

CHAPTER XVI

FLOW OF FUNDS

1. CONCEPTUAL FRAMEWORK¹

FLOW-OF-FUNDS analysis represents one method of describing economic activity in the aggregate. For purposes of the analysis, the economy is divided into a number of sectors, which in turn may be classified into three broad groups:

(1) Domestic sectors active mainly in the real (i.e. nonfinancial) sphere: the public sector (the Government, National Institutions, and local authorities), public sector companies,² nonprofit institutions, households, and nonfinancial business enterprises.³

(2) Domestic sectors active in the financial sphere: the banking system (the Bank of Israel and the banking institutions), provident funds and insurance companies, and other financial institutions such as mortgage banks and investment companies.

(3) The rest-of-the-world sector.

Economic activity in a developed country is reflected almost completely in money flows. Examination of the changes in the magnitude and direction of these flows can prove a useful tool in analyzing economic trends. The intersector flows pertain to three types of transactions: purchases and sales of goods and services, unilateral transfers such as taxes and grants, and credit transactions such as loans and deposits.

Each domestic sector buys goods and services, which are financed by sales of goods and services on the one hand, and by transfer receipts or borrowing on the other. A sector is defined as having a demand surplus if its sales plus

¹ For a more detailed description of flow-of-funds analysis, see the relevant chapter in the Bank of Israel Annual Reports for the years 1959-63.

² Public sector companies are companies operating as autonomous legal entities (as distinct from the Post Office and Israel Railways, for example), and at least 25 percent of whose equity capital is owned by public sector authorities, which actively participate in the management. Public sector companies include Amidar, Mekorot, Israel Electric Corporation, Zim, El Al, Rassco, and others.

³ Owing to lack of reliable data, it is generally impossible to differentiate between the transactions of households and those of private business enterprises. Hence an analysis of the relationships between these two sectors is largely a matter of conjecture and estimation. Where it is impossible to separate the two, we shall call the combined sector the "private sector".

Table XVI-1

INDICATORS OF THE INFLUENCE OF REAL DOMESTIC SECTORS
ON TOTAL DEMAND, 1962-64^a

(IL million)

| | Demand surplus | Net credit to or from (-) real domestic sectors ^b | Omissions and rounding-off | Net credit from or to (-) financial sectors ^c | Net credit and transfers from abroad |
|--|----------------|--|----------------------------|--|--------------------------------------|
| | (1) | (2) | (3) | (4) | (5) |
| Private business enterprises and households | | | | | |
| 1962 | 547 | — | 23 | -284 | 808 |
| 1963 | 572 | -79 | 12 | -403 | 884 |
| 1964 | 889 | -164 | 18 | -95 | 802 |
| Public sector | | | | | |
| 1962 | 429 | 225 | — | 31 | 623 |
| 1963 | 381 | 266 | 1 | 248 | 400 |
| 1964 | 334 | 357 | — | 179 | 512 |
| Public sector companies | | | | | |
| 1962 | 315 | -205 | 1 | 46 | 63 |
| 1963 | 234 | -173 | 2 | 46 | 13 |
| 1964 | 306 | -188 | 2 | 10 | 110 |
| Nonprofit institutions | | | | | |
| 1962 | 121 | -20 | 3 | -16 | 114 |
| 1963 | 134 | -14 | 1 | -7 | 128 |
| 1964 | 152 | -5 | 1 | 5 | 143 |
| Total real domestic sectors | | | | | |
| 1962 | 1,412 | — | 27 | -223 | 1,608 |
| 1963 | 1,321 | — | 12 | -116 | 1,425 |
| 1964 | 1,681 | — | 15 | 99 | 1,567 |

^a Demand surplus (1) plus credit granted to other real sectors (2) is conceptually equal to credit and transfers from abroad (5) plus credit from financial sectors (4). Discrepancies in totals are due to rounding-off and omissions. Figures for 1962 and 1963 have been revised.

^b Credit given by the sector to other real sectors, less the credit received from them. (A minus sign indicates that the sector was a net recipient of credit.)

^c Credit received from financial sectors (including the banking system), less credit given to them (including the increase in bank deposits). For the nature of the credit to the banking system, see explanation in the text.

transfer receipts from other domestic sectors do not cover its purchases.¹ A sector with a demand surplus requires financing by way of domestic credit or unilateral transfers and credit from abroad.

In Israel all domestic sectors engaging in real transactions have a demand surplus. (The household sector, which cannot be separated from business enterprises, may have been an exception to this rule in several of the last few years, but there are many indications that in 1964 it too had a demand surplus.) Since the financial sectors do not in themselves constitute a major source of financing—serving mainly as intermediaries between the real sectors—it follows that the financing of the demand surpluses of the domestic sectors is dependent on unilateral transfers and credit from abroad. The aggregate demand surplus is equal to the deficit on current account in the balance of payments, or to the import surplus (plus the small supply surplus of the financial sectors).

The banking system is an exception to the above rule about the financial sectors being mere intermediaries, for the banking institutions and the central bank are able to create new sources of financing of an inflationary character without first having to borrow from other sectors. One limitation of the analytical method employed here is that it may give a misleading impression of the operations of the banking system and their possible influence on aggregate demand. As against the expansion of credit by the banking system, we set off the increase in its liabilities in the form of cash and various deposits, even though these differ in essence from ordinary credit (holders of cash and demand deposits have no intention of forgoing the use of this “credit”, unlike those who extend ordinary credit in the form of loans or securities).

2. MAIN DEVELOPMENTS

The increase in Israel's adverse balance on current account in 1964 is reflected in a similar growth in the aggregate demand surplus of the domestic sectors. For purposes of the present analysis, the changes in the sectorial distribution of the demand surplus are more significant than the aggregate figure, for they indicate changes in the direct contribution of the different sectors to the prevailing demand pressure. Another significant indicator is the ratio of the demand surplus of each sector to its purchases. This ratio measures the proportion of purchases not covered by domestic sales and transfer receipts, and hence indicates the extent to which the sector has to resort to domestic credit and receipts from abroad.

¹ A sector's receipts from sales and domestic transfers reduce the purchasing power of the purchasing or transferring sector while correspondingly increasing its own purchasing power. Domestic nonbank credit also reduces the purchasing power of the lending sector, but not to the same degree, since the creditor retains a financial asset, i.e. there is a change in the composition of his assets but not in their total amount.

In 1964 there was a striking increase in the demand surplus of the private sector, which reached almost IL 900 million, or IL 300 million more than in 1962 and 1963. This represents a considerable rise also in relation to the surpluses of the other sectors. Sufficient data are not available to permit a separation of developments in each of the two segments of the private sector—households and business enterprises—but the national accounts show that a particularly large change occurred in 1964 in investment of business enterprises.¹ There is reason to believe that the additional investment was largely financed by borrowing and not from retained earnings. There was also some increase in the demand surplus of nonprofit institutions, and a larger rise in that of public sector companies, but in neither case was the relative change as pronounced as in the private sector. In the public sector companies the change in the demand surplus more or less corresponded to that in capital purchases, as in previous years.

The demand surplus of the public sector was further reduced in 1964; its weight in the total surplus is gradually returning to the level of 1961, before the large increase brought on by the devaluation.

The demand surplus is only a partial indicator of a sector's influence on the level of demand in the economy—it reflects the direct contribution to aggregate demand. Credit extended to other sectors with a demand surplus represents an indirect contribution of the lending sector to total demand, although it is difficult on the strength of the data available to point to a direct casual relationship between the financing of the demand surplus and its creation. (In other words, there are cases in which it is difficult to determine whether it was the possibilities of obtaining finance capital that induced a sector to expand demand, or whether the expansion of demand made it necessary to find sources of financing. As long as this is not determined, it cannot be said which sector is responsible for the creation or expansion of the demand surplus.)

If we add the demand surpluses of the various sectors to the amount of credit they extended to other real sectors (see Table XVI-1), a quite different picture emerges from that described above with regard to the influence of the different sectors on the level of demand.

The only real domestic sector that has been a net lender in recent years is the public sector. (Actually, the household sector also extends net credit; its being lumped together with the private business sector is what makes the private sector as a whole a net recipient of credit. In the absence of separate data on the demand surplus of the household sector, there is no alternative to combining the two sectors.) The net amount lent by the public sector to

¹ Business investments are residually derived after deducting the capital expenditure of all the other sectors (according to the data presented in this chapter) from total investment as recorded in the national accounts. The order of magnitude of the rise in such investment thus calculated leaves no room for doubt as to the direction of its development.

Table XVI-2
DEMAND OR SUPPLY SURPLUSES, BY SECTOR, 1962-64^a
(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) |
| Private business enterprises and households^b | | | | | | | | |
| 1962 | 4,011 | 1,216 | — | — | — | — | — | 547 |
| 1963 | 4,797 | 1,406 | — | — | — | — | — | 572 |
| 1964 | 5,556 | 1,765 | — | — | — | — | — | 889 |
| Public sector^c | | | | | | | | |
| 1962 | 1,556 | 377 | 153 | 1,780 | 520 | 1,871 | 1,351 | 429 |
| 1963 | 1,829 | 422 | 182 | 2,069 | 575 | 2,263 | 1,688 | 381 |
| 1964 | 2,083 | 526 | 233 | 2,376 | 673 | 2,715 | 2,042 | 334 |
| Public sector companies^d | | | | | | | | |
| 1962 | 661 | 430 | 776 | 315 | 12 | 12 | — | 315 |
| 1963 | 759 | 384 | 907 | 236 | 16 | 18 | 2 | 234 |
| 1964 | 877 | 458 | 1,018 | 317 | 17 | 28 | 11 | 306 |
| Nonprofit institutions^e | | | | | | | | |
| 1962 | 430 | 59 | 90 | 399 | 16 | 294 | 278 | 121 |
| 1963 | 485 | 77 | 104 | 458 | 18 | 342 | 324 | 134 |
| 1964 | 547 | 99 | 114 | 532 | 19 | 399 | 380 | 152 |
| Provident funds and insurance companies^f | | | | | | | | |
| 1962 | 87 | 6 | 107 | -14 | 88 | 96 | 8 | -22 |
| 1963 | 113 | 10 | 138 | -15 | 118 | 120 | 2 | -17 |
| 1964 | 130 | 7 | 143 | -6 | 122 | 142 | 20 | -26 |

^a Figures for 1962 and 1963 have been revised.

^b Purchases of the sector include consumption and investment of households and investment of private business enterprises, as recorded in the national accounts. The demand surplus is calculated as a residual, by deducting the demand surpluses of the other sectors from the supply surpluses.

^c As defined in Chapter VII, "Public Sector Operations", except that sales include interest receipts.

^d Companies in which the public sector holds at least 25 percent of the equity capital and actively participates in the management.

^e As defined in Chapter VIII, "Nonprofit Institutions".

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

Table XVI-2

DEMAND OR SUPPLY SURPLUSES, BY SECTOR, 1962-64 (cont.)

(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) |
| Banking system^a | | | | | | | | |
| 1962 | 205 | 9 | 255 | -41 | 33 | — | -33 | -8 |
| 1963 | 236 | 7 | 304 | -61 | 41 | — | -41 | -20 |
| 1964 | 284 | 22 | 349 | -43 | 43 | — | -43 | — |
| Financial institutions^b | | | | | | | | |
| 1962 | 66 | 2 | 93 | -25 | 10 | — | -10 | -15 |
| 1963 | 84 | 4 | 111 | -23 | 18 | — | -18 | -5 |
| 1964 | 139 | 7 | 174 | -28 | 22 | — | -22 | -6 |
| Rest of the world^c | | | | | | | | |
| 1962 | | 1,429 | 2,796 | -1,367 | — | — | — | -1,367 |
| 1963 | | 1,795 | 3,074 | -1,279 | — | — | — | -1,279 |
| 1964 | | 1,930 | 3,577 | -1,647 | — | — | — | -1,647 |

^a Commercial banks, cooperative credit societies, and Bank of Israel.^b As defined in Chapter XVII, "Financial Institutions".^c Sales include, in addition to 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.

other sectors with a demand surplus rose in the last two years almost proportionally to the decline in the demand surplus of this sector. In 1962 the aggregate demand surplus plus net credit granted came to about IL 650 million, whereas in 1964 the figure stood at nearly IL 690 million.

An entirely different situation exists in the public sector companies. Their demand surplus is financed for the most part by credit from the public sector, so that its influence on aggregate domestic demand largely hinges on the credit policy of the latter.

The credit transactions of nonprofit institutions are of relatively minor importance. The private sector as a whole is a net recipient of credit from real domestic sectors, so that its overall influence on the level of domestic demand is less than would appear from the size of its demand surplus. But even taking this into account, the influence of the private sector on the level of demand in 1964 was still outstanding.

3. DEMAND SURPLUSES OF THE VARIOUS SECTORS

Table XVI-2 shows the development of the demand surpluses of the different sectors from 1962 to 1964. The most striking feature of the money-flows structure in 1964 was the big increase in the demand surplus of the private sector. Both segments of this sector contributed to this development, the contribution of the business enterprises apparently being the larger.

The national accounts indicate that private consumption spending rose slightly faster in 1964 than income from domestic sources, which may explain part of the growth of the demand surplus. (Data on consumer credit are not available, but we know that in 1964 purchases of durable consumer goods continued to expand and were at least partly financed by credit.) The household expenditure item having the greatest bearing on the size of this sector's demand surplus is housing. To all appearances, the data in Table XVI-3 suggest a substantially larger investment in housing in 1964, but this is misleading. In previous years such investment was regarded as an indicator of household expenditure for this purpose, despite the fact that the figure also included changes in the stock of dwellings held by contractors. It was assumed that inventory changes were not so great as to distort the trend. In 1964 there was apparently a large rise in the number of unsold dwelling units, so that the increase in the value of new residential construction does not accurately reflect additional household spending on this item. (That part of housing investment which does not represent household expenditure consists in the main of business investments.) It is therefore difficult to ascertain whether the amount spent on housing was a factor in the larger demand surplus of the private sector in 1964, but that it was not an important factor is practically certain.

On the other hand, there is no doubt that business investment accelerated in 1964. The extent of the rise depends of course on the question left unsolved above about the percentage of residential construction investment that should be attributed to private contractors. Rough estimates of the change in the stock of dwellings held by contractors allow us to assume that total business investment rose in 1964 by nearly IL 300 million—somewhat more than would appear from Table XVI-3. This goes far to explain the increase in the demand surplus of the private sector, since only a small part of it was financed from retained business earnings.

The demand surplus of the public sector has been on the decline since the large increase which followed the devaluation of 1962. The contraction of the demand surplus in 1964 was a result of the slower expansion of purchases on current account as compared with 1963. Capital expenditure increased considerably more than in the previous year, but total public sector outlay was influenced more by the rate of change in purchases on current account. In this connection it should be noted that retroactive payments on account of 1964

Table XVI-3

CONSUMPTION, INVESTMENT, AND DEMAND SURPLUS OF
HOUSEHOLDS AND PRIVATE BUSINESS ENTERPRISES, 1962-64^a

(IL million)

| | 1962 | 1963 | 1964 |
|---|-------|-------|-------|
| Purchases by households | | | |
| Consumption ^b | 4,011 | 4,797 | 5,556 |
| Investment in housing ^c | 663 | 682 | 802 |
| Investment of business enterprises ^d | 691 | 850 | 1,082 |
| Total purchases by households and investment of business enterprises | 5,365 | 6,329 | 7,440 |
| Demand surplus of households and business enterprises | 547 | 572 | 889 |
| Demand surplus as a percentage of total purchases | 10.2 | 9.0 | 11.9 |
| Demand surplus as a percentage of purchases on capital account | 40.4 | 37.3 | 47.2 |

^a The figures for 1962 and 1963 have been revised.

^b Private consumption less consumption of nonprofit institutions.

^c Total private and public expenditure on housing, unadjusted for changes in the stock of dwellings held by public sector companies and private builders.

^d Total gross domestic investment less capital expenditure of the other sectors (excluding capital outlay of public sector companies engaged in housing construction).

to civil servants upon completion of their regrading may have an effect on the public sector accounts in 1965.

The decline in the demand surplus of the public sector indicates that the growth of net transfers from the other domestic sectors exceeded the rise in its purchases, but it was still lower than in 1963. The rate of increase in gross transfers to the public sector went down only slightly, but there was a much greater rise in public sector transfers to other sectors in the form of benefit payments, grants, and subsidies, so that the percentage increase in the net sum absorbed from the rest of the economy was smaller than in 1963.

It should also be noted that the size of the public sector demand surplus is influenced by changes in the effective exchange rate. Imports by this sector are carried out at the official exchange rate, and any change in the ratio between the effective exchange rate and the official rate affects the relative size of its demand surplus. This was strikingly pointed up in 1962, when devaluation led to a substantial rise in the demand surplus. It is difficult to say to what extent exchange rate developments had a bearing on the decline in the sector's demand surplus in 1963 and 1964, but apparently it was not very great.

Public sector companies increased their demand surplus in 1964, after a decrease in the previous year. The change can be attributed to purchases on capital account. In 1963 investment by these companies—particularly in transportation, water, and electricity—fell off. In 1964 capital outlay of the transport companies went up sharply, balancing a slight reduction in the case of companies engaging in construction and mining and quarrying. It should be noted that, owing to the large size of a number of public sector companies,¹ the changes in their annual investment figures amount to tens of millions of pounds, which may give rise to substantial fluctuations in the sector's capital purchases. At the same time, it should be kept in mind that, while the public sector companies are autonomous legal entities, they are not independent of the public sector. The relations between the two sectors affect the demand surplus of the companies, at least in that the bulk of the credit which the companies need originates in the public sector or requires Government approval (for example, the approval of loans from foreign sources or Government guarantee of bond issues, such as the debentures sold by the Israel Electric Corporation to the insurance companies). The large-scale investment programs of the public sector companies are drawn up in coordination with the public sector.

As already mentioned, the demand surplus of the public sector companies increased by almost the same amount as their capital outlay. This represents a departure from the trend of 1963, when the demand surplus declined to a greater extent than capital expenditure. The suggestion then made that the public sector companies were progressing in their effort to finance a larger part of their investments from internal sources (depreciation and undistributed profits) was not borne out by developments in 1964.

The nonprofit institutions showed no change in development trends. The demand surplus again went up slightly, but its weight relative to total purchases held steady. There was a further rise in investments, particularly by institutes of higher education and research. There is undoubtedly a connection between changes in the amount of capital-account purchases and those in the demand surplus, but the institutions resort to external financing (particularly transfers from abroad) even for covering part of their current operations. The increase in transfer payments from the public sector (as well as the transfer of some of the institutions to the public sector) served as a substitute for foreign transfers in financing current outlays. The institutions have been relying on the public sector to a growing extent in recent years, and while this is a gradual trend, there is no doubt as to the direction being taken.

The supply surpluses of two of the financial sectors—provident funds and insurance companies and the financial institutions sector—were somewhat larger

¹ E.g. Amidar, Israel Electric Corporation, Zim, Dead Sea Works, Rassco, El Al.

in 1964.¹ On the other hand, the supply surplus of the banking system shrank appreciably and in fact vanished altogether. This can be attributed to two factors:

1. There was a large increase in capital expenditure by a number of banking institutions, which in 1964 completed extensive building programs and invested substantial sums in modern office machines.
2. Bank profits fell off slightly but dividend payments by commercial banks were considerably higher than in 1963. The sale of shares to the public by most large and medium-sized banks has resulted in a gradual rise over the past few years in the proportion of total profits distributed to stockholders.

4. FINANCING THE SECTORS' DEMAND SURPLUSES

As already pointed out, the influence of each of the sectors on the level of domestic demand is measured not only by the growth of its own demand surplus, but also by its influence on the ability of other sectors to finance their demand surpluses.

Table XVI-4 summarizes the sources for financing the demand surpluses of the real sectors and the structure of their credit flows, indicating the changes that occurred therein over the past two years.

Since all of the real domestic sectors have a demand surplus, it is obvious that their aggregate demand surplus is financed principally by unilateral transfers and credit from abroad. (It will be recalled that the supply surpluses of the financial sectors are relatively small.) Each individual domestic sector, however, need not be dependent on foreign financing; sectors in which foreign financing exceeds the demand surplus give credit to domestic sectors which do not resort directly to the rest of the world.

Total unilateral transfers from abroad in 1964 remained as approximately the same high level reached in 1963 (over IL 1 billion). But they were not enough to finance the large increase in the aggregate demand surplus of the domestic sectors, and hence there was need for additional foreign credit. Net borrowing from abroad (after the deduction of loan repayments and the increase in foreign exchange reserves held by the banking system) rose from IL 232 million in 1963 to IL 587 million during the year reviewed. The change in the net amount of credit received did not stem from increased borrowing—here there was no marked change—but from a drop in public sector repayments to the rest of the world and a much slower growth in foreign currency assets held by the banking system.

¹ The data on the supply surpluses of the banking system and the financial institutions for 1962 and 1963 are substantially lower than those cited last year. Income tax payments have been adjusted, and dividend payments, which were not taken into account previously because of insufficient data, have been included.

Table XVI-4
FINANCING OF DEMAND SURPLUSES, BY SECTOR, 1962-64^a
(IL million)

| Sector | Transfers from rest of the world | Net credit from rest of the world | Net credit from domestic sectors ^b | Net credit to domestic sectors ^c | Total net credit received or granted (-) (2) + (3) - (4) | Adjust- ments and round- ing-off | Demand or supply (-) surplus (1) + (5) + (6) |
|--|---|--|--|--|--|--|---|
| | (1) | (2) | (3) | (4) | (5) | (6) | (7) |
| Private business enter- prises and households | | | | | | | |
| 1962 | 575 | 233 | 201 | 465 | -31 | 3 | 547 |
| 1963 | 682 | 202 | 241 | 536 | -93 | -17 | 572 |
| 1964 | 692 | 110 | 584 | 515 | 179 | 18 | 889 |
| Public sector | | | | | | | |
| 1962 | 233 | 390 | 169 | 363 | 196 | — | 429 |
| 1963 | 253 | 147 | 248 | 266 | 129 | -1 | 381 |
| 1964 | 215 | 297 | 179 | 357 | 119 | — | 334 |
| Public sector com- panies | | | | | | | |
| 1962 | — | 63 | 319 | 68 | 314 | 1 | 315 |
| 1963 | — | 13 | 238 | 19 | 232 | 2 | 234 |
| 1964 | — | 110 | 273 | 75 | 308 | -2 | 306 |
| Nonprofit institutions | | | | | | | |
| 1962 | 114 | — | 22 | 18 | 4 | 3 | 121 |
| 1963 | 128 | — | 15 | 8 | 7 | -1 | 134 |
| 1964 | 143 | — | 13 | 3 | 10 | -1 | 152 |
| Provident funds and insurance companies | | | | | | | |
| 1962 | — | 1 | 140 | 158 | -17 | -5 | -22 |
| 1963 | — | 8 | 206 | 233 | -19 | 2 | -17 |
| 1964 | — | 8 | 223 | 256 | -25 | -1 | -26 |
| Banking system | | | | | | | |
| 1962 | — | -347 | 377 | 58 | -28 | 20 | -8 |
| 1963 | — | -215 | 346 | 150 | -19 | -1 | -20 |
| 1964 | — | -9 | 296 | 287 | — | — | — |
| Financial institutions | | | | | | | |
| 1962 | — | 50 | 89 | 167 | -28 | 13 | -15 |
| 1963 | — | 77 | 55 | 137 | -5 | — | -5 |
| 1964 | — | 71 | 179 | 254 | -4 | -2 | -6 |
| Rest of the world^d | | | | | | | |
| 1962 | -922 | — | 362 | 752 | -390 | -55 | -1,367 |
| 1963 | -1,063 | — | 249 | 481 | -232 | 16 | -1,279 |
| 1964 | -1,050 | — | 50 | 637 | -587 | -10 | -1,647 |

^a The figures for 1962 and 1963 have been revised.

^b Total of the columns in Table XVI-6, less credit from the rest of the world.

^c Total of the rows in Table XVI-6, less credit to the rest of the world.

^d The figures here differ slightly from those presented in Chapter III, "The Balance of Payments", because of conceptual differences.

Unilateral transfers from abroad to households exceeded the demand surplus of the entire private sector (including business enterprises) in 1962 and 1963. This enabled the sector to be a net lender to the other domestic sectors. However, a substantial part of this credit went to the financial sectors (see Table XVI-1), and included credit of special types, such as demand deposits and Pazak and Tamam accounts of restitution recipients. (Such credit constitutes an increase in the liquid asset holdings of the lenders, without being accompanied by the financing of other real sectors, as is the case with ordinary credit). In any event, the credit most likely originates in the household sector, while the business enterprises were recipients of net credit in 1964, as in former years.¹ In 1964 unilateral transfers did not keep pace with the big increase in the demand surplus of the sector, which consequently became a net recipient of credit on a large scale. The additional credit was derived from other domestic sectors, while the amount of credit obtained from abroad by the private sector apparently declined.²

The public sector had a smaller inflow of unilateral transfers than in 1962 and 1963, but its net foreign borrowing expanded following a decline in 1963 due to the early repayment of loans. Total foreign financing rose from IL 400 million in 1963 to over IL 500 million in 1964. This increase, which was accompanied by a reduction of the demand surplus of the public sector itself, domestic sectors. A sector which resorts to it on a large scale is that of the public sector provided the domestic sectors with IL 266 million in credits and received from them IL 248 million, including a loan from the banking system for the advance repayment of foreign debts. In 1964 the public sector granted the domestic sectors IL 357 million and received only IL 179 million.

The magnitude of the financing received by the public sector from abroad enables it, as already mentioned, to serve as a source of financing for other domestic sectors. A sector that resorts to it on a large scale is that of the public sector companies. In 1964 there was an appreciable rise in the amount of credit obtained by the companies themselves from abroad, but this still did not cover more than one-third of their demand surplus. The balance was financed by credits from other local sectors, particularly the public sector.

The demand surplus of nonprofit institutions was financed, as in previous years, almost entirely by unilateral transfers from abroad.

The financial sectors also maintain credit ties with the rest of the world, and some noteworthy developments took place here during the year reviewed. The amount of funds mobilized by the financial institutions—mainly through

¹ In the absence of data on the credit transactions between business enterprises and households—particularly consumer credit on the one hand, and private loans to business enterprises on the other—we cannot say definitely how much net credit the business enterprises and households each gave (or received).

² We must express a reservation about the accuracy of this figure, which was residually derived from the capital account in the balance of payments.

debenture and share issues—did not change much in 1964, and the same is true of the insurance companies, which raised only a relatively small sum abroad. On the other hand, there was a striking change in the credit transactions of the banking system—a sharp decline in net credit outflow to the rest of the world by way of foreign currency asset accumulation, particularly by the Bank of Israel. In 1962 net accumulation reached a record high of almost IL 350 million, while in 1963 the figure dropped as a result of the advance repayment of foreign debts with the help of a loan granted to the Government by the banking system. (As against the slower accumulation, there was a decline in the net amount of credit received from abroad by the public sector.) The smaller accumulation in 1964 was connected with the increase in the import surplus, and for the first time in recent years it occurred despite a rise in the total volume of capital imports.

5. CREDIT FLOWS

The summary of credit transactions of the different sectors, as set forth in Table XVI-4, shows the mutual relationships existing between each of the sectors and all the other sectors combined. For an understanding of the structure of credit flows it is important to have a description of the mutual relationships between each pair of sectors; this is given in Tables XVI-5 and XVI-6.

Table XVI-5 presents the gross credit flows. The amount of credit given by each sector to each of the other sectors is listed in the relevant row, and the amount of credit each sector received from each of the others is listed in the relevant column.¹ In addition to loans granted, credit includes by definition deposits and purchases of securities. (Moreover, credit to the Bank of Israel, which constitutes part of the banking system, also includes the cash holdings of the public.)

Table XVI-6 shows the net credit flows, i.e. the net balance of the change in the credit relationships between each pair of sectors during the year. It describes the structure of credit relationships between the different sectors. Apart from the rest-of-the-world sector, net credit was extended to real domestic sectors by the public sector, households, and the financial sectors. The sources of finance of the lending sectors may be classified as follows:

1. *Rest-of-the-world sector.* Unilateral transfers from abroad, which are not presented in Table XVI-6, undoubtedly served as a source of finance for the public and household sectors. Foreign credit constituted a major source for the public sector and the financial institutions.

2. *Households.* Directly and indirectly, households are the second most important source of credit. They provide most of the funds obtained by provident

¹ These credit flows are not entirely gross. Payments on account of short-term loans granted in the past are deducted from the credit given, and occasionally the data do not enable us to show long-term loans gross, as we should like to.

funds and insurance companies, which in turn are a source of finance for the public sector, financial institutions, and to a lesser degree for the banking system. The bulk of the credit to the banking system likewise comes from households, but because of the peculiar nature of part of this credit—demand deposits and cash, which are means of payment—it cannot be regarded as a source of ordinary financing.

3. *The banking system.* Credit from this source, which has an expansionary monetary influence, has helped to finance the public sector and private business enterprises, and in 1964 the financial institutions as well.

Thus we see that, while the public sector and nonbank financial institutions have granted credit on a large scale, only three sectors can be regarded as the sources of credit received by the real domestic sectors: the rest of the world, households, and the banking system.

Following are the main developments in the intersectorial credit flows in 1964:

(a) *Households*

The gross credit outflow of households was only slightly larger in 1964 (IL 930 million as against IL 919 million in 1963), and there was no striking change in its composition. As in the previous year, the biggest amount went to the banking system, although demand, Pazak, and Tamam deposits and cash holdings are not to be considered ordinary credit transactions. Other major recipients of credit were the provident funds and insurance companies, private business, and the public sector. The data available on credit to business enterprises are very fragmentary. We have assumed that the lion's share of bank-negotiated bill credits¹ was given by households to business enterprises; no information is available on other household loans to business enterprises or investment therein.

As against the stable trend in the credit outflow of households, there was an increase in the amount which they received, mainly for the purchase of housing. Credit from both the public sector (about two-thirds of it in the form of deposits in financial institutions for the grant of loans) and own means of financial institutions rose by about 50 percent during the year. Another item on the receipt side for which we have no information is consumer credit, but presumably there was an increase here too.

It would therefore appear that, on balance, the net credit outflow of households in 1964 was smaller than in the previous year.

(b) *Public sector*

Gross credit inflow and outflow of the public sector were smaller than in 1963, for two reasons:

¹ The reference is to the bill brokerage trade.

Table XVI-5

GROSS CREDIT FLOWS BETWEEN SECTORS, 1963^a-64

(IL million)

| Receiving sector | Lending sector | | | | | | | | | | |
|-------------------------|----------------|-------------------------|-------------------------|----------------------|--------------|---|-------------------|----------------|---|------------------------|-----------------------|
| | Public sector | Public sector companies | Non-profit institutions | Business enterprises | Households | Total credit to sectors with a demand surplus | Rest of the world | Banking system | Provident funds and insurance companies | Financial institutions | Total credit extended |
| Public sector | | | | | | | | | | | |
| 1963 | × | 179 | 14 | 69 | 111 | 373 | 457 | 20 | — | 29 | 879 |
| 1964 | × | 183 | 8 | 78 | 183 | 452 | 315 | -85 | — | 16 | 698 |
| Public sector companies | | | | | | | | | | | |
| 1963 | 7 | × | — | 77 | 9 | 93 | 38 | 15 | 3 | 10 | 159 |
| 1964 | -7 | × | — | 85 | 10 | 88 | 18 | -3 | 1 | 30 | 134 |
| Nonprofit institutions | | | | | | | | | | | |
| 1963 | 2 | — | × | 4 | 3 | 9 | — | 10 | — | 1 | 20 |
| 1964 | 1 | — | × | 6 | 3 | 10 | — | 5 | — | 1 | 16 |
| Business enterprises | | | | | | | | | | | |
| 1963 | 8 | 58 | 5 | × | ^b | 71 | 109 | 138 | 19 | 56 | 393 |
| 1964 | -4 | 62 | 4 | × | ^b | 62 | 199 | 76 | 20 | 69 | 426 |

| | | | | | | | | | | | | |
|---|-------|-----|----|------------------|--------------|-------|-----|-----|-----|-----|-------|--|
| Households | | | | | | | | | | | | |
| 1963 | 90 | 29 | 4 | 171 ^c | × | 294 | 34 | 312 | 235 | 44 | 919 | |
| 1964 | 105 | 31 | 3 | 179 ^c | × | 318 | 41 | 274 | 259 | 38 | 930 | |
| Rest of the world | | | | | | | | | | | | |
| 1963 | 604 | 51 | — | 345 | ^b | 1,000 | × | 116 | 8 | 79 | 1,203 | |
| 1964 | 612 | 128 | — | 350 | ^b | 1,090 | × | 116 | 8 | 68 | 1,282 | |
| Banking system | | | | | | | | | | | | |
| 1963 | 138 | 23 | 3 | 162 | 4 | 330 | 331 | × | — | 12 | 673 | |
| 1964 | 23 | -8 | 8 | 191 | 3 | 217 | 125 | × | — | 24 | 366 | |
| Provident funds and insurance companies | | | | | | | | | | | | |
| 1963 | 92 | 23 | 1 | 55 | 29 | 200 | — | 30 | × | 57 | 287 | |
| 1964 | 49 | 63 | 3 | 72 | 36 | 223 | — | 20 | × | 71 | 314 | |
| Financial institutions | | | | | | | | | | | | |
| 1963 | 67 | 28 | — | 107 | 73 | 275 | 2 | 13 | 3 | × | 293 | |
| 1964 | 38 | -17 | — | 220 | 119 | 360 | -3 | -37 | 1 | × | 321 | |
| Total credit received | | | | | | | | | | | | |
| 1963 | 1,008 | 391 | 27 | 990 | 229 | 2,645 | 971 | 654 | 268 | 288 | 4,826 | |
| 1964 | 817 | 442 | 26 | 1,181 | 354 | 2,820 | 695 | 366 | 289 | 317 | 4,487 | |

^a Revised figures.

^b No data are available on credit flows between these sectors.

^c Represents only part of the credit granted—namely, the change in the balance of the bill brokerage trade. We have assumed that most of the money in this market originated in households. Data on loans from households to business firms and their other investments therein are not available.

Table XVI-6
NET INTERSECTORIAL CREDIT FLOWS, 1963-64^a

(IL million)

| Receiving sector | | Public sector | Public sector companies | Nonprofit institutions | Private business enterprises | Households | Total credit to sectors with a demand surplus | Rest of the world | Banking system | Provident funds and insurance companies | Financial institutions | Total credit extended |
|------------------------------|------|---------------|-------------------------|------------------------|------------------------------|--------------|---|-------------------|----------------|---|------------------------|-----------------------|
| Lending sector | | | | | | | | | | | | |
| Public sector | | | | | | | | | | | | |
| | 1963 | × | 172 | 12 | 61 | 21 | 266 | — | — | — | — | 266 |
| | 1964 | × | 190 | 7 | 82 | 78 | 357 | — | — | — | — | 357 |
| Public sector companies | | | | | | | | | | | | |
| | 1963 | — | × | — | 19 | — | 19 | — | — | — | — | 19 |
| | 1964 | — | × | — | 23 | — | 23 | — | 5 | — | 47 | 75 |
| Nonprofit institutions | | | | | | | | | | | | |
| | 1963 | — | — | × | — | — | — | — | 7 | — | 1 | 8 |
| | 1964 | — | — | × | 2 | — | 2 | — | — | — | 1 | 3 |
| Private business enterprises | | | | | | | | | | | | |
| | 1963 | — | — | 1 | × | ^b | 1 | — | — | — | — | 1 |
| | 1964 | — | — | — | × | ^b | — | — | — | — | — | — |

| | | | | | | | | | | | | |
|---|-----|-----|----|------------------|--------------|-------|-----|-----|-----|-----|-------|--|
| Households | | | | | | | | | | | | |
| 1963 | — | 20 | 1 | 171 ^c | × | 192 | 34 | 308 | 206 | — | 740 | |
| 1964 | — | 21 | — | 179 ^c | × | 200 | 41 | 271 | 223 | — | 735 | |
| Rest of the world | | | | | | | | | | | | |
| 1963 | 147 | 13 | — | 236 | ^b | 396 | × | — | 8 | 77 | 481 | |
| 1964 | 297 | 110 | — | 151 | ^b | 558 | × | — | 8 | 71 | 637 | |
| Banking system | | | | | | | | | | | | |
| 1963 | 118 | 8 | — | 24 | — | 150 | 215 | × | — | — | 365 | |
| 1964 | 108 | — | 3 | 115 | — | 226 | 9 | × | — | 61 | 296 | |
| Provident funds and insurance companies | | | | | | | | | | | | |
| 1963 | 92 | 20 | 1 | 36 | — | 149 | — | 30 | × | 54 | 233 | |
| 1964 | 49 | 62 | 3 | 52 | — | 166 | — | 20 | × | 70 | 256 | |
| Financial institutions | | | | | | | | | | | | |
| 1963 | 38 | 18 | — | 51 | 29 | 136 | — | 1 | — | × | 137 | |
| 1964 | 22 | — | — | 151 | 81 | 254 | — | — | — | × | 254 | |
| Total credit received | | | | | | | | | | | | |
| 1963 | 395 | 251 | 15 | 598 | 50 | 1,309 | 249 | 346 | 214 | 132 | 2,250 | |
| 1964 | 476 | 383 | 13 | 755 | 159 | 1,786 | 50 | 296 | 231 | 250 | 2,613 | |

^a Figures for 1963 have been revised.

^b No data are available on credit flows between these sectors.

^c Partial data (see footnote ^c to Table XVI-5).

1. Foreign debt redemption was lower (IL 315 million) owing to the advance repayments made in 1963.

2. The credit received by the public sector from the banking system was mainly reflected by a decline in deposits (indicated by a minus sign in Table XVI-5).

Apart from these two exceptional developments, the gross credit transactions of the public sector may be summed up as follows: it gave an appreciably larger sum to households—an amount equal to that extended to public sector companies (IL 183 million); it also provided a slightly larger amount to private business.

Gross credit from abroad remained at a high level (over IL 600 million), while that from provident funds and financial institutions declined considerably. (The provident funds gave more to public sector companies in 1964, while the sum extended by the financial institutions fell off as a result of the smaller amount of debenture issue proceeds deposited with the Accountant General.)¹

The net result of gross credit transactions was a rise in credit inflow from abroad, a decline in that from nonbank financial institutions, and virtual stability in that from the banking system.

The amount extended to the public sector companies, which are net recipients on a large scale, rose somewhat in 1964. Households generally receive a smaller sum, but showed a conspicuous increase in 1964 as compared with previous years.

(c) Private business enterprises

Business enterprises continued to be recipients of a large volume of credit. During the year reviewed they obtained about IL 1,200 million gross, as against some IL 1,000 million in 1963. The largest sum (IL 350 million) came from abroad, but here there was practically no change from 1963.

On the other hand, private business received comparatively more credit from financial institutions (IL 220 million, or twice as much as in 1963) and from the banking system (about IL 190 million as against some IL 160 million). Receipts from all the other domestic sectors were also somewhat larger.

The business enterprises also extended more gross credit in 1964; there was a particularly striking increase in foreign loan repayment (close to IL 200 million). The decline in credit to the banking system reflects the slower monetary expansion in 1964, while the changes in cash and demand deposit holdings, as was noted in connection with households, should not be regarded as ordinary credit transactions.

The net credit flows of the business enterprises show that there is practically

¹ See Chapter XVII, "Financial Institutions".

no sector to which they extend net credit (but it should be borne in mind that an important item—consumer credit—is missing from our data). An especially large growth took place in net receipts from financial institutions and the banking system; on the other hand, there was a net decline in the amount received from abroad.

(d) *Public sector companies*

The credit received by these companies originates mainly in the public sector and the rest of the world. There was an increase in the amount they received in 1964 from provident funds and insurance companies, but this was exceeded by their credit to financial institutions and the banking system. (Part of the credit to financial institutions was in the form of public building companies' deposits in mortgage banks.)

In conclusion, we should again stress the connection between the demand (or supply) surpluses and the sources of their financing. The ability of the domestic sectors to finance demand surpluses depends, in the last analysis, on transfers and credit from abroad. Reducing the economy's reliance on the rest of the world entails an increase in domestic saving and the replacement of part of the foreign financing by noninflationary local financing, i.e. other than through the banking system.