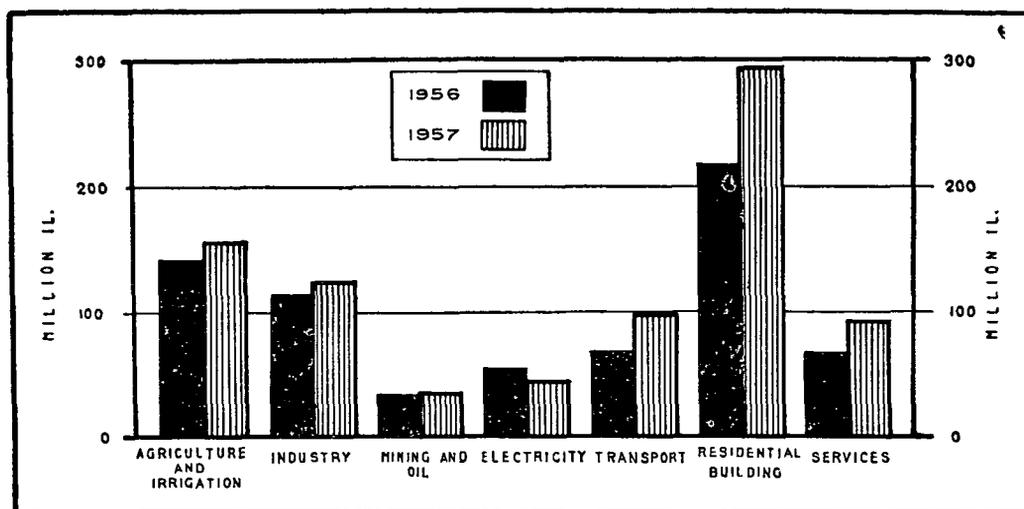
Residential Building Construction

The increase in investment in this sector was mainly in immigrant housing, which was double the investment in 1956. Total public residential building

DIAGRAM V-1

Gross Investment by Sectors, 1956-1957

(millions of 1957 IL.)



construction rose by 70 per cent, while private residential building increased only by a smaller extent (see Chapter XI, Building).

The import component in building and in non-building construction is lower than that of investment in equipment. The import component is about 20 per cent for investment in construction compared with 60 per cent for investment in industry. This means that a given sum invested in building requires a smaller outlay of foreign exchange on the one hand, and creates more employment than an identical sum invested in equipment on the other hand. In 1957, the Government was under strong pressure to supply more employment, both to new immigrants as well as to residents who entered the labour force as a result of the

TABLE V-3

Gross Fixed Investment, by Type of Asset, 1956-1957

(millions of 1957 IL.)

Type of asset	1956		1957	
	Million IL.	Percentages	Million IL.	Percentages
Machinery and equipment	239	34	245	29
Non-building construction	237	34	307	37
Residential building construction	219	31	288	34
<i>Total</i>	695	100	840	100

increase in the adult population. Priority was then given to investment in building and non-building construction (see Chapter VIII, Manpower, Employment and Unemployment).

Transport.

The increase in investment in transport is the result of the delivery, in 1957, of ships and the Britannia aircraft (see Chapter XII, Transport). Since this equipment was ordered and partly paid for in previous years, there is no necessary connection between the decisions which determined these investments and the economic development in 1957.

Industry.

Higher investment in equipment was responsible for the increase in investment in industry. This increase was not brought about by public financing, the volume of which did not differ considerably from the volume in 1956. Replacement of obsolete equipment represents over 50 per cent of investment, and it would appear that the depreciation charges allowed by enterprises constitute an important item in financing gross fixed investment in industry.

A substantial number of industrial branches and individual enterprises have excess capacity. This means that they can produce more with the available equipment than they do at present without a considerable change in their production costs. In many branches, excess capacity was the result of numerous factors, including among others entrepreneurs' expectations based on a higher level of demand for their produce than actually exists, and the installation of standard equipment, manufactured abroad, designed for greater output than is required in Israel. This does not imply that additional investment is unnecessary: it can be diverted to the production of new commodities for which there is no excess capacity. Investment may also be made in enterprises having excess capacity likely to disappear at a higher level of demand in the future. Without making investments now, future demand will be satisfied only at increasing costs per unit of output.

Agriculture.

The increase in investment covered most agricultural branches—irrigation, fruit plantations, livestock, farm buildings and land reclamation (see Chapter IX, Agriculture). There was a fall in investment in equipment. The increase in investment was mainly financed by the farmers themselves, and not by the Government or the Jewish Agency. The increase in farmers' investments was largely rendered possible by the extension of irrigation mains. This permitted the transformation of unirrigated areas into irrigated ones through the internal irrigation network. An additional factor was the higher profitability of certain products such as poultry and livestock products.

At the prevailing interest rate and the terms of credit granted by the public

authorities and the banking system, there is considerable demand for investment funds, exceeding by far the sums allotted for this purpose. This excess demand is to a certain extent engendered by the need experienced by farmers to complete their basic investments, which are only in part financed by public funds.

2. PRICES OF CAPITAL GOODS

The prices of capital goods rose by 6 per cent on the average. The prices of building and non-building construction are determined by factors other than the prices of equipment. The prices of building and non-building construction are determined by domestic supply and demand, and competition for the production and purchase is fairly strong, as there are many contractors and buyers in Israel. In 1957, building costs rose by 7 per cent, and the cost of non-building construction by about 9 per cent.

On the other hand, most equipment is purchased from abroad. It is imported directly by its users, and there is no exclusive trade in equipment between importers and users. Thus the price of this equipment is determined by its prices abroad. Moreover, the prices of much locally produced equipment and machinery are also determined by world market prices. Local prices are fixed through Government control of raw materials required for the manufacture of this equipment and machinery. Local prices are also affected by the granting of import licenses for equipment, as domestic prices are considerably higher than those in the world market. Prices of imported and locally produced equipment rose by 3-4 per cent in 1957. At present prices and at the easy credit terms granted for the purchase of equipment, the allocation of foreign exchange does not satisfy demand, and there remains excess demand. The total amount of foreign exchange requested from the Ministry of Commerce and Industry in 1957 for the import of industrial equipment was twice the amount of foreign exchange allotted. Applications for equipment and machinery intended for transport and agriculture also rose considerably.

The present prices of equipment are likely to influence the channelling of investments. The planning of enterprises is based on the relatively low price of capital goods. This leads to a misallocation of resources.

3. FINANCING OF INVESTMENTS

Public funds allocated for investment amounted to IL. 424 million in 1957 against IL. 350 million in 1956. In spite of this substantial increase, the share of investment financed by the public sector¹ fell from 53 per cent to 50 per cent.

Table V-4 shows public investment by sectors in 1956 and 1957.

Notwithstanding the fall in funds granted by the public sector, it still repre-

¹ Budget expenditure of the Government, the Jewish Agency and the local authorities.

TABLE V-4

*Share of Public Financing^a in Investments by Economic Sectors, 1956-1957**(Percentages)*

<i>Economic Sector</i>	<i>1956^b</i>	<i>1957</i>
Agriculture	70	60
Industry	32	29
Electricity	80	80
Mining and oil	65	85
Transport ^c	85	45
Building construction	35	45
Services	50	60
<i>All groups</i>	53	50

SOURCE: Bank of Israel.

^a Public financing refers to budget expenditure of the Government, the Jewish Agency and the local authorities, excluding financing by Government Corporations.

^b Revised estimate.

^c The decline in the financing of this item is due to the fact that Government payments designed for the financing of these imports, which were delivered in 1957, had been made in previous years and were accounted for under public financing.

sents more than half of all investment funds. Financing was effected either through direct investment made by the public sector, or through the granting of loans. This means a transfer of the resources of the public sector to non-government entrepreneurs for investment purposes. A large part of the loans granted to the non-government sector are given on the condition that recipients will participate in the financing of investments. The influence wielded by public bodies thus extends beyond the limits of the amounts attained through direct financing. They could consequently have determined the volume of investment and its channelling in accordance with economic policy.

The terms of credit granted by the Government's Development Budget¹ are very convenient, both relative to other sources of credit and as regards the expected profitability of investments. In a way they represent a subsidy to investment. Under such conditions demand for accommodation from this source is strong, the amount of credit asked for exceeding by far its supply. The limited quantity of credit available from the Development Budget is allocated by the different Government departments according to numerous criteria: the cost of the dollar saved, the present volume of output, the distribution of population and the priorities of development areas.

¹ Loans are given for two years during which they are not linked. Thereafter, they are linked to the dollar exchange rate or the consumers' price index. The average rate of interest paid on such loans is 7.5 per cent.

4. INCREASE IN STOCKS

In the absence of reliable figures, the investment data discussed in this chapter do not include figures for stock changes. In spite of this, an effort will be made to outline some of the tendencies in stock changes.

The substantial increase in output which occurred in 1957 had two opposed effects on the volume of stocks. On the one hand, stocks rose with the increase in output, because of the technical ratio of output to stocks, i.e. when output rises, stocks rise as well. There was also an increase in liquid fuel stocks held by the petroleum companies. On the other hand, the increase in output was apparently due to the exhaustion of stocks of finished goods and of raw materials, in particular of raw materials for building. In the absence of adequate data, no quantitative estimates of these opposed trends can be made, although it would seem that stocks increased somewhat in real terms. Government stocks and stocks held by the Reparations Corporation at the end of 1957 were at the same level as at the end of 1956.