CHAPTER IV

INVESTMENT

1. THE VOLUME OF INVESTMENT

The value of net investment in capital assets during 1955 totalled IL. 445 millions, or 26 per cent more than in 1954, as shown in Table 33. Net investment in 1954 was 7 per cent higher than in 1953.

TABLE 33

DOMESTIC INVESTMENT, 1953 TO 1955
(at 1955 prices)

	1953 *in IL. millions*	1954 *in IL. millions*	1954 *change in per cent*	1955 *in IL. millions*	1955 *change in per cent*
Net Investment in Capital Assets *	330	354	+ 7	445	+26
Increase in Stocks	13	32	+146	40	+25
Total Net Investment	343	386	+ 13	485	+26
Depreciation	108	111	+ 3	120	+ 8
Total Gross Investment	451	497	+ 10	605	+22**

* *Including investment in domestic housing and services.*
** *The difference of* 0.5 *per cent between this figure and the figure quoted in Chapter II is due to a different basis of calculation.*
SOURCE: *Calculations of the Bank of Israel.*

The increases in stocks of raw materials, work in progress and finished goods during 1955 were assessed at IL. 40 millions. Net investment in this year in capital assets and stocks may thus be estimated at IL. 485 millions, as compared with IL. 386 millions in 1954 (at constant prices).

The depreciation of existing capital assets (assessed at 7 per cent of the national income) reached IL. 120 millions in 1955. Total gross domestic investment in 1955, including net investment in capital assets and stocks, as well as depreciation, was estimated at IL. 605 millions in 1955, as compared with IL.496 millions in 1954 (at 1955 prices), representing an increase of 22 per cent.

The expansion rate of investment in 1955 was more rapid than the rate of expansion of the national product and the import surplus of goods and services. Its share in available national resources rose from 14.3 per cent in 1953 to 16.1 per cent in 1954 and to 18.7 per cent in 1955.

The net investment in capital assets, totalling IL. 445 millions in 1955, does not, however, represent all the resources applied to the expansion of the economy's productive capacity. Production increases in the coming years will not only be brought

TABLE 34

INVESTMENT AND RESOURCES AVAILABLE, 1953 TO 1955
(in IL. millions, at current prices)

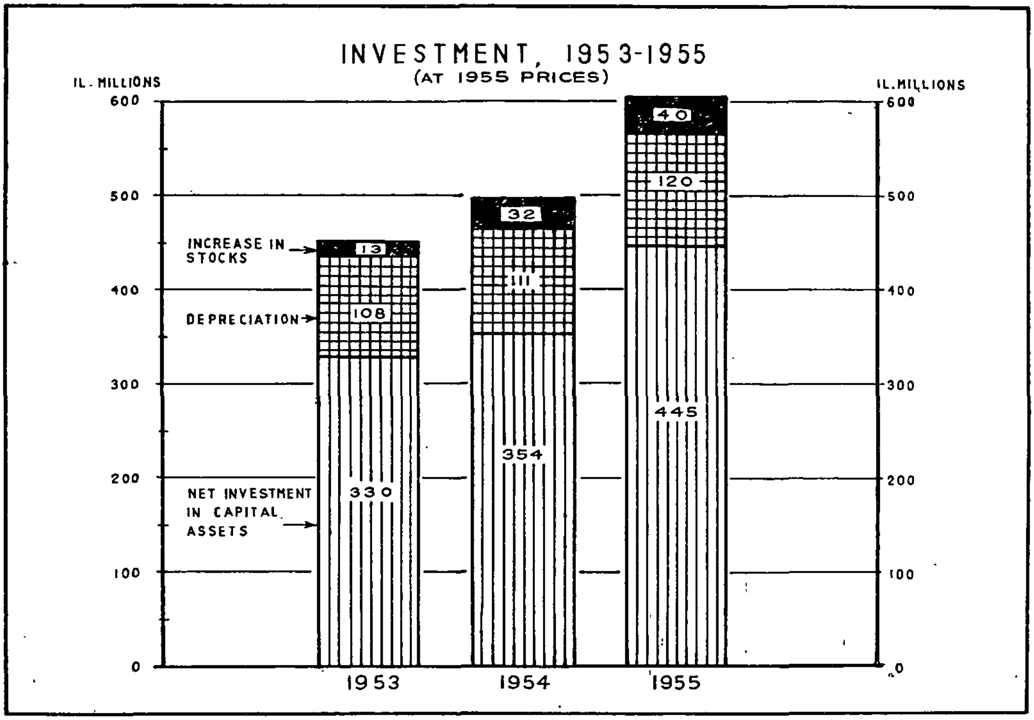
	1953	1954	1955
Resources Available to the Economy (i.e. Gross Product + Import Surplus)	1,671	2,167	2,600
Net Investment (in Capital Assets and Stocks)	239	349	485
Net Investment as Percentage of Resources Available	14.3	16.1	18.7

SOURCE: *Calculations of the Bank of Israel.*

about by the accumulation of material means of production, but also through investment in the manpower available, i.e. by improvement of hygienic conditions, provision of better health and educational facilities, expansion of vocational training and so forth. It is, however, impossible to assess the economic value of such investments and they therefore cannot be added to material production assets, when estimating the total expenditure required for the future expansion of the country's production capacity.

2. THE ECONOMIC DESTINATION OF INVESTMENT

No significant changes occurred during 1955 in the real volume of agricultural investment, as compared with 1954. This was mainly due to a decrease of investment in irrigation, as against an increase of investment in agricultural settlements.



Likewise, the volume of industrial investment remained virtually unchanged, since investment in completed industrial buildings was reduced, while the local output of machinery and equipment remained stable; there was also a certain rise in imports of capital goods for industrial use.

Investment in the development of natural resources, communications and services expanded during 1955, approximately in proportion to the increase in the total volume of investment. The productive capacity of the Dead Sea Works was increased; the implementation of the plan for the renewal of the merchant fleet continued.

Residential building and the development of the electric power supply proceeded apace during 1955, and the share that they represent in total investment greatly increased.

Table 35 shows investment in the years 1953 to 1955, by main economic sectors and at current prices. Further particulars of individual sectors are given in Chapters VIII to XII.

It is difficult to use a single criterion for assessing the contributions of capital investment to various branches of the economy, as well as the changes in the structure of investment during a particular year. This difficulty is caused by the multiplicity of factors which finally determine to what extent the economy will benefit from a certain capital investment (e.g. its influence on the balance of payments, on output, on employment, on the settlement of underpopulated areas, etc.) and by the small amount of research hitherto carried out on this subject.

TABLE 35

INVESTMENT IN THE MAIN ECONOMIC SECTORS, 1953 TO 1955

(at current prices)

Sector	1953		1954		1955	
	IL.millions	*per cent*	*IL. millions*	*per cent*	*IL. millions*	*per cent*
Agriculture and Irrigation	97	31.9	113	27.0	127	22.5
Industry	55	18.1	56	13.4	61	10.8
Mining	10	3.3	19	4.5	26	4.6
Communications	24	7.9	46	11.0	67	11.9
Electricity	9	3.0	9	2.1	33	5.8
Residential Housing	68	22.4	130	31.0	191	33.8
Services	41	13.5	46	11.0	60	10.6
Total Gross Investments in Capital Assets	304	100.0	419	100.0	565	100.0

SOURCE: *Calculations of the Bank of Israel.*

If the effect of investment on the balance of payments (be it by increasing exports or by substituting local produce for imports) is accepted as the most important criterion, it is possible to regard investment in residential housing and public services as of low priority, since no real contribution is made to the improvement of the balance of payments while, at the same time, the consumption level is raised.

It should nevertheless not be concluded that residential building, and especially the building of one and two room flats or of hospitals and schools, is superfluous. Quite apart from the fact that minimum housing is an essential pre-condition of economic absorption, housing schemes for labour often constitute an integral part of productive investment in industry and mining in development areas, particularly so in the establishment of agricultural settlements.

Despite the above reservation, it is useful to compare the volume of investment, the priority of which, from the viewpoint of improving the balance of payments, is low, with the volume of investment which should receive a higher priority. In 1955, low priority investment in residential housing and public services increased considerably, reaching 44 per cent of total investment, as compared with 35.8 per cent in 1953 and 42 per cent in 1954. The volume of high priority investment, namely investment in agriculture, industry and transportation, showed corresponding decreases — from 64.2 per cent in 1953, to 58 per cent in 1954 and to 55.6 per cent in 1955.

3. INVESTMENT AND ADDITIONAL OUTPUT

The stream of immigrants reaching Israel after the foundation of the State doubled the population within a few years and compelled the economy to refrain from consuming part of its available resources from local production and capital imports in order that these resources could be applied to increasing the national output. It would undoubtedly have been possible to raise output by more efficient use of the labour force, as well as by widening the framework of vocational training for immigrants and exploiting more fully the means of production in each of the economic sectors. Despite the fact that unused production capacity is frequently found today, it is still impossible to raise output more quickly than the increase of local population by natural causes and large-scale immigration, without heavy capital investment in all branches of the economy.

The investment of capital required in Israel to increase output is relatively very large. Water wells must be drilled and irrigation water conveyed to all parts of the country, whereas in the developed countries of Western Europe, this is usually unnecessary; nor does investment in Israel take the form of completing a developed industrial structure previously in existence for many years. On the contrary, large sums must simultaneously be invested in an extensive network of basic services. Investment in agriculture, for example, not only demands additional buildings and machinery but, primarily, the extension of the national irrigation and electricity supply networks, the construction of new roads and public buildings, and vocational training for those immigrants who are to settle on the land. Much the same applies to the establishment of industrial enterprises in development areas.

There seems, at first glance, a contradiction between the need for large basic investment and the fact that the additional output for every IL.1 invested since 1950 has been considerable, especially if compared with additional output per investment unit in the developed countries of Western Europe. Research carried out in this subject * shows that the ratio in such countries as Sweden, Great Britain, Denmark

* Memorandum by Dr. A. L. Gaathon, Economic Advisory Staff, Jerusalem, June 1955.

and the United States during the period 1947 to 1952 averaged about IL. 4 to IL. 5 of capital invested for every IL. 1 of additional production. In Israel, in the years 1950 to 1954, an average investment of IL. 2.5 to IL. 3 was sufficient to bring about an increase of IL. 1 in additional output. In countries where the stage of primary development has been passed but where capital assets were damaged by the ravages of war, e.g. in Western Germany and Austria, a capital investment of IL. 1.5 to IL. 2.5 sufficed during this period to increase the national product by IL. 1.

It should not be forgotten, however, that two factors were mainly responsible for the soaring output in Israel. There can be no doubt that the small amount of capital per earner in most branches of the economy increased extra output accruing from additional capital investment, after the initial stage of basic investment in electricity, water and roads. By contrast, in developed countries, where earners disposed of considerable capital, additional capital may increase their output to only a small extent. The most important factor affecting production was, however, the rapid growth of the population and of the number of earners. Even without any significant addition of investment capital, the rise in the labour force would have been sufficient in itself to increase output to a certain extent. This would have happened even if the average amount of investment capital available to each earner had diminished. Only a part of the additional output after 1950 was the direct result of investment, and this part alone should have been compared to the additional output in countries whose populations remained relatively stable during these years. Owing to insufficient data, this comparison cannot be made; nor is it possible to assess the most desirable relationship between future investment and further increase in output, in Israel currency, assuming a slow growth of population.

4. INVESTMENT AND CAPITAL IMPORTS

The relatively large scale investment implemented in all economic sectors since the establishment of the State far exceeded the amounts which the Israel economy could have invested from its own limited resources. The part played by capital imports was not, however, restricted to financing a certain proportion of investment, and thus supplementing internal savings; indeed, capital imports from abroad were only partly used for financing investment, the rest serving as a direct source of consumer goods for the additional population, and sometimes even for raising *per capita* consumption.

The physical composition of commodity imports is no indication of the extent to which capital from abroad is used for investment or consumption. Imports of consumer goods, providing they release local resources for the production of capital goods, are tantamount to using capital imports for increasing investment. The best way of measuring the use of capital imports for investment and consumption is by determining the amount by which total net investment exceeded capital imports from abroad and was financed from internal savings. It may also be that total investment is lower than capital imports from abroad, i.e. the economy consumes more than its current output. Although, in Israel, capital imports still exceed net investment, Table 36 shows that the gap is being steadily narrowed. In 1955, investment amounted to 89 per cent of capital imports, as compared to 81 per cent in 1954.

TABLE 36

CAPITAL IMPORTS AND NET INVESTMENT 1953 TO 1955

(at current prices, in IL. millions)

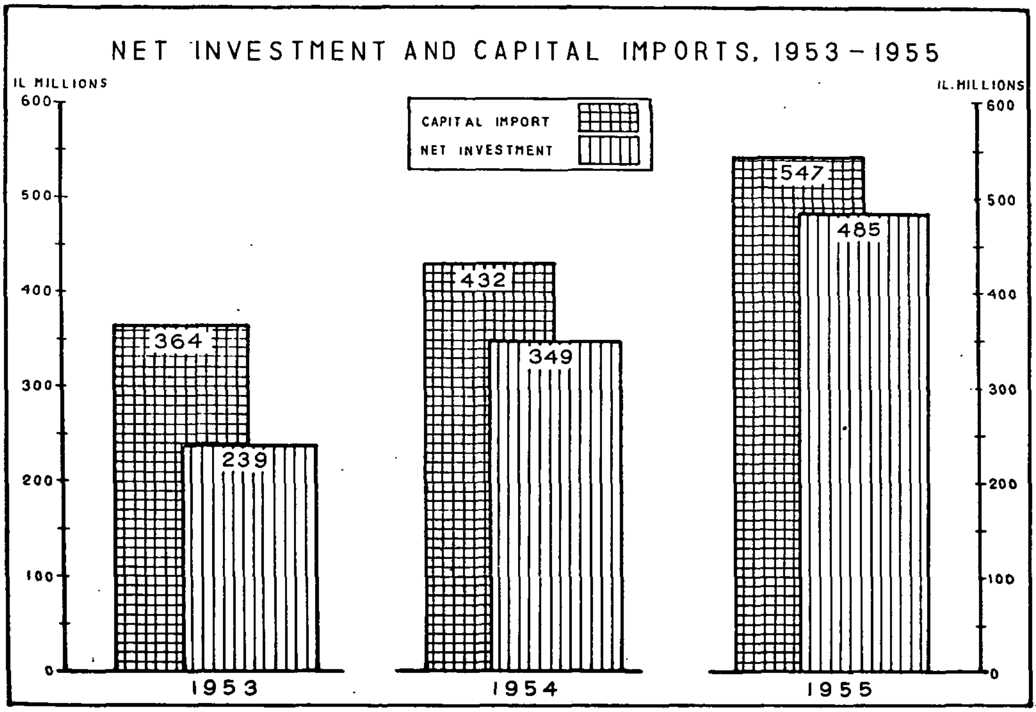
	1953	1954	1955
Capital Imports *	364	430	547
Net Investment	239	349	485
Net Investment as a Percentage of Capital Imports	66	80	89

* *At the following rates of exchange*:
1953: \$ 1.00=*IL*.1.400
1954 *and* 1955: \$ 1.00=*IL*.1.900
See note at the beginning of Chapter II.

SOURCE: *Calculations of the Bank of Israel.*

The decision to expand imports of investment goods at the expense of imports for consumption was neither the main reason for the increased volume of investment in relation to capital imports from abroad nor for the reduction in the surplus of consumption over the current output of the economy.

Had the restraint on effective demand during the second half of 1955 not succeeded, it would have proved impossible to increase the import of capital assets.



It is probable that such an attempt to increase the import of capital assets would not have sufficed to encourage the public to save on a large scale, and it is likely that the amounts spent on consumption would have remained unaltered. The unsatisfied demand for consumer goods would have transferred local factors of production from branches producing capital goods to branches catering to consumption — especially luxury consumption. Alternately, it might have led to the continuation of the inflationary pressure on prices and expenditure which existed in the first half of 1955, and to a further increase in consumer goods imports, or to a fall in exports.

Nonetheless, it seems that, as long as economic policy aims at raising the level of investment, a need will exist to increase considerably the import of capital assets. Given the present structure of production, it is impossible, at short notice, to change the proportion of direct imports of capital assets or of indirect imports of raw materials for the local production of capital assets, used in the implementation of the investment programmes. The essential import component of investment in its present form is more or less fixed and no rapid change in its size can be expected. Such changes may come about, either through the local production of ships, electric generators, special machinery, heavy vehicles, etc., or else through a considerable increase in the added value created by the domestic production of capital assets, at present concentrated almost entirely in the metal industries. The average import component of investment was estimated in 1955 at 41 per cent. The import component of consumer goods was much lower, being estimated at only 21.7 per cent. Every attempt to increase the volume of investment in agriculture, industry and communications, by diversion of local production from consumer goods to capital goods, must therefore be accompanied by a considerable expansion in the total volume of imports.

Moreover, the import component is relatively high in industry, electricity, communications, agriculture and irrigation (in 1955, it averaged 53 per cent in these branches), while in building and public services it is relatively low (23 per cent in 1955). Hence, every attempt to increase investment in branches requiring a high import component, at the expense of investment in building and services, will necessitate, at least in the short run, greater imports of capital assets from abroad.

5. INVESTMENT IN STOCKS

Government stocks of food, fuel, equipment, medical supplies and building materials as well as stocks in the warehouses of the Reparations Corporation, increased by IL. 25 millions during 1955. The value of Government stocks almost doubled, from approximately IL. 30 millions to IL. 50 millions.

As no summarised data are available on stocks of raw materials, work-in-progress and finished goods other than those stored in Government and Reparations Corporation warehouses, it is difficult to assess the changes occurring in stocks of this kind during 1955 in relation to the preceding year. There are, however, signs that stocks of raw materials for industry, agriculture and building fell to a certain extent, while stocks of manufactured goods increased considerably, especially during the second half of the year. A smaller increase occurred in stocks of work-in-progress goods, which kept pace with the general rise in output. The total increase in stocks stored elsewhere than in Government and Reparations Corporation warehouses is assessed at IL. 15 millions.

The rise in the value of stocks of all kinds during 1955 is thus estimated at IL. 40 millions. During 1954, the value of stocks, at fixed 1955 prices, rose by approximately IL. 32 millions.

Imports of industrial raw material increased to a lesser extent during 1955 than did local industrial production. This discrepancy is partly explained by the change-over to local raw materials, such as cotton, ground-nuts, phosphates and other minerals; but it also seems attributable to a decrease in the stocks of raw materials held by industrial concerns.

The difficulties encountered by industrialists in the financing of stocks, as a result of credit restrictions, were an important cause of the reduction in raw material stocks. Yet, owing to speculation and uncertainties regarding the orderly supply of goods, the accumulation of stocks seems also to have been interrupted. This was due to the relative ease in obtaining import licences for raw materials and to the relative stability of prices and currency. Many industrialists felt it unnecessary to lay in large stocks, assuming that, in an emergency, the ample stores of raw materials kept by the Government and the Reparations Corporation would be put at their disposal. It is estimated, nevertheless, that raw material stocks held by industrialists in 1955 are sufficient to maintain a stable level of production for an average period of three months.

While stocks of industrial raw materials fell slightly, there was a large increase in stocks of work-in-progress and finished goods. This was caused by unduly optimistic assessments during 1955 of the demand in the local market and of export possibilities.

Farmers and agricultural settlements reduced their fodder and grain stocks somewhat during 1954, as supplies were orderly and prices relatively stable, but they increased their stocks again during the first part of 1955. This was due to fear of a grain shortage after the drought and to delays in local supplies. However, large imports of grain and of fodder from American surplus stocks during 1955, as well as the shortage of turnover capital, decreased the amount of fodder stored by farmers, while stocks in Government warehouses rose in proportion. It must be supposed, on the whole, that the farmers' total stocks of finished and semi-finished products expanded slightly, as the volume of crops cultivated by them increased, especially crops grown for their own consumption.

The year 1955 witnessed a small decline in the stocks of building materials held by contractors; but this was compensated by a rise in the value of buildings under construction, which parallelled the increase in the volume of building.

6. FINANCING OF INVESTMENT

The share of public capital in the financing of gross investment fell during 1955 and was assessed at 60 per cent as compared with 64 per cent in 1954. There was a corresponding rise in the share of private investment, from 36 per cent in 1954 to 40 per cent in 1955, as shown in Table 37.

TABLE 37

FINANCING OF INVESTMENT, 1954 AND 1955
(at current prices)

	1954 *		1955 **	
	in IL.millions	*in per cent*	*in IL.millions*	*in per cent*
Total Gross Investment	449	100	605	100
of which:				
Financed by the Government	226	50	284	47
Financed by the Jewish Agency and Local Authorities	61	14	77	13
Financed from Other Sources	162	36	244	40

* *Financing by Government and Local Authorities during the period* 1.4.1954 *to* 31.3.1955; *financing by the Jewish Agency during the period* 1.10.1953 *to* 30.9.1954.
** *Financing by Government, Local Authorities and the Jewish Agency during the calendar year* 1955.
SOURCE: *Calculations of the Bank of Israel.*

The declining share of public financing and the increase in private financing, were mainly due to the large expansion of investment in residential housing financed from private sources. Public services were expanded to a lesser extent. The sources from which investments in the various branches of the economy were financed are described in more detail in other chapters.

Nevertheless, as in previous years, the budgets of public bodies, and especially the Government's Development Budget, continued to play the decisive part in the financing of investment. This was effected by granting loans to private investors, or through direct investment by the authorities concerned. The latter were thus able to exert great influence, not only on the general volume of investment in the country but also on its direction to specific branches, in accordance with the development policies of these authorities.

Moreover, the decisive weight of public capital in the financing of investment makes it possible to bridge the gap between the financial profitability of an individual enterprise and the benefits it confers upon the economy as a whole. This gap usually exists in economies in the first stages of development. The large size of public budgets permits them to create the necessary basis for the natural expansion of various branches of production, through the development of water resources, electric power and communications. Such projects are rarely financed by private investors who would be guided by considerations of profit.

The task of public capital in Israel is nevertheless not restricted to the financing of the country's basic development schemes. Since May 1948, the amount of capital available in most economic sectors has been largely dependent on public funds. Table 38 estimates the shares of public and private capital in the financing of investment in the main economic sectors during 1955.

TABLE 38

PUBLIC AND PRIVATE INVESTMENTS BY ECONOMIC SECTORS, 1955

Sector	*Public Resources*		*Private Resources*	
	in IL.millions	*in per cent of total public financing*	*in IL.millions*	*in per cent of total private financing*
Agriculture & Irrigation	98	27	29	12
Industry	16	4	45	18
Mining	16	4	10	4
Communications	38	11	29	12
Electricity	25	7	8	3
Residential Housing	89	25	102	42
Services	49	14	11	5
Stocks	30	8	10	4
Total	361	100	244	100

SOURCE: *Calculations of the Bank of Israel.*

The most important of the public budgets is the Government Development Budget; its expenditure has, since 1949—50, accounted for more than one-third of total investment. But it must be stressed that the influence of the Development Budget on investment might well be far greater than its direct part in the financing of investment since, in most cases, its loans are granted to development undertakings only on condition that the latter complement them by making additional capital available from their own resources. The financing of investment through the Development Budget is effected in the form of long term loans at a relatively low rate of interest, granted to public corporations, the Jewish Agency, local authorities and private commercial companies or, on a smaller scale, in the form of direct investment in communications.

In addition to investments in water and electricity projects and communications, and loans designed to increase industrial and agricultural production, the Development Budget played a vital part in the financing of housing schemes for new immigrants and the expansion of social services by the erection of schools, hospitals, etc. During 1955, some 23 per cent of Development Budget expenditure was devoted to investment in residential housing, some 18 per cent to investment in industry, electricity and mining, some 15 per cent to investment in agriculture and irrigation, some 11 per cent to investment in transportation and communications, and some 9 per cent to investment in public services and under various other heads. The remaining expenditure, amounting to 24 per cent of the total, included direct participation in the budgets of the Jewish Agency and the local authorities (9 per cent) and various items (15 per cent), such as purchase of shares of the Palestine Electric Corporation and in fortifications, etc., which cannot be defined as investments in the accepted sense of the term.

The Jewish Agency financed considerable capital investment in new agricultural villages from the budget of its Settlement Department and took care of newcomers during the first years of their settlement on the land. Of the investment financed by the Settlement Department of the Jewish Agency in 1955, 29 per cent was in water projects carried out by the *Mekorot* Company and by the villages themselves, 23 per cent in farm buildings, 15 per cent in the acquisition of livestock, 14 per cent in the planting of orchards and 7 per cent in the purchase of tools and machines, while 12 per cent was set aside for revolving capital and other purposes.

The local authorities financed a part of the investment in public buildings, hospitals, schools, religious and welfare institutions, road-building within their boundaries and public works. This was done with the help of their extraordinary budgets. A provisional estimate for 1955 shows that 37 per cent of the investment financed by local authorities was in public works (sewage, drainage, water works, etc.), 27 per cent in the erection of schools, 17 per cent in road-building within their boundaries, 9 per cent in public building, 8 per cent in hospitals and other health institutions and about 3 per cent in religious and welfare institutions.

Capital investment by private companies and individuals, calculated by deducting the investment of the public sector from total gross investment, reached IL. 224 millions in 1955, as against IL. 162 millions in 1954. A large proportion of these amounts was invested in the replacement of existing capital assets no longer fit for use.

Some idea of the extent of private investment in local and foreign currency, particularly with regard to industry, can be obtained from investment projects submitted for approval to the Government Investment Centre and duly approved by it. These include investment in existing as well as in new enterprises. The rapid fall in the volume of private investment through the Centre was arrested in 1955, and the number of approved projects involving the establishment of new undertakings quickly increased. During the year, 104 such projects were approved, representing a total investment of IL. 36 millions. Of this sum, 70 per cent was invested in industrial enterprises and the remaining 30 per cent in residential housing, agriculture, transportation and communications, and services. The comparative figures for 1954 include 78 approved undertakings, representing a total investment of some IL. 25 millions.

A large increase also occurred in further investment in existing undertakings approved by the Investment Centre and in the number of new enterprises reaching the stage of actual production. On the other hand, the number of approvals cancelled owing to the fact that no preparations for the establishment of the undertakings concerned had been made, fell during 1955. The total value of approved capital investment increased by 117 per cent in 1955 and amounted to IL. 62.4 millions, as against IL. 28.7 millions in 1954.

Table 39 summarises the activities of the Investment Centre in 1954 and 1955.

TABLE 39

CAPITAL INVESTMENT APPROVED BY THE INVESTMENT CENTRE, 1954 TO 1955
(in IL. millions)

Investment	1954			1955		
	in local currency	*in foreign currency*	*Total*	*in local currency*	*in foreign currency*	*Total*
New Undertakings	8.8	16.2	25.0	13.9	17.5	31.4
Existing Undertakings	1.0	2.7	3.7	8.7	17.6	26.3
Residential Housing	—	—	—	—	4.7	4.7
Total	9.8	18.9	28.7	22.6	39.8	62.4

SOURCE: *Government Investment Centre, Ministry of Commerce and Industry, Jerusalem.*

The increase in the number of investments submitted for approval to the Investment Centre partly evolved from the easing of facilities in ordering machinery and equipment through the Reparations Corporation. Loans from the Development Budget did not constitute an important source of funds for the financing of investment projects approved by the Centre, and totalled only IL. 1.1 millions during 1955, as compared with IL. 0.9 million in 1954. The larger volume of capital investments submitted for approval to the Investment Centre was mainly caused by the greater stability of the Israel currency and by new concessions granted to investors after the *Knesset*, in 1955, had enacted certain amendments to the Law for the Encouragement of Investment.

Among such amendments, the following change should be particularly noted. In the past, the approval of an investment project by the Investment Centre was a purely administrative step conferring no automatic privileges on the investor. Indeed, the privileges dealt with by the Law for the Encouragement of Investment were always granted, whether in part or in full, by virtue of special recommendations. The new amendments automatically confer some of these privileges on all investors whose projects have been approved, without leaving this matter to the discretion of the various authorities concerned.

The most important concessions concern income tax. The rate of depreciation for income tax purposes has been increased and the previous discrimination between individual investors and companies has been terminated. With regard to currency controls, the restriction limiting the added value from exports which a non-resident investor may transfer abroad in foreign currency, to 10 per cent of the value of the investment per annum, has been cancelled. Moreover, the status of an approved undertaking may now be conferred on foreign currency loans granted for periods of not less than ten years, and such loans will normally benefit from all ordinary privileges under the Investment Law. Special privileges are conferred on investors living abroad, who either built or acquired residences in Israel after April 1955.

To avoid discrimination against investors who established their undertakings prior to the formal *Knesset* enactment of the amendment in 1955, existing approved enterprises will benefit retroactively from the new concessions.