Chapter II

PRODUCT AND DOMESTIC DEMAND

1. Main Developments

In 1984 domestic demand[1] and the composition of resources at the disposal of the economy changed sharply. Domestic use of resources[2] declined by 6½ percent after rising rapidly for three years; similarly, the weight of import surplus in total available resources declined after rising for three years. The decline in resource use affected all components (see Table II–1). The change in resource composition was the outcome of a marked contraction of the civilian import surplus, while GNP rose by a moderate 1 percent (compared with an annual average of 2½ percent in 1980–83), the rise being almost entirely due to exports. The labor market also reflected the slow growth of product, and expansion was only moderate—the number of employed persons[3] rising by 1½ percent and the civilian labor force by 3 percent, so that the unemployment rate rose to 5.9 percent (annual average). The labor market slack was also reflected in a decline in business sector real wages.

Income from all sources[4] in dollar terms[5] declined similarly to total consumption (public and private). The net outcome is that national dissaving contracted slightly in absolute terms, with no change in the saving rate: although the private saving rate rose appreciably, it was offset by the decline in public saving. Thus this year's decline in the deficit on current account[6] reflects primarily a considerable decrease in net investment, and has much less to do with the decline in national dissaving. The gross saving picture (with direct defense imports excluded from consumption and defense grants from income) is somewhat different: gross saving rose by 1 percentage point and accounted for a quarter of the decline in the current deficit, the remainder being due to the marked drop in gross investment.

[1] Private consumption, domestic (i.e. excluding direct defense imports) public consumption, and gross domestic investment.

[2] *Ex post* identical with available resources, GNP *plus* import surplus.

[3] However, there was a surprisingly high rise in man-hours per employed person; labor input thus rose faster than product so that product per man-hour declined.

[4] NNP *plus* net unilateral transfers *less* net public sector interest payments to the rest of the world. Unilateral transfers converted to IS at the effective exchange rate of exports.

[5] The purchasing power of this aggregate (i.e., when deflated by the implicit price index of private consumption) also declined, but by less.

[6] Import surplus *less* unilateral transfers. This is identical with the difference between national saving from all sources and net investment.

Table II–1

RESOURCES AND USE OF RESOURCES, 1983–84

	At current prices, IS billion		Percent annual change							
			Quantity						Price	
	1983	1984	1969–72	1973–84	1981	1982	1983	1984	1983	1984
Resources										
GDP at market prices	1,431	6,963	11.1	3.0	3.2	0.8	2.0	1.1	149.9	381.5
Imports[a]	836	4,254	10.9	4.6	9.9	3.8	6.7	–0.7	127.5	412.6
thereof Civilian imports	761	3,671	10.2	4.9	7.8	11.2	11.2	–3.8	125.1	401.8
Total resources	**2,267**	**11,218**	11.0	3.6	5.7	2.0	3.9	0.3	140.9	393.3
Use of resources										
Private consumption	931	4,261	7.2	4.7	10.8	7.4	7.5	–6.3	144.4	388.5
Public consumption										
Total	443	2,410	10.1	2.7	6.9	–8.1	–5.7	6.8	149.8	408.9
Excl. direct defense imports	368	1,827	8.7	2.9	1.3	3.1	1.7	0.2	145.4	395.6
Gross domestic investment										
Total investment	346	1,441	18.4	–1.1	–5.7	14.5	10.1	–13.9	132.3	383.1
Fixed investment	341	1,464	19.3	–0.3	3.7	4.2	13.0	–13.3	130.7	394.4
subtotal: Domestic resource use excl. direct defense imports	1,645	7,529	10.2	2.9	5.0	7.8	6.8	–6.6	141.8	389.8
Exports[a]	546	3,106	13.2	5.9	4.3	–3.2	2.1	14.5	134.6	396.5
Total resource use excl. direct defense imports	2,191	10,635	10.8	3.7	4.8	4.5	5.5	–0.9	140.1	389.5
Total use of resources	**2,267**	**11,218**	11.0	3.6	5.7	2.0	3.9	0.3	140.9	393.3
Net factor payments to rest of world	57	381	11.0	11.7	–23.9	37.8	15.1	28.4	133.0	421.5
GNP at market prices	1,374	6,583	11.1	2.7	4.4	–0.4	1.4	–0.3	150.9	380.8
Business sector GNP at market prices[b]	993	4,773	12.4	2.6	3.8	–0.4	2.4	1.1	148.1	375.7

[a] Imports c.i.f., exports f.o.b., including respectively factor payments to and from abroad and valued at effective exchange rates.
[b] Defined as GDP *less* product of public services, private nonprofit institutions, and residential services.

SOURCE: Central Bureau of Statistics.

This is the third consecutive year of net national dissaving—it has been rising at an annual average of $700 million (in previous years it was positive; see Figure II–1). This is a serious situation, since it means that part of the increment in the country's foreign debt is being used to maintain the level of consumption. If it persists, it is liable to prevent resumption of growth (the country's ability to raise foreign loans is presumably not unlimited) and transmit the burden of debt to future generations.

The contraction of domestic resource use is in part a cyclical reaction to the rapid expansion of the preceding three years. Several factors are responsible for its timing.

1. A new exchange-rate regime and an increase in import duties, which reduced speculative purchases of imports (for both consumption and investment). Consumption therefore began to adjust to disposable income and investment to the growth trend and the appropriate level of capital stock.

2. A marked decline in the liquidity of the assets held by firms and individuals at the end of 1983 (because of the bank-share crash) and a rise in the real rate of interest encouraged (or forced) firms and individuals to defer their investment or consumption plans. The bank-share crisis also reduced the public's wealth, so that consumption was adjusted to a lower level of wealth. Note that the wealth factor affects long-run as well as current consumption.

3. The ratio of wages and transfers to disposable income declined.[7] This reflects a decline in the share of gross wages and a decline in tax rates on nonwage income.

4. There was a large decline in public sector (dwelling and nondwelling) investment, which exceeded the 1½ percent rise in domestic public consumption; the net outcome was a 2 percent decline in public sector demand (in purchasing power terms).[8] The contractionary demand effect was partly offset by the decline in public sector income. The latter has an expansionary effect on disposable income and hence on private consumption (thus preventing the decline in consumption from being greater than it was); however, it appears that most of the additional disposable income went to private saving.[9]

Real disposable nonwage income rose rapidly, much faster than wages and transfers, and total private disposable income therefore rose by 6 percent (see Table II–4). Since private consumption declined, the private saving rate rose, after declining steeply in the preceding two years. The underlying causes are those which led to the demand contraction discussed above. The rise in real private sector savings was accompanied by a decline in real physical investment

[7] Since wages and transfers have a higher MPC than other income.

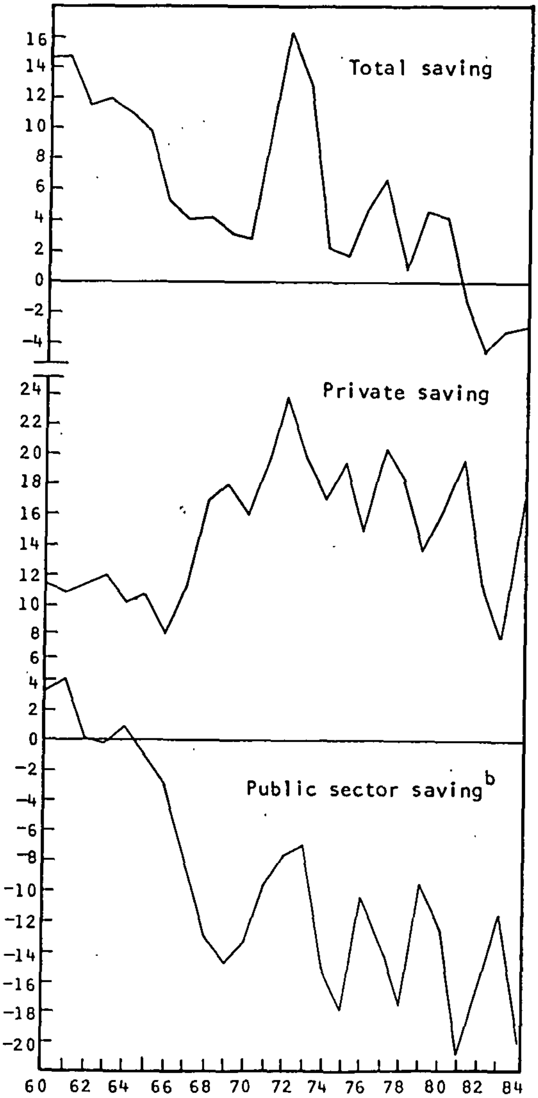
[8] A change in direct public sector demand has an immediate direct effect, which is less dependent on the reactions of firms and households than in the case of points 1–3.

[9] This impression is supported by the fact that the decline in real tax revenue was to a large extent due to the considerable fall in company tax (see Chapter V). A decline in company tax affects households only indirectly, and would thus not raise private consumption by much.

Figure II-1

THE NATIONAL SAVING RATE, 1960–84[a]

(Percent)



[a] Private and public sector saving as percent of GNP at market prices *plus* unilateral transfers.
[b] Import taxes and export subsidies appear in the foreign trade account as respectively absorption and injection (this accords with the national accounts treatment of Table II-1, see note b there). Accordingly, in the public saving calculation, they are not included in income.

(see Table II–A2). Thus the private savings increment went chiefly to financial assets, both domestic and foreign, including foreign exchange. This shift to foreign exchange was the expression of the public's loss of confidence in the integrity of domestic assets as the economic climate worsened. In the preceding two years, this factor had induced the public to buy consumer durables rather than foreign exchange.

As mentioned, the national saving rate hardly changed in 1984 in spite of the rise in private saving. In other words, the public sector saving rate declined strongly, chiefly because of the fall in tax revenue. Without this decline, private disposable income would have been lower, and it can be assumed that in that case private consumption would have declined more and national saving would have risen more, so that the current-account deficit would also have declined by more. This should not be interpreted as an argument in favor of the prevailing excessively high (gross) tax rates, with their serious effect on the efficiency of factor use and the welfare of individuals. Nonetheless, under present economic conditions, any reduction in effective taxes must be accompanied by a corresponding reduction in government expenditures (consumption, current transfers, and subsidies to local production), and by an overhaul of the inefficient tax system.

In 1981 and 1982 the net national saving rate declined steeply, turning to dissaving in 1982; in 1983 and 1984 there was little change. This pattern was a by-product of the economic policy pursued from 1981 to mid-1983, which concentrated on considerable budget expansion and slower devaluation (i.e. real appreciation of the IS). The persistent decline in the relative price of imports (particularly durables) and expectations of a large devaluation pushed up household demand for consumer imports, a trend reinforced by the high liquidity of the public's portfolio and reflected in the drop in the saving rate in 1982 and 1983.

As a result, domestic demand and the current-account deficit grew rapidly in 1982 and 1983. Long and medium term borrowing failed to cover the deficit and the economy had to resort to short-term borrowing (which amounted to $2.5–3 billion in 1982–84).

A prerequisite for remedying the country's balance-of-payments and inflation ills is to reduce public dissaving.[10] An efficient long-run solution is to cut public expenditure without raising the tax burden, which is already so heavy (averaging 47 percent of GNP in 1981–84) as to retard economic growth. Moreover, the present tax system is complicated and inefficient and seriously distorts relative prices.[11]

Domestic resource use, which began to contract in mid-1983, continued to

[10] Public dissaving has increased substantially in the last few years, the rate rising from 13 percent in 1975–80 to 17½ percent in 1984.

[11] Some of its worst features are the variability of tax rates (particularly on imports); the discrimination between consumer goods and services, and between returns to labor and capital; and the high variability of subsidy rates.

Table II–2

PRODUCT AND PRODUCTIVITY OF THE BUSINESS SECTOR, 1961–84

(Real average annual rate of change, percent)

	1961–72	1973–84	1975–77	1978–81	1982	1983	1984
Product[a]							
Estimate A	10.2	2.6	1.6	4.1	–0.4	2.4	1.1
Estimate B	9.1	3.2	2.5	3.7	2.6	4.4	0.2
Factor input							
Labor (man-hours)	3.6	1.2	0.8	2.2	0.1	3.2	2.4
Capital stock[b]							
Gross	8.7	5.2	6.1	4.1	2.9	3.1	4.7
Net	8.0	4.1	4.5	2.4	1.6	2.2	4.8
Productivity							
Product/man-hour							
Estimate A	6.4	1.4	0.8	1.8	–0.5	–0.7	–1.3
Estimate B	5.3	1.9	1.7	1.5	2.5	1.2	–2.2
Capital[c]/man-hour	5.0	4.0	5.2	1.8	2.8	–0.1	2.2
Total productivity[d]							
Estimate A	4.7	0.1	–0.9	1.3	–1.4	–0.7	–2.0
Estimate B	3.7	0.6	0.0	0.9	1.6	1.1	–2.8

[a] Estimate A is estimated from the expenditure side (national accounts). Estimate B is based on various indicators of output volume by industry.

[b] Beginning-of-year stock.

[c] Gross capital stock.

[d] The weights are 0.68 for labor and 0.32 for capital, based on distributive shares of gross national income (long-run average) and inspection of the 1977/78 input-output table.

do so throughout 1984 (except for a slight rise in the third quarter), when it declined by 9 percent. The civilian import surplus also began to decline in mid-1983, but stabilized in the course of 1984.

Per capita private consumption, which rose at an annual average rate of 6½ percent in 1980–83, dropped by an unprecedented 8 percent in 1984; the decline affected all types of consumption (except imputed rent and private nonprofit institutions).

Fixed investment, which rose in the preceding three years (see Table II–1), declined by 13 percent in 1984, all categories being affected except industrial investment. In 1983 there were heavy advance purchases of equipment and motor vehicles, in anticipation of the large devaluation which in fact occurred at the end of the year. This is reflected by the 1984 decline in private investment. The government deferred development loan approvals and this may have reduced private investment; the bank-share crisis, which reduced the liquidity of firms, may also have been contractionary.

The civilian import surplus dropped by $700 million, the net result of a 4 percent decline in the volume of imports and a 14½ percent increase in the volume of exports. The decline in imports reflects the contraction of local resource use and the 2½ percent increase in relative import prices. The rise in exports is due primarily to (a) recovery of the world market (with a 9 percent increase in world trade) and (b) a real rise in the effective exchange rate of 1½ percent; this rise in the relative profitability of exports was reinforced by the falling off of domestic demand.[12]

2. Product

Business sector product rose more slowly in 1984 (1 percent compared with an average 3–3½ percent in 1978–83). The slowdown appears to be due to a radical change in the composition of demand—domestic demand declined and the large increase in exports was not enough to take up the slack (see Table II–3). The

Table II-3

BUSINESS SECTOR GDP AT FACTOR COST, BY FINAL USE,[a] 1975–84

(Percent)

	Consumption		Fixed	Change in			
	Private	Public	investment	stocks	Subtotal	Exports	Total
Composition of product							
1975–81	38.0	9.0	17.2	0.3	64.5	35.5	100.0
1982	39.4	8.3	14.0	–0.2	61.5	38.5	100.0
1983	40.1	8.1	13.9	–0.2	61.9	38.1	100.0
1984	37.4	8.3	12.2	–0.4	57.5	42.5	100.0
Contribution to change in product							
1975–77	1.4	–0.8	–2.6	0.1	–1.9	4.5	2.6
1978–81	1.2	0.3	0.1	–0.2	1.4	2.5	3.9
1982	2.6	0.1	–0.3	0.1	2.5	–0.6	1.9
1983	2.1	0.2	0.4	–0.1	2.6	1.0	3.6
1984	–2.0	0.3	–1.6	–0.2	–3.5	5.0	1.5

[a] I.e., GDP excluding residential services and services of public sector and private nonprofit institutions. The breakdown shown here (based on input-output data) differs from the final-use data as follows: private consumption does not include compensation of employees of private nonprofit institutions and imputed rent; public consumption does not include compensation of employees; exports do not include factor payments from abroad.

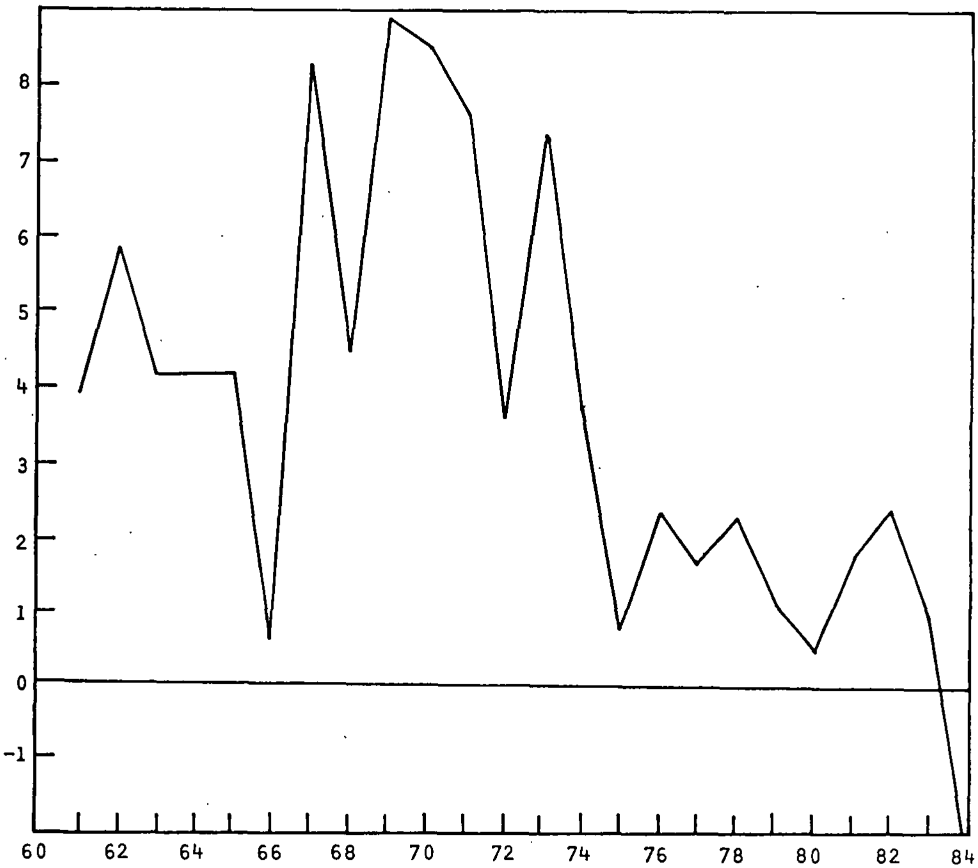
Source: The Bank of Israel's input-output table based on CBS input coefficients for 1977/78 and the national expenditure estimates of the CBS.

[12] More rapid devaluation means that the relative price of imports rises faster than the relative price of exports because of the trade-off between devaluation and exporters' exchange-rate insurance.

Figure II–2

BUSINESS SECTOR PRODUCT[a] PER MAN-HOUR, 1961–84

(Real annual change, percent)



[a] Estimate B in Table II–2 (see note a there).

changed composition of demand was also reflected in considerable inter-industry variability of growth rates: industry and transport again grew rapidly (by 5 percent), while the product of other sectors declined (see Chapter VI).

In recent years several factors reducing business sector product growth were at work: (a) the high rate of inflation and frequent changes of policy, which increased uncertainty and presumably deterred producers from expanding; (b) persistent appreciation of the IS, which diverted demand to imports and affected exports adversely; and (c) the disincentive effect of high tax rates (not confined to recent years).

The 1984 business slack was accompanied by a decline in productivity (according to all indicators). The productivity figures for 1982–84 are sensitive to the method of estimation: when measured from the expenditure side, the decline in productivity shows up clearly. The income-side estimate and the input-output table indicate stability (this is true particularly of labor productivity, see Figure II–2).

3. Disposable Income[13]

Disposable income rose by 6 percent in 1984, in spite of the fact that GNP did not change; indeed, its purchasing power declined by 2 percent. The difference between the two magnitudes stems chiefly from the decline in income tax on nonwage income. The loss of direct tax revenue is due partly to the stepping up of inflation since the end of 1983, and partly to the termination of the compulsory "Peace for Galilee" loan, the losses incurred by banks, and other factors (see Chapter V). Thus, unlike in 1981–82, the divergence between disposable income and GNP did not result directly from government measures; the increase in repayments of compulsory loans and the interest paid on them also played a part.

Incremental disposable income increased saving rather than consumption in 1984. The relationship between changes in GNP and changes in disposable income was weak in previous years too. In the last few years, taxes and hence disposable income have fluctuated owing to frequent and sharp changes in fiscal policy. The fluctuations in disposable income affected the saving rate rather than consumption—the relatively high liquidity of the public's portfolio enabled individuals to cope with short-term fluctuations in disposable income and to adjust consumption to the trend of income as perceived by them.

4. Private Consumption and Saving

Private consumption, which rose steadily at an average rate of 8½ percent in 1981–83, declined by 6 percent in 1984. Most of the decline was concentrated in consumer durables (down by 32 percent), with other consumption declining by 2 percent. Private disposable income rose by 6 percent in 1984, which implies an increase in the saving rate of 8 percentage points.

These developments are due partly to the contraction of the public's portfolio and its reduced liquidity (as a result of the October 1983 bank-share crisis), and partly to the process of adjustment of consumption to the trend of disposable income. The decline in real wages since the end of 1983 (accompanied by low liquidity) also played a part; moreover, incessant discussion of the need to cut

[13] In this section we refer to disposable income from all sources. See Table II–4 for alternative definitions of disposable income.

Table II-4

DISPOSABLE INCOME, 1980–84

	Billions of current IS					Real annual change, percent[a]				
	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984
1. National income	81.8	204.4	438.0	1,096.9	5,277.6	1.2	14.4	–0.9	2.5	–1.5
2. Public sector income from property and entrepreneurship	1.5	2.9	11.9	34.8	122.0	–31.6	–9.9	89.5	19.9	–28.3
3. Depreciation	14.5	34.3	77.5	187.1	983.4	4.3	8.1	4.5	–1.2	7.6
4. Gross private income from economic activity (1. – 2. + 3.)	94.8	235.8	503.6	1,249.2	6,139.0	2.4	13.8	–1.3	1.5	0.6
5. Direct taxes	26.0	61.1	135.4	336.5	1,373.1	9.7	7.4	2.4	1.7	–16.5
Income tax[b]	18.7	42.9	96.4	242.5	954.5	10.6	5.0	3.8	2.9	–19.4
National Insurance contributions[c]	7.3	18.2	39.0	94.0	418.6	7.3	13.5	–1.0	–1.4	–8.8
6. Net transfer payments[c]	19.0	44.6	101.1	261.4	1,279.2	4.2	7.3	4.9	5.7	0.2
7. Net compulsory loans	–1.1	–1.4	2.9	3.1	–39.8					
8. Gross private disposable income from domestic sources (4. – 5. + 6. – 7.)	88.9	220.7	466.4	1,171.0	6,084.9	2.4	13.6	–2.3	2.7	6.4
9. Personal transfer from abroad	5.9	13.1	26.0	51.9	214.9	–7.6	2.0	–8.1	–18.3	–15.3
10. Loan subsidy[d]	3.9	7.5	14.5	29.6	127.5	–7.3	–12.0	–11.0	–16.4	–11.8
11. Direct loan subsidy	2.8	6.1	12.7	26.9	150.0	20.5	1.6	–3.8	–13.5	14.2
Gross private disposable income from all sources										
12. Aggregate A (8. + 9.)	94.8	233.8	492.4	1,222.9	6,299.8	1.7	12.9	–2.6	1.6	5.5
13. Aggregate B (12. – 10. – 11.)	93.7	232.4	490.6	1,220.2	6,322.3	2.6	13.6	–2.3	1.7	6.1

[a] *See note* c *in* Table II–A1.
[b] Includes excess profits tax on inventories.
[c] Employer contributions to National Insurance are included in both direct taxes and transfers.
[d] See note b in Table II–A1.

SOURCE: Central Bureau of Statistics.

Table II–5

SAVING RATIOS, 1980–84[a]

(Percent)

Ratio of saving to	1980	1981	1982	1983	1984
Gross domestic disposable income	29.1	30.9	24.0	20.5	30.0
Total disposable income A	33.5	34.7	28.0	23.9	32.4
Total disposable income B	32.6	34.3	27.8	23.7	32.6

[a] Saving ratio = (disposable income − private consumption) ÷ disposable income. The disposable income variants entering the calculations here are respectively from lines 8, 12, and 13 in Table II–4.

the state budget and the rise in the interest rate raised expectations that restraint would in fact be implemented.

A 6 percent decline in private consumption is quite unprecedented in Israel, but the circumstances were also exceptional, with the saving rate declining steadily, by 11 percentage points over the preceding two years. This was due to the decline in relative import prices and the expectation that it would be reversed by increased duties, and to the public's fears for its portfolio—fears of both taxation and a capital market crisis—and, underlying the situation, persistent deterioration of the balance of payments.

The persistent and steep decline of the private saving rate in 1982–83 and the steady deterioration in the balance of payments led to a contractionary policy in the second half of 1983. Among other measures, import duties were raised in order to increase the relative price of imported consumer goods; this put a stop to the speculative purchases of consumer durables and other goods and services, and in effect determined the timing of the adjustment of consumption to the disposable income trend. This process is necessarily fairly slow, and it cannot by itself explain the 1984 consumption-saving picture. Another important factor is the October 1983 bank-share crisis, as a result of which the nonbanking private sector's wealth declined by 4 percent by the end of 1983. Liquid assets[14] eroded by 27 percent. The steep decline in wealth and its liquidity intensified the decline in consumption and the rise in the saving rate (as derived from the national accounts).

The measures introduced in late 1983 included a deposit requirement on imports, reduced subsidies, and two large devaluations, and were accompanied by many declarations on the necessity of budget restraint; this exacerbated

[14] The discussion refers to the nonbanking private sector. Liquid assets consist of cash, demand deposits, bonds, resident deposits (foreign-currency denominated) and financial shares.

Table II-6

PRIVATE CONSUMPTION, 1980–84

	1980	1981	1982	1983	1984
At current prices (IS billion)					
Goods for current consumption	27.3	61.7	141.5	361.8	1,681.2
Food, beverages, and tobacco	17.8	37.7	86.3	234.0	1,114.5
Other	9.5	24.1	55.2	127.8	566.7
Services[a]	13.1	31.6	73.9	197.5	927.2
Consumption of Israelis abroad	2.9	7.8	16.8	45.8	236.5
less Consumption of foreigners in Israel	5.1	12.3	24.3	64.3	344.7
Subtotal	38.1	88.8	208.0	540.7	2,500.2
Durables	6.2	17.0	40.5	110.5	391.3
Services of private nonprofit institutions	7.7	18.8	41.4	107.2	529.3
Residential services	10.9	28.0	64.5	172.5	840.7
Total	63.0	152.6	354.4	930.9	4,261.4
Total excluding durables	56.8	135.6	313.9	820.4	3,070.1
Quantity (percent annual change)					
Goods for current consumption	–6.5	7.5	5.6	5.1	–2.6
Food, beverages, and tobacco	–5.1	6.1	5.5	6.7	0.4
Other	–8.7	10.0	5.8	2.3	–8.0
Services[a]	–0.6	7.6	5.2	7.8	–1.7
Consumption of Israelis abroad	2.9	27.8	3.5	21.6	–4.9
Consumption of foreigners in Israel	–2.3	1.7	–12.8	3.2	12.6
Subtotal	–4.5	9.8	7.6	7.6	–4.0
Durables	–8.4	37.6	17.9	15.6	–31.9
Services of private nonprofit institutions	0.9	3.0	–0.4	2.7	2.3
Residential services	4.2	4.2	4.2	3.4	3.4
Total	–2.9	10.8	7.4	7.5	–6.3
Total excluding durables	–2.0	7.8	5.9	6.2	–1.9
Prices (percent annual change)					
Goods for current consumption				143.2	377.0
Food, beverages, and tobacco				154.1	374.6
Other				126.2	382.3
Services[a]				147.9	377.5
Consumption of Israelis abroad				123.7	443.2
Consumption of foreigners in Israel				156.8	375.9
Subtotal				141.6	381.5
Durables				136.1	420.1
Services of private nonprofit institutions				152.4	382.9
Residential services				158.5	371.2
Total				144.4	388.5
Total excluding durables				146.1	381.0

[a] Excluding residential services and services of private nonprofit institutions.

SOURCE: Central Bureau of Statistics.

Table II-7

DETERMINANTS OF PRIVATE CONSUMPTION, 1975–84

(Real annual change, percent)

	1975	1980	1981	1982	1983	1984
Disposable income[a]						
Total	4.5	1.7	12.9	–2.6	1.6	5.5
From wages and current transfers	4.4	–5.5	11.0	4.7	3.2	1.0
Wealth[b]	11.3	2.9	6.6	9.3	6.7	–1.5
Liquid assets[c]	–12.0	–11.2	14.5	19.6	19.4	–24.8
Relative price of durables[d]	2.7	–17.2	–9.5	–6.6	–3.4	6.5
Private consumption	0.3	–2.9	10.8	7.4	7.5	–6.3
Consumer durables	–15.6	–8.4	37.6	17.9	15.6	–31.9

[a] Deflated by implicit price index of private consumption.

[b] Real assets deflated by the relevant price indexes, financial assets by the CPI. (End-of-year figures.)

[c] Deflated by the CPI.

[d] Relative to private consumption prices.

inflation and, in the short run, reduced real wages. Coming on top of the erosion of liquid assets due to the bank-share crisis, these events gave rise to expectations that in the next few years disposable income would be below the level of the last decade, and this too helped to reduce consumption and raise the saving rate in 1984.

5. Investment

Gross fixed investment dropped by 13 percent in 1984 (9 percent in dwellings and 15 percent in nondwelling investment). All types of investment were affected; motor vehicles were down by 37 percent and nondwelling structures by 14 percent, while machinery and equipment declined by 7 percent, the result of contradictory movements—a rise of 2 percent in industry and a 16 percent decline in other sectors.

The capital stock grew more slowly this year because of the decline in investment, with gross stock rising by 3.1 percent (compared with 4.5 percent in 1983) and net stock by 2.4 percent (4.6 percent in 1983).

This year's sharp contraction of nondwelling investment is in part the reaction from the exceptional (24 percent) rise in 1983, which stemmed from advance purchases, and is in part due to the decline in public-sector initiated investment. The rise in the relative price of imported producer durables, the aftermath of

Table II-8

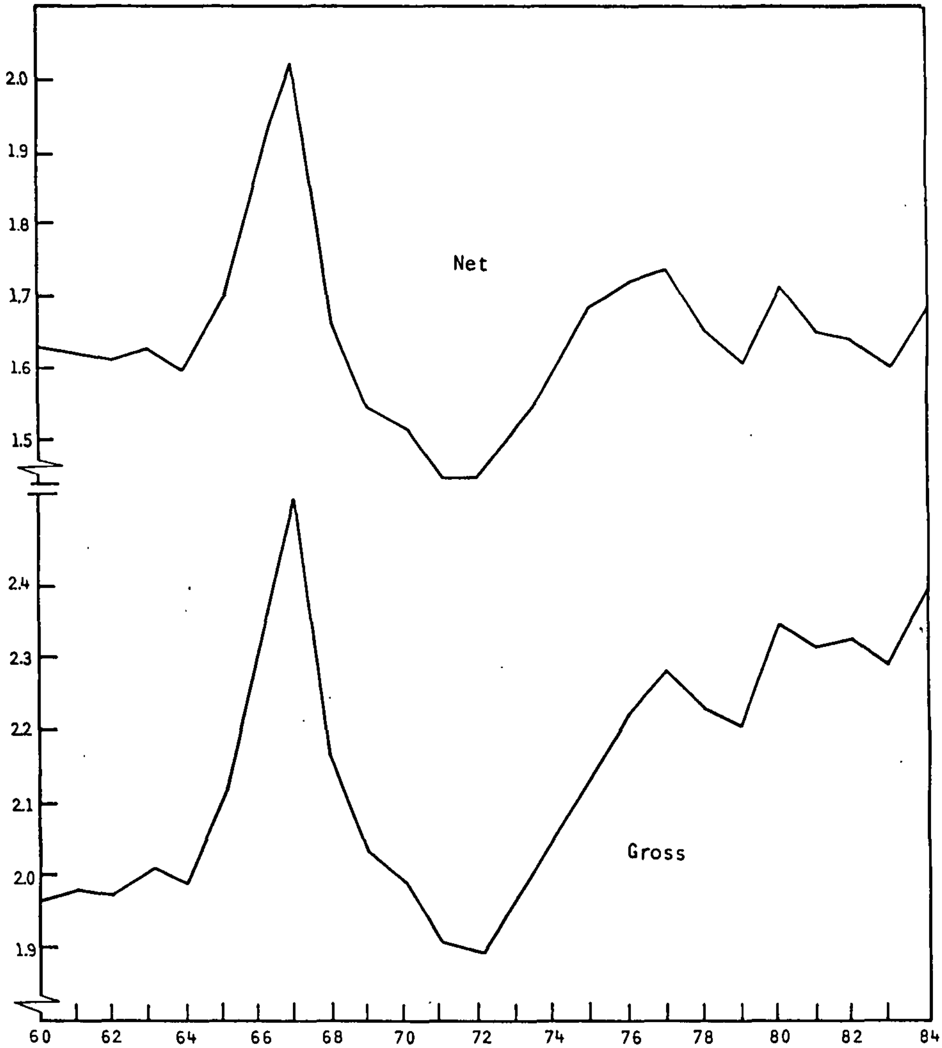
GROSS DOMESTIC INVESTMENT BY TYPE OF CAPITAL GOOD, 1980-84

	Current IS million		Percent annual change						
			Quantity					Price	
	1983	1984	1980	1981	1982	1983	1984	1983	1984
Nondwelling structures									
Structures	31.3	150.8	−15.5	−8.9	−1.0	5.1	−7.7	135.4	421.2
Earthworks	29.0	92.3	−8.5	−0.3	−2.1	2.8	−21.3	141.5	303.9
Total	60.4	243.1	−12.5	−5.1	−1.5	4.0	−13.9	138.2	367.7
Machinery and equipment									
Transport	43.6	134.1	−44.0	25.2	31.4	55.5	−36.6	117.8	385.9
Ships and aircraft	9.2	29.4	−92.6	494.9	6.3	227.1	−22.5	89.1	312.7
Other	34.4	104.8	−30.2	8.7	36.2	29.8	−42.0	132.8	425.2
Other machinery and equipment	135.2	642.0	−10.8	6.9	9.7	24.9	−7.1	135.7	410.9
Imported	93.0	444.5	−16.8	5.9	17.4	28.5	−6.6	132.3	411.3
Locally produced	42.2	197.5	0.4	8.5	−3.4	17.4	−8.3	143.4	410.3
subtotal: Nondwelling investment	**239.2**	**1,019.3**	−16.8	5.0	9.4	24.4	−15.1	131.1	401.9
Excl. transport equipment	**195.6**	**885.2**	−11.5	2.2	5.7	17.9	−9.1	136.0	397.9
Dwellings	**102.3**	**444.5**	5.6	1.8	−3.9	−7.1	−9.1	130.1	377.9
Private	82.4	372.8	−5.4	4.5	3.0	−3.6	−5.6	131.2	378.9
Public	19.9	71.7	48.6	−4.7	−21.7	−19.3	−23.5	126.1	371.5
Total fixed investment	**341.5**	**1,463.7**	−9.8	3.7	4.2	13.0	−13.3	130.7	394.4
Change in stocks	4.8	−23.0							
Total gross domestic investment	**346.3**	**1,440.8**	−13.8	−5.7	14.5	10.1	−13.9	132.3	383.1

SOURCE: Central Bureau of Statistics.

Figure II-3

CAPITAL/OUTPUT RATIO, 1960–84[a]



[a] Ratio of net (gross) capital stock to net (gross) business sector product.

the bank-share crisis, the rise in the price of credit, and the slower increase in discards also played their part.

About half of the decline in nondwelling investment is attributable to transport equipment, the rest declining by 9 percent. Most of the decline in nontransport investment was concentrated in public-sector initiated investment, private investment declining by only 2 percent (compared with an annual average rise of 14 percent in the preceding three years). The high level of private sector investment is the net outcome of the continuing rise in industrial investment and a steep decline in the rest, due largely to the changes in the composition of demand that occurred in 1984.

The capital stock again grew more slowly, in consequence of the steep decline in nondwelling investment. Its growth rate has been slowing down since the mid-1970s (with a temporary rise in 1983), a trend which fits the concurrent slowdown in output growth. The composition of the stock has also been changing, with the weight of machinery and equipment, which are import intensive, rising. The slowdown is more marked in net stock (a better measure of future production capacity), which has grown a little more slowly than net business sector product for the last ten years. Viewed against the background of sluggish growth and frequent changes in credit policy, this casts doubt on the usefulness of the selective investment encouragement pursued at present.