

CHAPTER V

DOMESTIC INVESTMENT

GROSS DOMESTIC investment¹ totalled, at current prices, IL. 924 million in 1958, as against IL. 868 million in 1957 (or IL. 883 million at 1958 prices)—an increase of about 7 per cent. However, as investment prices are estimated to have risen by 1 to 2 per cent between 1957 and 1958, the real increase in gross investment amounted to approximately 5 per cent, the value of investment in 1957 at 1958 prices being about IL. 883 million.

Net investment (i.e., gross investment less depreciation) increased by under 2 per cent—3 per cent less than gross investment—since the depreciation item² was considerably bigger, due to large scale investments in the last few years.

The changes in gross and net investment are shown in Table V-1.

TABLE V-1
Domestic Investment (1958 prices), 1957-1958
(millions of IL.)

	1957	1958	<i>Percentage increase from 1957 to 1958</i>
Gross investment	883.3	923.5	4.6
Depreciation	270.0	300.0	11.1
<i>Net investment</i>	613.3	623.5	1.6

SOURCE: Central Bureau of Statistics and Bank of Israel

While domestic investment expanded slowly in 1958, there was apparently an improvement in its structure: Agriculture, industry, mining and electricity absorbed 45 per cent of total domestic investment in 1958, as compared with 40 per cent in 1957, while the share of transport declined from 17 to 13 per cent, and that of residential construction and the services remained unchanged (42 to 43 per cent).

The larger proportion of investments in “productive branches” (agriculture,

¹ Owing to lack of data, the term “gross investment”, as used in this chapter, excludes changes in inventories, referring solely to investment in buildings and equipment.

² See Chapter II—“Resources, Product and National Income”.

industry, mining and electricity) furthers the economic objective of expanding capacity in branches able to produce at reasonable cost for export or for the substitution of imports. This may enable the economy to adjust itself gradually to the anticipated reduction in capital imports from abroad. Given an adequate level of investments, it will also be possible to prevent the lowering of living standards which would result from the growth of the population, through immigration and natural increase, if the economy's production assets are not increased correspondingly.

Despite the improved structure of investments in 1958, their level and channelling did not contribute to any marked extent to the attainment of these goals. Not all investments made in "productive branches" during 1958 are necessarily conducive to an improvement in the balance of payments. A considerable proportion of investments in agriculture and industry is intended to expand the output of commodities—such as dairy products and various industrial goods—which are not exported and cannot replace imports at reasonable production outlays. It would seem that the existing price structure encourages the establishment of enterprises which are incapable of contributing to an improvement in the balance of payments. As to the Government, it seems to be giving greater weight to the dispersal of the population, the stabilization of farm incomes, the improvement of the housing situation, etc., (all of which are admittedly important objectives) than to balance of payments considerations.

It should be noted that the investments discussed here do not comprise certain outlays included in consumption expenditure, which affect output and production costs in much the same way as investments in buildings and equipment. In 1958, tens of millions of pounds were spent on vocational training, scientific research, etc., which must be taken into account when considering overall domestic investment.

1. FACTORS DETERMINING THE VOLUME AND DISTRIBUTION OF INVESTMENTS

The level of domestic investment is determined by the volume of private consumption, which in turn governs the volume of private saving, as well as by the size of the Jewish Agency budget and the Development Budget and of the Government deficit. The Jewish Agency Budget and the Development Budget were drawn up by the Government on the basis of income from the following sources:

1. Imports of public capital, such as German Reparations, transfers by the United Jewish Appeal, the Development Loan and other long-term loans, which together totalled IL. 245 million in 1958;
2. Other receipts earmarked for the financing of the Development Budget, such as collections on account of outstanding loans, national insurance payments, income from the floating of securities, war risk insurance tax, etc., which totalled IL. 165 million.
3. A net transfer of IL. 16 million from the Ordinary to the Development Budget.

The Government deficit was considerably smaller in 1958 than in 1957.

The distribution of investments among the economic sectors is given in Table V-2.

TABLE V-2
Gross Investment, by Branches (1958 prices), 1957-1958
(millions of IL.)

Branch	1957	1958	Increase or decrease from 1957 to 1958	
			millions of IL.	percentages
Agriculture and irrigation	171.4	211.7	40.3	23.5
Industry	106.0	151.5	45.5	42.9
Mining	18.2	5.5	-12.7	-69.8
Electricity	57.5	51.5	- 6.0	-10.4
Transport, postal services and oil pipelines	148.3	117.1	-31.2	-21.0
Housing	278.2	277.5	- 0.7	- 0.1
Services	103.7	108.7	5.0	4.8
Total	883.3	923.5	40.2	4.6

SOURCE: Central Bureau of Statistics and Bank of Israel

Agriculture. The large increase in investment funds channelled to agriculture was almost wholly caused by investments in livestock and farm buildings. An agreement concluded between the Government and poultry farmers fixed the prices of fodder and eggs at levels ensuring a high profitability in this branch and was directly responsible for the considerable expansion of poultry farms. Investments in cattle farming likewise expanded.

Other agricultural branches underwent no marked changes. The level of investment in orchards, afforestation, land reclamation, the development of natural pastures, the irrigation of additional areas, etc., was similar to that of 1957. The development of Israel's water resources continued, the planning and construction of national and regional water networks also proceeding at the same pace as in 1957.

The share of public funds in the financing of agricultural investments remained unchanged, i.e., new investments were largely financed from other sources, such as farmers' savings, short-term bank credit, etc. Certain agricultural sectors, and in particular the moshavim, appear to have financed many of their investments from their own resources, by saving part of their incomes. This type of financing had characterized Israel agriculture also in previous years, but became even more important in 1958, as the signing of the Poultry Agreement ensured high profits on investments in poultry-farming.

Industry. The higher level of investment in industry was only partly due to factors operative during the year under review, since much of the equipment imported in 1958 had been ordered abroad already in 1957. As in 1957, some 37 per cent of total industrial investment was financed from public funds. The volume of private financing was thus considerably expanded, mainly owing to the impact of the following factors:

- (a) An optimistic appraisal of future industrial development, based on recent and present market trends, as well as on the policy of the Government and the Bank of Israel, which encouraged investment and production by protecting local enterprises, granting credit at interest rates below the equilibrium rate, and so on.
- (b) A general improvement in industrial profitability during the last two years, enabling the financing of investment from undistributed profits.
- (c) The increase in amortization funds, following the larger capital investments in industry.
- (d) The relatively low prices of capital goods, caused by an effective exchange rate for the import of equipment—which is lower than that for other imports—and the availability of long-term low-interest loans from the Development Budget.

Certain industrial branches possess excess capacity, i.e., their output can be substantially increased at no additional outlay per unit of production. In 1958, some investment funds were diverted to these branches, often with Government approval. Excess capacity can be absorbed—and even a shortage created—by a rapid increase in demand or improved export possibilities; it does not, therefore, necessarily imply that no additional investments are required in the branch concerned. It would seem, however, that certain industrial investments in 1958 were channelled to branches where excess capacity is not likely to disappear in the near future and it would have thus been possible to reach the planned volume of output with a smaller outlay of capital. In some cases, the production system of a branch with excess capacity is unbalanced, part of the equipment in existing enterprises being designed for a larger volume of output, while another part is designed for a smaller output. This limits the expansion of production. In such cases production can be expanded by the acquisition of certain types of equipment, and it is not necessary to erect new plants or replace the entire production system. However, when weighing these alternatives, considerable stress has been laid on the need to industrialize development areas by setting up new enterprises.

The development of industry is effected mainly through the granting of loans to private entrepreneurs. This limits the Government's ability to channel investment, since it is restricted to choosing from the plans submitted for its approval. In many branches, these plans do not meet the long-term requirements of the economy.

TABLE V-3

The Structure of Capital Goods (1958 prices), 1957-1958
(millions of IL.)

	1957	1958
		<i>branch</i>
<i>Agriculture</i>		
Structures and earth works	132.1	160.1
Equipment	18.8	21.4
Livestock	20.5	30.2
<i>Industry</i>		
Structures and earth works	14.8	24.8
Equipment	91.2	126.7
<i>Mining and oil</i>		
Structures and earth works	8.4	2.4
Equipment	9.8	3.1
<i>Electricity</i>		
Structures and earth works	30.6	15.5
Equipment	26.9	36.0
<i>Transportation, posts and pipelines</i>		
Structures and earth works	46.2	36.4
Equipment	102.1	80.7
<i>Services</i>		
Structures and earth works	84.3	84.6
Equipment	19.4	24.1
<i>Residential building</i>	278.2	277.5
<i>Total</i>	883.3	923.5
		<i>capital goods</i>
Structures and earth works	316.4	323.8
Equipment	268.2	292.0
Livestock	20.5	30.2
Residential building	278.2	277.5
<i>Total</i>	883.3	923.5

SOURCE: Central Bureau of Statistics and Bank of Israel

Electricity and mining. Investments in electricity were somewhat lower in 1958 than in the preceding year. Two units were completed in the Sukreir power station, raising the country's power production capacity by 35 per cent.

Investments in mining and oil prospecting declined steeply, due to the completion of a number of projects (such as the Copper Works at Timna) and the slower pace of oil drilling.

*Transportation and communication.*¹ The substantial decline in investments in this branch may be attributed to several factors, which will be discussed against the background of developments in each individual branch.

The total value of ships acquired in 1958 was IL. 20 million lower than that of the ships which joined the Israel fleet in 1957. The purchase of shipping is effected according to a long-term plan. Hence, this decline is not indicative of future trends. The value of new ships to be completed in 1959 will probably equal the investment in shipping during 1957 (some IL. 40 million). The 1958 investments in shipping increased the carrying capacity of the Israel fleet by 14 per cent.

The major investments in aviation were made in 1957, when three "Britannia" aircraft were acquired by "EL AL". In 1958 only one additional aircraft was received, which completed the expansion programme of "EL AL" for the next few years.

The greater part of the Eilat-Beersheva and Haifa-Tel-Aviv pipelines was laid already in 1957. In 1958, these lines were only lengthened and completed, the investment capital required being considerably smaller.

Investments in other types of communications and in postal services increased by approximately IL. 10 million, of which IL. 6 million were invested in commercial vehicles, IL. 3 million in postal services and IL. 1 million in the road network.

Residential building. Owing to the smaller volume of immigration in 1958, the area of buildings commenced declined significantly as against 1957. However, no changes occurred in the level of building activity, as many buildings started at the end of 1957, were completed in 1958.

The share of public funds in the financing of residential building was IL. 20 million smaller in 1958 than in the preceding year. This decline was mainly reflected in the lower value of buildings erected by the Housing Division of the Ministry of Labour. However, as there was more private building, the total expenditure on housing remained unaffected.

The average dwelling density at the beginning of 1958 was 2 persons per room. The situation improved somewhat during the year, since $1\frac{1}{2}$ new rooms were erected for every additional inhabitant.

¹ The definition of "transportation and communication" in this chapter differs from that in the 1957 Report. Under the U.N. definition here used, this item includes oil pipelines and postal services. In the 1957 Report, oil pipelines were included with "mining" and postal services with "services".

Services. Investments in services were somewhat larger than in the preceding year (see Table V-2), reflecting a slight expansion in certain branches, such as public buildings, higher education institutions, etc.

2. INVESTMENT PRICES

The average prices of capital goods were 1 to 2 per cent higher in 1958 than in 1957. This may be attributed to the cumulative effect of a number of factors:

1. The 2 per cent rise in the prices of imported equipment;
2. The 10 per cent lower transportation costs of such equipment;
3. The stable prices of locally-produced investment goods;
4. The 1 per cent increase in building costs;
5. The 3 to 4 per cent rise in the costs of equipment installation and of public works.

As imported equipment is duty-free, and as by 1958 all restrictions on such imports had been abolished, the prices of equipment—including machinery of local manufacture—were fixed on the basis of the foreign price, at the official rate of exchange.

The big gap between the effective rate for imports of equipment and that for other imports reduced the prices of equipment, both in comparison with other investment components (such as wages and cement) and as against current production costs. This has, on the one hand, increased the import component of investments (e.g., causing a higher input of iron and a lower input of cement in reinforced cement constructions) and led to greater mechanization of building and earth-works; and on the other hand encouraged the over-utilization of equipment. At existing prices, producers find it more profitable to purchase machinery and substitute it for workers, whereas at higher equipment prices this would not be advantageous. The anticipated increase in import prices, which induces potential investors to implement their projects while the existing price level persists, reinforces this trend. The impact of these price ratios on the various branches of industry has been considerable: Not only have they caused excessive mechanization (chiefly via imports) but investors have been led to prefer capital intensive branches to branches where labour is the main production factor. Thus, the expenditure of foreign currency has been stimulated, while the local demand for manpower to manufacture and operate equipment has declined.

Imports of equipment are further facilitated by the availability of credit on easy terms within the framework of the Reparations Agreement. Such credit is not given for the purchase of locally manufactured equipment.

In general, this method of financing investments from public funds encourages investment in buildings and equipment rather than in working capital.

Investment funds from the Development Budget (the interest on which is lower than the real rate) are mainly used to finance investments in fixed assets with a high import component, rather than in turnover capital (wages and other operating costs). The effect of this preference is similar to that of the low import prices, causing excessive investments in buildings and equipment, while reducing the expenditure on turnover capital.

3. THE FINANCING OF INVESTMENTS

The amount of public funds used to finance investment was somewhat lower in 1958 than in the preceding year, while private financing was substantially expanded and raised the total volume of investment. As a result, the share of public financing¹ within total investment fell to 50 per cent in 1958, as compared with 57 per cent in 1957 (see Table V-4).

TABLE V-4
*The Share of Public Financing in Gross Investment (current prices),
by Branches, 1957-1958*

Branch	1957		1958	
	millions of IL.	share of public financing (per cent)	millions of IL.	share of public financing (per cent)
Agriculture and irrigation	167	56	212	56
Industry	104	37	152	37
Mining	18	95	5	95
Electricity	56	77	51	57
Communications	145	81	118	70
Residential building	275	52	278	44
Services	103	39	108	41
<i>Total</i>	868	57	924	50

¹ The public financing of investments comprises: A. Direct investments by public authorities (the Government, the Jewish Agency, the National Funds and the local authorities). B. Loans and capital transfers by these bodies; C. Part of the loans granted to various companies at Government initiative, such as credit for ship-building from German shipping concerns and credit from the Bristol-Britannia companies to "El-Al" for the purchase of "Britannia" aircraft. This last item was first defined as a publicly financed investment in the 1958 Report and is responsible for the discrepancies between the figures in the 1957 and 1958 Reports as regards investment in individual branches (mainly Communications) and total investment. Other discrepancies are due to differences in the definitions of the various branches (see Note 1 on page 56). As the estimate of investment does not comprise changes in inventories, amounts earmarked for turnover capital were not included with publicly financed investments.

Most public funds have their origin in the substantial capital imports received by the public authorities through Reparations, the United Jewish Appeal, the U.S. grant-in-aid, and various foreign loans. These sources may dwindle in the future, when the Reparations Agreement has been fully implemented and larger amounts become due for repayment on account of long-term loans obtained in the past. Despite the higher level of private domestic saving, its share within total investment is too small, in view of the anticipated decline in imports of investment capital.

4. INVESTMENT IN STOCKS

As already pointed out, the measurement of gross investment does not cover investment in stocks, owing to the absence of sufficient data. Public stocks increased by IL.32 million, Government inventories expanding by IL.30 million and stocks of the Reparations Corporation by IL.2 million.