

CHAPTER V

CAPITAL IMPORTS AND THE FOREIGN DEBT

1. MAIN DEVELOPMENTS

The pressure on the economy's short-term capital resources slackened to a certain extent in 1976, after intensive utilization of these resources in 1975. This slackening is related to the fact that current account deficit declined this year and long- and medium-term capital imports covered the entire current deficit. In contrast, in the two previous years there was a considerable difference between those two items, and the economy had to bridge this gap by increasing its short-term liabilities abroad. As a result of this year's developments, foreign exchange reserves rose, while at the same time outstanding short-term liabilities fell. From the point of view of the composition of the foreign debt, it seems that these positive developments were to a great extent only a short-term trend.

Long- and medium-term capital imports reached \$ 3.3 billion this year, similar to their level last year. This stability of capital imports was accompanied by a decrease of \$ 782 million in the current account deficit. To a great extent, this eased the problem of deficit financing, which has become more serious in the last two years. Another positive development was the growing weight of unilateral transfers within capital imports. The accumulation of long- and medium-term debts continued this year and the nominal addition to the foreign debt was the highest ever reached.

The relative share of the private and public sectors in capital imports remained similar to their share last year. However, the developments in the composition of capital imports in the sectors was different: in the public sector, the weight of unilateral transfers increased as the result of a considerable expansion of U.S. government grants, whereas in private sector the weight of loans increased considerably following various measures taken by the government in 1975 to intensify the capital flow from this source.

U.S. government assistance this year amounted to \$ 1.7 billion as against \$ 1.8 billion in 1975. This decline entailed a positive change in its composition: a steep rise in grants and an even steeper drop in loans.

In 1976, the capital items of the private sector developed in contradictory directions. The continuing decline in investments of foreign residents in Israel, which began in 1973, became considerably more acute this year; personal restitutions and transfers of new immigrants and Israeli residents also declined. On the other hand, long- and medium-term loans from abroad increased greatly. Those developments were affected by two groups of factors: within the first group are the unprecedented worsening in the current deficit,

TABLE
FINANCING OF CURRENT
(\$)

	1972	1973	1974	1975
A. Current accounts and long-term capital movements				
Balance on current account	-1,101	-2,642	-3,387	-4,050
Unilateral transfers	1,052	2,173	1,737	1,771
Balance on current account and transfers	-49	-469	-1,650	-2,280
Long-term capital movements				
Investments from abroad, net	143	185	94	68
Independence and Development Loans	184	359	165	118
U.S. government loans	205	252	147	1,193
Other loans	191	205	227	163
Total long-term capital movements	723	1,001	633	1,542
Total capital imports (including transfers)	1,775	3,174	2,370	3,313
Surplus of capital imports over deficit	674	532	-1,017	-737
B. Israeli investment abroad	-1	-13	-10	18
C. Short-term credit, net (nonfinancial)	-75	56	79	237
D. Financial sectors				
Deposits in commercial banks	363	351	349	566
Deposits in Bank of Israel	-6	-4	0	2
Total (a)	357	347	349	568
Loans by commercial banks to foreigners	6	-270	-80	-185
Loans by Bank of Israel	-30	-18	24	12
Loans by IMF	-33	-	39	215
Total (b)	-57	-288	-17	42
Foreign exchange reserves of central monetary institutions	-632	-692	719	-30
Reserves of other monetary institutions	-457	-194	82	-30
Total (c)	-1,089	-886	801	-60
Foreign currency valuation adjustments	31	224	88	-46
Total change in reserves due to economic transactions (d)	-1,058	-662	889	-106
Total financial sectors (a)+(b)+(c)	-644	-603	1,221	504
E. Errors and omissions	45	-29	-272	-18

V-1

ACCOUNT DEFICIT, 1972-1976

million)

1976	1975				1976			
	I	II	III	IV	I	II	III	IV
-3,268	-1,017	-925	-1,121	-987	-725	-899	-769	-875
2,239	524	441	425	381	512	494	669	563
-1,029	-494	-484	-696	-606	-213	-405	-100	-312
44	28	9	22	9	8	8	16	12
108	32	26	20	40	30	26	10	42
541	253	302	267	371	117	122	99	203
362	10	46	50	57	51	41	71	199
1,055	323	383	359	477	206	197	196	456
3,294	847	824	784	848	718	691	865	1,019
26	-170	-101	-337	-129	-7	-210	95	145
-15	11	2	-5	10	-8	-5	6	-9
118	129	-40	85	63	-40	144	34	-21
237	-79	-47	116	576	-257	79	76	339
5	0	0	0	2	2	4	-1	0
242	-79	-47	116	578	-255	83	75	339
59	-66	-3	-16	-100	-133	50	-68	-56
-171	-202	124	88	2	-1	-109	-34	-27
89	94	16		105			75	14
-23	-174	137	72	7	132	-59	-27	-69
-170	-279	-4	255	-2	45	-64	-94	-57
-143	371	-14	-99	-288	136	-43	-35	-201
-313	92	-18	156	-290	181	-107	-129	-258
55	31	-5	-88	17	15	-2	23	19
-258	123	-23	68	-273	196	-109	-106	-239
-39	-130	67	256	312	73	-85	-58	31
-92	162	74	5	-259	-20	154	-79	-147

the aggravation of the problem of financing, and the government measures taken to diminish the current deficit in the last two years. All these have a deterring cumulative effect on the flow of capital to the economy. Within the second group are the introduction of the creeping devaluation, which decreased expectations for a one-time large devaluation, government encouragement of loans from abroad, and the increase of interest differentials between Israel and other countries. All those have encouraged the flow of capital into the Israeli economy.

The composition of the foreign debt according to maturity dates underwent two important developments this year: first, the weight of debts due this year was reduced because of the absolute decline in short-term liabilities; this development allowed the economy a further breathing space for financing the deficit. Secondly, the weight of medium-term debts increased this year, due to the policy measures taken previously, to encourage loans of this type. These developments lead one to the conclusion that the economy will very shortly face repayments at a higher extent than ever before.

Interest payments on debts did not increase this year, despite the increase of the foreign debt, due to the decline in interest rates throughout the world. This fact, together with the income of revenues from export, reduced the burden that debt repayment imposed on the balance of payments, as measured by the ratio of debt services to revenues in the current account.

2. BACKGROUND TO THE CAPITAL IMPORT DEVELOPMENTS

In 1976 there was a slight drop in the flow of capital from abroad, with relatively moderate fluctuations in most items.

Capital imports to the public sector, which are mainly affected by non-economic considerations, remained fixed, and their weight was about three quarters of total capital imports. This increase to such a high level on the part of the public sector occurred in 1975, after developments in contradictory directions affected capital imports to the different sectors: on the one hand a decline in capital to the private sector, and on the other hand a sharp rise in capital to the public sector. A similar composition of capital imports occurred previously only in the first years of the state, but whereas most capital imports came from Jewish sources, in the last two years most of the capital derived from U.S. government aid.

Capital imports for the private sector, which are more affected by economic considerations, decreased slightly this year, but when taking into account other factors such as price increases in the world and the economic recovery, this stability can be seen as a substantial drop in real terms. The absolute decline of the private sector's capital import has continued for three years running. This development should be regarded in view of two main factors: first, the general balance of payments situation — an unprecedented increase in the current deficit in the previous two years and the aggra-

vation of the problem of its financing; second, the direct and indirect effects of policy measures taken in order to tackle the balance of payments problem.

The sharp rise in the current deficit in the last two years was a deterrent on potential foreign currency transfers: the worsening balance of payments problem presents a gloomy picture of the economic situation together with the expectation of radical policy measures which might endanger these transfers.

TABLE V-2
U.S. GOVERNMENT AID AND DEFENSE IMPORTS, 1972-1976

	Grants	Loans	Total	Direct defense imports ^a
1972	71	191	262	490
1973	820	237	1,057	1,253
1974	672	150	822	1,224
1975	642	1,200	1,842	1,846
1976	1,183	542	1,725	1,603

^a In comparing direct defense imports with U.S. government aid, it should be remembered that there are also indirect defense imports, which amounted to \$ 300 million in 1976.

Because of the worsening situation in the current account, the government took measures to restrain economic activity, causing a nearly complete standstill in the last three years. This factor had a negative effect on many capital items, the most striking being investments from abroad, which reached an insignificant level this year, after a steep decline over the entire period.

The problem of financing the deficit worsened in 1975 and led to a sharp decline in the foreign exchange reserves of the economy. These developments created the need for a series of measures which were intended to accelerate capital flow. The number of approvals granted by the Ministry of Finance for loans from abroad increased in 1975, but the ceiling on interest rates was raised, and the repayment period of those loans was shortened. In this way, the Ministry of Finance enabled borrowing from abroad, but at worse terms than those previously prevailing. At the same time, various exchange rate guarantee arrangements were reached with different bodies in the economy, making it more worthwhile to obtain loans from abroad, especially at a time of rapid price increases. The effect of such measures on the volume of loans is generally noticeable only after a few months. Thus there was an increase only in the last quarter of 1975, which continued in the first half of 1976.

TABLE
CAPITAL IMPORTS BY SOURCE
(\$)

	1972	1973	1974	1975
1. Private sector				
a. Unilateral transfers				
Personal restitution	291.5	264.3	317.0	358.6
Other transfers	391.1	378.1	343.9	261.1
Transfers to nonprofit institutions	100.8	135.5	109.6	112.1
Total	783.4	777.9	770.5	731.8
b. Investments from abroad, net	143.0	185.2	93.5	67.3
c. Long-term loans	170.0	181.0	79.0	73.0
Total private sector	1,096.4	1,144.1	943.0	872.1
2. Public sector				
a. Unilateral transfers				
To National Institutions	209.4	607.6	269.5	397.7
Intergovernmental transfers	58.0	788.0	697.0	642.0
Total	267.4	1,395.6	966.5	1,039.7
b. Long-term loans (net)				
Independence and Development Loans	184.0	359.0	165.0	118.0
U.S. government loans	191.4	236.7	150.0	1,200.4
Other loans	35.9	39.3	143.0	95.0
Total	411.3	635.0	458.0	1,413.4
Total public sector	678.7	2,030.6	1,424.5	2,456.1
3. Total capital imports	1,775.1	3,174.7	2,367.5	3,328.2
Less: Israeli investments abroad	0.6	12.5	9.5	-16.8
Total, excl. Israeli investments abroad	1,774.5	3,162.2	2,358.0	3,345.0

AND BY SECTOR, 1972-1976
million)

1976	1975				1976			
	I	II	III	IV	I	II	III	IV
313.7	98.7	99.9	74.9	85.1	77.6	76.3	78.1	81.2
248.8	76.7	65.5	55.7	63.2	46.4	49.6	73.4	79.4
122.8	33.0	28.2	22.4	28.5	27.3	26.6	40.4	28.5
685.3	208.4	193.6	153.0	176.8	151.3	153.0	191.9	189.1
43.9	27.7	9.1	21.9	8.6	7.9	7.9	16.2	11.9
119.0	8.0	24.0	-8.0	49.0	52.0	8.0	-15.0	74.0
848.2	244.1	226.7	166.9	234.4	211.2	168.9	193.1	275.0
417.8	107.7	128.8	71.0	90.2	86.0	124.1	93.9	113.8
1,135.0	208.0	119.0	201.0	114.0	275.0	217.0	383.0	260.0
1,552.8	315.7	247.8	272.0	204.2	361.0	341.1	476.9	373.8
108.0	32.0	26.0	20.0	40.0	30.0	26.0	10.0	42.0
542.8	261.7	299.4	268.0	371.3	112.9	150.1	98.4	181.4
241.0	3.0	23.0	57.0	12.0	3.0	4.0	87.0	147.0
891.8	296.7	348.4	345.0	423.3	145.9	180.1	195.4	370.4
2,444.6	612.4	596.2	620.0	627.5	506.9	521.2	672.3	744.2
3,293.8	856.5	822.0	786.9	862.9	718.1	691.1	865.4	1,019.2
14.7	-10.5	-1.5	4.7	-9.5	7.7	4.7	-6.3	8.6
3,279.1	867.0	824.4	782.2	871.4	710.4	686.4	871.7	1,010.6

The introduction of the creeping devaluation reduced the expectations for a large one-time devaluation, and under normal conditions this should have a considerable positive effect on the capital items, which are affected mainly by short-term considerations. In view of the scope of the current account deficit, the worsening of the financing problem and the implications deriving therefrom, the contribution of a creeping devaluation to the encouragement of capital transfers to the economy can only be marginal.

In 1976 there was a slight easing of the financing problem, following a considerable decline in the current deficit. However, it seems that the policy measures taken provided only a short-term solution, and that the scope of the problem did not diminish significantly. It can therefore be assumed that the factors that deterred the flow of capital to the economy in the last two years existed this year as well, causing a continuous decline of capital imports to the private sector. The exceptional increase in loans from abroad in this sector was a delayed effect of the special measures taken in 1975.

3. UNILATERAL TRANSFERS

The flow of unilateral transfers increased sharply this year and reached 2.2 billion, after 1.7 billion in the last two years. The increase this year derived entirely from the expansion of U.S. government grants; in other transfer items only minor changes took place.

Total U.S. government grants doubled this year and reached \$ 1,183 million as against \$ 642 million in 1975. Especially notable was the military grant, which was increased from \$ 254 million in 1975 to \$ 850 million this year. The increase in grants is especially striking in view of the declining weight of loans within the U.S. government aid this year – a development contrary to that of the previous year, and significant in view of the decrease in direct defense imports.

The fluctuations in the flow of unilateral transfers in other items were relatively small this year. Most of the transfer items of the sectors declined, whereas the transfers of institutions grew slowly this year. Total transfers in these items remained stable, but after deducting price increases – there was actually a decline. However, the weight of these items in the financing of the current account deficit (excluding defense imports) increased from 50 percent in 1975 to 55 percent in 1976.

Institutional transfers increased this year, reaching \$ 541 million as compared with \$ 510 million in 1975. The change in institution transfers was smaller than the considerable fluctuations which characterized this item in the years before and after the war. This fact may possibly indicate a new average level for transfers from the various fund-drives. At the beginning of the seventies the average level of this item was less than \$ 300 million whereas in the last two years it has stabilized at approximately half a billion dollars.

Personal restitutions decreased this year after a continuous increase over the previous three years. Total personal restitutions reached \$ 314 million as compared with \$ 359 million in 1975. The components of personal restitutions can be divided into two items: one, the lump-sum restitutions, resulting from one-time arrangements between the German government and Nazi victims living in Israel; and second, the annuities and pensions, under periodical payment arrangements from Germany, adjusted annually to price increases there. The pensions received by Israeli residents from the German government continued to increase this year, due to their adjustment to price increases in Germany and the evaluation of the German mark as compared with the U.S. dollar. Lump-sum restitutions decreased sharply this year, following a drop in the number of new contracts signed, offsetting the slow growth in pensions and causing a decline in the total volume of personal restitutions.

Private transfers, including transfers of new immigrants and Israeli residents, decreased this year following a continuous decline since 1973. The transfers of new immigrants declined to about \$ 40 million as compared with \$ 63 million in 1975. This reduction is essentially due to the decreasing number of new immigrants to Israel, a trend which has continued since 1971. Israeli residents' transfers including, by statistical definition, gifts, inheritance, and pensions received from abroad, increased this year to about \$ 222 million, as compared with \$ 212 million in 1975.

4. FOREIGN INVESTMENTS

The decline in foreign investments in Israel continued in 1976. Total investments from abroad reached \$ 44 million, as compared with \$ 67 million in 1975 and \$ 94 million in 1974. At the same time Israeli investments abroad increased, reaching 15 million after a net decline of \$ 17 million last year. These contradictory developments in the direction of investments sharpened the decline in net foreign investments, which amounted to only \$ 29 million this year — the lowest level since the beginning of the sixties.

The decline in investments from abroad affected most areas: foreign acquisitions of negotiable securities on the Tel Aviv Stock Exchange declined sharply; direct investments and acquisition of non-negotiable securities continued to decline. On the other hand, foreign investments in approved enterprises increased this year.

These developments in investments were mainly the result of the standstill in economic activity during the past year, and increasing expectations for drastic policy measures to solve the balance of payments problem. These two factors had a large negative effect on investments from abroad. At the same time, there were other factors with a positive effect on the flow of investments, but it would seem that they were only of secondary importance. These factors include the economic recovery throughout the world and the rate of exchange agreements which went into effect during this period and lowered the expectations for a large devaluation.

TABLE

UNILATERAL
(\$)

	1973	1974	1975
Personal restitution from West Germany (a)			
Lump-sum	98.0	117.8	121.7
Pensions	166.3	199.2	236.9
Total	264.3	317.0	358.6
Personal transfers in cash (b)	370.1	342.0	274.8
Immigrants	147.5	99.7	62.9
Others	222.6	242.3	211.9
Personal transfers in kind (c)	16.0	11.9	9.3
Total (a)+(b)+(c)	650.4	670.9	642.7
Personal transfers to foreign countries	8.0	10.0	23.0
Total net personal transfer receipts (d)	642.4	660.9	619.7
Institutional transfers			
Nonprofit institutions	135.5	109.6	112.2
Jewish Agency	602.0	270.4	394.6
Transfers in kind	4.8	-0.9	3.1
Total institutional transfers (e)	742.3	379.1	509.9
Net transfers to the government (f)	788.0	697.0	642.0
Total unilateral transfers (d)+(e)+(f)	2,172.7	1,737.0	1,771.6

V.4

TRANSFERS, 1973-1976
million)

1976	1975				1976			
	I	II	III	IV	I	II	III	IV
57.5	40.2	40.8	21.9	18.8	13.0	15.5	14.9	14.1
256.2	58.5	59.1	53.0	66.3	64.6	61.3	63.2	67.1
313.7	98.7	99.9	74.9	85.1	77.6	76.8	78.1	81.2
262.0	81.6	74.3	55.5	63.4	52.0	56.0	73.0	81.0
39.6	27.6	16.6	8.9	9.8	5.9	5.7	11.4	16.6
222.4	54.0	57.7	46.6	53.6	46.1	50.3	61.6	64.4
13.8	2.2	2.1	2.2	2.8	3.4	3.6	3.4	3.4
589.5	182.5	176.3	132.6	151.3	133.0	136.4	154.5	165.6
27.0	7.0	11.0	2.0	3.0	9.0	10.0	3.0	5.0
562.5	175.5	165.3	130.6	148.3	124.0	126.4	151.5	160.6
122.8	33.0	28.2	22.4	28.6	27.3	26.6	40.4	28.5
415.2	107.4	128.1	69.2	89.9	85.7	122.4	93.6	113.5
2.6	0.3	0.7	1.8	0.3	0.3	1.7	0.3	0.3
540.6	140.7	157.0	93.4	118.8	113.3	150.7	134.3	142.3
1,135.0	208.0	119.0	201.0	114.0	275.0	217.0	363.0	260.0
2,238.1	524.2	441.3	425.0	381.1	512.3	494.1	668.8	562.9

TABLE
FOREIGN INVESTMENT IN ISRAEL AND
 (\$

	1972	1973	1974	1975
INVESTMENT IN ISRAEL BY NONRESIDENTS				
Investments	171.8	234.5	127.5	91.0
Investments repatriated	-47.5	-78.5	-59.4	-22.6
Net investments	124.3	156.0	68.1	68.4
In Israeli currency from blocked accounts	3.0	-8.2	-12.6	-28.9
In Independence and Development Bonds	7.3	12.5	10.6	10.7
In kind	1.0	8.6	9.0	9.1
Total	135.6	168.9	75.1	59.3
Reinvestment of profits	7.4	16.3	18.4	8.0
Total, net	143.0	185.2	93.5	67.3
ISRAELI INVESTMENT ABROAD				
Direct	-0.5	-0.5	-0.2	-1.9
Portfolio				
Private individuals	2.5	6.4	5.1	-9.2
Banks	-1.4	6.6	4.6	-5.7
Total Israeli investment abroad	0.6	12.5	9.5	-16.8
NET FOREIGN INVESTMENT IN ISRAEL	142.4	172.7	84.0	84.1

ISRAELI INVESTMENT ABROAD, 1972-1976

million)

1976	1975				1976			
	I	II	III	IV	I	II	III	IV
70.0	21.8	22.2	20.6	26.4	11.4	26.2	11.1	21.3
-47.0	-2.3	-11.5	-3.2	-5.6	-9.2	-21.1	-1.6	-15.1
23.0	19.5	10.7	17.4	20.8	2.2	5.1	9.5	6.2
-14.2	-1.2	-6.4	-4.3	-17.0	-3.4	-5.9	-1.9	-3.0
10.2	4.1	2.5	2.7	1.4	2.8	2.5	2.4	2.5
16.9	3.3	0.3	4.1	1.4	4.3	4.2	4.2	4.2
35.9	25.7	7.1	19.9	6.6	5.9	5.9	14.2	9.9
8.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
43.9	27.7	9.1	27.9	8.6	7.9	7.9	16.2	11.9
8.4	-0.1	-1.9	0.2	-0.1	1.9	3.8	2.8	-0.1
-2.2	-6.1	-0.4	2.9	-5.6	2.7	-3.6	-1.5	0.2
8.5	-4.3	0.8	1.6	-3.8	3.1	4.5	-7.6	8.5
14.7	-10.5	-1.5	4.7	-9.5	7.7	4.7	-6.3	8.6
29.2	38.2	10.6	17.2	18.1	0.2	3.2	22.5	3.3

TABLE V-6
FOREIGN INVESTMENT IN ISRAEL, QUARTERLY, 1972-1976
(\$ million)

		Securities listed on the Tel Aviv Stock Exchange	Of these: foreign currency securities	Direct investment and unlisted securities	Investment in approved enterprises	Total
1972	I	4.0		22.4	3.0	29.4
	II	18.0		30.0	4.9	52.9
	III	8.0		31.6	1.9	41.5
	IV	9.4		33.8	6.1	49.3
1973	I	13.3		45.2	2.8	61.3
	II	11.5		48.3	2.0	61.8
	III	7.0		62.6	1.9	71.5
	IV	4.7		34.2	1.5	40.4
1974	I	2.8		23.6	0.9	27.3
	II	5.8		30.6	1.0	37.4
	III	2.1		24.5	1.6	28.2
	IV	4.1		29.8	2.6	36.5
1975	I	4.0		17.1	2.6	23.7
	II	6.6		14.6	1.7	22.9
	III	5.8		15.2	0.6	21.6
	IV	6.5		19.4	0.8	26.7
1976	I	0.9	0.2	8.8	2.7	12.4
	II	3.9		11.1	0.1	15.1
	III	4.0	1.4	7.5	2.0	13.5
	IV	3.7	0.2	11.5	7.1	22.3

SOURCE: Foreign Currency Department, Ministry of Finance.

5. LONG- AND MEDIUM-TERM LOANS

The net volume of long- and medium-term loans decreased considerably this year, and reached \$ 1,025 million as compared with \$ 1,476 million in 1975. This development followed a sharp drop in the government's direct loans which was only slightly offset by the increase in loans of other economic sectors.

Gross U.S. government loans, which reached \$ 1.2 billion in 1975, decreased this year to approximately half a billion dollars, the main decline being in defense loans. This year there was an increase in the rates of interest on U.S. government loans; part of them bore interest at a rate of more than 7 percent, as against less than 6 percent in previous years. However, the repayment periods of the loans remained relatively long, between 15 and 20 years. The decrease in loans, which was accompanied by a considerable increase in the weight of grants within the framework of this year's U.S. government aid, constitutes a positive development for the economy in the future, when it must pay interest and either repay the capital or renew the credit.

The gross revenues from the Independence and Development Loans ("The Bonds") remained stable this year, amounting to \$ 292 million, similar to the revenues in previous years, except 1973. In contrast to stability of revenues, the redemption of these loans has been increasing continuously. It seems that the intensive utilization of this source in recent years has created difficulties for further net sales. This is because the volume of funds to be renewed increases at a rapid annual rate in view of the high level of gross sales.

Gross revenues from loans of other bodies in the economy were subject to considerable fluctuations during the year. They rose considerably in the first half of the year but dropped sharply in the third quarter, and then in the fourth quarter they again experienced a steep rise.

It seems that the development of loans at the beginning of the year was connected with the special measures taken by the Ministry of Finance in the previous year in view of the sharp decline in the foreign exchange reserves of the economy. These measures included raising the ceiling on interest rates and shortening the repayment period of those loans approved by the competent authorities. At the same time, there was a growth in the volume of foreign currency loans granted to various institutions with exchange rate guarantees. The rapid price increases in the Israeli economy which have characterized the past year were an incentive for taking loans with these guarantees. The effect of such measures is normally felt only after a few months, and the increase in loans of various institutions at the beginning of 1976 was the result of measures taken in 1975¹. After the improvement in the level of reserves, the Ministry of Finance began to restrict the

¹ The delay connected with those measures can be seen by comparing Table V-7 pertaining to the loans themselves and Table V-8 pertaining to loan approvals for various bodies in the economy, excluding the government.

LONG- AND MEDIUM-TERM FOREIGN LOANS, 1972-1976

(\$ million)

	1972	1973	1974	1975	1976	1975				1976			
						I	II	III	IV	I	II	III	IV
LOANS RECEIVED													
Government	701	910	792	1,763	1,293	278	441	423	521	235	279	305	474
Independence Loan	(300)	(592)	(326)	(290)	(292)	(77)	(73)	(54)	(86)	(69)	(75)	(49)	(99)
Other	311	326	214	247	337	44	64	42	97	97	82	24	134
Total	1,012	1,236	1,008	2,010	1,630	422	505	465	618	332	361	329	608
LOANS REPAYED													
Government	291	275	334	360	402	91	93	78	98	89	98	110	105
Independence Loan	(116)	(143)	(161)	(172)	(184)	(45)	(47)	(34)	(46)	(39)	(49)	(39)	(47)
Other	141	145	135	174	203	36	40	50	48	45	74	24	60
Total	432	420	469	534	605	127	133	128	146	134	172	134	165
NET LOANS RECEIVED													
Government	410	635	458	1,403	891	287	348	345	423	146	181	195	370
Independence Loan	(184)	(359)	(165)	(118)	(108)	(32)	(26)	(20)	(40)	(30)	(26)	(10)	(42)
Other	170	181	79	73	134	8	24	-8	49	52	8	0	74
Total	580	816	539	1,476	1,025	295	372	337	472	198	189	195	444

flow of loans, while taking measures which were contrary to those taken in the previous half year. The effect of these measures were felt in the third quarter of the year, when the gross loans of other bodies in the economy declined to a minimal level of \$ 24 million. As mentioned above, loans showed extraordinary growth in the last quarter of the year, reaching \$ 134 million. The bulk of this sum represents loans to shipping and aviation companies for which a different policy has been adopted, since they have no relation to the balance of payments situation.

TABLE V-8
FOREIGN LOAN PERMITS, 1973-1976
(\$ million)

Quarter	1973		1974		1975		1976	
	Value	No.	Value	No.	Value	No.	Value	No.
I	69	60	114	36	76	47	113	34
II	9	49	90	57	127	42	69	39
III	38	80	351	70	105	40	172	43
IV	51	36	120	47	408	50	104	46
Total	167	225	675	210	716	179	458	162

SOURCE: Foreign Currency Department, Ministry of Finance.

6. FOREIGN EXCHANGE RESERVES OF THE BANK OF ISRAEL

At the end of 1976 gross foreign exchange reserves of the Bank of Israel totaled \$ 1,373 million; net reserves came to \$ 1,156 million as compared with \$ 1,040 million in 1975. This growth in the level of reserves was the result of a slow decline in net foreign currency liabilities of all banking institutions, after a sharp rise in 1975. This development, which constituted a clear indicator of a short-term pressure letup, resulted from the drop in the current account deficit and the stability of long- and medium-term capital imports.

Due to a decline in imports of goods and services this year, the ratio of net reserves to the value of imports rose: reserves at the end of the year were sufficient to cover 1.8 months of imports (in 1976) as compared with 1.5 months in 1975. In spite of the slight increase this year, this level is still considered low, both in comparison with other countries and with previous levels in Israel. The level of reserves remained relatively low until the middle of May, which was a turning point; from then on the level of reserves showed a tendency to rise, accompanied, however, by considerable fluctuations.

TABLE V-9

FOREIGN EXCHANGE RESERVES HELD AT BANK OF ISRAEL, 1976
(\$ million)

End of month	Gross reserves	Less foreign bank deposits	Less Patach deposits	Net reserves	Change in net reserves	Exchange rate differentials	Change in net reserves adjusted for differentials
December 1975	1,183.6	2.0	142.1	1,039.5	-50.6	0.7	-51.3
January 1976	1,164.1	4.0	140.2	1,019.9	-19.6	3.6	-23.2
February	1,160.3	4.0	140.4	1,015.9	-4.0	9.3	-13.3
March	1,149.9	4.0	142.1	1,003.8	-12.1	0.6	-12.7
April	1,389.2	6.0	191.5	1,006.4	2.6	2.8	-0.2
May	1,188.7	6.0	159.6	1,023.1	16.7	-6.8	23.5
June	1,214.3	8.0	172.2	1,034.1	11.0	3.5	7.5
July	1,258.9	8.1	175.1	1,075.7	41.6	-2.5	44.1
August	1,303.2	10.7	180.1	1,112.3	36.6	10.2	26.4
September	1,315.7	10.7	185.3	1,119.7	7.4	14.1	-6.7
October	1,325.6	10.7	184.8	1,130.1	10.4	13.9	-3.5
November	1,351.1	10.1	197.1	1,143.9	13.8	-0.2	14.0
December	1,373.2	10.1	206.8	1,156.3	12.4	8.1	4.3
Total					116.8	56.6	60.2

A large proportion of the foreign exchange reserves in the Bank of Israel is designated in European currencies, and therefore, changes in these currencies as compared with the dollar cause changes in the reserves in dollar terms. The rise in the value of the European currencies as compared with the dollar in 1975 caused an increase in the total reserves in the Bank of Israel of about \$ 57 million. This represents about half the total growth in net reserves for 1976.

7. FOREIGN CURRENCY DEBT ²

The rapid increase in the foreign currency debt continued this year. The balance of debts at the end of 1976 reached \$ 9.3 billion as compared with \$ 7.6 billion in 1975 and \$ 6.3 billion in 1974. The nominal growth³ of the debt this year, was the highest annual rise to date. However, upon investigating the change in its composition, and deducting the world price increases⁴, the significance of the rise is considerably less serious.

Short-term liabilities mobilized by the economy declined absolutely this year, causing a reduction in the weight of debts which fall due within a year. In the coming year the economy will have to repay about a billion and half dollars, of which \$ 805 million will be for short-term liabilities. The weight of debts due in the next year in the total debt shrank, reaching 15.8 percent as compared with 18.6 percent in 1975. This development indicates a certain easing in the pressure on the balance of payments, due, among other things, to the possibility of rolling the debt, following the absolute decrease in short-term liabilities.

Another important fact, which became clear this year, is the rapid increase of medium-term debts within the total debt; their weight reached 34 percent of the total debt this year, which is its highest weight ever. This development is connected with the policy measures taken in 1975 to encourage mobilization of loans abroad, which resulted in a steep rise in loans falling due within one to five years. This fact supports the explanation that the easing in the deficit financing problem is only temporary. In the near future, the economy will face much higher capital repayments than previously.

² The foreign currency debt is not identical to the external debt of the economy, which also includes Israeli currency liabilities abroad, balances in clearing accounts, foreign investment in Israel, deposits of foreign nationals in Israeli banks, and loans whose maturity date is less than ninety days.

³ The changes in the debt include revaluations, but are not otherwise adjusted. They therefore do not accurately represent the change in loans as registered in the balance of payments.

⁴ A rise in foreign prices actually reduces the amount of real resources which an economy must forgo in order to finance its external debt. Assuming that other factors remain constant, this enables the borrowing country to finance its debt by a smaller quantitative increase in exports or a smaller decrease in imports.

TABLE
FOREIGN CURRENCY ASSETS IN
(\$)

	1972	1973	1974	1975
A. Bank of Israel				
1. Foreign currency assets				
Foreign currency reserves	1,154.4	1,690.7	1,150.3	1,134.6
Gold	43.4	46.3	46.5	46.5
Gold quota in IMF		39.2		
Special drawing rights	31.7	33.6	3.0	2.5
Total (1)	1,229.5	1,809.8	1,199.7	1,183.6
2. Liabilities				
Foreign banks		3.5		2.0
Patach	159.9	112.7	129.1	142.1
Total (2)	163.4	112.7	129.1	144.1
3. Net balance with Bank of Israel	1,066.1	1,697.1	1,070.6	1,039.5
B. Other monetary organizations				
1. Assets				
Deposits abroad ^a of other central monetary organizations	57.1	168.5	58.5	105.0
Commercial bank deposits	1,118.5	1,294.7	1,224.0	1,211.0
Other	15.1	32.9	21.6	13.9
Total (1)	1,190.7	1,496.1	1,304.0	1,329.9
2. Liabilities				
Foreign bank deposits and loans	670.0	837.9	1,101.7	1,546.2
Patach in commercial banks	687.4	913.2	1,070.6	1,148.7
Total (2)	1,357.4	1,751.1	2,172.3	2,694.9
C. Assets in banking system				
1. Assets (A1+B1)	2,420.2	3,305.9	2,503.7	2,513.5
2. Liabilities (B2+ foreign banks)	1,360.9	1,751.1	2,172.3	2,696.9
3. Net assets	1,059.3	1,554.8	331.4	-183.4
4. Change in net assets		495.5	-1,223.4	-514.8
(-) rate adjustments		181.2	16.3	33.7
5. Change in net assets due to transactions		676.7	-1,207.1	-548.5

^a According to the definition of the balance of payments.

V-10

BANKING INSTITUTIONS, 1972-1976

(million)

1976	1975				1976			
	I	II	III	IV	I	II	III	IV
1,318.3	1,440.4	1,431.9	1,198.9	1,134.6	1,101.9	1,166.2	1,267.9	1,318.3
44.8	46.4	46.5	46.5	46.5	46.5	46.6	46.5	44.8
10.0	2.2	2.7	0.8	2.5	1.5	1.6	1.6	10.0
1,373.1	1,489.0	1,481.0	1,237.2	1,183.6	1,149.9	1,214.3	1,316.0	1,373.1
10.1				2.0	4.0	8.0	10.7	10.1
206.8	133.1	139.0	137.3	142.1	142.7	172.2	185.3	206.8
216.9	133.1	139.0	137.3	144.1	100.7	180.2	196.0	216.9
1,156.2	1,355.9	1,342.0	1,099.9	1,039.5	1,003.2	1,034.1	1,120.0	1,156.2
89.8	48.2	60.3	49.0	105.0	93.8	93.5	85.5	89.8
1,351.4	804.0	821.8	908.8	1,211.0	1,096.9	1,117.6	1,143.8	1,351.4
16.1	21.3	17.0	28.5	13.9	18.8	14.0	23.0	16.1
1,457.3	873.5	899.1	986.3	1,329.9	1,182.5	1,225.1	1,252.3	1,457.3
1,571.4	1,006.7	977.7	1,036.8	1,546.2	1,234.4	1,223.9	1,392.7	1,571.4
1,372.6	1,077.0	1,059.8	1,059.3	1,148.7	1,184.5	1,274.7	1,252.0	1,372.6
2,944.0	2,083.7	2,037.5	2,096.1	2,694.9	2,418.9	2,498.6	2,594.7	2,944.0
2,830.4	2,362.5	2,380.1	2,223.6	2,513.5	2,332.4	2,439.4	2,568.3	2,830.4
2,954.1	2,083.7	2,037.5	2,096.1	1,696.9	2,422.9	2,506.6	2,605.4	2,954.1
-123.7	278.8	342.6	127.5	-183.4	-90.5	-67.1	-37.1	-123.7
59.7	-52.6	63.8	-215.1	-310.9	92.9	23.3	30.1	-86.6
-42.6	-9.4	5.9	31.4	5.7	-33.1	2.1	-2.6	-9.0
17.1	-43.2	57.9	-246.5	-316.1	59.8	25.4	27.5	-95.6

TABLE

ISRAEL'S FOREIGN CURRENCY
(\$)

	1967	1968	1969
Up to one year	198	301	244
Thereof: short-term loans	(78)	(92)	(82)
One to two years	141	135	195
Two to three years	82	114	135
Three to four years	87	112	122
Four to five years	85	110	109
Five years or more	963	1,130	1,316
Total	1,556	1,902	2,121
		Percentage distribution	
Up to one year	12.7	15.8	11.5
Thereof: short-term loans	(39)	(31)	(34)
One to two years	9.0	7.1	9.2
Two to three years	5.3	6.0	6.4
Three to four years	5.6	5.9	5.7
Four to five years	5.5	5.8	5.1
Five years or more	61.9	59.3	62.0
Total	100.0	100.0	100.0
		Cumulative	
Up to one year	12.7	15.8	11.5
Up to two years	21.7	22.9	20.7
Up to three years	27.0	28.9	27.1
Up to four years	32.6	34.8	32.8
Up to five years	38.1	40.6	37.9
Five years or more	100.0	100.0	100.0

DEBT, BY REPAYMENT DATE, 1967-76

(million)

1970	1971	1972	1973	1974	1975	1976
398	475	434	549	968	1,414	1,480
(115)	(183)	(187)	(187)	(564)	(927)	(805)
195	224	263	329	504	490	785
174	202	241	351	423	511	850
136	159	268	327	439	628	725
117	192	238	369	481	530	813
1,602	2,178	2,637	3,168	3,435	4,044	4,718
2,622	3,430	4,081	5,093	6,250	7,617	9,371

by repayment date

15.2	13.9	10.6	10.8	15.5	18.6	15.8
(39)	(39)	(43)	(34)	(58)	(66)	(54)
7.4	6.5	6.4	6.5	8.1	6.4	8.4
6.6	5.9	5.9	6.9	6.8	6.7	9.1
5.2	4.6	6.6	6.4	7.0	8.2	7.7
4.5	5.6	5.8	7.3	7.7	7.0	8.7
61.1	63.5	64.6	62.1	55.0	53.1	50.3
100.0	100.0	100.0	100.0	100.0	100.0	100.0

percentage distribution

15.2	13.9	10.6	10.8	15.5	18.6	15.8
22.6	20.4	17.0	17.3	23.6	25.0	24.2
29.2	26.3	22.9	24.2	30.4	31.7	33.3
34.4	30.9	29.9	30.6	37.4	39.9	41.0
38.9	36.5	35.3	37.9	45.1	46.9	49.7
100.0	100.0	100.0	100.0	100.0	100.0	100.0

There was a positive development this year in the payment of interest. For the first time, interest payments remained stable as compared with the previous year, and did not increase together with the general increase in the debt. This fact is explained mainly by the considerable decline of interest rates in the world. In addition, credit lines bearing subsidized commercial interest which were at the disposal of the economy were utilized intensively. Short-term debts bearing relatively high interest also decreased. The volume of interest payments reached \$ 523 million this year as compared with \$ 530 million in 1975 and \$ 389 million in 1974. The average interest rate on long-term debts (excluding the Development Loans) reached 5.00 percent as compared with 5.05 percent in 1975. The average interest rate on medium-term loans decreased this year to about 6.75 percent as compared with 8.6 percent in 1975 and 9.6 percent in 1974.

TABLE V-12
INDICATORS OF THE SERVICING BURDEN, 1968-1976
(\$ million)

	1968	1969	1970	1971	1972	1973	1974	1975	1976
1. Interest payments	92	109	133	147	180	261	389	530	523
2. Principal payments (long- and medium-term)	229	252	292	330	432	420	469	534	604
3. Total debt servicing (1)+(2)	321	361	425	477	612	681	858	1,064	1,127
4. Exports of goods and services	1,132	1,265	1,361	1,814	2,129	2,654	3,648	3,766	4,422
5. Unilateral transfers	435	450	649	765	1,051	2,173	1,737	1,770	2,239
	(percent)								
6. Ratio (3/4)	28.4	28.5	31.2	26.3	28.7	25.7	23.5	28.3	25.5
7. Ratio 3/(4+5)	20.5	20.9	21.1	18.5	19.2	14.1	15.9	19.2	16.9

The accepted scale for measuring the burden of debt repayments on the economy is the proportion of the economy's foreign currency income in the current account which is allocated for financing debt services. Since 1970, the ratio between debt services and revenues from export has shown a declining trend. This indicates that the burden of repayment for debt services on the balance of payments has decreased. In 1975, this declining trend ceased, and the ratio rose considerably. This year, after a large increase in exports and a moderate rise in debt services, the ratio dropped back to a level of

25.5 percent. For the Israeli economy, which has continuously enjoyed a high level of unilateral transfers, it is customary to use another indicator for measuring the burden of debt services. This is the ratio between debt services and the income both from exports and unilateral transfers. This indicator as well shows that there was a decrease in the burden of repaying the external debt on the balance of payments in 1976.

The easing in the problem of financing the current deficit this year is reflected in changes that took place in the composition of the short-term debt: short-term debts decreased by \$ 122 million, with contradictory developments within the debt item. Bank and other loans diminished by \$ 193 million and there was also a decline of \$ 105 million in Patach loans. On the other hand, there was an increase of \$ 191 million in the "other creditors" item. These developments were, to a certain extent, contrary to the developments that took place in the previous year. It can be seen that the mobilization of capital eased somewhat as the economy repaid the capital items which were reserved for emergencies.

The direct government debt amounted to \$ 6.9 billion as compared with \$ 5.6 billion in 1975 and \$ 4.7 billion in 1974. Debts of other bodies reached \$ 2.4 billion this year after a rise of \$ 378 million. This year's debt on account of the Development Loans reached \$ 2.1 billion, and its weight in the total foreign debt fell to 23 percent as compared with 27 percent in 1975 and 31 percent in 1974. In effect, there exists a long-term trend in which the weight of the Development Loans has dropped, owing to the fact that the weight of the Security Loan has increased. The total this year for the Security Loan came to \$ 2.6 billion and for the first time exceeded the volume of debt of the Development and Independence Loans. In recent years, the Development and Security Loans together constituted about half of the debt, but in view of the worsening repayment schedules, their weight in the annual repayment of the principal has lessened.

TABLE V-13

**ISRAEL'S SHORT-TERM FOREIGN CURRENCY DEBT TO THE END OF THE YEAR
BY CREDITOR, 1973-1975**
(\$ million)

	Balance				Annual change		
	1973	1974	1975	1976	1974	1975	1976
Bank and other loans	87.4	243.8	268.8	75.4	156.4	25.0	-193.4
Patach loans	43.3	146.9	304.4	199.4	156.4	157.5	-105.0
Bank credit for import	31.1	7.7	254.5	291.3	-23.4	246.8	36.8
Suppliers	6.9	7.7	90.1	37.9	0.8	82.4	-52.2
Others	21.6	158.1	9.5	200.9	136.5	-148.6	191.4
Total	190.3	564.2	927.3	804.9	373.9	363.1	-122.4

SOURCE: Foreign Currency Department, Ministry of Finance.