CHAPTER VIII

DOMESTIC INVESTMENT

1. MAIN DEVELOPMENTS

For the first time since 1967, gross fixed capital formation slumped in the year reviewed—by about 6 percent including ships and aircraft, and a milder 2 percent excluding them. Nondwelling investment fell off 7 percent, this too being the first decrease recorded since 1967, although not counting ship and aircraft purchases, it was very slight (0.5 percent). These rates of change from 1973 somewhat understate the contraction of investment. The sharp cutback in the final wartime quarter of 1973 pulled down the average for that year, with many projects being deferred to 1974.

The downturn in capital formation was thus far sharper than indicated by the above figures. In the first quarter of 1974 a substantial percentage of the economy's productive factors was still mobilized, retarding primarily the expansion of residential construction and capital spending on equipment; in the second quarter, with the gradual release of reservists, these two items moved up more strongly. A glance at Table VIII-3 shows that in the first quarter of 1974 total investment (excluding ships and aircraft) was 15 percent up on the previous quarter and it continued rising at a 9 percent rate in the second quarter, plateauing at this level in the second half of the year. It is therefore a reasonable assumption that the supply of productive factors constrained capital spending only in the first quarter. Hence a comparison of the last nine months of 1974 with the first nine months of 1973 gives an estimate of the growth of investment net of the wartime effects. But since the rate of change is between two periods more than a year apart, the comparison overstates the annual average rate of change. In the last three quarters of 1974 total investment (excluding ships and aircraft) ran 7 percent below its level in the first three quarters of the previous year (the decrease between the two years as a whole was, as stated, 2 percent). The decline in nondwelling investment (excluding ships and aircraft) came to 5 and 0.5 percent respectively.

Apart from imported plant and equipment, which were up 5 percent in 1974, other investment items—residential and nonresidential construction, capital assets from agricultural output, and domestically manufactured plant and equip-

Table VIII-1

GROSS AND NET INVESTMENT, 1970–74

(IL million, at current prices)

						Percent annual increase (constant prices)					
									1973		
	1970	1971	1972	1973	1974	1970	1971	1972	Jan.–Sept.[a]	Entire year	1974
Gross fixed nondwelling investment											
Excl. ships and aircraft	3,090	3,094	5,480	6,970	9,471	1	10	21	14	4	0
Incl. ships and aircraft	3,288	4,589	5,696	7,877	10,150	5	22	6	25	12	–7
Less: Depreciation	1,372	1,719	2,207	2,872	4,442	10	10	10	..	6	12
Net fixed nondwelling investment	1,916	2,870	3,489	5,005	5,708	2	31	4	..	17	–17
Gross investment in dwellings	1,736	2,348	3,510	4,567	6,365	39	20	28	17	4	–5
Less: Depreciation	452	555	703	1,003	1,627	7	9	8	..	14	11
Net investment in dwellings	1,284	1,793	2,807	3,564	4,738	55	24	34	..	1	–9
Total gross fixed investment	**5,024**	**6,937**	**9,206**	**12,444**	**16,515**	**14**	**21**	**13**	**22**	**9**	**–6**
Increase in inventories	349	486	548	867	1,426	0	25	2	–5	14	40
Total gross investment	**5,373**	**7,423**	**9,754**	**13,311**	**17,941**	**13**	**22**	**13**	**20**	**9**	**–3**
Less: Depreciation	1,824	2,274	2,910	3,875	6,069	9	10	9	..	7	11
Total net investment	**3,549**	**5,140**	**6,844**	**9,436**	**11,872**	**16**	**27**	**14**	..	**11**	**–12**

[a] Compared with January–September 1972.

ment—sagged from 4-6 percent, with the total figure for locally produced capital goods dropping 4 percent. This development had a dampening effect on economic activity. The product generated by investment fell off 3 percent, but the required import of inputs edged down by a mere 1.5 percent owing to the relatively small import component of construction, which accounts for the bulk of the investment in domestically produced capital goods. The heavier spending on imported equipment, as opposed to the decline in other investment items, was partly due to the relative drop in the price of such equipment compared with that produced in Israel: whereas foreign plant and equipment became 21 percent dearer in 1974, that made in Israel soared 47 percent.

In analyzing investment trends a differentiation must be made between capital expenditures reflecting current economic developments, which are generally implemented by the private sector, and those that are not directly influenced by short-term developments, which are executed mostly by the public sector and nonprofit institutions. Public sector investments are generally implemented in accordance with the long-term infrastructure requirements of the economy, but in the short run the government can step up or reduce its direct investment activity in line with its policy aims. During the period surveyed here the main influences in both categories of investment worked in the same direction, depressing total domestic capital formation.

In private sector capital spending, particularly in residential construction and industry, the trend began to turn in 1973 as a result of expectational changes in these two areas. In both the slowdown in the first nine months of 1973 was preceded by an acceleration of the growth that had been sustained since the end of the 1966-67 slump. The last few years saw an overbuilding of homes (i.e. compared with current requirements). The ebbing of housing demand, reflected by the accumulation of a stock of unsold dwellings, began to be felt in 1972 and led to the cutting back of starts toward the end of that year.

Private building starts sagged in absolute terms in every quarter of 1973. In the first half of 1974 they recovered some ground after being virtually paralyzed in the previous wartime quarter, but in the third quarter of 1974 they again dipped to stand at its level in the same quarter the year before, the downtrend gathering momentum in the final quarter of 1974 (see Table VIII-4).

This development was of course reflected in the value of private residential construction put in place,[1] which shrank 11 percent in 1974. An examination of the

[1] The estimate of private residential construction is a function of the area of starts and construction time; therefore the reduction of starts in 1973, whose weight in the year's investment was still small, found full expression in the data for 1974.

Table VIII-2

MAIN INDICATORS OF CONSTRUCTION ACTIVITY, 1970–74

	1970	1971	1972	1973	1974	Percent annual increase: 1971	Percent annual increase: 1972	Percent annual increase: 1973 Jan.–Sept.[a]	Percent annual increase: 1973 Entire year	Percent annual increase: 1974
Construction output (IL million, at 1973 prices)										
Residential	2,881	3,457	4,412	4,567	4,345	20	28	17	4	–5
Nonresidential	2,148	2,370	2,777	2,769	2,638	10	17	10	—	–5
Total value of new construction	**5,029**	**5,827**	**7,189**	**7,336**	**6,983**	**16**	**23**	**14**	**2**	**–5**
Other[b]	1,117	1,129	990	881	1,336	1	–12	–5	–11	52
Total output	**6,134**	**6,956**	**8,179**	**8,217**	**8,319**	**13**	**18**	**12**	**0.5**	**1**
Building starts (thousand m²)										
Residential	4,500	5,085	6,340	5,320	5,105	13	25	–3	–16	–4
Nonresidential	1,460	1,850	2,240	1,945	1,665	27	21	2	–13	–14
Total	**5,960**	**6,935**	**8,580**	**7,265**	**6,770**	**16**	**24**	**–1**	**–15**	**–7**
Building completions (thousand m²)										
Residential	3,134	3,805	4,670	4,945	4,800	21	23	14	6	–3
Nonresidential	1,323	1,600	1,345	1,545	1,500	21	–16	19	15	–3
Total	**4,457**	**5,405**	**6,015**	**6,490**	**6,300**	**21**	**11**	**18**	**8**	**–3**

[a] Compared with January–September 1972.
[b] Partial estimate; consists of defense construction, maintenance, and repair work.

quarterly data (Table VIII-3) shows an accelerated expansion in the first and second quarters, an absolute decline in the third, and an accentuation of the downturn in the last three months. It will thus be seen that the effect of the war ran its course in the first half of the year reviewed, the second half witnessing a resumption of the falling trend begun in 1973.

Industrial capital spending inched up a mere 1 percent in 1974 (a comparison of the last nine months of 1974 with the first nine months of 1973 shows a drop of 2 percent). In January-September 1973 such investment rose by only 6 percent, well below the rates recorded in previous years (in 1969-72 the level moved up by an average of 17 percent a year and at no time did it fall below 10 percent). The more sluggish growth in 1974 was probably due to the conjunction of expectational changes in branches experiencing a deceleration or slackening of demand for their output and the uncertainties facing a smaller number of branches despite a heavier demand for their products. The required industrial capital stock (assuming constant capital-output coefficients in the various branches)[2] and the actual capital stock moved up in unison until 1972, but thereafter the actual outpaced the required stock by a 2:1 margin, even though the growth rate of the former flagged somewhat. This differential development can perhaps be attributed to the fact that branches experiencing expectational changes due to the slowdown in their activity did not react immediately by halting or shelving the implementation of investment projects; the virtual stabilization of capital spending in 1974 reflected the onset of such a process of adjustment. It may also be that the inflation, which began to accelerate in 1972 and greatly increased the subsidy element in unlinked loans provided under the Law for the Encouragement of Capital Investments, stimulated the expansion of the capital stock by more than warranted by the growth of industrial output. The change in industrial investment (mostly private sector) in 1974 may therefore be viewed as the combination of a long-run trend necessitating a deceleration of investment so as to bring the actual rates of change in the capital stock back into line with the required rates, and short-term uncertainties arising from the greatly disparate interbranch rates of change in production since 1973.

Public sector investment consists partly of projects undertaken directly by the government, which can speed up or slow down their implementation accordingly as to whether it wishes to expand or moderate investment activity in the economy. A glance at Table VIII-5 shows an absolute drop in 1974 in investments of the government, local authorities, and National Institutions. The overwhelming share of such outlays is made on building and earthwork jobs, and the downturn in 1974 was due mainly to a cutback in road construction (21 percent) and the erection of

[2] For a fuller discussion of this see the section on nondwelling investment.

Table VIII–3

GROWTH OF FIXED INVESTMENT, QUARTERLY, 1973–74

(percent real change from previous quarter)

	Residential construction			Nonresidential construction	Total construction	Equipment			Motor vehicles	Nondwelling investment, excl. ships and aircraft	Total fixed investment
	Public	Private	Total			Imported	Local	Total			
1973 I	7.4	0.8	2.9	1.7	2.5	–13.4	1.0	–8.4	12.6	–2.1	–0.2
II	5.2	3.9	4.3	–12.2	–2.1	9.9	–11.4	1.7	–9.1	–5.4	1.7
III	–3.0	2.1	0.4	11.4	4.2	–5.9	19.7	2.6	–12.3	4.2	–0.6
IV	–24.4	–44.9	–38.0	–27.2	–34.0	–15.2	–13,1	–14.4	2.6	–17.9	–26.1
1974 I	3.9	24.3	15.9	18.0	16.7	7.8	–1.1	4.3	42.7	14.2	14.7
II	21.0	25.3	23.8	–6.1	11.4	10.5	2.2	7.4	–1.2	1.0	8.8
III	19.4	–5.8	3.2	13.0	6.6	1.2	–6.4	–1.5	–40.0	–2.5	0
IV	–1.4	–8.0	–5.2	–1.2	–3.7	8.8	11.4	9.7	9.1	5.2	1.0

government service structures (11 percent) under the policy of economic restraint. The government attempted to extend this policy to other services, the administrative restriction of building, introduced at the beginning of July 1974, being intended to regulate construction activity. But the ban seems to have been of only limited efficacy, the main victim being nonprofit institutions, notably the country's universities.

Table VIII–4

CONSTRUCTION STARTS, QUARTERLY, 1973–74

(thousand sq. meters)

	Total starts	Residential starts	Thereof: Private building	Nonresidential starts	Thereof: Hotels and commercial and office buildings	For industry and crafts	Public buildings	Farm buildings
1972 IV	2,165	1,590	1,020	575	152	167	199	57
1973 I	2,185	1,620	1,140	565	112	190	218	45
II	2,160	1,570	940	590	119	210	193	68
III	1,980	1,430	900	550	99	196	193	62
IV	940	700	370	240	27	97	89	27
1974 I	1,385	950	515	435	52	160	136	87
II	2,020	1,485	870	535	100	245	122	68
III	1,870	1,450	780	420	66	201	110	43
IV	1,495	1,220	660	275	21	132	94	28

In moderating such activity the government hoped above all to cool off the economy, thereby permitting action to improve the balance of payments. The slackening of construction goes a long way to explain the easing of overemployment, but since the import component of construction is among the lowest in the entire economy, the direct contribution of this industry to the reduction of imports was small. The government would have achieved better results if it had endeavored to dampen equipment spending, which has a high import content. To some extent the government did move in this direction, raising the price of imported capital assets by hiking the defense levy under its new economic policy and by devaluing the IL in November, but these steps of course had only a limited effect in the year reviewed.

The other exogenous investments are made by public sector companies, over which the government wields only a minor influence in the short run. These investments are concentrated in a small number of projects, and the downswing in 1974 was due to the larger weight of projects completed compared with those launched or continued during the year.

In 1974 expenditure on construction equipment accelerated. Such investment, the bulk of which consists of imported items, shot up 43 percent, owing to the larger volume of defense jobs this year. However, it is not certain that this necessitated such a big increase in heavy engineering equipment, even if allowance is made for the wear and tear during the war period, for considerable spare capacity had built up before then. Outlay on motor vehicles also rose, although at a laggard rate compared with the first nine months of 1973. Much of the increment (which was concentrated in the first half of the year—see Table VIII-3) consisted of trucks that were imported for fear of a possible shortage during the period of fighting.

2. Investment by Initiating Sector[3]

A classification of nondwelling investment (excluding transport equipment) by initiating sector reveals an absolute drop in that of the public sector and nonprofit institutions and a marked slowdown in the growth of private investment. If residential construction[4] is included in the data, public sector and nonprofit institution investment declined to a milder extent and private investment held steady.

In public investment there was a steep 23 percent fall in that of public sector companies, which comprise the electricity, water, and almost all of the mining and quarrying industries. These expenditures are characterized by two main features:

(a) Their very erratic movement over time, due to the largeness of the projects.

(b) The highly autonomous nature of such investments: on the one hand, the decision to launch a project, while requiring government approval, does not generally depend on the latter's investment policy; on the other hand, such investments are not directly influenced by current economic developments.

The contraction of such expenditure in 1974 therefore reflected the completion of several sizable projects.

Investment by government enterprises, made in transportation and telecommunication services, was down 11 percent. The principal long-run determinant of such expenditure is the infrastructure requirements of the economy,

[3] Transport equipment (ships, aircraft, and motor vehicles) has not been included in the investment data because of difficulties in determining its sectoral breakdown.

[4] The residential construction data by initiating sector set forth in Table VIII-5 have been revised, with building for young couples (under the bond program) being shifted from the private to the public sector. Such construction, while executed by large housing companies defined as private, is initiated and controlled by the government and is intended for population groups eligible for its support. Hence, it would be more proper to include it under public construction.

Table VIII-5
GROSS FIXED INVESTMENT (EXCL. TRANSPORT EQUIPMENT), BY TYPE OF INVESTOR AND INITIATING SECTOR, 1970–74
(IL million, at 1973 prices)

						Percent annual increase				
								1973		
	1970	1971	1972	1973	1974	1971	1972	Jan.–Sept.[a]	Entire year	1974
Nondwelling investment (excl. transport equipment), by investing sector										
1. Government, local authorities, and National Institutions	851	893	1,109	1,137	1,105	5	24	13	3	–3
2. Government enterprises	394	544	690	717	628	38	27	13	3	–11
3. Subtotal (1+2)	1,245	1,437	1,799	1,844	1,733	15	25	13	3	–6
4. Public sector companies	839	817	1,048	899	689	–3	28	–10	–14	–23
5. Total public sector investment (3+4)	**2,084**	**2,254**	**2,847**	**2,743**	**2,422**	**8**	**26**	**5**	**–3**	**–11**
6. Nonprofit institutions	359	436	470	443	377	21	8	3	–6	–15
7. Total public sector and nonprofit institutions (5+6)	**2,443**	**2,690**	**3,317**	**3,186**	**2,799**	**10**	**23**	**4**	**–4**	**–12**
8. Private sector investment, excl. transport and construction equipment	1.985	2,168	2,574	2,768	2,990	9	19	20	- 8	8
9. Private sector investment, excl. transport equipment (10–7)	**2,119**	**2,337**	**2,763**	**2,957**	**3,261**	**10**	**18**	**18**	**7**	**10**
10. Total nondwelling investment, excl. transport equipment	**4,562**	**5,027**	**6,080**	**6,143**	**6,060**	**10**	**21**	**13**	**1**	**–1**
Investment in dwellings, by initiating sector										
11. Public	931	1,121	1,424	1,582	1,680	20	27	21	11	6
12. Private	1.950	2,336	2,988	2,985	2,665	20	28	15	0	–11
13. Total	**2,881**	**3,457**	**4,412**	**4,567**	**4,345**	**20**	**28**	**17**	**4**	**–5**

[a] Compared with January–September 1972.

but in the short run what typifies it is that it is also an instrument of government economic policy, used for smoothing cyclical swings. In 1974 it was employed to help blunt inflation and improve the balance of payments. The restraining measures were reflected, albeit less potently, in the direct investments of the government, local authorities and National Institutions, which were down 3 percent from 1973. Most of the decrease was in roadbuilding (off 20 percent) and government service structures (11 percent). Because of the small import component of such investments, their cutback contributed only fractionally to the balance of payments, but more to the easing of pressure in the labor market. Furthermore, because of the (erroneous) assessment that there was a shortage of building workers, the industry continued to use building methods with a high foreign exchange component.

Total nondwelling investment by the public sector dipped 11 percent this year. By contrast, there was a 6 percent expansion of dwelling investment initiated by this sector, which stands out against the general downswing in residential building. This was apparently due to the government's long-range considerations, the execution of government housing projects being the crucial factor.

Nonprofit institution investment fell off steeply. The 15 percent drop indicated by the reports of several institutions should be regarded as an upper limit; examination of the institutions' budgets indicates that the decline was more in the region of 25 percent (see Table XI-1), but this seems to be an overestimate. In all events, the sector's building activity was pared by at least 15 percent, with that by institutions of higher education being slashed appreciably. It also seems that this sector was the main victim of the government's administrative ban on building published in the middle of the year.

Private sector investment, which is calculated residually, was up about 10 percent (8 percent excluding expenditure on construction equipment), with most of the increase being in the services industry. If private residential construction is included, total private investment held steady in the year reviewed.

3. Investment by Economic Sector

(a) *Agriculture*

Investment in agriculture, after remaining stable during the first nine months of 1973, moved up 3 percent in the year reviewed. This is explained primarily by a 15 percent increase in imported equipment (compared with a 33 percent rise in the first nine months of 1973). The livestock inventory, on the other hand, fell off 27 percent in absolute terms, due to the continued liquidation of byres in moshavim (cooperative agricultural settlements) because of sinking profitability (this is discussed more fully in Chapter XIII, "Agriculture").

(b) *Industry*

The contraction of industrial capital spending continued the trend evident in the first nine months of 1973: after averaging 17 percent higher in 1969-72 and in no year rising less than 10 percent, in January-September 1973 the growth curve tapered off to a low 6 percent and in 1974 it virtually flattened out. Applying the annual rates of change in industrial production (between 1969 and 1974) in order to project capital stock estimates of the various industrial branches at the beginning of 1968 gives the capital stock required for current production in each of the years 1969-74, assuming constant capital-output coefficients in the various industrial branches. The annual change in the total required capital stock so calculated can be compared with the actual rates of change.[5] The comparison, made for both net and gross capital stock, reveals that until the beginning of 1972 the required and actual capital stock moved up almost in step, but since 1972 the actual stock, while decelerating, has risen twice as fast as the required stock. The more sluggish expansion of investment in 1973-74 may have reflected the process of adjusting the actual to the required capital stock. It is also conceivable that the inflation, which began to sharpen in 1972 and thereby greatly increased the subsidy element in directed credit (provided under the capital investments law), partly explains why the actual capital stock outpaced that required for current output.

GROWTH OF ACTUAL AND REQUIRED[a] INDUSTRIAL CAPITAL STOCK, 1970–75

(percent change in beginning-of-year levels)

	1970	1971	1972	1973	1974	1975
			Gross capital stock			
Required change	9.3	10.6	10.7	4.6	4.0	..
Actual change	11.2	10.6	11.0	10.5	8.7	8.5
			Net capital stock			
Required change	10.7	10.6	11.1	5.0	4.2	..
Actual change	11.2	11.5	11.3	11.2	8.8	7.5

[a] The change attributable to the growth of industrial output of the various branches, calculated according to constant output-capital stock coefficients.

[5] Current data on the actual capital stock are available only for industry as a whole.

Table

GROSS FIXED INVESTMENT,

	IL million, at current prices				Percent change in value			
							1973	
	1971	1972	1973	1974	1971	1972	Jan.–Sept.[a]	Entire year
Agriculture	267	380	453	653	12	42	20	19
Thereof: Agricultural output	77	128	146	192	20	66	14	14
Water	66	93	97	106	27	41	11	4
Industry, mining and quarrying	1,059	1,365	1,651	2,201	29	29	30	21
Construction equipment	118	152	189	337	43	29	35	24
Electricity	141	321	341	363	–5	128	9	6
Transport and com.	1,692	1,708	2,855	3,114	79	1	94	67
Ships and aircraft	685	216	907	679	247	–68	424	320
Motor vehicles	388	579	827	1,103	23	49	64	43
Other items	619	913	1,121	1,332	44	47	34	23
Trade and services	1,246	1,678	2,291	3,376	25	35	48	36
Total nondwelling investment								
Incl. ships and aircraft	**4,589**	**5,697**	**7,877**	**10,150**	**40**	**24**	**52**	**38**
Excl. ships and aircraft	**3,904**	**5,480**	**6,970**	**9,471**	**26**	**40**	**37**	**27**
Dwellings	2,348	3,510	4,567	6,365	35	49	40	30
Total fixed investment	**6,937**	**9,207**	**12,444**	**16,515**	**38**	**33**	**50**	**35**

[a] Compared with January–September 1972.

Besides the adjustment factor, in 1974 industrial investment was unquestionably constrained by the prevailing uncertainties, which made manufacturers more cautious in carrying out capital expenditure programs and even led to the temporary shelving of outlays in branches where the growth of output warranted the expansion of capacity. The mild 1 percent rise in industrial investment stemmed entirely from the 5 percent increase in imported equipment. The increment was concentrated in a limited number of industries: food, chemicals and petrochemicals, metal products, and basic metals. Almost all the other industries posted real absolute decreases in imported equipment spending. About half the imported equipment went to the metal industries, apparently reflecting the expanded investment in Steel City during the year; investment in the latter is not directly influenced by domestic demand for the industry's output, but is connected with long-term plans for the greater vertical

VIII–6

BY SECTOR, 1971–74

	Percent change in quantity					Percent change in prices				
			1973					1973		
1974	1971	1972	Jan.–Sept.[a]	Entire year	1974	1971	1972	Jan.–Sept.	Entire year	1974
44	–1	23	1	–3	3	13	16	20	22	40
32	4	23	1	–3	3	15	12	15	15	40
9	12	21	–17	–18	–24	14	16	34	28	44
33	10	11	6	–2	1	17	16	22	24	32
78	26	12	11	0	43	14	15	22	24	24
6	–18	96	–6	–13	–23	15	16	17	23	39
9	58	–16	63	39	–22	14	20	19	20	40
–25	219	–73	304	222	–55	9	18	30	30	67
33	1	23	45	28	7	22	21	13	12	24
19	23	30	12	0	–17	17	13	20	23	43
47	10	17	20	9	4	13	15	24	25	41
29	**22**	**6**	**25**	**12**	**–7**	**15**	**17**	**22**	**23**	**39**
36	**—**	**21**	**14**	**4**	**0**	**16**	**16**	**20**	**22**	**36**
39	20	28	17	4	–5	13	17	26	26	47
33	**21**	**13**	**22**	**9**	**–6**	**14**	**17**	**24**	**25**	**39**

integration of metal fabrication for export.

Total industrial borrowing through the capital market[6] was up 15 percent in 1974, following a 28 percent rise in directed credit and a sharp absolute drop in nondirected credit. Since the latter change was not accompanied by a compensatory increase in soft directed credit, it may be concluded that it did not stem from the substitution of one type of credit for the other, but reflected the slackening of investment growth. This pulled up the proportion of equity capital in total planned investment in 1974, thereby permitting a diminished resort to nondirected sources of funds, which became much more expensive this year.

Directed credit and outright grants provided under the Law for the

[6] For a definition of this market and further explanations see Chapter XVIII.

Encouragement of Capital Investments to approved enterprises rose 28 and 12 percent respectively, compared with a 33 percent gain in nominal industrial capital spending. In other words, the rate of directed financing declined this year. Two reasons can be adduced to explain this:

(1) One is the war-induced deferral of the implementation of projects for which financing had already been obtained. There is apparently some time-lag between the disbursement of the loans and grants and implementation of the investment itself. The Yom Kippur War, coming as it did unexpectedly, could not influence investments planned for the final quarter of 1973, i.e. the funding of such projects which had been obtained before the outbreak of hostilities. A comparison of loans and grants disbursed in 1973 with investments carried out therefore overstates the proportion of such financing in 1973. In 1974, on the other hand, the ratio is downward-biased, for the data for the year include some projects for which the funds had actually been received in 1973 but whose implementation had been held up because of the war. This, however, is only a partial explanation, for it is not known how much implementation lags behind disbursement of the directed investment loan capital, and the final quarter of the year always shows a seasonal decline in such financing.

(2) Another reason was an apparent change in the regional distribution of investment in 1974. There was probably a drop in the figures for approved enterprises in development areas, which are eligible for a higher rate of soft directed credit than enterprises in other districts; this may also explain the declining share of investment grants.

(c) *Electricity and water*

The downturn in these two items was more pronounced in the year reviewed. As regards electricity, there was no significant lag in the erection of new power stations: the decline occurred in equipment, which was more than a third down from the previous year, while investment in building rose. This reversed the pattern in 1973, when building investment accelerated while equipment fell off (see Table VIII-6). This is explained by the completion of the large Eshkol III power station in 1973 and the launching of the Eshkol IV station in 1974; investment in power stations is heavy on buildings in the initial stages and on equipment in the final stages. The absolute drop in domestic electricity consumption in the wake of the tariff hike and the more sluggish growth of industrial consumption had only a marginal effect in this sector. The smaller consumption mainly depressed expenditure on distribution lines, which are generally installed at the consumers' request.

Investment in waterworks is small (in 1970-72 it averaged about IL 100 million

Table VIII-7

GROWTH OF GROSS FIXED INVESTMENT, BY SECTOR AND TYPE OF ASSET, 1971–74

(percent annual rates-of-change)

	1971	1972	1973 Jan.–Sept.[a]	1973 Entire year	1974
Agriculture	–0.6	22.8	0.0	–2.6	2.9
Structures	–14.1	30.6	–15.6	–15.6	1.5
Equipment	18.3	15.0	19.1	12.4	4.1
Water	11.8	20.9	–16.9	–18.0	–24.1
Structures	22.8	22.5	–11.6	–19.1	–26.5
Equipment	–22.2	13.3	–41.2	–12.6	–12.4
Industry	10.3	10.9	6.4	2.3	1.4
Structures	2.9	16.0	25.8	8.2	–1.7
Equipment	12.1	9.7	1.6	–4.8	2.3
Construction equipment	26.0	12.0	10.9	0.0	43.7
Electricity	–17.5	95.7	–6.5	–13.5	–23.4
Structures	–4.2	30.3	–25.5	30.9	5.9
Equipment	–29.1	172.9	3.9	–3.7	–35.2
Transportation and com.	57.6	–16.1	62.6	39.4	–22.0
Structures	26.1	6.8	7.3	0.6	–16.4
Equipment	72.3	–23.9	92.1	57.6	–23.8
Ships and aircraft	218.6	–73.3	304.0	222.1	–54.8
Land transport equipment	1.4	22.7	44.6	27.8	7.0
Trade and services	9.9	17.2	20.0	9.0	4.0
Structures	9.6	19.1	18.7	5.0	0.0
Equipment	10.3	14.6	21.9	15.1	9.8
Total nondwelling investment	**22.1**	**6.1**	**24.9**	**12.4**	**–6.6**
Structures	9.7	17.1	10.0	0.0	–4.7
Equipment	30.3	0.0	34.8	20.7	–7.6
Total nondwelling investment, excl. ships and aircraft	**9.6**	**20.8**	**13.6**	**3.8**	**–0.5**
Structures	9.7	17.1	10.0	0.0	–4.7
Equipment	9.6	23.5	15.5	6.7	2.3

[a] Compared with January–September 1972.

a year at 1973 prices, less than 2 percent of total nondwelling investment during that period; small absolute changes therefore result in large percentage increases or decreases. About half of such investment is for the replacement of equipment that has to be scrapped. Because of the low level of such investment, the sector's capital stock does not expand greatly.

Since 1970 the capital stock of this sector has edged up by an average of 1.5

percent a year, after advancing some 6 percent p.a. during the 1960s. The slowdown can be attributed to the fact that the country's water potential is being almost fully exploited. Any further substantial expansion of supply can come only from costly sources, such as desalination and extension of the cloud-seeding program. An optimal allocation of the extra water (i.e. whose price would reflect its marginal value to the economy) might justify investing in the production of water also from these more expensive sources.

(d) *Transportation and communications*

Capital expenditure here fell off noticeably in telecommunications, roadbuilding, and ship and aircraft acquisitions. Investment in the first two items is implemented exclusively by the government sector, and in the long run is determined by the country's infrastructure needs. But in the short run the government can reduce or expand such expenditures in accordance with its policy. In the year reviewed it decided to curtail investment activity, and this was mainly reflected in its spending in this sector: roadbuilding was cut back 21 percent and telecommunications spending by 10 percent.

Ship and aircraft acquisitions were down 60 percent. This item displays considerable lumpiness, due to the large size of the investment unit and the irregularity of deliveries. The 1974 downturn followed a sizable expansion in the first nine months of 1973, when the level quadrupled.

Expenditure on motor vehicles was moderately higher than in January-September 1973. Some of these purchases (notably private cars) were motivated by devaluation expectations, while another part represented the huge import of trucks after the mobilization of civilian trucking capacity during the Yom Kippur War.

(e) *Trade and services*

Investment in this sector was up 4 percent, with all the increment being in equipment spending, while buildings remained at their 1973 level. The latter development was the resultant of an absolute decrease in the erection of hotels and university buildings, and a marked slowdown in all other types of construction other than hospitals. Hotel building was down 18 percent, following a perceptible slowing of growth in the first three quarters of 1973. Signs of a slackening appeared as early as 1972, when starts fell off, reflecting the process of adjusting the tourist industry's capacity to output. This adjustment does not proceed smoothly, there being periods of spare and sometimes undercapacity. In 1970 the upsurge in tourism spurred the launching of numerous new hotels and the expansion of existing facilities. Between that year and 1972 such building shot up by an average of 43 percent p.a. The absolute downturn since 1973 thus indicates that the wave of such building is petering out. The heavy equipment spending in services (which was up 10 percent in 1974, accounting for all the growth of the sector's capital expenditure) was probably due to the equipping of hotels completed in 1973 and 1974.

The administrative restriction of construction in July 1974 was aimed primarily at the services industry. A committee of experts appointed to enforce the ban ordered the freezing by September 1974 of a number of large projects, notably university buildings and hotels and commercial centers in the large cities, but in some cases work nevertheless went on. It seems that the chief victim of this administrative order was the country's universities, as is borne out by the 18 percent slump in their construction program.

(f) *Residential construction*

Residential construction, reflected in the annual data on starts and completions, remained at roughly its 1973 level. But since the volume dipped sharply in the last quarter of 1973 because of the war, a comparison of annual averages obscures a downturn in 1974. This year there was a marked trend differential between private and public building: whereas the former declined sharply, the latter expanded.

The war caused the postponement of activity from the end of 1973 to 1974; this, together with the high level of public housing starts (despite the operation of factors that should have constrained such building), virtually stabilized residential construction starts at its 1973 level—54,000 as against 55,500 units respectively. Moreover, in some brief subperiods (the second and third quarters) the war-induced postponement of activity pushed the level up to almost its 1972 peak (see Table VIII-9).

Since dwellings are long-lasting commodities, in analyzing development trends in any particular period account must also be taken of the volume of construction activity in previous periods. Because of the pronounced decline in demand since the third quarter of 1973, home starts in the last year and a half (including both the wartime reduction and the subsequent compensatory increase) totalled about 77,000 units, compared with 99,000 in the preceding year and a half—down 23 percent (see Table VIII-9). These developments too must be viewed against the backdrop of the longer-run trends in this industry. Demand for new homes[7] began to plateau already in 1972. In mid-1973 the curve turned downward, and the decline gathered speed in 1974 (see Table VIII-8). This of course was reflected in the prices paid: the

[7] As an indicator of the public's demand for housing we shall use the data on sales of privately built homes in the 12 large towns.

uptrend in the relative price of dwellings (in comparison with the consumer price index), which was very strong until 1972, abated in the course of 1973, and the year reviewed saw a downturn, even though the absolute level still went up by a fairly steep 36 percent. A comparison of dwelling prices with residential building input prices reveals a similar picture, but here the relative fall in dwelling prices began in 1973, and its impact on the industry's profits was reflected, in addition to the cutting back of building starts, by a softening of land prices. It is noteworthy that home sales slackened despite the much larger volume of mortgage credit provided in 1974, an increase exceeding the nominal rise in dwelling prices (see Table VIII-8). Whereas in private construction, which is more sensitive to current demand, the drop in starts was evident already in the second quarter of 1973 and, not counting the wartime disruptions, was aggravated in the course of 1974, public residential starts continued to run at a high level (see Table VIII-9). The latter took place despite the subsiding of demand for homes, the contraction of immigration, and the government's declared policy of restraining economic activity in general and construction in particular.

1. Housing demand trends

Current sales of privately built homes serve as an indicator of the public's demand for housing. From the middle of 1973 onward sales sagged, after having plateaued from mid-1972 to the beginning of 1973 (see Table VIII-8). At the height of the boom they approached the 6,000 quarterly mark, over half the current supply of newly built units; in the final quarter of 1974 the figures tumbled to 2,700 units and some 30 percent respectively. If the comparison is made with longer periods in order to eliminate the effect of short-run swings, due *inter alia* to the war, it turns out that in the last year and a half sales were down 35 percent compared with the previous 18 months—from 4,900 to 3,200 units per quarter—with the percentage of sales from the current supply of new homes dipping from 39 to 27 percent.

The current demand trends should be seen in conjunction with the enormous growth of starts and completions, including public building, in the preceding years. The recovery of the construction industry from the 1966-67 recession was accompanied by a heavy oversupply (after plunging from 48,000 units in 1964 to 19,000 in 1967, the number of starts rebounded to 66,000 in 1972). Completions ranged from 38,000 in 1964-66 to 23,000 in 1968, rising to 50.000 in 1973. Various indicators[8] suggest that the level of completions in 1971 (38,000) already

[8] The population census taken at the beginning of 1972 and the records of the Israel Electric Corporation for 1972 revealed that the stock of vacant homes ran into several tens

Table VIII-8
PRIVATELY BUILT HOME MARKET INDICATORS, 1970–74

	12 large towns ('000 units, quarterly)				Total completions—private and public (No. of units—annual data)	Percent change in prices during the year					Mortgage credit granted during the year (IL million)	
	Sales	Current supply	Percent of sales from current supply	Starts		Dwelling prices	Residential construction input prices	Consumer price index	Dwelling prices relative to input prices	Dwelling prices relative to consumer prices	Total	Non-directed
1970 III	3.9	3.6	40									
IV	4.1	9.4	44		31.4	37.0	13.3	12.6	20.9	21.7	424	110
1971 I	4.2	9.1	46	4.7								
II	5.0	9.8	51	6.2								
III	5.9	11.2	53	6.8								
IV	5.4	11.9	45	6.6								
Quarterly average	5.1	10.5	49	6.1	38.5	18.0	14.9	13.1	2.7	4.3	298	55
1972 I	5.7	11.7	49	5.8								
II	4.6	11.6	40	5.3								
III	3.9	12.5	32	5.6								
IV	5.1[a]	14.0	36	5.0								
Quarterly average	4.8	12.4	39	5.4	47.2	27.3	18.0	13.2	7.9	12.5	584	105
1973 I	5.0	13.7	37	6.6								
II	5.1	13.0	39	4.8								
III	3.6	12.5	29	4.2								
IV	1.6	10.7	15	1.9								
Quarterly average	3.8	12.4	31	4.4	50.7	30.8	39.8	29.5	−6.4	1.0	767	135
1974 I	3.7	12.2	31	2.6								
II	4.1	12.8	32	4.2								
III	3.2	11.5	28	3.1								
IV	2.7	11.3	24	2.9								
Quarterly average	3.4	11.9	29	3.2	50.5	36.0	53.8	47.1	−11.5	−7.5	1,445	2,330
1972 to mid-1973	4.9	12.7	39	5.5	73.8							
Mid-1973 to end-1974	3.2	11.8	27	3.2	74.7							
Percent change	−36			−43								
1974 IV compared with 1971 III[a] — percent change				−57								

[a] Peak period.

Table VIII-9

RESIDENTIAL CONSTRUCTION STARTED, 1970–74

(thousands of units, at annual rates)

	Total	Public	Private	Private building in 12 large towns
1970	46.5	21.3	25.2	18.0
1971	51.0	17.7	33.9	23.3
1972	66.1	30.3	35.8	21.7
1973	55.5	25.9	29.5	17.6
1974	54.2	30.0	24.2	12.8
1973 (Jan.–Sept.)	64.0	29.0	35.0	20.8
1974 (Jan.–Sept.)	54.5	30.0	24.5	13.2
1974 (April–Dec.)	59.0	32.5	26.5	13.7
Mid-1973 to end-1974	51.0	27.4	24.0	12.6
1973 III	59.5	27.4	32.0	16.7
IV	30.0	17.0	13.0	7.7
1974 I	40.0	22.0	18.0	10.2
II	62.0	33.0	29.0	16.9
III	61.3	35.3	26.0	12.5
IV	53.3	29.5	23.8	11.7
1975 I			15.0[a]	8.0

[a] Preliminary Bank of Israel estimate.
SOURCE: Central Bureau of Statistics and Bank of Israel calculations.

fully met the demand for immediate occupancy, but the previous period of housing shortage gave rise to a speculative demand, while in public building there was a lag between the construction of homes and their supply on the market; to these factors must be added the much larger volume of mortgage credit provided to home buyers.

However, these developments—together with the policy of administratively regulating construction, which repeatedly generated fears of a renewed shortage of homes—staved off for a time a significant slackening of demand. Meanwhile a large stock of vacant dwellings accumulated, in the hands of both the general public and public housing companies, with the consequence that the volume of starts, and hence the stock of units under construction, reached a record high.

Only when it finally became plain that there was a surplus of homes for

of thousands. This situation was also reflected by the ease with which the Ministry of Absorption was able to rent some 8,000 units from the public for providing provisional housing to new immigrants.

immediate occupancy, and that a sizable stock of vacant units had accumulated, did current demand undergo a drastic change. The country had witnessed a similar development in the past: advance and speculative purchases of homes in previous boom periods pushed demand up well above current requirements, creating a stock of vacant dwellings which subsequently pressed in the opposite direction, with sales weakening progressively until they sank below current requirements. This speculative behavior in the housing market is reflected by rising demand concurrently with escalating prices (which persists until the public is finally convinced that there really is a surplus supply), and subsequently a steadily shrinking demand as prices taper off and then dip.

Besides the above factors which in 1974 dampened demand for homes and concomitantly the volume of private starts (a cyclical swing characteristic of this industry), several other influences were at work. One was the decline in real private income since the Yom Kippur War (however, home purchases, as already noted, tapered off much earlier and since mid-1973 have been on the downgrade). Another factor was the limitation imposed on the total volume of mortgage loans and on the maximum home values eligible for such financing. These restrictions were introduced in the middle of 1972, but nonetheless there was at least one further upsurge in sales at the end of 1972 and the beginning of 1973; the continued escalation of housing prices, however, made these limitations more effective in 1973 and 1974. Restrictions were also placed on the sale of homes to nonresidents; these too were introduced in the middle of 1972, but they have had only a marginal effect, since the volume of such sales is in any case small and lags behind domestic market trends. With the property market boom losing steam, nonresidents, instead of acquiring homes, have started to dispose of those they bought earlier (partly for speculative reasons). The drop in immigration in 1974 had only a minor effect on the private housing market, since the majority of the immigrants from the Soviet Union were provided rental housing by the public sector (it should again be noted that the turnabout in private home sales came precisely during the upsurge in immigration in 1972-73). Mention should also be made of the defense procurement tax imposed on immovable property and fears that the government would heavily tax the appreciation of real estate values in cases where homes are sold a relatively short time after their purchase. On the other hand, the rental of dwellings from the general public for temporarily housing immigrants slowed and even fell off in 1974; this heightened the feeling, particularly at the end of the year, of a surplus supply of homes in the private market. The large volume of housing credit made available by the public sector this year (supported groups could obtain mortgage loans for up to 95 percent of the value of their home) moderated the slump in demand. The decrease in the portion of the dwelling price covered from the buyer's own means and in the share of freely loanable bank funds in effect lowered the price of the home to the buyer.

Besides upping both the total volume and the rate of home loans, the government embarked on a program before the war to improve the housing standards of those living in dwellings with a density of three or more persons per room. But even this increase in the number of persons eligible for public support failed to keep demand from shrinking in 1974.

2. Residential construction starts

The development of housing starts in the year reviewed must be viewed against the faltering of demand in 1972-73, which grew more pronounced in 1974. But there were two other factors that affected the volume of starts: the effect of the war and the behavior of public building.

The war caused activity, both in the housing market and in the volume of starts, to be deferred from 1973 to the following year, but the annual data obscure the falling trend in private building. A quarterly breakdown reveals that in the first three months of 1975 starts ran at an annual rate of 15,000 units, as opposed to 35,000 in 1972.

The second influence was the expansion of public building, which is less sensitive to changes in housing demand. Such construction is carried out by concerns that can essentially be defined as housing companies (e.g. Shikun Ovdim and Rassco), contracting firms (such as Solel Boneh), and management companies (such as Amidar). No data have hitherto been available on public building which match those published by the Central Bureau of Statistics on the current supply and sale of privately built homes.

Thus it will be seen that, whereas private building adjusts to a sharp downturn in current demand by cutting back new starts (the war, to be sure, interrupted the declining trend by causing a short-lived compensatory upsurge after activity had been virtually paralyzed during the final wartime quarter of 1973), public building in 1974 displayed no sign of the change in the housing market—at least as far as new home starts are concerned.

To some extent the high level of public sector starts concurrently with the decline in that by private builders may have been directly due to the reduction of private construction. Apparently contractors working for both the private market and the public sector sought to ride out the demand slump under the public sector umbrella, stepping up their activity for the latter market.

Since the war disrupted trends in this industry, in Table VIII-9 we present data for various subperiods. In general, the trend was patently downward in private building starts, in line with the ebbing of housing demand. In public building, which is less influenced by the current market situation, activity continued at a vigorous pace. Moreover, annual data and those for a longer period—from mid-1973 to the end of 1974, a period which saw the wartime slump and probably a brief compensatory spurt—reveal that total building starts fell below their 1972 peak, while in certain subperiods (such as the middle of 1974) the volume was very close to its level at the height of the boom.

To sum up, because of the interruptions caused by the war and the failure of public building to adjust to the changing demand situation (as evidenced by the data on sales and prices), building starts in some subperiods in 1974 ran at an unusually high level. Even the total volume of starts for the year was high, given the prevailing circumstances and the estimated long-term demand for new homes, which ranges between 40,000 and 50,000 units (assuming an annual immigration of 60,000). In the second half of 1974 the downtrend reasserted itself after the upswing in the immediate postwar period. Private building fell far short of its 1972 high: in the 12 large towns it plummeted to half its peak level, and in the country as a whole it dropped to two-thirds, with preliminary data for the first quarter of 1975 indicating that it sank to as low as a third of its 1972 peak.

3. Public housing starts[9]

In contrast to private building starts, which more or less adjusted to the sagging current demand, those by the public sector, as already mentioned, continued at a high level, and the number of units begun actually eclipsed the figure for 1973, but fell a little short of the 1972 high.

[9] The usual distinction between public and private construction is based on the definition of public housing as that initiated by the government, Jewish Agency, local authorities, and companies controlled by these three entities. Since the Six Day War this differentiation has become increasingly blurred for purposes of analyzing developments in the housing market, since the acute shortage of units put up under its own construction program prompted the government to divert an increasing percentage of families eligible for public support to the private market. The supply situation underwent a dramatic change at the end of 1971: the reference is to the putting up of homes for newly married couples by large housing companies under the special bond issue program. Although this is defined as private building, in many respects it is actually public building: it is initiated and controlled by the public sector, is financed from special funds, and is intended exclusively for a population group with the right to public support. All these reasons justify including it under the head of public building, but it is only recently that the Central Bureau of Statistics decided to do so and to revise the data on building starts from 1972 onward. From the aspect of home buyers, the

The lagging of public construction behind changing demand conditions is a recurrent feature in this country. The adjustment process, whether upward or downward, has always trailed well behind that in private building, and as a rule is sharper and more intense than the gradual accommodation of private building.

The authorities were aware of the slowdown in sales of privately built homes (for which data are available) and were concerned about a possible overbuilding. It was therefore decided at the beginning of 1973 to voluntarily regulate residential construction (this is the reason why private building starts broke all previous records in this quarter) and, in the summer of 1973, also to increase the categories of persons eligible for public support to include those living in overcrowded conditions (homes with a density of three or more persons a room). But for lack of data on the stock, sale, and rental of public sector housing, nothing was done to retard the pace of starts by this sector. At the same time, large building companies that both operated in the private market and executed projects for the government exerted pressure to step up public starts so as to offset the decline in their own-initiated starts. This situation lasted until the end of 1974, when the authorities were finally convinced that there was a large stock of vacant publicly built homes. (Detailed data on this are not published, and as far as is known even the Housing Ministry itself does not have full information on the position. However, the very mild response to the supply of some 6,000 units to young couples at the end of 1974 is a good indicator.)

4. Construction Inputs

Construction output edged up 1 percent in 1974, falling short of its prewar level throughout the year. The movement in the course of the year was similar to that in other sectors: a rapid rebounding in the first and second quarters, after a sharp drop

distinction between the two sectors was further blurred in the last two years, when it was decided to permit those entitled to public support, such as families living in overcrowded conditions and young couples, to purchase homes (both new and secondhand) in the open market. The differentiation between private and public construction, therefore, seems to be essentially twofold: (1) A large proportion of public building consists of rental housing for new immigrants and supported low-income groups, while practically all of that put up by the private sector is intended for sale on the market. (2) Private building is decisively affected by current housing demand; it does not have at its disposal sources of funds permitting it to deviate for any length of time from the demand trend (it is the downpayments made by buyers as building progresses that enable the industry to finance such activity). By contrast, in public building, including that of a commercial nature, the government budget and the available directed credit funds permit a lag, sometimes of considerable duration, in adjusting construction activity to a change in the sale and rental of the finished homes to the public.

Table VIII–10

MAIN INDICATORS OF CONSTRUCTION INPUTS, 1970–74

						Percent annual increase				
								1973		
	1970	1971	1972	1973	1974	1971	1972	Jan.–Sept.	Entire year	1974
Employment (in thousands, annual average)	91.3	106.0	125.4	127.7	123.8	16.1	18.3	4.9	1.8	–3.1
Israelis	80.1	88.3	99.3	96.0	87.7	10.2	12.5	–2.2	–3.3	–8.6
From the administered areas	11.2	17.7	26.1	31.7	36.1	58.0	47.5	58.6	21.5	13.9
Gross investment in construction equipment (IL million, at 1973 prices)	134	169	189	189	271	26	12	11	0	44
Stock of construction equipment (IL million, at 1973 prices)	1,032	1,067	1,122	1,194	1,267	3	5	..	6	6
Capital stock per worker (IL, at 1973 prices)	11,303	10,066	8,947	9,350	10,234	–11	–11	..	5	9
Cement sales ('000 tons)	1,426	1,671	2,114	1,940	2,149	17	27	2	–8	11
Imports of current inputs ($ million, at 1970 prices)	21.5	33.1	43.7	46.3	..	54.0	32.0	24.6	6.0	..
Construction output (IL million, at 1973 prices)	6,134	6,956	8,179	8,217	8,319	13	18	12	0.5	1

at the end of 1973 to a little below the prewar level, and stability in the last two quarters of 1974 with a declining tendency.

As opposed to the general sagging of private residential and nonresidential construction, reflected by a decrease in new building starts (see Table VIII-4), there were several factors (although much weaker than the others) working in the other direction. One was a compensatory increase for the steep downswing at the end of 1973 and the beginning of 1974 (in retrospect, the volume of starts in the fourth quarter of 1973, when there was generally thought to be an acute shortage of productive factors, is surprising). Other influences were the sustained growth of public residential construction and the building of fortifications after the war.

The conspicuous slackening of construction activity led to the laying off of workers. In this context it should be noted that the policy of regulating building in 1974 was premised, among other things, on a shortage of labor. It is now clear that employment in this sector was already on the decline before introduction of the July administrative orders. Moreover, because of the assessment that the foremost problem was a shortage of labor, preference was accorded to the continuation of construction by methods with a high foreign exchange component (steel skeletons, for example). As regards building materials, the stepping up of defense jobs apparently generated an abnormally large demand—relative to total construction—for cement. As in previous years, it was partly met by importing this product. In other building materials, including those required for the final stages, demand slumped fairly sharply already in the third quarter, even though the sector's activity remained quite buoyant. It seems that in the face of the accelerating downturn in starts those builders who previously had stockpiled materials now decided to draw on their stocks, thus depressing current sales more than actual current consumption of such materials. By the end of the year it was obvious that the industry had on hand a huge stock of imported lumber and finished steel products, which had been purchased on a large scale in anticipation of a possible shortage and of a rise in prices—both in the international market and as a result of the devaluation of the Israeli pound.

The large import of construction equipment is explained by the exaggerated fear of a shortage immediately after the war because of the wearing out of equipment during the fighting and the subsequent heavy demand for such items for fortifications work. As with the trucking industry, surpluses that had existed before the war grew even bigger following the overpurchases immediately afterward.

Table VIII-11

GROSS FIXED INVESTMENT, BY TYPE OF ASSET, 1970–74

(IL million, at 1973 prices)

	1970	1971	1972	1973	1974	Percent annual increase 1971	1972	1973 Jan.–Sept.[a]	1973 Entire year	1974
New construction	4,974	5,753	7,079	7,232	6,879	16	23	15	2	–5
Residential	2,881	3,457	4,412	4,567	4,345	20	28	17	4	–5
Nonresidential	2,093	2,296	2,667	2,665	2,534	10	17	11	0	–5
Assets from farm output	96	100	148	146	137	4	48	–1	–1	–6
Machinery and equipment	2,372	2,631	3,263	3,333	3,389	11	24	11	2	2
Locally produced	773	877	1,009	1,122	1,075	13	15	18	11	–4
Imported	1,599	1,745	2,254	2,211	2,314	10	29	7	–2	5
Motor vehicles	520	527	647	827	885	1	23	45	28	7
Ships and aircraft	331	1,056	281	907	410	219	–73	304	223	–55
Total fixed investment	**8,294**	**10,067**	**11,418**	**12,445**	**11,700**	**21**	**13**	**22**	**9**	**–6**

[a] Compared with January–September 1972.

5. Investment by Type of Asset

The stabilization of nondwelling investment (excluding ships and aircraft) in 1974 was the resultant of an absolute drop in nonresidential construction and domestically produced equipment and an increase in imported equipment and motor vehicles. The decline in nonresidential construction was caused by three factors:

(a) A change in investors' expectations in the wake of the general economic slowdown. This caused them to be more cautious in implementing projects, preferring expansion investments over the establishment of new enterprises, which in turn depressed the structures share of investment.

(b) The cyclical factor in hotel construction. The upsurge in such investment, which began in 1970, fizzled out in the year surveyed, when the level even turned sharply downward in absolute terms.

(c) The government's policy of regulating construction, which was aimed primarily at service structures and in fact retarded the erection of public buildings.

Besides the long-run rising trend in the equipment share of investment (due to the shorter life of equipment compared with buildings), the year reviewed saw a short-run factor working in the same direction, namely the reduction of nonresidential construction; this was most manifest in the services (see Table VIII-12). An exception was electricity, where the equipment proportion of investment dropped precipitately. But outlays in this sector display sharp fluctuations in the equipment-structures proportions, depending on the stage of implementation of the project. The Eshkol III power station was completed in 1973, pulling up the equipment component of investment, whereas in 1974 work got underway on the new Eshkol IV station, and consequently such investment was heavy on the structures side.

Expenditure on imported capital goods rose 5 percent in 1974, while that on locally manufactured plant, equipment, and motor vehicles was down 4 percent, reducing the share of domestic production (see Table VIII-13). To some extent this was due to the decline in the relative price of imported capital goods, which became 21 percent dearer in 1974, as contrasted with a 47 percent jump in the price of local items.

The decline in the structures share of investment and that of domestic production depressed the product more than the import generated by investment—3 vs. 1.5 percent. What is more, under its policy of regulating construction activity, the government accorded priority to the continued erection of buildings involving a relatively larger import, thereby vitiating still more the contractionary effect of the investment slowdown on the balance of payments.

Table VIII-12

EQUIPMENT SHARE OF GROSS FIXED INVESTMENT, BY SECTOR, 1967–74

(percentages; at 1970 prices)

	1967	1968	1969	1970	1971	1972	1973	1974
Agriculture[a]	36.7	41.3	49.2	39.8	46.8	42.8	50.1	51.8
Water	11.9	18.5	22.0	24.3	16.8	15.9	16.9	19.5
Industry	65.8	72.7	80.8	79.7	81.1	80.2	78.1	78.7
Electricity	50.5	60.3	45.5	52.4	45.9	64.0	71.3	60.3
Transportation and com.[b]	46.2	35.3	34.5	43.2	39.5	55.5	57.4	55.4
Trade and services	28.2	30.8	35.5	40.2	39.6	39.9	42.1	44.4
Total[c]	**39.7**	**47.1**	**51.7**	**55.5**	**55.1**	**57.1**	**58.1**	**59.1**

[a] Excluding livestock inventory.
[b] Excluding ships, aircraft, motor vehicles, and roads.
[c] Excluding ships, aircraft, motor vehicles, and roads, but including construction equipment.

Table VIII-13

SHARE OF LOCALLY PRODUCED CAPITAL GOODS,[a] IN TOTAL INVESTMENT, BY SECTORAL DESTINATION, 1964–74

(percentages; at 1970 prices)

	Average								
	1964–65	1966–67	1968	1969	1970	1971	1972	1973	1974
Agriculture	57	64	58	56	60	60	58	53	50
Industry	29	32	24	26	24	23	21	22	20
Electricity and water	25	25	27	36	28	43	30	30	37
Construction equipment	23	37	12	16	16	16	18	13	8
Transportation and com.[b]	43	48	45	42	38	36	30	31	36
Trade and services	53	52	48	48	51	54	49	50	46
Total									
Excl. ships and aircraft	**41**	**45**	**37**	**38**	**37**	**36**	**32**	**34**	**33**
Incl. ships and aircraft	**35**	**42**	**31**	**36**	**32**	**27**	**30**	**28**	**30**

[a] Machinery, equipment, and mobile transport equipment.
[b] Excluding ships and aircraft.

6. The Capital Stock

The uptrend in the economy's gross capital stock tailed off a bit in 1974—8.5 as against 10 percent in each of the three preceding years. But the slowdown was not as marked as that of the gross national product in 1973-74; the divergence was evident in most sectors of the economy, but particularly in industry (discussed in section 3).

The long-run trends in the sectoral breakdown of the capital stock carried over through the year reviewed. The most prominent are the steady rise in the proportions of transportation and communications and the services sector, and the decline in agriculture, water, and electricity (see Table VIII-14). The advance in the first two sectors is explained *inter alia* by the long-term program for the development of the country's road and telecommunications systems and the expansion of educational and health facilities, which reflect the rise in the country's welfare.

Capital stock per worker went up nearly twice as fast in 1974 as the average for the three preceding years. This was apparently due to the lag in adjusting the capital stock to the slowdown in economic activity, whereas labor responded fairly rapidly. A similar development happened during the 1966-67 recession, when capital stock per worker almost doubled then too (albeit at a higher level). The increases were highest in agriculture, construction, and the services (see Table VIII-15).

Table VIII–14

GROSS FIXED CAPITAL STOCK, BY SECTOR, 1974–75

(IL million at 1973 prices)

	1974				Stock at beginning of 1975	Percent of total		
						Beginning-of-year stock		1974 stock increment
	Beginning-of-year stock	Gross investment	Discards	Net stock increment		1960	1975	
Agriculture	8,117	466	101	365	8,482	22	11	6
Water	3,947	74	45	29	3,976	9	5	0
Industry	14,860	1,675	381	1,294	16,154	23	22	23
Construction equipment	1,267	271	121	150	1,417	3	2	3
Electricity	3,792	261	145	116	3,908	7	5	2
Transportation and com.	18,167	2,226	548	1,678	19,845	18	26	30
Trade and services	19,633	2,382	341	2,041	21,674	18	29	36
Total nondwelling stock	**69,783**	**7,355**	**1,682**	**5,673**	**75,456**	**100**	**100**	**100**
Dwellings	44,424	4,345	322	4,032	48,447			
Total fixed capital stock	**114,207**	**11,700**	**2,004**	**9,696**	**123,903**			

Table VIII-15

GROWTH OF REAL CAPITAL STOCK PER EMPLOYED,[a] BY SECTOR, 1961-74

(percentages)

	Agriculture	Industry	Construction	Transport and com.	Trade and services	Total[b]
1961-65 (average)	6.7	..	3.5	7.6	10.5	6.1
1966	10.4	2.5	33.3	21.5	11.2	10.2
1967	6.4	15.2	18.6	2.4	14.4	12.2
1968[c]	3.9	-11.5	-19.0	1.5	2.8	-3.3
1969	4.0	3.8	-3.6	2.0	4.8	3.4
1970	7.0	7.8	-7.7	16.7	6.0	6.2
1971	1.3	6.9	10.0	7.0	6.0	3.4
1972	1.6	5.2	-11.1	11.2	7.3	3.7
1973	7.6	-0.8	4.4	11.2	5.9	4.8
1974	15.7	6.8	15.5	2.8	9.2	7.3

[a] Data on the capital stock are for the beginning of the year; those on the number of employed are annnual averages.
[b] The total includes electricity and water, which are not listed separately. The inclusion of water in the agricultural sector and of electricity in industry would not affect the results significantly.
[c] Residents of the administered areas working in Israel are included in the number of employed since 1968.