

CHAPTER V

CAPITAL IMPORTS AND THE FOREIGN DEBT

1. MAIN DEVELOPMENTS

Long and medium-term capital imports amounted this year to \$3.3 billion, as compared to \$2.4 billion in 1974 and \$3.2 billion in 1973. However, even this sharp increase of capital imports was insufficient to finance the parallel rise in the current account deficit of the balance of payments. The economy was forced to finance as much as 20 percent of the current deficit by means of short-term capital loans, an action that hastened the depletion of the economy's liquid assets in foreign currency by more than half a billion dollars.

Although in 1975, the rise in capital imports exceeded the rise in the deficit of the current account, the problem of financing the current deficit worsened, expressing itself in two developments that occurred during the year. First, capital imports in 1975 as in 1974 did not catch up with the deficit on current account, and the net deficit reached \$776 million, as compared to more than a billion dollars in 1974. However, in 1974 most of this excess was covered by decreasing foreign exchange reserves, whereas in 1975 - a year which began with relatively low reserves - this net deficit was covered through additional short-term loans from foreign sources. This change in funding increased the economy's dependence on short-term capital, a dependency which had grown significantly in 1974, and the economy was forced to mobilize credit from sources previously held in low priority. Second, this year gave evidence of a significant change in the structure of medium- and long-term capital imports: the proportion of these imports in the form of loans rose substantially, while the proportion of unilateral transfers and foreign investments declined. Together, total current account deficit transfers amounted this year to \$2.2

Table V-1

FINANCING OF CURRENT ACCOUNT DEFICIT IN LONG-TERM CAPITAL MOVEMENTS AND SHORT-TERM CAPITAL MOVEMENTS, 1972-75

(\$ million)

	1972	1973	1974	1975	1974 quarterly				1975 quarterly				
					I	II	III	IV	I	II	III	IV	
A. Current account and long-term capital movements													
Balance on current account	-1,101	-2,642	-3,387	-4,037	-674	-925	-900	-888	-1,026	-926	-1,118	-967	
Unilateral transfers	1,052	2,173	1,737	1,755	358	513	437	429	525	450	413	367	
Balance on current account and transfers	-49	-469	-1,650	-2,282	-316	-412	-463	-459	-501	-476	-705	-600	
Long-term capital movements													
Investments from abroad, net	143	185	94	81	14	27	26	27	28	17	21	15	
Independence and Development Loans	184	359	165	118	80	43	6	36	32	26	20	40	
U.S. government loans	205	252	147	1,214	32	5	26	84	257	307	272	378	
Other loans	191	205	227	93	2	60	38	127	3	22	37	31	
Total long-term capital movements	723	1,001	633	1,506	128	135	96	274	320	372	350	464	
Total capital imports (including transfers)	1,775	3,174	2,370	3,261	486	648	533	703	845	822	763	831	
Surplus of capital imports (including transfers) over deficit on current account	674	532	-1,017	-776	-188	-227	-367	-185	-181	-104	-355	-136	
B. Israeli investment abroad	-1	-13	-10	17	-5	-10	-6	12	10	2	-5	10	
C. Short-term credit, net of nonfinancial sectors	-75	56	79	238	76	-10	7	6	123	-44	90	69	
D. Financial sectors													
Deposits in commercial banks	363	351	349	566	-71	-9	-82	511	-79	-47	116	576	
Deposits in Bank of Israel	-6	-4	—	2	—	8	-6	-2	—	—	—	2	
Total (a)	357	347	349	568	-71	-1	-88	509	-79	-47	116	578	
Loans by commercial banks	6	-270	-80	-185	120	-23	13	-190	-66	-3	-16	-100	
Loans by Bank of Israel	-30	-18	24	12	19	-10	2	13	-202	124	88	2	
Total (b)	-24	-288	-56	-173	139	-33	15	-177	-268	121	72	-98	
Foreign exchange reserves of central monetary institutions ^a	-552	-692	758	185	199	239	318	2	-185	12	255	103	
Reserves of other monetary institutions	-457	-194	82	-27	-80	109	144	-91	371	-14	-99	-288	
Total	-1,008	-886	840	156	119	348	462	-89	186	-2	156	-185	
Foreign currency valuation adjustments	17	224	88	-46	37	13	-33	71	31	-5	-88	17	
Special Drawing Rights	14												
Total change in reserves due to economic transactions (c)	-977	-662	928	110	156	361	429	-18	217	-7	68	-168	
Total financial sectors (a)+(b)+(c)	-644	-603	1,221	505	224	327	356	314	130	68	256	312	
E. Errors and omissions	45	-29	-272	16	106	-31	11	146	178	80	14	-256	

^a According to the definitions of the balance of payments.

SOURCE: Central Bureau of Statistics.

billion, as compared to \$1.7 billion in 1974. Most of this (net) deficit was covered by means of medium- and long-term loans. The implications of this shift in emphasis will be felt most sharply in the years ahead when the economy will be obliged to repay principal and interest or to renew the loans.

Capital movement as assistance from the United States government expanded by \$1 billion this year and totalled \$1.9 billion, of which \$1.5 billion were granted as military aid. This year, U.S. aid comprised more than half of the total capital transfers, as opposed to only a third in 1974; this development stresses the growing dependence of the Israeli economy on the United States government as its major source of capital. Furthermore, in contrast to the practice of previous years, most of the financial aid was allocated in the form of long-term loans which totalled \$1.2 billion, and only a small proportion as a grant. This fact ties the economy to steep repayments of principal and interest in the future, exacerbating long-term dependence on the United States.

Unilateral transfers remained stable this year and totaled \$1,755 million. This stability in the level of unilateral transfers loses its significance, however, in view of the world-wide price rises that occurred this year on the one hand, and in view of the decreasing importance of these transfers in financing the current deficit on the other hand. One particularly noteworthy development occurred in the foreign medium- and long-term loans recruited by the economy: loans to the public sector, essentially assistance from the United States government, tripled, reaching \$1.4 billion, whereas loans to the private sector shrank to a mere \$42 million, as compared to \$79 million in 1974 and \$171 million in 1973. This year's decline in private sector loans is mostly due to the drop in loans taken by shipping and aviation companies. Investments by foreign residents continued to fall this year, following their sharp decline in 1974. At the same time, Israeli investments in foreign securities underwent a partial reduction.

It appears that this year's developments in the area of capital movements express the continuing effects of economic, political, and other factors that have been at work since 1973, both in the Israeli economy and abroad. These factors have weakened the capacity of the economy to attract foreign capital, whose movements are chiefly influenced by economic considerations. This is particularly true in the face of a growing deficit in the balance of payments and the exorbitant costs of national security. Thus, the growing concentration on capital sources which are affected mainly by political and emotional considerations.

At year's end the foreign currency reserves were at the same level as at the beginning of the year. This stability was obtained through special efforts of the national economy, required in view of the rising deficit in the current account and of the depletion of

traditional financial sources following their accelerated utilization in the recent period. This year, permits establishing new short-term credit lines were expanded, allowing Israeli residents to operate through foreign banks. Furthermore, authorization was granted for the expansion of loans, based on deposits of foreign residents in local banks. Exploitation of these sources, which were previously held in lower priority, serves as an indication of the growing difficulty encountered in financing the balance of payments deficit.

Collectively, these developments brought about an unprecedented increase in the economy's foreign debt, which by the end of the year totalled \$7.6 billion, as compared to \$6.25 billion in 1974. Moreover, the periods for defraying the foreign debt took a turn for the worse. During the coming year the economy will have to repay \$1.4 billion on account of principal, out of which the short-term component is \$390 million;¹ this is only \$100 million smaller than the foreign currency reserves of the Bank of Israel. Interest payment on the foreign debt rose this year to more than half a billion dollars, as compared to \$389 million in 1974. Altogether, the total foreign exchange burden on the economy from debt repayments increased considerably.

2. BACKGROUND TO THE CAPITAL IMPORT DEVELOPMENTS

Since the Yom Kippur War a pronounced change has occurred in the composition of capital movements to the economy. A sharp rise took place in the proportion of public sector receipts, while a parallel decrease occurred in those of the private sector. 1975 witnessed an additional development in capital movements: the proportion of long- and medium-term loans rose, while the share of investments and unilateral transfers dropped. This process, underway since 1973, is inexorably related to the growing size of the current deficit in the balance of payments and reflects the continuing activities of economic factors in the capital structure. The unabated rise in the deficit level repeatedly confronts the economy with a critical financing problem and forces the authorities to turn to less convenient capital sources. While currently presenting no urgent problems, the developments of 1975 - the steep rise in medium- and long-term loans, coupled with decreased investments and unilateral transfers - will certainly create a considerable burden in future years, when the economy will need to ensure payments on principal and interest.

1. This sum does not include obligations which must be repaid in 90 days. Naturally, some of these loans may be renewed.

Table V-2
CAPITAL IMPORTS BY SOURCE AND BY SECTOR, 1972-75

(\$ million)

	1972	1973	1974	1975	1974 quarterly				1975 quarterly			
					I	II	III	IV	I	II	III	IV
1. Private sector												
a. Unilateral transfers												
Personal restitution	291.5	264.3	317.0	359.0	94.0	72.0	61.0	90.0	99.0	100.0	75.0	85.0
Other transfers	391.1	378.1	343.9	252.3	69.6	85.9	101.9	86.5	76.2	68.1	50.2	57.8
Transfers to nonprofit institutions	100.8	135.5	109.6	111.9	25.0	26.9	28.1	29.6	32.9	28.2	22.3	28.5
Total	783.4	777.9	770.5	723.2	188.6	184.8	191.0	206.1	208.1	296.3	147.5	171.3
b. Investments from abroad, net	143.0	185.2	93.5	81.0	140.0	27.2	25.5	26.8	28.3	16.5	20.8	15.4
c. Long-term loans	170.0	181.0	79.0	42.0	4.0	32.0	1.0	42.0	10.0	12.0	-11.0	31.0
Total private sector	1,096.4	1,144.1	943.0	846.2	206.6	244.0	217.5	274.9	246.4	224.8	157.3	217.7
2. Public sector												
a. Unilateral transfers												
To National Institutions	209.4	607.6	269.5	367.8	59.4	66.2	58.0	85.9	103.9	128.7	59.5	75.7
Intergovernmental transfers	58.0	788.0	697.0	664.0	110.0	262.0	188.0	137.0	213.0	125.0	206.0	120.0
Total	267.4	1,395.6	966.5	1,031.8	169.4	328.2	246.0	222.9	316.9	253.7	265.5	195.7
b. Long-term loans (net)												
Independence and Development Loans	184.0	359.0	165.0	118.0	80.0	43.0	6.0	36.0	32.0	26.0	20.0	40.0
U.S. government loans	191.4	236.7	150.0	1,190.5	34.5	7.4	26.6	81.5	252.1	299.4	267.7	371.3
Other loans	35.9	39.3	143.0	74.5	-4.5	25.6	35.4	86.5	-2.1	17.6	52.3	6.7
Total	411.3	635.0	458.0	1,383.0	110.0	76.0	68.0	204.0	282.0	343.0	340.0	418.0
Total public sector	678.7	2,030.6	1,424.5	2,414.8	279.4	404.2	314.0	426.9	598.9	596.7	605.5	613.7
3. Total capital imports	1,775.1	3,174.7	2,767.5	3,261.0	486.0	648.2	531.5	701.8	845.3	821.5	762.8	831.4
Less: Israeli investments abroad	0.6	12.5	9.5	-16.8	5.2	9.9	6.0	-11.6	-10.5	-1.5	4.7	-9.5
Total, excl. Israeli investments abroad	1,774.5	3,162.2	2,358.0	3,277.8	480.8	738.3	525.5	713.4	855.8	823.0	758.1	840.9

It is possible to view the changes that took place in capital imports during the recent period against the background of similar developments that occurred simultaneously within two groups of factors: the first stems from the political and military situation which emerged immediately following the Yom Kippur War; the second is related to the unprecedented and worsening problem of financing the economy's balance of payments. This problem brought in its wake various economic policy measures, a decrease in economic activities in the economy, and intensified anticipations of a devaluation of the Israeli pound.

The influence of the first group of factors caused a sharp rise in capital flows to the public sector, as compared to the period preceding the war. Furthermore, the special nature of these capital movements (which includes military assistance, development loans, and contributions from Diaspora Jewry), and their domestic uses caused severe fluctuations in the capital movements to the economy. Following large capital transfers in the last quarter of 1973, capital movement slowed down during 1974 and then rose once more to the level of 1975, although still lower than the level reached at the height of 1973.

The second group of factors led to a considerable decrease in the movement of private capital during the years 1974 and 1975. Together with these factors, others also operated at the time, collectively effecting a decrease in capital imports: the lethargic activity of the economy during this period and the subsequent loss of profitability of investments, the fall of immigration from Western countries, the anticipation of changes in the tax structure, and finally fears of drastic changes in the value of the Israeli pound, fears that were maintained well into 1975. It should be noted that the introduction of the creeping devaluation policy, at least in its earlier stages, did not eliminate fears of a major devaluation. In addition, with the inception of this method, patterns of investment were upset, particularly in the area of private loans and transfers. Thus, the method did not contribute - as initially hoped - to an increase in the flow of private capital to the economy.

Capital imports were affected negatively not only by the post-war conditions of the Israeli economy, but also by the negative developments that occurred in the world economy during this period. Among these, two stand out most strongly: first, the steep price rise over the past three years was such as to decrease the amount of capital import in real terms; second, the slackening of economic activity abroad depleted potential capital sources, in particular contributions from Jews in the United States.

3. UNILATERAL TRANSFERS

In 1975 the level of unilateral transfers - in nominal terms - remained unchanged, and totalled \$1,755 million, as compared to \$1,737 million in 1974. However, this stability loses much of its economic significance when considering the increase of the current account deficit on the one hand, and the continuing inflationary trends in the economy on the other.

This year transfers to the public sector amounted to a billion dollars, in which the share of Jewish Agency transfers rose, while that of U.S. grants declined. Transfers to the private sector decreased and came to \$723 million as compared to \$771 million in 1974, while private transfers declined and personal restitutions increased. Grants from the United States government decreased this year by \$33 million and totalled \$642 million. This decrease is particularly significant this year in view of the marked rise in the overall amount of U.S. aid.

Transfers of the Jewish Agency amounted this year to \$365 million as compared to \$270 million in 1974. The increase compared with 1974 is due to the overexploitation of this source in 1973, which in turn brought about the depletion in 1974. Transfers to nonprofit institutions reached \$112 million this year, an annual rise of \$3 million only.

Personal restitutions to Nazi victims continued to grow in the year reviewed, and totalled \$359 million, as compared to \$317 million in 1974 and \$264 million in 1973. One-time restitution payments grew in the first half of the year as they included institutional transfers within the framework of the Immigrant Fund. Pension payments also rose in the first half of the year but declined afterwards. The increase in personal restitutions occurred despite the devaluation of the German mark as compared with the dollar.² At the same time, the devaluation effect was almost completely corrected by a simultaneous price rise in Germany (prices which serve as the basis for determining the amount of restitution payments).

The decrease in personal transfers, which began in 1973, worsened this year and they amounted to only \$252 million, as compared to \$344 million in 1974 and \$378 in 1973.

Transfers by immigrants fell progressively in 1975 and totalled at year's end only \$63 million, as compared to \$100 million in 1974 and \$148 million in 1973. This reduction is essentially due to the decreasing number of immigrants arriving from Western countries, a pattern noticeable since 1971. Moreover, it can be assumed that the growing anticipation of a devaluation in the second half of the year - which caused a large gap between the

2. At a yearly average rate of 7 percent.

Table V-3
UNILATERAL TRANSFERS, 1972-75

(\$ million)

	1972	1973	1974	1975	1974 quarterly				1975 quarterly			
					I	II	III	IV	I	II	III	IV
Personal restitution from West												
Germany												
Lump-sum	169.3	98.0	117.8	122.1	51.9	22.9	19.3	23.7	40.5	40.9	22.0	18.7
Pensions	122.2	166.3	199.2	236.9	42.1	49.1	41.7	66.3	58.5	59.1	53.0	66.3
Total	291.5	264.3	317.0	359.0	94.0	72.0	61.0	90.0	99.0	100.0	75.0	85.0
Personal transfers in cash	386.0	370.1	342.0	247.0	69.0	86.0	101.0	86.0	75.0	67.0	49.0	56.0
Immigrants	(166.7)	(147.5)	(99.7)	(62.9)	(15.9)	(23.1)	(27.5)	(33.2)	(27.6)	(16.6)	(8.9)	(9.8)
Others	(219.3)	(222.6)	(242.3)	(184.1)	(53.1)	(62.9)	(73.5)	(52.8)	(47.4)	(50.4)	(40.1)	(46.2)
Personal transfers in kind	13.1	16.0	11.9	9.3	3.6	2.9	2.9	2.5	2.2	2.1	2.2	2.8
Total personal transfers from the rest of the world	690.6	650.4	670.9	615.3	166.6	160.9	164.9	178.5	176.2	169.1	126.2	143.8
Personal transfers to the rest of the world	8.0	8.0	10.0	4.0	3.0	3.0	2.0	2.0	1.0	1.0	1.0	1.0
Total net personal transfer receipts (a)	682.6	642.4	660.9	611.3	163.6	157.9	162.9	176.5	175.2	168.1	125.2	142.8
Institutional transfers												
Nonprofit institutions	100.8	135.5	109.6	111.9	25.0	26.9	28.1	29.6	32.9	28.2	22.3	28.5
Jewish Agency	204.7	602.0	270.4	365.1	60.0	67.1	57.9	85.4	104.1	127.8	57.7	75.5
Transfers in kind	4.7	4.8	-0.9	2.7	-0.6	-0.9	0.1	0.5	-0.2	0.9	1.8	0.2
Total institutional transfers (b)	310.2	742.3	379.1	479.7	84.4	93.1	86.1	115.5	136.8	156.9	81.8	104.2
Net transfers to the government (c)	58.0	788.0	697.0	664.0	110.0	262.0	188.0	137.0	213.0	125.0	206.0	120.0
Total unilateral transfers (a)+(b)+(c)	1,050.8	2,172.7	1,737.0	1,755.0	358.0	513.0	437.0	429.0	525.0	450.0	413.0	367.0

official and the free market rate for foreign exchange - also contributed to the reduction of immigrant transfers by dissuading many from converting their foreign currency through official channels.

Israeli transfers including, by statistical definition, gifts, inheritance, and pensions received from abroad, declined this year after their continuous rise in preceding years. However, both developments during earlier years and the amount of recorded receipts raise doubts as to whether this branch accurately reflects the statistical description upon which it is based. It can be assumed that within the framework of Israeli transfers additional funds of unspecified amount and nature are likewise transferred. Apparently the fall in receipts which occurred this year is a consequence of the high agio rates for foreign currency available on the open market, stimulating those converting currency to undertake transactions outside the official channels.

4. FOREIGN INVESTMENTS

Gross investments by foreign residents continued to decrease in 1975, following the sharp decline that occurred in 1974. At the same time, as a result of a reduction in the scope of investments liquidated by foreign residents on the one hand, and a partial liquidation of Israeli investments in foreign securities on the other, a certain rise in net foreign investments could be noted: the flow of net investment reached \$98 million this year, as compared to \$84 million in 1974 and \$171 million in 1973; if the world-wide rate of inflation is taken into account and deducted from total nominal investments even this slow increase is rendered insignificant.

The ongoing decline in foreign investment during the past two years reflects the weakened capacity of the economy to attract capital investments from abroad; this situation arose in the wake of economic and political factors active both in the domestic economy and abroad. The slowdown of economic activity, which led to a reduction of investment profitability, the strong anticipation of a devaluation, and the tense unabated security problem can all be cited as main factors affecting changes in investment trends. Other factors, less influential, are sluggish trends in world-wide economic activities during the same period, anticipation of changes in the Israeli tax structure, and a slowdown in the real estate and construction markets (to which generally a sizable portion of foreign investments are directed). Implementation of creeping devaluations should also be considered a factor of some magnitude, at least in its first stages, as it upset the

Table V-4
FOREIGN INVESTMENT IN ISRAEL AND ISRAELI INVESTMENT ABROAD, 1972-75
(\$ million)

	1972	1973	1974	1975	1974 quarterly				1975 quarterly			
					I	II	III	IV	I	II	III	IV
A. Investment in Israel by non-residents												
Investments	171.8	234.5	127.5	91.0	29.8	39.4	26.8	31.5	21.8	22.2	20.6	26.4
Investments repatriated	-47.5	-78.5	-59.4	-19.1	-20.4	-17.1	-9.6	-12.3	-2.3	-8.0	-3.2	-5.6
Net investments	124.3	156.0	68.1	71.9	9.4	22.3	17.2	19.2	19.5	14.2	17.4	20.8
In Israeli currency from blocked accounts	3.0	-8.2	-12.6	-28.9	-4.9	-2.7	-2.2	-2.8	-1.2	-6.4	-4.3	-17.0
In Development Bonds	7.3	12.5	10.6	10.7	1.6	2.7	1.8	4.5	4.1	2.5	2.7	1.4
In kind	1.0	8.6	9.0	19.3	3.3	0.3	4.1	1.3	3.9	4.2	3.0	8.2
Total	135.6	168.9	75.1	73.0	9.4	22.6	20.9	22.2	26.3	14.5	18.8	13.4
Reinvestment of profits	7.4	16.3	18.4	8.0	4.6	4.6	4.6	4.6	2.0	2.0	2.0	2.0
Total, net	143.0	185.2	93.5	81.0	14.0	27.2	25.5	26.8	28.3	16.4	20.8	15.4
B. Israeli investment abroad												
Direct ^a	-0.5	-0.5	-0.2	-1.9	-0.1	-0.1	0.1	-0.1	-0.1	-1.9	0.2	-0.1
Portfolio												
Private individuals	2.5	6.4	5.1	-9.2	5.0	1.9	1.7	-3.5	-6.1	-0.4	2.9	-5.6
Banks	-1.4	6.6	4.6	5.7	0.3	8.1	4.2	-8.0	-4.3	0.8	1.6	-3.8
Total Israeli investment abroad	0.6	12.5	9.5	-16.8	5.2	9.9	6.0	-11.6	-10.5	-1.5	4.7	-9.5
C. Net foreign investment in Israel	142.4	172.7	84.0	97.8	8.8	17.3	19.5	38.4	38.8	18.0	16.1	24.9

^a Excluding investments in the administered areas.

established investment patterns and even brought about a slowdown in foreign investments.³

Expectations of an impending devaluation - the major factor holding back foreign investments - intensified during the second half of 1975, as a result of which the level of investments remained low. In October, following the 10 percent devaluation, direct investments perked up perceptibly, as did securities not traded on the stock market. Soon afterwards investments shrank back again to their previous level.

Table V-5
FOREIGN INVESTMENT IN ISRAEL, QUARTERLY, 1972-75
(\$ million)

Year	Quarter	Securities listed on the Tel Aviv Stock Exchange	Direct investment and unlisted securities	Investment in approved enterprises	Total
1972	I	4.0	22.4	3.0	29.4
	II	18.0	30.0	4.9	52.9
	III	8.0	31.6	1.9	41.5
	IV	9.4	33.8	6.1	49.3
1973	I	13.3	45.2	2.8	61.3
	II	11.5	48.3	2.0	61.8
	III	7.0	62.6	1.9	71.5
	IV	4.7	34.2	1.5	40.0
1974	I	2.8	23.6	0.9	27.3
	II	5.8	30.6	1.0	37.4
	III	2.1	24.5	1.6	28.2
	IV	4.1	29.8	2.6	36.5
1975	I	4.0	17.1	2.5	23.6
	II	6.7	14.6	1.6	22.9
	III	5.7	15.1	0.5	21.3
	IV	6.5	19.5	0.7	26.7

During the last quarter of 1974 and during much of 1975, a notable irregularity appeared in the area of Israeli investments abroad: the impression arose of negative investments abroad as private investors and banking institutions sold foreign securities held in their possession. This development in fact created a favorable capital transfer to the economy, which amounted to \$17 million. This is certainly a surprising development, considering the pronounced trend in the economy towards investments in foreign currency assets.

3. The creeping devaluation in itself diminished the factor of uncertainty regarding the rate of currency, which puts off various investors. However, inception of new policy measures delays implementation of new investments until after a certain trial period in which investors prefer to "wait, see and learn."

Table V-6
LONG- AND MEDIUM-TERM FOREIGN LOANS, 1972-75

(\$ million)

	1972	1973	1974	1975	1974 quarterly				1975 quarterly			
					I	II	III	IV	I	II	III	IV
Loans received												
Government	701	910	792	1,743	190	157	143	302	373	436	418	516
Thereof: Development and Independence Loans	(300)	(502)	(326)	(290)	(115)	(83)	(37)	(91)	(77)	(73)	(54)	(86)
Other	311	326	214	210	35	60	33	86	43	52	36	79
Total	1,012	1,236	1,008	1,953	225	217	177	389	416	488	454	595
Loans repaid												
Government	291	275	334	360	80	81	75	98	91	93	78	98
Thereof: Development and Independence Loans	(116)	(143)	(161)	(172)	(35)	(40)	(31)	(55)	(45)	(47)	(34)	(46)
Other	141	145	135	168	31	28	32	44	33	40	47	48
Total	432	420	469	528	111	109	107	142	124	133	125	146
Net loans received												
Government	410	635	458	1,383	110	76	68	204	282	343	340	418
Thereof: Development and Independence Loans	(184)	(359)	(165)	(118)	(80)	(43)	(6)	(36)	(32)	(26)	(20)	(40)
Other	170	181	79	42	4	32	1	42	10	12	-11	31
Total	580	816	539	1,425	114	108	70	247	292	355	329	449

5. MEDIUM- AND LONG-TERM LOANS

This year an unprecedented rise occurred in receipts of medium- and long-term foreign loans; their sum came to almost double the amounts received in all three years prior to 1975 together. Gross receipts totalled \$2 billion, as compared to \$1 billion in 1974. This increase is essentially due to the expansion of U.S. government loans in the framework of military assistance.

Total gross loans in the framework of U.S. military credits reached \$1.2 billion this year, as compared to \$300 million in 1974. Gross receipts from development loans decreased this year by \$36 million, and payments grew by \$11 million; total net receipts from these loans amounted in the year reviewed to \$118 million, as compared to \$165 million in 1974.

Loans to shipping and aviation companies fell considerably because of the sharp decline in imports of ships and aircraft. These reached a gross total of only \$60 million, as compared to \$140 million in 1974. In contrast, gross receipts of other public sector companies multiplied and totalled at year's end \$58 million. Loans to building and real estate companies grew tenfold this year and amounted to \$33 million. Likewise, an impressive rise was noted in gross loans taken by industrial and import firms, which totalled \$30 million at year's end.⁴

Table V-7
FOREIGN LOAN PERMITS, 1972-75
(\$ million)

Quarter	1972		1973		1974		1975	
	Value	No.	Value	No.	Value	No.	Value	No.
I	179	154	69	60	114	36	76	47
II	131	97	9	49	90	57	127	42
III	125	95	38	80	351	70	105	40
IV	111	78	51	36	120	47	408	50
Total	546	424	167	225	675	210	716	179

A breakdown of the loans according to their receivers and exploitation dates can be instructive as regards policy measures that were taken this year in attempting to finance the current account deficit. The increase in loans to various import firms,

4. In view of the global inflation which continued this year, these loans become reduced in real terms, although even if estimating them according to appropriate price measures, it is possible to observe the substantial increase in loans received by some of the nongovernmental sector.

industrial companies, real estate and building companies, as well as to other public sector companies (except shipping and aviation firms), stems from the authorization policy for foreign loans of the Ministry of Finance.⁵ If we take into account an average delay of three months between the date of authorization and the date of exploitation, then a high correlation can be established between a decline in the balance and the bulk utilization of loans by the various bodies. The major part of loans to these bodies was concentrated at the beginning of the year, consequent to developments in 1974, and in the period beginning in September 1975, resulting from developments that took place during 1975.⁶

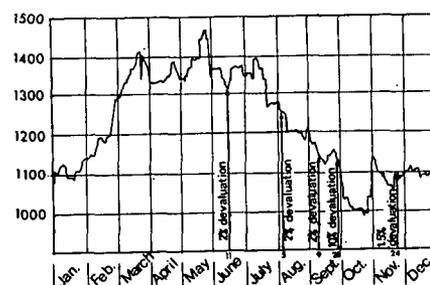
Loan permits to nongovernmental bodies in money terms rose in scope this year and reached \$715 million, as compared to \$675 million in 1974. At the same time, the number of permits itself dropped to 179, as compared to 210 in 1974. The last quarter of the year witnessed the major growth. This increase occurred among public sector companies, some of whom enjoyed guaranteed rates. The consequences of this extended authorization will presumably be felt during next year, when the permits will begin to be exploited.

6. FOREIGN EXCHANGE RESERVES OF THE BANK OF ISRAEL

At the end of 1975, gross foreign exchange reserves of the Bank of Israel totalled \$1,184 million; net reserves came to \$1,040 million, as compared to \$1,071 in 1974. This apparent stability in the level of reserves during the last two years is misleading in view of the large amount of short-term loans the economy enlisted abroad. Due to the increased value of imports, the proportion between the reserves and import diminished: in terms of monthly imports, foreign currency reserves were sufficient to cover in 1975 only a month and a half of imports, as compared to two months in 1974 and four months both in 1973 and 1972.

The bank of Israel foreign exchange reserves swelled sharply in the first quarter of 1975 and increased by more than \$100 million per month (see diagram). This

Figure V-1
NET FOREIGN EXCHANGE RESERVES IN BANK OF ISRAEL, 1975
(daily, in \$ million)



5. In 1972, the defrayment period/maturity structure allowable for loans stood at ten years, while in 1975 loans were authorized with a maturity period of three years. Furthermore, loans were authorized with an interest rate of the Eurodollar +1³/₄ percent, and loans with a set interest rate were authorized with an interest rate of 9-10 percent, as compared to a ceiling of 6 percent in 1972.

6. In effect, this development stands in contradiction to the conceivable impact expectations of a devaluation might have. A partial explanation of this could be that a portion of those taking loans enjoy a guaranteed rate.

phenomenon resulted from special measures, already undertaken by the end of 1974, aiming to counteract the steady reduction in the level of reserves. The measures taken included, among others, a devaluation in the rate of the Israeli pound and expansion of permits for short-term loans. In the second quarter of this year the average level of reserves stood at \$1,350 million, notwithstanding acute fluctuations during this period. In the third quarter sharp and continuous decline occurred, in spite of the 10 percent devaluation of the Israeli pound in September; by October the reserves reached a minimal level of less than \$1 billion. Towards the end of the year the foreign currency reserve rose once more and stabilized during November-December at a level of \$1,070 million.

A large proportion of the foreign currency reserves of the Bank of Israel are specified in European currency. So fluctuations in the dollar values of these currencies will cause changes in the reserve value in terms of dollars. In effect, the declining value of European currencies in dollar terms brought about a reduction in the amount of reserves held by the Bank of Israel by \$36 million, and after deducting the revaluation of the European currencies the Bank's foreign currency reserves grew by \$5 million, as compared to the end of 1974.

7. FOREIGN CURRENCY DEBT⁷

This year the economy's foreign currency liabilities continued to grow. The outstanding balance at the end of 1975 totalled \$7.6 billion,⁸ as compared to \$6.25 billion in 1974 and \$5.1 billion in 1973. The nominal growth in the foreign debt, which was the largest rise to date, is actually somewhat smaller in real terms, considering world-wide inflation.⁹ However, the seriousness of the foreign debt situation becomes clear considering the changes in its composition.

The share of medium- and long-term liabilities fell steadily this year, against the growing share of short-term liabilities: short-term liabilities rose to 12 percent of the total foreign currency debt, as compared to 9 percent in 1974 and 4 percent in 1973, and amounted to \$927 million. In the coming year, the economy will have to repay \$1.4 billion

7. The economy's foreign currency debt is not identical with its external debt which also includes Israeli currency liabilities abroad, balance in clearing accounts, foreign investment in Israel and deposits of foreign nationals in Israeli banks, as well as loans whose maturity date is less than 90 days.

8. The changes in the foreign debt include currency revaluations but not some of the other adjustments, hence it does not completely correspond to the change in loans as shown in the balance of payments.

9. A rise in foreign prices actually reduces the amount of real resources which an economy must forgo in order to finance its external debt. Assuming that other factors remain constant, this enables the borrowing country to finance its debt by a smaller quantitative increase in exports or a smaller decrease in imports.

FOREIGN CURRENCY ASSETS IN

(\$)

	End-year balances			
	1972	1973	1974	1975
A. Foreign exchange reserves at Bank of Israel				
1. Foreign currency assets with Bank of Israel				
Reserves	1,154.4	1,690.7	1,150.3	1,134.6
Gold	43.4	46.3	46.4	46.5
Gold quota in IMF	—	39.2	—	—
Special Drawing Rights	31.7	33.6	3.0	2.5
Total (1)	1,229.5	1,809.8	1,199.7	1,183.6
Change due to:				
Foreign currency valuation adjustments and SDR allocation				
Total transactions and transfers				
2. Deposits in Bank of Israel				
Foreign banks	—	—	—	2.0
Patach	159.9	112.7	129.1	142.1
Total (2)	159.9	112.7	129.1	152.1
3. Net balances with Bank of Israel	1,069.6	1,697.1	1,070.6	1,039.5
B. Net foreign currency balances				
4. Gross foreign currency balances:				
Deposits abroad ^a of other central monetary organizations	57.1	168.5	58.4	105.0
Bank deposits + loans abroad	1,133.6	1,327.6	1,245.6	1,224.9
Total (4)	1,190.7	1,496.1	1,304.0	1,329.9
Change in gross foreign currency balances due to:				
Foreign currency valuation adjustments				
Total transactions and transfers				
5. Total foreign currency assets (1+4)	2,420.2	3,305.9	2,503.7	2,513.5
Change due to foreign currency valuation adjustments				
Total transaction and transfers				
6. Foreign-held deposits				
In commercial banks				
Foreign bank deposits and loans	670.0	837.9	1,101.7	1,546.2
Total in banks	1,342.6	1,741.9	2,164.0	2,687.8
Nonresident deposits	672.6	904.0	1,062.3	1,141.6
In Bank of Israel (excl. Patach)			1.7	1.9
Total in banking system	1,342.6	1,741.9	2,165.7	2,689.7

^a According to the definition of the balance of payments.

SOURCE: Central Bureau of Statistics.

in principal, as compared to \$968 million in 1974; the short-term element in these repayments rose to 64 percent, as compared to 58 percent in 1974 and only 34 percent in 1973. This development serves as a clear indication of the deteriorating structure of the foreign debt with respect to repayment dates, i.e., the obligation for higher repayments within shorter time periods.

The substantial growth in short-term liabilities induced the average interest rate on the foreign debt to increase. Likewise, interest payments grew appreciably and totalled

BANKING INSTITUTIONS, 1972-75

million)

1974 quarterly				1975 quarterly				Increase	
I	II	III	IV	I	II	III	IV	1974	1975
1,528.8	1,335.8	1,064.7	1,150.3	1,440.4	1,431.9	1,189.9	1,134.6		
46.4	46.4	46.4	46.4	46.4	46.4	46.5	46.5		
39.2	—	—	—	—	—	—	—		
33.6	33.4	33.4	3.0	2.2	2.7	0.8	2.5		
1,648.0	1,415.6	1,144.5	1,199.7	1,489.0	1,481.0	1,237.2	1,183.6	-610.1	-16.1
		28.4	-25.8	-25.1	+4.2	+73.6	15.2	(+)56.3	-(+)37.5
-188.0	-238.1	-242.7	2.4	204.2	-10.2	-253.0	-68.8	-666.4	-67.8
—	7.8	2.0	—	—	—	—	2.0		
113.6	110.3	116.0	129.1	133.1	139.0	137.3	142.1		
113.6	118.1	118.0	129.1	133.1	139.0	137.3	142.1	16.4	13.0
1,534.4	1,129.5	1,026.4	1,070.6	1,356.0	1,342.0	1,099.9	1,039.5	-626.5	-31.1
130.9	124.0	76.9	58.4	48.2	60.3	49.0	105.0		
1,407.7	1,289.4	1,154.5	1,245.6	825.3	838.8	937.3	1,224.9		
1,538.6	1,422.4	1,231.4	1,304.0	873.5	899.1	986.3	1,329.0	-192.1	25.9
								-(+)70.0	(+)(+)29.7
								-262.1	55.6
3,181.6	2,830.0	2,375.9	2,503.7	2,362.5	2,380.1	2,223.5	2,513.5	-802.2	9.8
								-(+)126.3	-(+)22.0
								-928.5	-12.0
735.6	701.2	581.8	1,101.7	1,006.7	977.7	1,036.8	1,546.2		
960.8	999.2	1,024.4	1,062.3	1,067.8	1,051.2	1,050.3	1,141.6		
1,696.4	1,700.4	1,606.2	2,164.0	2,074.5	2,028.9	2,087.2	2,687.8		
—	7.8	2.0	1.7	2.0	1.9	1.9	1.9		
1,696.4	1,708.2	1,608.2	2,165.7	2,076.5	2,030.8	2,089.1	2,689.7	423.8	524.0

more than half a billion this year, as compared to \$390 million in 1974 and \$261 million in 1973. The average interest rate for long-term liabilities (not including development loans) reached 5.05 percent this year, as compared to 4.9 percent in 1974. At the same time the average interest rate for medium-term liabilities fell to 8.6 percent this year, as compared to 9.6 percent in 1974. The interest rate on the total debt for long- and medium-term liabilities remained stable this year at a level of 5.4 percent. This, however, represents a decline in real terms considering world-wide inflation.

Table V-9

FOREIGN EXCHANGE RESERVES HELD AT BANK OF ISRAEL, 1975

(\$ million)

End of month	Gross reserves	Less: Foreign bank deposits	Less: Patach deposits	Net reserves	Change in net reserves		
					Before adjustment	Exchange rate differentials	Adjusted for differentials
1974 December	1,200.0	—	129.0	1,071.0	38.0	11.0	27.0
1975 January	1,268.3	—	125.3	1,143.0	72.0	25.6	46.4
February	1,411.8	—	127.7	1,284.1	141.1	10.1	131.0
March	1,489.1	—	133.1	1,356.0	71.9	-11.1	83.0
April	1,474.8	—	129.9	1,344.9	-11.1	-16.4	5.3
May	1,480.5	—	134.8	1,345.7	0.8	14.9	-14.1
June	1,480.9	—	138.9	1,342.0	-3.7	-2.3	-1.3
July	1,403.5	—	133.2	1,270.3	-71.7	-50.2	-21.5
August	1,343.8	—	134.8	1,209.0	-61.3	-3.2	-58.1
September	1,237.2	—	137.3	1,099.9	-109.1	-17.8	-91.3
October	1,271.4	—	139.8	1,131.6	31.7	22.1	9.6
November	1,229.4	—	139.3	1,090.1	-41.5	-8.3	-33.2
December	1,183.6	2.0	142.1	1,039.5	-50.5	0.7	-51.3
Jan.-Dec.					-31.5	-35.9	4.5

A conventional indicator for the burden pressure of an economy's debt service is the proportion between foreign currency revenues on current account and foreign currency payments for servicing the debt. Between 1970 and 1974 the trend indicated a reduction in the proportion between debt servicing and receipts from exports. This would suggest a decline in the debt servicing burden in the balance of payments. In 1975 this proportion jumped drastically because of a sharp rise in the debt service on the one hand, and only a slight rise in exports on the other hand. For the Israeli economy, which has continually enjoyed a high level of unilateral transfers, it is customary to apply an additional indicator in measuring the burden of debt repayments by including in the foreign currency revenues not only exports, but unilateral transfers as well. Also according to this indicator the burden of repaying the external debt on the balance of payments was greatly aggravated in 1975.

The reduction in unilateral transfers and investments, alongside the low level of reserves at the start of 1975, forced the economy to finance all annual additions to the current deficit through foreign loans. With the maturity structure steadily worsening already last year, this year witnessed a substantial rise in the repayment of principal, and consequently pressures intensified to expand the volume of gross loans. These developments, which emerged as the economy drained a portion of its convenient credit sources, at times completely so, led to crucial changes in the share of various branches in the foreign debt.

Table V-10

ISRAEL'S FOREIGN CURRENCY DEBT, BY REPAYMENT DATE, 1967-75

(\$ million)

	1967	1968	1969	1970	1971	1972	1973	1974	1975
Up to one year	198	301	244	398	475	434	549	968	1,414
Thereof Short-term loans	(78)	(92)	(82)	(115)	(183)	(187)	(187)	(564)	(927)
One to two years	141	135	195	195	224	263	329	504	490
Two ^{to} to three years	82	114	135	175	202	241	351	423	511
Three to four years	87	112	122	136	159	268	327	439	628
Four to five years	85	110	109	117	192	238	369	481	530
Five years or more	963	1,130	1,316	1,602	2,178	2,637	3,168	3,435	4,044
Total	1,556	1,902	2,121	2,622	3,430	4,081	5,093	6,250	7,617
	Percentage distribution by repayment date								
Up to one year	12.7	15.8	11.5	15.2	13.9	10.6	10.8	15.5	18.6
Thereof Short-term loans	(39)	(31)	(34)	(39)	(39)	(43)	(34)	(58)	(66)
One to two years	9.0	7.1	9.2	7.4	6.5	6.4	6.4	8.1	6.4
Two to three years	5.3	6.0	6.4	6.6	5.9	5.9	6.9	6.8	6.7
Three to four years	5.6	5.9	5.7	5.2	4.6	6.6	6.4	7.0	8.2
Four to five years	5.5	5.8	5.1	4.5	5.6	5.8	7.3	7.7	7.0
Five years or more	61.9	59.3	62.0	61.1	63.5	64.6	62.1	55.0	53.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
	Cumulative percentage distribution								
Up to one year	12.7	15.8	11.5	15.2	13.9	10.6	10.8	15.5	18.6
One to two years	21.7	22.9	20.7	22.6	20.4	17.0	17.3	23.6	25.0
Two to three years	27.0	28.9	27.1	29.2	26.3	22.9	24.2	30.4	31.7
Three to four years	32.6	34.8	32.8	34.4	30.9	29.9	30.6	37.4	39.9
Four to five years	38.1	40.6	37.9	38.9	36.5	35.3	37.9	45.1	46.9
Five years or more	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

This year the growth of short-term liabilities was of a different nature from that which took place in the preceding year, although its magnitude was similar. In 1974 the growth of short-term liabilities was mainly concentrated in debts to foreign banks and other creditors, whereas this year the major growth occurred in the area of bank loans for imports and in credit granted by local banks from sums deposited by foreign residents. At the same time, however, short-term loans from other creditors were not renewed this year, and only repayments were carried out. These developments in short-term liabilities tell something about the growing difficulty the economy faced this year in recruiting capital.

The direct government debt this year amounted to \$5.6 billion, as compared to \$4.7 billion in 1974 and \$3.9 billion in 1973. Debts of other bodies reached \$2 billion after a rise of \$446 million. This year debt on account of development loans amounted to \$2 billion, and its weight in the local foreign debt fell to 27 percent as compared to 31 percent in 1974 and 34 percent in 1973. In effect, there exists a long-term trend in which

Table V-11

INDICATORS OF THE SERVICING BURDEN, 1967-75

(\$ million)

	1967	1968	1969	1970	1971	1972	1973	1974	1975
(1) Interest payments	86	92	109	133	147	180	261	389	530
(2) Principal payments (long- and medium-term)	169	229	252	292	330	432	420	469	528
(3) Total debt servicing (1)+(2)	255	321	361	425	477	612	681	858	1,058
(4) Exports of goods and services	930	1,132	1,265	1,361	1,814	2,129	2,654	3,648	3,827
(5) Unilateral transfers	521	435	450	649	765	1,051	2,173	1,737	1,755
(6) Ratio (3/4) (%)	27.4	28.4	28.5	31.2	26.3	28.7	25.7	23.5	27.6
(7) Ratio 3/(4+5) (%)	17.6	20.5	20.9	21.1	18.5	19.2	14.1	15.9	19.0

the weight of development loans has dropped, owing to the fact that the weight of the security loan has increased. The total this year for the security loan came to \$1.8 billion after an increase of more than half a billion dollars and its weight in the total foreign debt rose to 24 percent as compared to 20 percent in 1974 and 18 percent in 1973. In recent years the development and security loans together represent half of the debt, although viewing the worsening repayment schedules, their share in the payment of principal has lessened. After a three-year period in which no substantial change occurred in the composition of the foreign debt in terms of currencies, this year saw an increase in liabilities quoted in dollars, while that of liabilities in other currencies dropped.

Table V-12

ISRAEL'S SHORT-TERM FOREIGN CURRENCY DEBT TO THE END OF THE YEAR, BY CREDITOR, 1973-75

(\$ million)

	1973	1974	1975	1974	1975
	Balance			Annual change	
Bank and other loans	87.4	243.8	268.8	156.4	25.0
Patach loans	43.3	146.9	304.4	103.6	157.5
Bank credit for import	31.1	7.7	254.5	-23.4	246.8
Suppliers	6.9	7.7	90.1	0.8	82.4
Others	21.9	158.1	9.5	136.5	-148.6
Total	19.3	564.2	927.3	373.9	363.1

SOURCE: Foreign Currency Department, Ministry of Finance.

This appreciable rise in dollar debts totalled \$1.3 billion; in comparison, there was a notable decline, for the first time, in the value of the debts quoted in German marks. In effect, the indebtedness grew by DM96 million, but taking into consideration the depreciation this year of the mark as compared to the dollar, as occurred this year, its

numerical value in terms of the dollar actually lessened.

The depreciation of the mark and that of other currencies in dollar terms brought about a reduction in the size of the foreign debt estimated at \$100 million, out of which \$62 million direct government debt.

Table V-13
ISRAEL'S FOREIGN DEBT, BY CURRENCY, 1972-75^a
(\$ million)

	1972		1973		1974		1975	
	\$ m.	Percent of total						
Total foreign debt								
In dollars	3,291	82.6	4,074	81.6	5,043	81.2	6,363	84.8
In sterling	78	2.0	85	1.7	85	1.4	101	1.4
In DM	583	14.6	763	15.3	1,001	16.1	955	12.7
In other currencies	33	0.8	73	1.5	81	1.3	87	1.1
Total	3,985	100.0	4,995	100.0	6,210	100.0	7,506	100.0
Direct government debt								
In dollars	2,560	82.8	3,176	82.9	4,051	85.1	4,874	86.9
In sterling	7	0.2	5	0.1	3	—	17	0.3
In DM	496	16.2	64.2	16.8	698	14.7	710	12.7
In other currencies	29	0.9	8	0.2	10	0.2	8	0.1
Total	3,092	100.0	3,831	100.0	4,762	100.0	5,609	100.0
Nongovernmental debt								
In dollars	731	81.8	898	77.1	992	68.5	1,489	78.5
In sterling	71	8.0	80	6.9	82	5.7	84	4.4
In DM	87	9.7	121	10.4	303	20.9	245	12.9
In other currencies	4	0.4	65	5.6	71	4.9	79	4.2
Total	893	100.0	1,165	100.0	1,448	100.0	1,897	100.0

^a Excluding liabilities to the World Bank denominated in various currencies. (This is the difference between these data and those of Table V-10.)