

CHAPTER XV

FLOW OF FUNDS¹

1. CONCEPTUAL FRAMEWORK

ANALYSIS OF THE FLOW of funds is concerned with the mutual relationship between different sectors of the economy as reflected in the money flows between them.² These flows pertain to three types of transactions: the purchase and sale of goods and services; unilateral transfers, such as taxes, subsidies, and grants; and the various types of credit.

Five of the domestic sectors are mainly active in the real (i.e. non-financial) sphere: the public sector (the Government, National Institutions, and local authorities), public sector companies,³ non-profit institutions, households, and private business enterprises. Three other domestic sectors are active in the financial sphere: the banking system (including the Bank of Israel), provident funds and insurance companies, and other financial institutions, such as mortgage and investment banks. In addition to the domestic sectors, the rest of the world is presented as a separate sector.

The total payments of each sector are by definition equal to its receipts. This equality, however, generally does not exist in each of the three transaction groups *per se*. A sector whose receipts in the real accounts (purchases and sales of goods and services and local transfer payments) are less than its payments requires credit from other sectors or transfers from abroad. Such a sector is defined as having a demand surplus.⁴ Although they grant credit to other sectors, the financial sectors are not in themselves sources of financing, with the exception

¹ After this chapter had gone to press, the estimate of unrequited receipts of the public sector from the rest of the world was revised: IL 13 million (\$ 7.3 million), which was recorded as unrequited receipts in 1961, was in fact long-term loans. On the other hand, IL 13 million (\$ 4.7 million), recorded in 1962 as long-term loans, should have been recorded as unrequited receipts. This revision slightly alters the means of financing the demand surplus of the public sector, but it does not affect the general conclusions of the chapter.

² A detailed description of the conceptual framework may be found in the following Bank of Israel Annual Reports: 1959, p. 264; 1960, p. 264; 1961, p. 314.

³ Public sector companies are companies in which the public sector owns at least 25 per cent of the equity capital and actively participates in the management. They include Amidar, Israel Electric Corporation, Zim, El Al, Israel Mining Industries, Rassco, etc.

⁴ The demand surplus of a sector is the balance of its net purchases (i.e. purchases of goods and services less sales of goods and services) over its net transfers from other domestic sectors (transfers from domestic sectors less transfers to domestic sectors).

of the banking system, whose special position in the flow-of-funds structure will be discussed below. The other financial sectors generally limit themselves to transferring credit from sectors with a supply surplus to those with a demand surplus.¹ In a closed economy, in which there are sectors with a demand surplus, there are perforce sectors with a supply surplus, the aggregate demand surplus being equal to the aggregate supply surplus. One of the characteristics of the Israel economy is the existence of a demand surplus in all sectors active in the real sphere. This situation is made possible by the large volume of receipts from abroad, in the form of both unilateral transfers and various types of credit.² The aggregate demand surplus of the domestic sectors (less the small supply surpluses of the financial sectors) equals the supply surplus of the rest-of-the-world sector, or in other words, the deficit in the current account of the balance of payments. The key position of the rest-of-the-world sector, which is strikingly borne out by an analysis of the money flows, requires special attention as regards the effect of the devaluation of February 1962, which engendered several changes in inter-sector relationships and in the weight of foreign receipts in the financing of payments of the various sectors.

2. MAIN DEVELOPMENTS

The nominal increase in the demand surpluses of the domestic sectors in 1962 was quite marked (see Table XV-1), but it does not reflect the real changes in the behavior of these sectors. Importance must of course be attached to the fact that the deficit in the balance on current account increased from \$ 402 million in 1961 to \$ 416 million in 1962, but even if the deficit had decreased somewhat, the alteration of the exchange rate would have brought about a growth in the supply surplus of the rest-of-the-world sector, and consequently in the aggregate demand surplus of the domestic sectors. The main indicators for evaluating developments in this sphere are:

1. The changes in the ratio between the demand surpluses and the total purchases of the different sectors. This ratio measures the weight of purchases not covered by receipts from sales and by transfers from other domestic sectors but financed through unilateral transfers from the rest of the world and through credit.

2. The changes in the distribution of the aggregate demand surplus among the domestic sectors, which tend to indicate the behavior of the various sectors with regard to the volume of purchases and method of financing.

The most noteworthy change in 1962 was the trend of development in the

¹ A sector with a demand surplus may also be a net lender, if its unilateral receipts from abroad are greater than its demand surplus.

² In this chapter credit includes all changes in financial claims: in addition to loans, it includes deposits, investments, and contributions to provident funds. The repayment of any type of credit is also defined as credit.

Table XV-1
INDICATORS OF THE INFLUENCE OF EACH SECTOR ON TOTAL
DEMAND, 1960-62^a

(IL million)

	Demand or supply (-) surplus			Net credit to sectors with a demand surplus ^b		
	1960	1961	1962	1960	1961	1962
Sectors with a demand surplus						
Public sector	157	113	351	251	308	306
Public sector companies	152	197	330	9	—	—
Non-profit institutions	103	109	121	—	—	—
Households and private business enterprises	194	353	509	15	48	44
Sectors with a supply surplus						
Provident funds and insurance companies	-4	1	-3	44	61	92
Banking system ^c	—	-8	-12	109 (13)	97 (28)	143 (40)
Financial institutions	-6	-10	-21	69	139	173
Rest of the world	-596	-755	1,275	243	247	687

^a For 1961 and 1962—revised figures.

^b Net credit is defined as the surplus of credit (after deduction of repayments) extended to a sector with a demand surplus over credit (after deduction of repayments) received from it.

^c Figures in parentheses are after deduction of incremental deposits and cash held by households and private business enterprises (considered as credit from them to the banking system); other figures are before deduction of these items.

public sector. The demand surplus of this sector, which dropped between 1959 and 1961 from IL 177 million to IL 113 million, or from 17.5 per cent of its purchases to 9 per cent, rose in 1962 to IL 351 million, or 19 per cent of purchases. The real increase, however, was smaller in real terms, since in 1959-61 the sector's demand surplus was artificially reduced in that most of its purchases from abroad were made according to the official rate of exchange, which was lower than the effective rates applicable to a considerable part of the purchases of other sectors. The increase in the weight of the public sector in the total demand surplus of domestic sectors, from 15 per cent in 1961 to 27 per cent in 1962, also partly reflects the fact that in 1961 the level of the sector's demand surplus was artificially lower.

The position of the public sector in respect of credit flows also underwent a change in 1962. In several of the preceding years it had advanced net credit, since the transfers it received from abroad (such as reparations and U.S. Government grants) exceeded its demand surplus. In 1962 the volume of unilateral transfers was less than the demand surplus, and in order to finance the balance simultaneously with the granting of credit to the domestic sectors on the same

scale as in 1961, the public sector's need for credit increased. Several noticeable changes took place in the sources and destination of credit: an increase in credit from abroad from \$ 75 million to \$ 140 million, a reduction in the debt to the banking system, and a change in the credit relationship between the public sector and households, the latter becoming net lenders instead of net borrowers.

The demand surplus of private business enterprises and households also showed a considerable increase of about IL 150 million, bringing the total up to more than IL 500 million. However the share of this sector in the total demand surplus of the domestic sectors fell from 47 to 40 per cent.¹ The data do not permit a distinction to be made between the demand surplus of private business enterprises and that of households; however, the information available on consumption and investment trends and on the large increase in transfers from the rest of the world to households tends to substantiate the assumption that the source of the larger demand surplus of this sector as a whole lies principally in the consumption of households, rather than in the investment of business enterprises, which was the decisive factor in the incremental demand surplus of 1961. (The consumption of households expanded more rapidly than their local income. In calculating the demand surplus, transfers from the rest of the world have not been regarded as income.) The credit relationships of the two sectors show the same characteristics as in the past. The private business sector is the recipient of a considerable sum of net credit. Credit received by it from the rest of the world in 1962 was greater than in the previous year, while a decrease took place in credit received from the financial and public sectors. The household sector extended more credit in 1962 than in 1961, most of the increment being destined for the financial sectors.

Public sector companies continued to increase their demand surplus during the year reviewed. The size of this surplus, which is related to the scope of the companies' investments, amounted in 1962 to more than 30 per cent of their aggregate purchases and to 80 per cent of their purchases on capital account—a rate considerably greater than in 1961. The share of the sector in the total demand surplus of the domestic sectors—26 per cent—was slightly higher than in 1961. Its demand surplus was financed with the help of credit, a large part of it—as in the past—from the public sector. Nevertheless, credit from the rest of the world and from financial institutions tended to rise.

A moderate growth in the volume of transactions has characterized the non-profit institutions in the last few years. They have increased their demand surplus slightly, but the ratio of the surplus to total purchases has remained almost unchanged at about 25 per cent. This sector benefits from foreign transfers to a considerable degree, and the new exchange rate increased its IL receipts

¹ This statement is made with reservations (see footnote ², p. 358).

at a faster rate than in former years. As a result, the sector's resort to credit, which even before had not been very great, diminished in 1962.

Before analyzing the flow-of-funds structure, note should be made of a point having direct relevance to the influence of devaluation on this structure. The discussion here is in terms of current prices, so that changes in the size of the flow of payments from year to year reflect not only real changes but also fluctuations in prices: these fluctuations were sharp in 1962, particularly in those spheres where the foreign currency component in transactions was high. Our analysis, however, is confined to flows of payments during the year and does not take into account changes in the value of the balance of assets and liabilities not arising from these flows. A not insignificant part of the financial assets and liabilities in the economy were either in the form of foreign currency or linked to the rate of exchange, and their value increased with devaluation. It may be assumed that the behavior of economic units was influenced not only by changes in assets and liabilities arising from money flows, but also by changes in value due to devaluation, the extent of which is not represented in the money-flows structure. Sufficient data are not available for a full analysis of the influence of devaluation on the financial position of the various sectors in the economy, and in any case, such an analysis cannot be very meaningful so long as there are no data on changes in the value of physical assets and in the flow of income arising from them. This factor, however, should be kept in mind when analyzing the behavior of the various sectors in the devaluation year.¹

3. THE DEMAND SURPLUSES OF THE VARIOUS SECTORS

The flow of payments and receipts in the Israel economy has been increasing steadily, as a result of both expanded activity and a rise in prices. In 1962 another factor was added—devaluation, which at once inflated part of the transactions by two-thirds. There was an especially large increase in public sector purchases, which rose by 45 per cent compared with the previous year (when the increase came to about 15 per cent). The growth was particularly great in defense expenditure, interest payments, and investment in stocks, where the foreign currency component is relatively high. At the same time, the increase in the other items, including wages, was by no means insignificant.²

The increment, as stated, reflects not only an increase in prices but also a real increase in activities. Even disregarding the effect of devaluation, the rate of expenditure growth is not in itself sufficient for determining the influence

¹ The following example may clarify the extent of this phenomenon: households increased their net deposits in the banking system (i.e. net of credit received) by more than IL 250 million in 1962. In addition, as a result of the new exchange rate, there was an increase of almost IL 150 million in the balance of deposits held by households on the eve of devaluation.

² See Table VII-12, p. 120.

Table XV-2
DEMAND OR SUPPLY SURPLUS, BY SECTOR, 1960-62*
 (IL million)

	Purchases on current account	Purchases on capital account	Sales	Net purchases (1) + (2) - (3)	Transfers to domestic sectors	Transfers from domestic sectors	Net transfers from domestic sectors (6) - (5)	Demand or supply (-) surplus (4) - (7)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Public sector^b								
1960	929	188	146	971	425	1,239	814	157
1961	1,061	224	131	1,154	508	1,549	1,041	113
1962	1,497	363	157	1,703	518	1,870	1,352	351
Public sector companies^c								
1960	444	240	513	171	—	19	19	152
1961	535	278	584	229	8	40	32	197
1962	647	403	700	350	8	28	20	330
Non-profit institutions^d								
1960	335	53	68	320	12	229	217	103
1961	376	55	78	353	14	258	244	109
1962	435	53	88	400	15	294	279	121
Households and business enterprises^e								
1960	2,772	714						194
1961	3,263	897						353
1962	3,966	1,084						509

Provident funds and insurance companies ^c								
1960	59	3	55	7	49	60	11	-4
1961	70	8	69	9	64	72	8	1
1962	89	5	93	1	93	97	4	-3
Banking system ^e								
1960	105	10	134	-19	19	—	-19	—
1961	133	9	178	-36	28	—	-28	-8
1962	207	13	268	-48	36	—	-36	-12
Financial institutions ^b								
1960	13	—	19	-6	—	—	—	-6
1961	18	—	28	-10	—	—	—	-10
1962	23	—	44	-21	—	—	—	-21
Rest of the world ^d								
1960	659		1,255	-596	—	—	—	-596
1961	748		1,503	-755	—	—	—	-755
1962	1,408		2,683	-1,275	—	—	—	-1,275

^a For 1960 and 1961—revised figures.

^b As defined in Chapter VII, "Public Sector Operations".

^c Companies in which the public sector holds at least 25 per cent of the equity capital and actively participates in the management.

^d As defined in Chapter XVI, "Non-profit Institutions".

^e Purchases of the sector include consumption and investment of households and investment of businesses, as recorded in the national accounts. The demand surplus of the sector was calculated as a residual, by deducting the demand surpluses of the sectors from the supply surpluses of the other sectors.

^f As defined in Chapter XVIII, "Provident Funds and Insurance Companies".

^g Commercial banks, cooperative credit societies, and the Bank of Israel.

^h As defined in Chapter XVII, "Financial Institutions".

ⁱ Sales also include, apart from imports as per the balance of payments, payments of the Jewish Agency abroad (excluding interest). Purchases include exports as per the balance of payments, less Jewish Agency expenditure on the transport of immigrants.

of the public sector on aggregate demand. The important fact is that, despite this increase in expenditure, net transfers to the public sector from other domestic sectors expanded by only 30 per cent,¹ and the demand surplus therefore increased considerably, amounting to 19 per cent of total purchases. Between 1959 and 1961 purchases grew at an annual rate of 10–15 per cent, as against an annual increase of 16–24 per cent in transfers. However, it should be borne in mind that if the valuation of public sector imports had been made at the average effective exchange rate in the economy, the growth rate of purchases would have been more rapid.) In the devaluation year, when a considerable expansion in receipts from the rest of the world to households and private business enterprises was expected—and in its wake an increase in purchases—the public sector was obliged to strive for a greater balance between its expenditure and its domestic transfer receipts—either through restricting purchases (e.g. cutting down on investment) and reducing credit to other sectors, or through increasing its transfer receipts (e.g. by expanding tax revenue or reducing transfer payments and subsidies).

A change also took place in 1962 in the method of financing the demand surplus of the public sector. In former years unilateral transfers from the rest of the world (mainly German reparations, U.S. Government grants-in-aid, and Jewish Agency appeals) amounted to more than the sector's demand surplus. These transfers, together with the credit received by the public sector (to a considerable extent also from abroad), were used to finance the demand surplus and enabled it to grant large sums of credit to other domestic sectors, mainly through the development budget. Despite the alteration of the exchange rate, transfers from the rest of the world diminished in 1962 (from \$ 146 million to \$ 89 million, but only from IL 261 million to IL 244 million),² and the public sector became a net borrower, i.e. it required credit to finance part of its demand surplus and the credit granted by it to other sectors. A considerable share of the credit originated, as stated, in the rest-of-the-world sector—\$ 140 million, compared with \$ 75 million in 1961.

Another sector whose demand surplus expanded greatly is the combined household and private business enterprise sector. In several important areas the data do not make it possible to differentiate between private businesses and households, and an analysis of the developments in each segment is to a large extent purely a matter of conjecture and estimation. The measurement of the sector's

¹ The increment arising from the revaluation of foreign currency balances held by the Bank of Israel and transferred to the Government was not included in the transfers. A transfer is defined as a transaction which diminishes the demand for goods and services of the transferring sector. Such a contraction did not take place in the case under discussion. Had the Government used the revaluation differentials for financing its expenditure, this would have been tantamount to financing it through bank credit.

² See footnote ¹ on p. 349 regarding the revision of the unrequited receipts estimate; as a result of this revision there was a slight increase in the counterpart of such receipts.

(IL million)

		Transfers from rest of the world	Net credit from rest of the world	Net credit from domestic sectors	Net credit to domestic sectors	Net credit received or granted (-) (2) + (3) - (4)	Adjust- ments and rounding	Demand or supply (-) surplus (1) + (5) + (6)
		(1)	(2)	(3)	(4)	(5)	(6)	(7)
Public sector	1960	228	180	19	273	-74	3	157
	1961	261	136	49	333	-148	—	113
	1962	244	357	154	399	112	-5	351
Public sector companies	1960	—	-3	158	3	152	—	152
	1961	—	39	159	5	193	4	197
	1962	—	81	260	10	331	-1	330
Non-profit institutions	1960	86	—	18	4	14	3	103
	1961	92	—	17	—	17	—	109
	1962	114	—	16	9	7	—	121
Households and business enterprises ^b	1960	252	60	245	268	37	-95	194
	1961	291	62	359	308	113	-51	353
	1962	581	234	225	486	-27	-45	509
Provident funds and insurance companies	1960	—	1	90	97	-6	2	-4
	1961	—	4	109	112	1	—	1
	1962	—	6	143	154	-5	2	-3
Banking system	1960	—	-155	176	16	5	-5	—
	1961	—	-130	174	47	-3	-5	-8
	1962	—	-347	379	47	-15	3	-12
Financial institutions	1960	—	6	51	69	-12	6	-6
	1961	—	49	77	139	-13	3	-10
	1962	—	56	105	173	-12	-9	-21
Rest of the world ^c	1960	-566	—	158	247	-89	59	-596
	1961	-644	—	140	300	-160	49	-755
	1962	-939	—	362	749	-387	51	-1,275

^a For 1960 and 1961—revised figures.

^b In the absence of data on credit transactions between businesses and households, these two sectors were taken together. However, credit transactions between them were undoubtedly on a considerable scale.

^c The definitions implicit in this table differ from those used in the balance of payments. Part of the adjustments stem from the item "errors and omissions" in the balance of payments.

demand surplus is also far from exact: it is arrived at by subtracting the demand surpluses of other domestic sectors from the supply surplus of the rest-of-the-world sector. The demand surplus of the sector grew from approximately IL 350 million in 1961¹ to more than IL 500 million in 1962,² and its weight increased both in relation to total purchases of households and private business enterprises (from 8 to 10 per cent) and in relation to purchases on capital account (from 39 to 47 per cent).

There is generally a connection between the size of the demand surplus of a sector and the volume of its purchases on capital account. However, at least part of the increase in the demand surplus in 1962 was apparently due to the rise in consumption, which reached 22 per cent as against 18 per cent in 1961. Investment of households in dwellings—and more conspicuously, investment of private business enterprises—expanded more slowly in 1962 than in 1961. Nevertheless, the ratio of the demand surplus to total purchases on capital account rose, as mentioned above. A considerable part of this increase apparently must be attributed to the rise in consumption, particularly in view of the effect that devaluation had on households. Transfers to households from abroad amounted to over \$ 200 million in 1962—\$ 50 million more than in the preceding year. In local currency, however, the sum doubled—from IL 300 million to IL 600 million. The household sector, which received transfers from abroad in previous years (mainly German restitution) and held considerable sums in the form of deposits linked to the rate of exchange, gained an additional IL 150 million in revaluation profits. To be sure, devaluation also caused part of the households to restrict their purchases—mainly those whose dollar-linked debts increased and who had to take advantage of the special arrangements for the advance repayment of their debts. However, it appears that on balance the developments tending to expand consumption outweighed the others.

Support for this opinion may be found in the composition of the sources of financing the demand surplus of the household and private business sector. The dependence of households on credit diminished, and the amount of credit they advanced to other sectors, principally the financial sectors, increased. Credit to private businesses grew in comparison with 1961, but little change took place in its share as compared with the volume of their investments. The

¹ The 1961 Annual Report gave an estimate of about IL 400 million. The revision made here was due to a change in the estimated investment of public sector companies in 1961, which increased the demand surplus of that sector by IL 50 million. Since the demand surplus of households and private business enterprises is calculated as a residual, this alteration resulted in a contraction of the sector's demand surplus.

² The demand surplus may have increased even more, since the item "errors and omissions" in the balance of payments, which came to about \$ 40 million in 1962 (see Chapter III), possibly reflects an incomplete recording of imports. When all imports are recorded, the growth in the supply surplus of the rest-of-the-world sector will lead, owing to the system of calculation, to an increase in the demand surplus of the households and private business sector.

Table XV-4

**CONSUMPTION, INVESTMENT, AND DEMAND SURPLUS OF
HOUSEHOLDS AND BUSINESS ENTERPRISES, 1960-62**

	1960	1961	1962
IL million			
Purchases by households:			
Consumption	2,772	3,263	3,966
Investment in housing ^a	332	396	458
Investment of business enterprises	382	501	626
Total investment and consumption of households and investment of business enterprises	3,486	4,160	5,050
Demand surplus of households and business enterprises	194	353	509
Percentages			
Demand surplus as a percentage of total purchases	5.6	8.5	10.1
Demand surplus as a percentage of purchases on capital account	27.2	39.4	47.0

^a Investment in housing less new dwellings added to the public sector companies (dwellings under construction come under households, even though part of them may belong to business enterprises).

absence of a marked increase in credit received by both segments of the sector is in line with developments in the sphere of investment.

Public sector companies expanded their demand surplus in 1962 to a considerable degree. A large part of this increase was due to the steep rise in immigrant housing construction, as reflected by the doubling of the number of dwelling units put at Amidar's disposal.¹ Other companies in this sector, where the connection between changes in capital purchases and the extent of the demand surplus is marked, also increased their investment. The big investors in 1962 were the mineral extracting enterprises (mainly the Dead Sea Works), the Israel Electric Corp., and Mekorot (water). As regards the transport companies, the rate of investment slowed down during the year reviewed, in contrast to the large expansion of 1961. In 1962 the weight of the demand surplus increased as compared with purchases on capital account,

¹ See Chapter XII, "Construction", section 2(b).

i.e. the percentage of investment financed from own resources dropped from the 1960 and 1961 levels. It appears that this development was largely due to the increased share of Amidar in the sector's investment. As in the past, the public sector was the main source for financing the demand surplus, even though increases took place in credit from abroad and from the financial institutions.

In the non-profit institutions no connection is to be found between the size of the demand surplus and the changes in purchases on capital account.¹ Their demand surplus grew somewhat, while their investment fell. These institutions finance part of their current expenditure with the help of unilateral transfers from abroad. In 1962 their current purchases increased more than their local receipts, but they were not forced to restrict their capital purchases to any great extent or to resort to credit, since the IL counterpart of foreign transfers grew following devaluation, even though the volume of transfers diminished somewhat in terms of foreign currency.

The magnitude of the demand surpluses of the various sectors and the changes that took place in them in 1962 underline the main problem of the anti-inflationary policy: the effect of devaluation on assets linked to foreign currency and on the value of unilateral transfers considerably increased the potential demand of the household sector and its ability to finance other sectors, either directly or through increasing the capacity of the financial sectors, particularly the banking system, to grant credit. Checking the demand pressure arising from these developments required the reduction of the demand surplus of other sectors; however, this was not achieved, as the above data show.

4. CREDIT FLOWS

The influence of each sector on the aggregate demand surplus is measured not only by the size of its own demand surplus but also by the credit it makes available to other sectors for financing their demand surplus. As stated, the financial sectors cannot be net lenders on any appreciable scale, since all of them—except for the banking system—are intermediaries, whose task is the transfer of purchasing power from one sector to another. All domestic sectors mainly engaged in real transactions have a demand surplus, and their capacity to be net lenders is due to the fact that the demand surplus of several of them is often smaller than the volume of unilateral transfers received from the rest of the world. An additional lending sector is the rest-of-the-world sector itself.

In describing the flow of credit between the sectors, two points should be noted:

1. The table of gross credit flows (Table XV-5) shows the flows between

¹ A connection presumably exists between the demand surplus of private businesses and their investment. Households, enjoying transfers from abroad, permit themselves the creation of a demand surplus also for current purchases; that is, their expenditure on consumption is in many instances greater than current income. The non-profit institutions resemble households in this respect.

each pair of sectors in two directions—credit given and credit received. In most instances the data are derived from balance-sheet changes, and the credit flows are therefore shown after deduction of repayments. In the table on net credit flows (Table XV-6), only the excess of credit advanced over credit received is shown. Net credit flows suffice to describe the means of financing the demand surpluses of the sectors, although in many cases it is of interest to examine the mutual credit relationships between each pair of sectors.

2. The creation of a demand surplus by any sector, with the help of credit from another domestic sector, does not have an expansionary effect if the grant of credit involves a corresponding reduction in the demand of the lending sector. Only when the extension of credit is not accompanied by a reduction in the demand of the lending sector does it have an expansionary effect. This applies to every domestic sector except one, the banking system. However, a description of the activities of the banking system from the credit-flows aspect tends to blur the significance of this fact. Demand deposits in the banks and cash issued by the central bank are deemed to be credit granted to the banking system by the depositors and holders of cash. This "credit", being in itself a liquid asset, generally has no contracting effect on the demand of the lending sector. Means of payment are considered credit, since, while they constitute potential purchasing power, the growth in their balances means abstention from expenditure. However, there is no doubt that an increase in such credit arising from the activities of the banking system has a definite expansionary effect. In the structure of net credit flows, credit from the banking system is offset by the deposits held in it, and the resulting expansionary effect is not fully revealed. The flows of credit from the banking system to the other sectors should therefore be presented gross. Another sector whose credit and transfer payments may have an expansionary effect is the rest of the world, since financing supplied by it does not involve a reduction of demand in any domestic sector.

The two most important sectors from the point of view of credit granting are the rest of the world and the public sector, which are the sources for most of the financing extended to sectors with a demand surplus. Next in order come households and the banking system, although most of the credit from these two sectors goes to sectors with a supply surplus. Credit from households consists mainly of bank deposits and contributions to provident funds, and credit from the banking system mainly assumes the form of accumulation of foreign currency reserves.

An important change occurred in 1962 in the place of the public sector in the credit-flows structure. Credit from this sector to sectors with a demand surplus remained at the same level as in 1961, although there was a structural change in its destination; however, the credit it received reached far greater

Table XV-5
GROSS CREDIT FLOWS BETWEEN SECTORS, 1961* AND 1962
 (IL million)

Receiving sector	Credit to sectors with a demand surplus					Total credit to sectors with a demand surplus	Credit to sectors with a supply surplus				Total credit extended
	Public sector	Public sector companies	Non-profit institutions	Private business enterprises	Households		Rest of the world	Banking system	Provident funds and insurance companies	Financial institutions	
Public sector											
1961	—	131	7	199	79	416	116	40	—	65	637
1962	—	244	5	155	85	489	209	119	—	35	852
Public sector companies											
1961	31	—	—	41	11	83	7	8	—	12	110
1962	15	—	—	71	16	102	17	10	—	9	138
Non-profit institutions											
1961	—	—	—	4	4	8	—	—	—	—	8
1962	—	—	—	3	3	6	—	9	—	—	15
Private business enterprises											
1961	24	56	5	—	^b	85	^b	56	9	22	172
1962	83	71	7	—	^b	161	^b	66	12	3	242

Households											
1961	53	42	5	^b	—	100	10	156	132	44	442
1962	121	16	7	^b	—	144	15	294	178	73	704
Rest of the world											
1961	252	46	—	72	^b	370	—	62	4	50	486
1962	566	98	—	249	^b	913	—	78	6	59	1,056
Banking system											
1961	15	3	3	81	12	114	192	—	2	22	330
1962	26	—	—	106	37	169	425	—	1	10	605
Provident funds and insurance companies											
1961	18	5	3	44	25	95	—	—	—	51	146
1962	45	7	—	52	35	139	—	11	—	53	203
Financial institutions											
1961	96	20	2	120	35	273	1	5	—	—	279
1962	108	33	3	76	27	247	3	3	1	—	254
Total credit received											
1961	489	303	25	561	166	1,544	326	327	147	266	2,610
1962	964	469	22	712	203	2,370	669	590	198	242	4,069

^a Revised figures.

^b No data are available on the credit flows between business enterprises and households. Data on credit from the rest of the world to households and on credit from business enterprises to the rest of the world are deficient and have therefore been omitted.

Table XV-6
 NET CREDIT FLOWS BETWEEN SECTORS, 1961* AND 1962
 (IL million)

Receiving sector	Credit to sectors with a demand surplus					Total credit to sectors with a demand surplus	Credit to sectors with a supply surplus				Total credit extended
	Public sector	Public sector companies	Non-profit institutions	Private business enterprises	Households		Rest of the world	Banking system	Provident funds and insurance companies	Financial institutions	
Public sector											
1961	—	100	7	175	26	308	—	25	—	—	333
1962	—	229	5	72	—	306	—	93	—	—	399
Public sector companies											
1961	—	—	—	—	—	—	—	5	—	—	5
1962	—	—	—	—	—	—	—	10	—	—	10
Non-profit institutions											
1961	—	—	—	—	—	—	—	—	—	—	—
1962	—	—	—	—	—	—	—	9	—	—	9
Private business enterprises											
1961	—	15	1	—	^b	16	—	—	—	—	16
1962	—	—	4	—	^b	4	—	—	—	—	4

Households												
1961	—	31	1	^b	—	32	10	144	107	9	302	
1962	36	—	4	^b	—	40	15	257	143	46	501	
Rest of the world												
1961	136	39	—	72	—	247	—	—	4	49	300	
1962	357	81	—	249	—	687	—	—	6	56	749	
Banking system												
1961	—	—	3	25	—	28	130	—	2	17	177	
1962	—	—	—	40	—	40	347	—	—	7	394	
Provident funds and insurance companies												
1961	18	5	3	35	—	61	—	—	—	51	112	
1962	45	7	—	40	—	92	—	10	—	52	154	
Financial institutions												
1961	31	8	2	98	—	139	—	—	—	—	139	
1962	73	24	3	73	—	173	—	—	—	—	173	
Total credit received												
1961	185	198	17	405	26	831	140	174	113	126	1,384	
1962	511	341	16	474	—	1,342	362	379	149	161	2,393	

^a Revised figures.

^b No data are available on credit flows between households and business enterprises.

proportions. In former years the receipts of the public sector from foreign transfers were greater than its demand surplus, whereas in 1962 the demand surplus considerably exceeded these transfers; in order to grant the same amount of credit as in 1961, the public sector had to borrow on a much larger scale than in 1961.

A distinction must be made between credit from domestic sectors and credit from the rest of the world. Part of the credit from domestic sectors—mainly households and financial institutions—was not intended to finance Government activities but to be frozen. This absorption of funds by the public sector expressed itself in the reduction of its debt to the banking system, presented in the table of credit flows as credit granted. On the other hand, the receipt of credit from abroad had an expansionary effect. The volume of credit received rose from \$ 75 million in 1961 to \$ 140 million in 1962; in terms of Israel pounds, the net increase was from IL 136 million to IL 357 million.

As stated, the volume of credit from the public sector did not increase in 1962, but a larger percentage of it was granted to public sector companies (mainly in connection with the expansion of Amidar's stock of immigrant dwellings). On the other hand, credit to private business dropped.¹ This was partly connected with the smaller amounts lent to agriculture from Government deposits, and in part it reflected the tendency to divert those requiring credit for investment purposes to non-governmental sources (the Government, however, influences the direction of credit from the resources of provident funds and insurance companies, as well as of the financial institutions).

In the credit flows between the domestic sector and the rest of the world, 1962 saw a strengthening of the trend which had prevailed in the last few years. On the one hand, various sectors receive credit from abroad—namely, the public sector, private business enterprises (mainly in the form of direct investment), public sector companies, and the financial institutions (mainly loans from foreign financial institutions and the issue of securities). On the other hand, foreign currency balances accumulate in the banking system, mainly in the Bank of Israel, and this constitutes investment abroad. The receipt of foreign loans in a period of foreign currency accumulation accentuates the inflationary effects of such accumulation. Credit to the public sector reached \$ 140 million, and direct investment rose from \$ 50 million to \$ 91 million; on the other hand, net foreign currency assets of the banking system expanded by more than \$ 120 million.

A large increase took place in the volume of credit granted by households.

¹ Public sector credit was partly given directly—either through loans or the acquisition of securities—but a considerable part was extended through deposits in various financial institutions which were earmarked for the granting of loans for specific purposes. This credit is defined here as credit from the public sector, and not from the institutions through whose agency it was given.

Credit to the public sector through the purchase of debentures, mainly the Short-Term-Loan, attained considerable proportions. In addition, credit received by households from the public sector diminished as a result of the premature repayment of mortgage loans. The increase in credit from households to provident funds and insurance companies was due to a normal increase in accumulation (however, credit from this sector to households also rose somewhat—see Table XV-5). The growth of household deposits in the banking system reflects the rise in the exchange rate and the increase in transfers from abroad, and in part is the result of the considerable monetary expansion of 1962. Credit to households from the banking system also expanded, though by a fairly modest amount.

The lack of data on credit flows between households and private business enterprises affects the completeness of the picture even more so than in the past. Trading in notes through the banks became an important channel for the flow of credit from households to private businesses. Credit from the banking system to private businesses rose slightly as compared with 1961 (both gross and net), but apparently there was a greater increase in the amount of credit from households to private businesses. As against this, there was a flow of credit in the opposite direction as well, from businesses to households, mainly in the form of consumer credit; it is very possible that such credit also expanded in 1962.

Net credit from the rest of the world to the private business sector increased markedly as compared with the previous year—a development which may be ascribed to the devaluation. Direct investment from abroad rose from \$ 59 million to \$ 91 million—an increase of IL 160 million. Credit from the financial sectors to private businesses dropped somewhat: that from the banking system and from provident and insurance companies increased at a similar rate as in 1961; but on the other hand, credit from the financial institutions increased at a slower rate, apparently reflecting the decrease in credit to farms, which form part of the business sector. The drop in the net amount lent by the public sector to businesses was greater than that in the gross amount, owing to a considerable increase in credit from private businesses to the public sector (more than half of it supplier credit).

Public sector companies, many of which belong to branches undergoing rapid expansion in recent years, need credit on a large scale in order to finance their investments. These companies do not benefit directly from unilateral transfers from abroad, and the fluctuations in the credit they receive generally reflect changes in the rate of investment in them. Their main source of credit is the public sector, although the importance of other sources is growing. Thus, for example, the Dead Sea Works, Fertilizers and Chemicals, Zim, and El Al received loans from abroad, and this tendency is expected to continue as the various companies consolidate their position. Credit to public

sector companies from the financial institutions also rose.¹ The substantial increase in the amount lent by the public sector to these enterprises is mainly connected with the investment of Amidar in immigrant housing, though considerable credit was also granted to Mekorot, the Israel Electric Corporation, El Al, and others.

The non-profit institutions hardly require any credit, and the chief characteristic of the sector in 1962 was a further reduction in its dependence on credit from other sectors.

The financial sectors, apart from the banking system, do not constitute a source of financing in themselves, but this does not detract from their central position in the credit-flows system. Their function is generally that of receiving credit from certain sectors (mainly households) and allocating it to the various sectors at their discretion. They therefore influence the destination of credit more than its volume. In respect of the Israel economy, this situation is true only to a limited extent. The main source of credit, apart from the rest of the world, is the public sector. Households generally lend to the financial sectors, and thus they do not influence the ultimate allocation of such credit. On the other hand, the public sector exerts influence not only on the credit given by itself, either directly or through the financial sectors, but also on a large part of the credit received by the financial sectors for transfer to other sectors. The regulations dealing with the direction of investments of provident funds, the control of security issues by the financial institutions, and—to a lesser extent—the regulations pertaining to liquidity and the control of credit from the banking system, all serve this end.

Provident funds and insurance companies extended net credit primarily to the financial institutions and private businesses. Most of the credit to businesses and part of that to the financial institutions was channelled to the economic enterprises of the Histadrut. The remainder was transferred to the public sector, or channelled by it.

Some change took place in the credit flows through the financial institutions. In 1961 most of the net credit was directed to businesses. In 1962, as already indicated, the share of businesses was reduced, while much larger sums were channelled to the public sector and to public sector companies.

The banking system occupies, as stated above, a special position in the credit-flows structure, and its influence is reflected in flows of gross credit. Gross credit from the banking system to businesses and to households was expanded by a greater amount than in 1961, but most of the incremental credit was directed to the rest-of-the-world sector, mainly in the form of expanded foreign currency reserves. As for credit to the banking system, the

¹ This development is partly explained by the fact that one of the public sector companies, Amidar Ltd., opened a mortgage bank, Tfahot, through which other financial institutions also channelled credit for financing Amidar's activities.

nature of the increase in the deposits of households has been explained above. The growth in credit from the public sector reflects the reduction of its debts to the banking system.¹ Also to be noted is the increase which took place in 1962 in credit from abroad in the form of foreign residents' deposits.

¹ The reduction of the Government's debt by using the increment arising from the revaluation of the foreign currency reserves held by the Bank of Israel and the Government itself (foreign currency deposits in the Bank of Israel) has not been taken into account, since this is merely an accounting operation and does not involve any contraction in the Government's demand.