CHAPTER V

DOMESTIC INVESTMENT

1. Main Developments

Gross domestic capital formation expanded strongly in 1971, with the gain in nondwelling investment accelerating from 4 percent in 1970 to 22 percent, while that in dwelling investment slowed from 35 to 16 percent. Excluding ships and aircraft, nondwelling investment was up 9 percent in 1971, as opposed to a mere 1 percent the year before.

The development of investment over the last two years can be largely attributed to Government policy. The negligible growth in 1970 was due mainly to the Government's decision to cut back its direct investment and retard the expansion of private investment by tightening directed credit. This was an integral part of the overall policy designed to counter inflationary pressures. In 1971, however, there was a turnabout: in contrast to the tendency to restrain public and private consumption, the Government stepped up its capital spending on public buildings, telecommunications, waterworks, and roads, with the result that Government and local authority investment taken together went up 19 percent after slumping 8 percent in 1970. The Government also stimulated private investment indirectly, by increasing its supply of cheap loans and grants by about 40 percent and enabling the private nonprofit institutions to expand their capital outlays by 22 percent, after having taken steps in 1970 to damp down that sector's building activity (by granting fewer building permits to universities).

Capital formation in the private sector was greatly affected by changes in the demand for its output and by the much larger volume of directed credit made available during the year. Most of the incremental investment was in ships, hotels and other lodging places, business establishments, and construction equipment. The figure for hotels and other lodging places was up 45 percent, the dominant influence being the impressive gain in tourism. Investment in ships tripled, with most of the increment concentrated in tankers – a development explained by the enlarging of the capacity of the Eilat-Ashkelon pipeline. The growth of industrial investment, on the other hand, slowed to 10 percent; the deceleration of the last two years stemmed from the more sluggish expansion of demand for manufactures and the stability of profit margins.

The gross nondwelling capital stock was up 10 percent, as against 8 percent in 1970. The acceleration reflects the exceptionally strong rise in transportation and communications, while in other sectors the gain was similar to that of the two preceding years. For the most part the capital stock and product in each sector grew at roughly the same rate.

Table V–1

GROSS AND NET INVESTMENT, 1966-71

(IL million, at current prices)

	1966	1967	1968	1969	1970	1971	Percent annual increase or decrease (–)		
							1969	1970	1971
Gross fixed nondwelling investment	1,700	1,455	2,223	2,828	3,218	4,464	22	4	22
Less: Depreciation	842	915	1,016	1,141	1,365	1,699	7	10	9
Net fixed nondwelling investment	858	540	1,207	1,687	1,853	2,765	35	0	1
Gross investment in dwellings	787	532	657	1,023	1,596	2,111	45	35	16
Less: Depreciation	273	292	325	364	449	555	8	7	9
Net investment in dwellings	514	240	332	659	1,147	1,556	80	51	19
Total gross fixed investment	2,487	1,987	2,880	3,851	4,814	6,575	28	13	20
Change in inventories	118	52	284	341	355	358			
Total gross investment	2,605	2,039	3,164	4,192	5,169	6,933	28	11	18
Less: Depreciation	1,115	1,207	1,341	1,505	1,814	2,254	7	9	9
Total net investment	1,490	832	1,823	2,687	3,355	4,679	43	12	22

SOURCE: Central Bureau of Statistics and Bank of Israel.

Although the expansion of dwelling investment dropped steeply from 35 percent in 1970 to 16 percent, this is still a respectable figure. Demand pressure for housing persisted and was reflected by a 30 percent price rise (as against the 13.4 percent increase in the consumer price index). Demand for housing was influenced by the increase in the number of immigrants and young couples and by the growth of real disposable income in the last few years. The proportion of advance and speculative purchases also went up this year.

Prices of investment goods, both buildings and equipment, rose 14 percent. In the case of equipment the increase was due mainly to the import surcharges levied in 1970 and the devaluation of 1971, as well as the dearer cost of foreign equipment. Some items (mainly tractors) were exempt from the surcharge and therefore rose at a below-average rate. Industrial equipment prices were up 17 percent, or more than the average. The increase in construction input prices is explained by the mounting demand for workers and construction materials following the vigorous expansion of housing and other construction. Dwelling prices rose by about 15 percent more than input prices, which is additional evidence of the demand pressure prevailing in this sector.

The increase in raw material and finished goods stocks amounted in 1971 to IL 320 million (at 1970 prices), compared with IL 350 million the year before. Most of the increment was in rough diamonds, aircraft and parts, and other manufactures.

2. Public and Private Investment

During the past two years investment activity was decisively influenced by the Government's economic policy. In both years the Government took vigorous steps in this sphere, regulating both its own direct capital spending and that of the private sector, in the case of the latter by cutting down on cheap credits. But whereas in 1970 the Government attempted to dampen investment activity, in the year reviewed it both stepped up its own capital expenditure and contributed to the growth of private investment by providing 40 percent more in soft loans.

In 1970 the Government's investment-policy measures were dovetailed into its overall anti-inflationary fiscal policy. Inflationary pressures persisted in 1971 and even intensified, but this year the Government preferred to moderate public and private consumption while stimulating investment. Government and local authority investment was 19 percent above its 1970 level, after sagging 8 percent in 1970. A partial indicator underscoring the dramatic shift in the Government's investment policy is the change in the volume of public buildings started: this shot up 32 percent in 1971, whereas in each of the two preceding years it had fallen off 15 percent.

In view of the full employment situation and the severe inflationary pressures, it was clearly essential to keep public and private consumption in check in order to permit more capital formation. On the other hand, the upswing in public sector investment in itself undoubtedly had an inflationary impact, the more so as most of the increase was in construction, where the value-added component is high. Since 80 percent of Government and local authority investment is made in construction, any increase in such investment is bound to have a strongly inflationary effect.

Table V–2

GROSS FIXED INVESTMENT, BY TYPE OF INVESTOR AND INITIATING SECTOR, 1966-71

(IL million, at 1970 prices)

	1966	1967	1968	1969	1970	1971	Percent annual increase or decrease (–)					
							1966	1967	1968	1969	1970	1971
Nondwelling investment, by investing sector[a]												
Government, local authorities, and National Institutions	380	436	465	561	509	576	–9	15	7	21	–9	13
Government enterprises[b]	258	216	230	238	226	296	–3	–16	6	3	–5	31
Public sector companies[c]	342	280	480	680	534	773	–14	–18	71	42	–21	45
Total public sector investment	980	932	1,175	1,479	1,269	1,645	–9	–5	26	26	–14	30
Nonprofit institutions	179	167	190	228	230	280	11	–7	14	20	1	22
Private business enterprises[d]	940	674	1,166	1,382	1,720	1,985	–22	–28	73	19	24	15
Total private sector investment	1,119	841	1,356	1,610	1,950	2,265	–18	–25	61	19	21	16
Total nondwelling investment	2,099	1,773	2,531	3,089	3,219	3,910	–15	–16	43	22	4	22
Investment in dwellings, by initiating sector												
Public	339	200	193	279	411	500	–26	–41	–4	45	47	22
Private	693	498	619	901	1,185	1,351	–16	–28	24	46	32	14

[a] There is a conceptual difference between the public sector's investment and its purchases on capital account.
[b] The trading enterprises of the public sector, including the Post Office, Israel Railways, air and sea ports, and local authority enterprises.
[c] Companies in whose management the public sector has the decisive voice.
[d] Calculated as a residual.

SOURCE: Central Bureau of Statistics and Bank of Israel estimates.

In the long run public sector investment is a function of demand for infrastructure; in the short run, however, it depends less on demand and profit factors and more on the Government's countercyclical policy. In 1970 Government investment activity apparently had a mitigating effect on the inflationary pressures, whereas in the year reviewed the Government's policy was itself influenced by the pressure to step up infrastructure investment. Nearly all the incremental public investment was of this sort: capital outlays on Government services rose 15 percent, after a decline of similar magnitude in the preceding year; those on road construction went up by 12 percent; and the figure for public sector enterprises (the Post Office, Israel Railways, sea and air ports) jumped 31 percent. There was also a much heavier investment in local authority services, such as schools, hospitals, and sewerage.

Public sector companies expanded their investment by 30 percent in 1971, compared with a 14 percent drop in 1970. All of the gain was due to the enormous increase in ships and aircraft. Exclusive of this item, the level declined steeply in each of the last two years – by 18 percent in 1970 and 15 percent in 1971. This was due chiefly to the completion of several large nonrecurring projects in which investment is irregular, such as the Eilat-Ashkelon pipeline and the Arad chemical complex. Capital outlays on electric power also sagged, mainly because equipment for the new Eshkol III power station had not yet arrived from abroad by year's end.

The Government also expanded investment indirectly, by granting more building permits to private nonprofit institutions and by making more loan capital available to all sectors. Here too the 1970 policy was reversed: in 1970 the Government had clamped down on building permits to private nonprofit institutions, as a result of which their capital expenditure remained fairly stable; in 1971 these restrictions were lifted and the institutions' investment moved up 22 percent. Most of the increase was in education and research.

The strong advance in private nondwelling investment was due to an unprecedented rise in ships. Excluding this item,the growth rate slackened from 14 percent in 1970 to 10 percent. This followed exceptional gains of 57 percent in 1968 and 32 percent in 1969; however, these can be ascribed to the natural rebounding of the level after it had sunk noticeably during the economic slowdown. The smaller percentage rise in the last two years was due to the deceleration of demand and the standstill in profitability, both of which had risen appreciably in 1968 and 1969. The slowdown was particularly marked in industry and agriculture, whereas the figures for business establishments and hotels and other lodging places were sharply higher in the year surveyed.

The Government's expansionary policy also left its impress on dwelling construction, where there was a much faster growth in public than in private investment. However, here too the increases were smaller than in the preceding year: the figure for publicly sponsored housing was up 22 percent in 1971 as opposed to 47 percent the year before, while that for the private sector went up by 14 as against 32 percent.

3. Investment by Economic Sector

Capital spending rose in all sectors in 1971, but at widely divergent rates. This reflected changes in the demand for their output and in the share of public sector investment in the total for each of the other sectors.

(a) *Industry*

After a sharp upswing in 1968 and 1969, the growth of industrial investment slowed to 13 percent in 1970 and continued downward to 10 percent in the year reviewed. But this deceleration must be viewed in the light of the heavy investment in 1968 and 1969, as well as the slackening of demand for manufactures in 1970-71. Whereas in 1968-69 industrial production averaged 22 percent higher per annum, in 1970-71 the growth rate slipped to 11 percent p.a. Industrial investment is very sensitive to changes in the demand for manufactures, so that when demand dropped from its peak level, this affected capital spending as well. This becomes clear if investment is regarded as the process of adjusting the existing to the desired capital stock; it turns out that the industrial capital stock did in fact expand at much the same rate as product. Another major cause of the slowdown was the stability in the sector's profitability.

Data on imported equipment (which accounts for about 60 percent of total industrial investment and serves as a useful indicator) suggest that the metals, machinery, and electronics branches recorded a further relatively sharp rise in 1971 – close to 20 percent. Since the Six Day War the principal growth factor in these branches has been the enormously heavier noncivilian demand. The nonmetallic minerals industry, which produces mainly building materials, also registered a notable 37 percent advance, which is largely explained by the continued strong uptrend in residential and nonresidential construction.

Industrial investment is influenced by the grants and cheap loans granted to investors. Both the loans made available at the direction of the Ministry of Commerce and Industry and the grants made by the Investment Center rose by 40 percent (gross) in 1971, while nominal industrial capital outlays were up 28 percent. These figures indicate a considerable increase in the proportion of investment financed from Government and other public sources. In view of the close link between industrial investment and public financing, it is a reasonable assumption that the latter was a very formidable factor in the growth of investment, both as a major source of direct financing and through the provision of soft loans.

In the preceding year public financing went up only 14 percent, compared with a 27 percent rise in nominal investment. The much larger volume of such financing in the year reviewed can be partly ascribed to the sanctioning until September 1972 of an increase in credit to nonapproved enterprises.[1] The time limit placed on this authorization resulted in a very steep increase in industrial loan approvals: whereas loan disbursements were up 40 percent (gross), the amount of loans approved soared 120 percent. Since only a third of the sum was disbursed in 1971, directed credit will probably expand appreciably over

1. Enterprises approved under the Law for the Encouragement of Capital Investments are entitled to a number of concessions, including loans at a relatively low rate of interest.

Table V–3

GROSS FIXED INVESTMENT, BY SECTOR, 1965-71

(IL million, at 1970 prices)

	1965	1966	1967	1968	1969	1970	1971	Percent annual increase or decrease (–)		
								1969	1970	1971
Agriculture	203	178	182	192	206	237	239	7	15	1
Thereof: Agricultural output	88	70	88	74	68	64	65	–8	–6	1
Irrigation	92	89	84	69	49	52	59	–29	7	13
Industry, mining, quarrying	492	368	286	538	727	823	906	35	13	10
Construction equipment	80	28	8	68	77	82	103	13	7	26
Electric power	122	129	84	104	136	151	137	31	11	–9
Transportation and communications	723	576	491	820	966	939	1,425	18	–3	52
Ships and aircraft	109	55	53	191	91	198	613	–52	116	211
Motor vehicles	216	158	94	182	318	306	315	75	–4	3
Other items	398	363	344	447	557	435	497	25	–22	14
Trade and services	739	731	638	740	928	935	1,041	25	1	11
Total nondwelling investment	2,451	2,099	1,773	2,531	3,089	3,219	3,910	22	4	22
Dwellings	1,280	1,032	698	812	1,180	1,596	1,852	45	35	16
Total fixed investment	3,731	3,131	2,471	3,343	4,269	4,815	5,762	28	13	20

SOURCE: Central Bureau of Statistics.

the next two years as well.[2] Because of the time limit, some investments will probably be implemented earlier than originally planned.

In 1971 industrial investment grants came to IL 73 million. A large portion went to enterprises in the development areas: about 40 percent in Development Zone A, 32 percent in Development Zone B, and the rest in the coastal districts. As in previous years, the grants were concentrated in a few branches: 22 percent in textiles, 15 percent in metal products, and 10 percent each in rubber and plastics and nonmetallic minerals. These branches also receive a large proportion of the development loans, and the assistance they get through such soft credits and grants is reflected in the fact that they have outpaced the rest of industry in investment growth.

Besides these two forms of aid, investors receive other concessions, the most important of which are income tax exemption for the first five years in which the enterprise shows a profit, accelerated depreciation (which makes it possible to defer income tax payments), and exemption from indirect taxes on investment goods.

(b) *Transportation and communications*

Investment in transportation and communications went up by an impressive 51 percent in 1971, considerably more than in the rest of the economy or in this sector in the past. The jump was due mainly to the tremendous expansion of the marine and air fleets. The larger investment in aircraft is explained by the delivery of jumbo jets ordered several years earlier following the Ministry of Transport's forecast of a rapid development of tourism. With quiet borders, tourism swelled during the year reviewed, and El Al was able to fill these planes to capacity. The biggest investment was in ships: IL 500 million at current prices, or triple the figure for the preceding year. Nearly all the new bottoms were tankers for serving the Eilat-Ashkelon pipeline. Tanker tonnage was stepped up after the capacity of the pipeline was enlarged, a development made possible by the completion of the running-in phase and by investment in pumps, berths, and storage tanks, all of which make for greater regularity in handling the ships. This enormous investment in shipping by Israeli companies, both private and public, is due *inter alia* to the necessity of using Israeli ships on the oil run.

Capital spending on telecommunications came to IL 185 million (at 1970 prices), about 33 percent over the 1970 figure. The largest amounts were for extending the telephone network and erecting a satellite telecommunication earth station. This notable expansion of the telephone infrastructure came in response to strong demand for telephone lines. The number of telephones installed declined steadily in the last three years, and there was also a drastic reduction in unutilized exchange capacity. If we also take the 26 percent increase in telephone applications in 1971, it all adds up to strong pressure for expanding infrastructure investment, and it is against this background that investment in the telephone network jumped in 1971. Budgetary data suggest that the uptrend will carry over through 1972.

2. For a detailed analysis of industrial and other sectoral financing see Chapter XVI, "Financial Institutions".

Outlays on road construction increased 12 percent in 1971, after dipping slightly the year before. The investment of Government enterprises (the railway and sea and air ports) was up by an appreciable 30 percent.

(c) *Trade and services*

Investment in trade and services rose 11 percent, after inching up only 1 percent in 1970. Whereas in 1970 capital spending by the private sector grew rapidly while that on public services declined, in the year reviewed both categories recorded higher figures. The largest advance was in Government and local authority hospitals and schools; investment in public buildings moved up after falling for two years. These increases appear to be an outgrowth, among other things, of pressure on the Government to expand infrastructure investment.

Investment by private nonprofit institutions was 22 percent over the 1970 level. As in previous years, the bulk of the sum was spent by universities on education and research.

Private sector investment in business premises rose 23 percent, while that in hotel construction went up by an even steeper 45 percent. Investment in the latter, like that in civil aviation, is largely determined by the development of tourism. The improved security situation of the last two years contributed to the rapid increase in the number of visitors to Israel, especially in 1971; in 1970 the figure went up 8 percent and in 1971 by nearly 50 percent. This resulted in a steep rise in hotel occupancy and in the profitability of the branch, and hence a considerable increase in hotel construction. Among the contributory factors in this expansion is the fact that hotels are recognized as an approved enterprise for purposes of the Law for the Encouragement of Capital Investments, a status that entitles them to cheap credit and income tax relief. In 1971, 40 percent more directed credit was granted to the hotel trade than in the previous year.

Investment in business premises has been influenced chiefly by the vigorous growth of economic activity since the Six Day War. The data on new construction do not reflect all the purchases of this sector, since there is a fairly extensive conversion of dwellings to business use, mainly in the commercial centers of the bigger towns.

(d) *Agriculture and irrigation*

Agricultural investment fell off during the first half of the sixties, the turning point coming in 1967 when the trend began to turn slowly upward. In 1970 there was a spurt, connected in the main with the considerable expansion of internal irrigation networks. In 1971 the level remained steady, edging up only 1 percent; this was the resultant of a decline in afforestation and internal irrigation and a 17 percent larger expenditure on farm machinery and equipment.

Outlay on afforestation continued downward, by 8 percent. Since the afforestation activities of the Jewish National Fund help the Government to regulate employment, in a year of full employment a contraction of such investment is only to be expected.

Investment in water projects rose 13 percent in 1971, most of it in the construction of the Dan sewage conversion plant. This project is designed to solve both the sewage and irrigation problems of the Tel Aviv metropolitan area.

(e) *Residential construction*

The year reviewed saw a continuation of the housing boom which began after the Six Day War. Although the growth of investment slowed from 35 percent in 1970 to 16 percent, this still far exceeded the figure for nondwelling investment exclusive of ships and aircraft. Demand for homes continued to be very brisk, and in consequence dwelling prices shot up 30 percent, compared with the 13.4 percent increase in the consumer price index and that of 14 percent in the index of residential construction inputs. This gap between dwelling and input prices reflects the jump in land prices and contractors' profits, neither of which is reflected in the index of construction inputs.

Most of the upward thrust in residential construction since the Six Day War has emanated from the increase in annual new household formation (including that due to immigration) and the growth of spendable income. In 1971 the number of immigrants rose 14 percent, but the number of immigrant families went up by 25 percent, from 7,300 in 1970 to 9,100, owing to the decline in the average size of the families. The demand of newlyweds for homes was also heavier in 1971. It should be noted that whereas in 1968 and 1969 demand for housing was mainly a function of the increase in family formation and in real disposable income from all sources, and advance and speculative purchases were of minor importance, in 1970 and 1971 the weight of the last-mentioned component rose appreciably. It is not possible to assess the impact of such purchases, since there are no reliable data on annual family formation. A partial indicator is the ratio of incremental dwelling units to the population increment. In 1971 both the number of completions and the number of starts outpaced the population growth; the ratio of starts and completions per thousand additional inhabitants was significantly higher than in previous periods of peak demand.

The August 1971 devaluation and its effect on foreign currency conversions was among the major causes of the continued lively demand for homes. Another factor is apparently the demand of foreign residents for apartments in Israel, although so far it is of only minor importance.[3]

4. INVESTMENT BY TYPE OF CAPITAL GOOD

Nonresidential structures and equipment both rose about 10 percent in 1971, so that the composition of total nondwelling investment did not change. However, there were intersectoral differences, with the share of equipment going up in some sectors and falling in others. It went up in agriculture, industry, and services, and there was a small increase in the weight of equipment in their capital stock. The equipment share of the capital stock rises much more slowly than the equipment share of investment because structures have a much longer lifespan than equipment. The proportion of replacements is therefore much higher for equipment than for structures: in 1971 only 3 percent of the investment in structures represented replacements, compared with 30 percent for equipment. It follows that in an economy with a steadily growing capital stock, investment in equipment must grow faster

3. For a more detailed analysis of the housing market see Chapter XII, "Construction and Housing".

Table V–4

GROSS FIXED INVESTMENT, BY TYPE OF ASSET, 1966-71

(IL million, at 1970 prices)

	1966	1967	1968	1969	1970	1971	Percent annual increase or decrease (–)			
							1968	1969	1970	1971
New construction	2,094	1,634	1,946	2,483	2,821	3,194	19	28	14	13
Residential buildings	1,032	698	812	1,180	1,596	1,852	16	45	35	16
Nonresidential buildings	636	510	588	692	733	801	15	18	6	9
Other construction	426	426	546	611	492	541	28	12	–19	10
Assets from farm output	70	88	74	68	64	65	–16	–8	–6	1
Machinery and equipment	754	602	950	1,309	1,426	1,575	58	38	9	11
Locally produced	433	323	597	799	905	994	85	34	13	10
Imported	321	279	353	510	521	581	27	44	2	12
Motor vehicles	158	94	182	318	306	315	94	75	–4	3
Ships and aircraft	55	53	191	91	198	613	260	–52	116	211
Total fixed investment	3,131	2,471	3,343	4,269	4,815	5,762	35	28	13	20

Table V–5

EQUIPMENT SHARE OF GROSS FIXED INVESTMENT, BY SECTOR, 1966-71

(percentages; at 1970 prices)

	1966	1967	1968	1969	1970	1971
Agriculture	37.3	34.1	40.5	47.6	38.2	43.8
Irrigation	13.6	11.9	18.5	22.1	24.3	16.5
Electric power	56.8	50.5	60.3	45.5	52.4	40.9
Industry	67.8	65.8	72.7	80.8	79.7	81.4
Transportation and communications [a]	45.2	50.3	35.2	37.3	43.2	39.5
Trade and services	27.4	28.3	30.8	35.5	40.2	41.0
Total [b]	42.0	40.9	47.2	51.8	55.6	56.0

[a] Excluding ships, aircraft, motor vehicles, and roads.
[b] Excluding ships, aircraft, motor vehicles, and roads, but including construction equipment. In the construction industry equipment is the only component of capital stock.

Table V–6

EQUIPMENT SHARE OF THE GROSS CAPITAL STOCK,[a] BY SECTOR, 1965-72

(percentages; at 1970 prices)

	1965	1967	1969	1970	1971	1972
Agriculture	11.6	11.5	11.5	11.7	11.6	12.2
Irrigation	10.5	11.0	11.0	11.0	11.2	11.1
Electric power	62.7	62.3	60.6	58.8	57.6	55.9
Industry	68.1	64.7	63.8	65.2	66.1	67.3
Transportation and communications [b]	36.5	38.7	37.4	36.1	35.7	35.2
Trade and services	19.1	19.9	19.9	20.3	21.1	21.8
Total [c]	38.3	37.0	36.1	36.6	37.1	37.8

[a] Gross capital stock at the beginning of the year.
[b] Excluding ships, aircraft, motor vehicles, and roads.
[c] Excluding ships, aircraft, motor vehicles, and roads, but including construction equipment. In the construction industry equipment is the only component of capital stock.

than that in structures if the proportion of the two in the capital stock is to be kept constant. We can say that nearly all of the increase in the equipment share of investment is due to the shorter lifespan of equipment. The equipment share of the capital stock failed to grow in 1966-71, while the equipment share of investment rose by 14 percentage points, from 42 percent in 1966 to 56 percent in 1971 (see Tables V-5 and V-6).

This is particularly striking in industry, where the share of equipment in investment grew by 20 percent from 1965 to 1971, but its share of the capital stock is still below that at the beginning of 1965. The decline in the equipment share of the capital stock during the recession of 1966-67 is explained by the existence of a stock of vacant buildings. It is a reasonable assumption that with the end of the slump it was mainly equipment whose growth rate picked up, thereby effecting an adjustment of the equipment/structures ratio of the capital stock.

In trade and services there is a definite uptrend in the equipment share of both the capital stock and investment. This is due to heavy purchases of electronic computers and modern office equipment, items previously not used in this sector.

In electric power and water projects the equipment share of investment went down steeply in the year reviewed. The equipment/structures ratio of investment in these two sectors generally traces an irregular path, since in each the investments are made by a single concern with only a small number of projects in the pipeline at any one time.

In the initial stage of a project most of the capital outlay is on structures, equipment being acquired much later. In sectors with many firms it is reasonable to assume that there will be no such sharp fluctuations in the equipment/structures ratio, since at any given time there will be firms at all stages of investment. In 1970 the Mekorot Water Company began work on a sewage purification plant for Greater Tel Aviv, and the project is still in the phase where structures outweigh equipment. The Israel Electric Corporation has the Eshkol III power station well under way; in 1971 most of the capital expenditure was on construction, and the equipment ordered will arrive in 1972. Next year, therefore, the ratio should change and the proportion of equipment will rise considerably.

The share of locally produced equipment and motor vehicles declined somewhat in 1971, mainly because of the steep decline in the latter; the proportion of domestic machinery and equipment was a shade higher than in the previous year. Short-run fluc-

Table V–7

SHARE OF DOMESTIC PRODUCTION IN INVESTMENT IN CAPITAL GOODS,[a] BY DESTINATION, 1964-71

(percentages; at 1969 prices)

	1964-65	1966-67	1968	1969	1970	1971
Agriculture	57	64	58	54	58	57
Industry	29	32	23	26	23	23
Electric power and water	25	25	26	35	27	42
Construction equipment	23	37	11	15	15	15
Transportation and communications[b]	43	48	45	42	39	36
Trade and services	53	52	54	54	54	56
Total, excl. ships and aircraft	41	45	37	38	36	35
Total, incl. ships and aircraft	35	42	31	36	32	26

[a] Machinery, equipment, and mobile transport equipment.
[b] Excluding ships and aircraft.
SOURCE: Central Bureau of Statistics.

tuations in the proportions expended on imported and domestic equipment are not particularly significant, since such outlays depend on the timing and sectoral composition of investment. The slight increase in domestic equipment occurred in electricity and water projects, and was due principally to the delay in the delivery of items ordered from abroad for the Eshkol III power station. This equipment arrived at the beginning of 1972, and will naturally have an opposite effect on the weight of imported equipment in that year. In other sectors the ratio between imported and domestic equipment held steady (see Table V-7).

Fixed investment is influenced by the level of economic activity in the country, but it also influences the latter by generating income and employment, directly and indirectly. In 1971 investment contributed 2 percent to the growth of GNP, mainly because of the big increase in structures, whose product component is high.

The product component of total investment is largely a function of its distribution by sector and by type of capital good. The product component of total investment declined slightly in 1971, since the value of new construction put in place rose 13 percent while the amount spent on new plant and equipment and transport equipment went up 30 percent. The product component of investment excluding ships and aircraft increased, since expenditure on new plant and equipment and transport equipment other than ships and aircraft grew by 9 percent, compared with 13 percent for buildings.

5. Capital Stock

The dominant factor affecting the economy's capital stock is changes in the demand for the various sectors' output; in 1971 the capital stock of each sector did in fact more or less keep pace with its product growth. The fluctuations of the last two years also reflect the process of adjusting the existing to the desired stock. Since 1967 the capital stock has expanded at an annual rate of 9 percent, which is similar to the average growth rate of the national product during this period.

In 1971 the capital stock expanded by 10 percent, compared with 8 percent in each of the years 1968-70, with both the dwelling and nondwelling stock moving up at an accelerated tempo. The 1971 increase was close to the rate that obtained in 1960-65. Like the earlier rapid expansion of the nondwelling capital stock, that in the year reviewed was due to the strong increase in transportation and communications, which scored a 15 percent gain (about the same as in the early 1960s), compared with 10 percent in 1970. This sector advanced at a rate far above the national average throughout the entire period. Even during the recession, when the capital stock in general grew very sluggishly, this sector showed a fairly strong expansion. As a result, its weight in the total capital stock has risen notably, from 18 percent in 1960 and 20 percent in 1965 to 25 percent in 1971. The other sector whose capital stock grew strongly during the past decade is trade and services, its relative share moving up from 18 percent in 1960 to 27 percent in 1971. It will be seen, therefore, that more than half the total nondwelling stock is concentrated in transportation and communications and the trade and services sector. At the beginning of the decade the development of these two sectors was dictated primarily by the heavy

Table V–8

GROSS FIXED CAPITAL STOCK, BY SECTOR, 1971-72

(IL million, at 1970 prices)

	1971				Stock at beginning of 1972	Percent of total		
	Beginning-of-year stock	Gross investment	Discards	Net stock increment		Begining-of-year stock 1960	Begining-of-year stock 1972	1971 stock increment
Agriculture	4,343	239	67	172	4,515	22	13	6
Irrigation	2,182	59	13	46	2,228	9	6	2
Industry	6,765	906	165	741	7,506	23	21	24
Construction equipment	662	103	69	34	696	3	2	1
Electric power	1,881	137	32	105	1,986	7	6	3
Transportation and communications	7,707	1,425	306	1,119	8,826	18	25	36
Trade and services	8,554	1,041	183	858	9,412	18	27	28
Total nondwelling stock	32,094	3,910	835	3,075	35,169	100	100	100
Dwellings	19,484	1,852	77	1,775	21,259			
Total fixed capital stock	51,578	5,762	912	4,850	56,428			

SOURCE: Based on estimates of Dr. A.L. Gaathon. For definitions and explanations see A.L. Gaathon, *Economic Productivity in Israel* (New York and Jerusalem: Bank of Israel in cooperation with Praeger Publishers, 1971).

infrastructure requirements of a rapidly developing country; the last two years witnessed a conspicuous expansion of business enterprises in these sectors, alongside a rapid infrastructural development. There was an appreciably higher investment in civil aviation and hotels, which is explained by the vigorous growth of tourism; there was an enormous increase in oil transport with the construction of the Eilat-Ashkelon pipeline and the acquisition of tankers; and a large number of refrigerated ships were acquired (most of them are not used on the Israeli run).

The weight of the above two sectors stands out even more in the increment to the capital stock. Transportation and communications accounted for 30 percent of the growth in 1970 and 36 percent in 1971, the corresponding figures for trade and services being 31 and 28 percent. The expansion of the gross capital stock is a function of gross investment and discards of worn-out or obsolescent assets. In recent years discards came to between 20 and 24 percent of gross nondwelling investment, with the rate being particularly high in agriculture and construction equipment.

The industrial capital stock grew in 1971 by 11 percent, about the same rate as in the two preceding years. The weight of this sector in the capital stock rose in the last three years to reach 21 percent. This is rather less than in the early sixties, a reflection of the steep drop in industrial investment during the recession, which held back the development of this sector as compared with the others.

Table V–9

GROWTH OF GROSS FIXED CAPITAL STOCK,[a] BY SECTOR, 1960-71

(percentages)

	Agri-culture	Irri-gation	In-dustry	Con-struction equip-ment	Elec-tric power	Trans-portation and com.	Trade and serv-ices	Total non-dwell-ing stock	Dwell-ings	Total capital stock
1960-65 (annual average)	5	9	9		8	15	16	11	10	10
1966	3	5	3	−1	8	9	12	7	7	7
1967	3	4	2	−4	4	7	10	5	4	5
1968	3	3	8	3	5	13	10	8	5	7
1969	3	2	11	2	6	13	11	9	9	9
1970	4	2	11	3	6	10	10	8	9	8
1971	4	2	11	5	6	15	10	10	9	9

a From the beginning to the end of the year.

Table V–10

GROWTH OF CAPITAL STOCK PER EMPLOYED,[a] BY SECTOR, 1966-71

	Agri-culture	Indus-try	Con-struction	Transpor-tation and com.	Trade and services	Total[b]
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[c]	4.0	3.8	−3.6	2.0	4.8	3.4
1970[c]	7.0	7.8	−7.7	16.7	6.0	6.2
1971[c]	1.3	6.9	−11.0	7.0	6.0	3.4

a Data on the capital stock are for the beginning of the year; those on the number of employed are annual averages.

b The total includes electric power and water, which are not listed separately. The inclusion of water in the agricultural sector and of electric power in industry would not affect the results significantly.

c Residents of the administered areas working in Israel are included in the number of employed for 1968-71.

The long-term rising trend in capital stock per employed person carried over through 1971, when the increase came to 3.4 percent. The biggest gain was in industry, transportation and communications, and trade and services. The construction industry is an exception in this respect – capital stock per employed has declined steadily since the Six

Day War. This must be ascribed to the fact that the relative prices of capital and labor have moved in an opposite direction to those in other sectors. Since the war contractors have been able to draw on a large supply of workers from the administered areas, whose wages have lagged behind the rise in equipment prices: whereas hourly earnings of building workers advanced 25 percent from 1967 to 1971, the price of construction equipment went up 46 percent.