CHAPTER XV

FLOW OF FUNDS[1]

1. MAIN DEVELOPMENTS

The principle features of the economy's flow-of-funds system in 1971 were the continued expansion of the already sizable demand surplus of the public sector, the rapid growth of that of public sector companies, and the continued uptrend in the demand surplus of private nonprofit institutions. These increases were offset by the supply surplus of the private sector – in contrast to the situation in 1970, when the public sector demand surplus was accompanied by the widening of the balance of payments deficit on current account.

The private sector supply surplus – which amounted to IL 573 million, compared with a IL 10 million demand surplus in 1970 – was apparently the resultant of contrasting changes in the sectoral surpluses of the household and business subsectors:[2] the supply surplus of the former expanded appreciably, while the latter almost certainly experienced an increase in its demand surplus.

Whereas the change in the private sector surplus had a deflationary effect, largely because of the compulsory loans imposed on both households and businesses, the development of real (i.e. nonfinancial) transactions in the public sector and public sector companies, as well as the change in the demand surplus of the nonprofit institutions, had a different impact.

After soaring 40 percent in 1970, the public sector demand surplus went up by a comparatively modest IL 200 million in the year reviewed to stand at IL 3,800 million. While this relative stability implies a decline in real terms (because of sharp price rises), it should be noted that the volume of real transactions shot up by IL 2,700 million, which in itself had an inflationary effect.

In 1971 as well, the balance between the supply and demand for real resources of the various domestic sectors was achieved under conditions of rapid GNP growth; nevertheless, the rise in the price level can be partly attributed to demand pressure. The policy adopted by the public sector, which aimed (successfully) to reduce the supply surplus of the rest-of-the-world sector, should have been accompanied by complementary measures to release resources, both within the framework of the budget and by controlling the

1. Those unfamiliar with the flow-of-funds technique would be well advised to read section 2 before section 1.
2. For technical reasons, transactions between businesses and households are not included in the definition of these surpluses (see below).

demand surpluses of business, public sector companies, and nonprofit institutions. This could have been accomplished by taking advantage of the Government's domination over the domestic capital market and over the inflow of capital from abroad, but it was not done. However, the public sector did continue to restrain private consumption, thereby contributing to the growth of the private sector supply surplus, but this was not sufficient to avert a demand-induced rise in prices.

Although the aggregate demand surplus of the economy held virtually steady in the year reviewed at about IL 4,300 million, there were changes in the composition of its financing. These were connected with the upsurge of personal cash remittances from abroad, which brought up the weight of unilateral transfers in the financing of the economy's import surplus from 53 percent in 1970 to 69 percent. Nonetheless, net foreign credit receipts remained at about the 1970 level. The outcome was the augmenting of the foreign currency reserve holdings of the banking system by IL 670 million.

There was no essential change in the manner of financing the demand surplus of the public sector. The same undesirable feature (evident since 1968) of financing most of the surplus by inflationary methods also marked the year reviewed. Net credit from abroad and from the domestic banking system together covered about 80 percent of the total demand surplus, as in 1970.

There were striking changes, however, in the financing of the demand surpluses of public sector companies and nonprofit institutions. In the former net credit from the domestic financial sectors fell steeply, accompanied by a rise in credit from abroad. In nonprofit institutions there was a return to their normal pattern of financing, with most of the financial resources being supplied by domestic real sectors and in the form of unilateral transfers from abroad. This was in contrast to 1970, when the sector relied heavily on short-term financing from the banking system (see below).

2. Conceptual Framework of Flow-of-Funds Analysis[3]

The flow-of-funds system is a statistical framework that describes the financial transactions accompanying the economic activity of the various economic units. For this purpose a distinction is made between real transactions (financial transactions reflecting trade in goods and services), domestic transfer payments (taxes, subsidies, etc., which absorb or inject purchasing power), and financial transactions (the granting and receiving of credit among the various units within the economy and between the economy as a whole and the rest of the world). This differentiation, combined with the division of the economy into a number of sectors, each comprising units resembling one another in character and behavior, makes it possible to present a clear picture of changes in the relative contribution of the various units to the financial developments which accompany – and to a large extent determine – the changes in the national product (and import surplus) and in the price level. The influence of the different sectors on the level of aggregate domestic demand is measured by means of two indicators:

3. A detailed explanation of the flow-of-funds approach may be found in M. Heth, *The Flow of Funds in Israel* (Jerusalem: Bank of Israel, 1968).

(1) The demand (or supply) surplus of the various sectors and changes therein. A demand surplus is defined as the difference between the sector's income from the sale of goods and services plus domestic transfer receipts on the one hand and its outlays on capital and current account plus domestic transfer payments on the other. In other words, it represents the difference between the sector's use of real resources and its contribution to the supply of real resources.

(2) The way in which the demand surpluses of the various sectors are financed, i.e. the credit flows among the sectors. In general, the sectors that are net lenders are those with supply surpluses. However, it is possible for a sector to be a net supplier of credit to other domestic sectors and yet have a demand surplus, if its unilateral transfers (or net credit) from abroad exceed its demand surplus.

The funds-flow system of the Israeli economy, which provides quantitative data for the above indicators, distinguishes nine sectors, which in turn can be divided into three broad groups: the domestic real sectors, the rest of the world, and the domestic financial sectors.

(1) Domestic real sectors, active mainly in the production and use of goods and services, are nonfinancial business firms, households, the public sector (the Government, National Institutions, and local authorities), public sector companies,[4] and nonprofit institutions. The level of activity of the nonfinancial business sector is determined by forces endogenous to the economy. By contrast, the level of public sector activity (and to a lesser extent that of public sector companies and nonprofit institutions) can be expected to be determined by factors exogenous (and countercyclical insofar as possible) to the economy.

(2) Rest-of-the-world sector – all economic units outside the Israeli economy.

(3) Domestic financial sectors – whose principal function is direct and indirect intermediation[5] between the domestic real sectors with demand surpluses on the one hand and those which have supply surpluses and the rest-of-the-world sector on the other. In this group are found the banking system (banking institutions and the Bank of Israel), financial institutions[6] (which specialize in the allocation of credit to the various sectors of the economy, in accordance with public sector directives), and social insurance funds and insurance companies (the main contractual savings institutions in Israel).

The usefulness of flow-of-funds-analysis and the conclusions that can be drawn are still very circumscribed because of technical and theoretical problems.

With respect to the latter, there is no complete body of theory comparable, for example, to input-output theory, which is based on a statistical framework with charac-

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

5. The funds mobilized by a financial sector from a real sector with a supply surplus are not always transferred directly to a real sector with a demand surplus, but may pass through a number of intermediaries.

6. On the nature of the activity and degree of autonomy of this sector see Chapter XVI, "Financial Institutions".

teristics similar to those of the flow-of-funds structure. Further, the flow-of-funds system of accounts cannot in itself answer the question whether the availability of funds induced a sector to expand its demand, or whether heavier demand necessitated recourse to external sources of funds. The function of the system is generally limited to presenting the relevant magnitude to be explained, and other analytical systems are required in order to determine the relationship between the creation of a demand surplus and its financing.

On the technical plane, the analysis is limited by the lack of data permitting a separation or differentiation of the nonfinancial transactions and part of the financial transactions of businesses from those of households. This deficiency is particularly serious in view of the dissimilar nature of the two sectors and their considerable weight in total economic activity. Another shortcoming, largely peculiar to the flow-of-funds system in Israel, is connected with the value-linkage (either to the dollar or to the cost-of-living index) of part of the financial liabilities of the different sectors. This practice, combined with the principle of accounting conservatism, results at a time of inflation (or devaluation) in marked discrepancies between the flow-of-funds estimates for the various sectors as derived from their financial reports. The closing and balancing of the system by adjusting entries based on rough estimates impairs the reliability of the derived data.[7]

Despite these shortcomings, the construction of a comprehensive and closed system of funds flows is still very useful, for the simple reason that it provides an overall picture of developments in the capital and money markets and makes it possible to analyze various aspects of the activity in these markets (and structural changes therein). If we limited the analysis of financial transactions to the individual sectors, we would not be able to derive information on the flow of funds of the private sector, for which direct data are not available; nor would it be possible to separate the credit flows of households from those of private business, for here too the information is obtained indirectly from the comprehensive, closed system.

3. Demand Surpluses of the Real Sectors

The year 1971 was characterized by the continued existence (and even growth) of the sizable demand surplus of the public sector, the rapid increase in that of public sector companies (after it had slowed down in 1970), and a further rise in the demand surplus of nonprofit institutions. These changes were set off by the creation of a supply surplus in the private sector (which is actually composed of two sectors with different behavioral characteristics – households and private business). This was in contrast to 1970, when a sharp rise in the public sector's demand surplus was offset by a conspicuous growth in the balance of payments deficit on current account (or, in flow-of-funds terminology, in the supply surplus of the rest-of-the-world sector).

The supply surplus of the foreign sector amounted to approximately IL 4,300 million. This was about the same as in 1970, but the sector's net contribution to real resources in the economy actually declined, for the devaluation resulted in the fourth-quarter supply surplus being converted into IL terms at a higher rate of exchange.

7. If the whole system were value-linked, this technical problem would be resolved.

As noted, it was the creation of a private sector supply surplus of IL 573 million, as contrasted with a diminutive IL 10 million demand surplus in 1970, that made it possible to balance the flow-of-funds system. This supply surplus was apparently the net outcome of contrasting changes in the household and business surpluses. It can reasonably be inferred that the more vigorous expansion of economic activity in 1971 and the rapid mounting of prices resulted in a sharply higher business demand surplus, which could be financed thanks to the increased amount of soft credit supplied directly and indirectly by the public sector.

On the other hand, the continued strong uptrend in spendable private income, combined with the sagging growth of private consumption, was reflected in a larger volume of household saving. The following factors were mainly responsible for the higher rate (and volume) of household saving in 1971.

(1) The increase in the compulsory element of the forced loans collected in 1971, due to the sharply lower volume of loan certificates distributed to households during the year. In previous years the distribution of certificates enabled some households to set off part of the current compulsory saving by selling certificates distributed against collections made in earlier years.

(2) The marked growth in contractual saving of various types. This can be ascribed to two principal factors: (a) regarding employees covered by collective agreements, the additional saving was in effect a direct consequence of the rise in wages and prices (and of the inclusion of part of the unorganized workers in contractual saving plans) rather than of any independent decision on the part of the individual savers; (b) regarding the self-employed, whose saving is largely voluntary and can be altered at will, the raising of the maximum tax deductions and credits in 1971 tended to increase their voluntary saving because of the stiff increase in real marginal tax rates during the year.

(3) In 1971 households stepped up their saving in the form of housing investment (purchases of and down payments on new homes).

Although no reliable data are available on the volume of such saving and changes therein in recent years, there is reason to believe that, given the sharp rise in the volume of transactions and in housing prices in the past two years, the much larger amount of long-term institutional financing made available to home buyers failed to meet all of their requirements. The balance was covered by short-term borrowing, which, of course, had to be repaid out of current income.[8]

As to down payments to contractors and building firms, these apparently increased in the year reviewed because of expectations of a further jump in housing prices. Thus it follows that the 1971 upswing in the supply surplus of households, which far surpassed the growth of the business sector demand surplus, was only partly due to an autonomous voluntary change in saving patterns. Apparently it was connected for the most part with

8. Even if the amount of short-term loans (up to two years) taken on by home buyers to complete their financing were only equal to that in 1970, it is clear that saving in the form of loan repayments would be greater in 1971 than in the previous year; and how much more so in view of the larger volume of transactions and the higher prices in the year reviewed, which increased the total amount of loans.

Table XV–1

SECTORAL DEMAND AND SUPPLY SURPLUSES, 1969–71[a]

(IL million)

	Purchases		Sales	Net purchases (1 + 2 – 3)	Transfers		Net transfer receipts (6 – 5)	Demand or supply (–) surplus (4 – 7)
	On current account	On capital account			To domestic sectors	From domestic sectors		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Business and households[b]								
1969		2,594						–103
1970		3,187						10
1971		4,287						–573
Public sector[c]								
1969	5,729	692	835	5,586	1,919	4,909	2,990	2,596
1970	7,739	758	956	7,541	2,285	6,222	3,937	3,604
1971	9,042	1,000	1,234	8,808	3,454	8,476	5,022	3,786
Public sector companies[d]								
1969	2,043	643	2,306	380	35	90	55	325
1970	2,184	814	2,576	422	32	79	47	375
1971	2,755	1,344	3,260	839	38	183	145	694
Nonprofit institutions[e]								
1969	1,072	222	260	1,034	25	775	750	284
1970	1,305	258	302	1,261	27	913	886	375
1971	1,565	378	345	1,598	26	1,168	1,142	456

Social insurance funds and insurance companies[f]								
1969	345	9	409	–55	410	361	–49	–16
1970	412	14	475	–49	477	431	–46	–13
1971	470	12	570	–88	598	538	–60	–28
Banking system[g]								
1969	786	34	943	–123	108	—	–108	–15
1970	1,203	39	1,398	–156	144	–	–144	–12
1971	1,968	46	2,134	–120	175	–	–175	55
Financial institutions[h]								
1969	423	3	518	–92	53	–	–53	–39
1970	537	1	635	–97	65	–	–65	–32
1971	766	–1	901	–136	87	–	–87	–49
Rest of the world[i]								
1969		4,509	7,533	–3,024	–	–	–	–3,024
1970		4,891	9,208	–4,317	–	–	–	–4,317
1971		6,982	11,323	–4,341	–	–	–	–4,341

[a] The data for 1969-71 were revised and reclassified.
[b] Since the demand and supply surpluses of all the sectors add up (in principle) to zero, the surplus of this sector is derived as the difference (with sign reversed) between the demand and supply surpluses of the other sectors.
[c] As defined in Chapter VII, "Government and Non-Government Public Sector", except that here purchases include interest paid to the rest of the world.
[d] Companies in which the public sector holds at least 25 percent of the equity capital and actively participates in the management.
[e] As defined in Chapter VIII, "Nonprofit Institutions".
[f] As defined in Chapter XVII, "Social Insurance Funds and Insurance Companies", with the addition of Bitzur Ltd. and Teudah Ltd.
[g] Commercial banks, cooperative credit societies, and the Bank of Israel.
[h] As defined in Chapter XVI, "Financial Institutions".
[i] For this sector purchases are identical with Israel's exports and sales are identical with imports as recorded in the balance of payments.

the increase in compulsory and contractual saving and the desire of households to hedge themselves against an anticipated rise in housing prices, even if this reduced their current consumption because of the inability to obtain all of the additional medium- and long-term credit required. These developments go far to explain the better household saving performance in 1971, at a time when surging prices and the expectation that the uptrend would persist should have at least retarded the growth of saving.

No direct data are available which would make it possible to quantitatively prove the assumption about the development of the business and household surpluses in 1971. Were there such data, they would also shed light on how the incremental private sector saving breaks down between households and businesses (undistributed profits, depreciation, etc.). The usefulness of the indirect estimates (Table XV-2) of the household and business surpluses (derived from the net credit inflow and outflow data of each of the other sectors for which there are direct data on financial resources and uses) is also limited. This is because the estimates fail to reflect credit movements between households and busi-

Table XV–2

INDIRECT ESTIMATE OF HOUSEHOLD AND BUSINESS SECTOR SURPLUSES, 1970–71

(IL million)

	1970	1971[a]
Households		
(1) Gross credit received	540	740
(2) Transfers from abroad	1,266	2,031
(3) Total financial resources (1 + 2)	1,806	2,771
(4) Gross credit granted[b]	2,746	4,154
(5) Indirect estimate of demand or supply (–) surplus (3 – 4)	**–940**	**–1,383**
Business		
(6) Gross credit received[b]	2,777	3,937
(7) Gross credit granted[b]	1,483	2,586
(8) Indirect estimate of demand or supply (–) surplus (6 – 7)	**1,294**	**1,351**
Private sector		
(9) Indirect estimate of demand or supply (–) surplus (5 + 8)	354	–32
(10) Residual estimate of demand or supply (–) surplus[c]	10	–573
(11) Difference between estimates[d] (9 – 10)	**344**	**541**

[a] The data for 1970 were revised and reclassified.
[b] As shown in Table XV–4.
[c] As calculated in Table XV–1.
[d] Identical with errors and omissions for the private sector in Table XV–3.

ness. A further problem which arises in analyzing these indirect estimates, and which imposes the utmost caution in drawing conclusions, lies in the fact that all the errors and omissions in the other sectors' accounts are accumulated in the estimates for households and business. This problem was particularly serious in 1970 and 1971, when the errors and omissions item in the balance of payments ranged between IL 300 million and IL 580 million. But in spite of all these qualifications, there does not seem to be anything in the indirect segregation of business and households that contradicts the aforementioned assumptions regarding the development of the subsectors' surpluses in 1971.

The indirect estimates show that the supply surplus of households[9] soared from about IL 950 million in 1970 to IL 1,400 million, and that the business sector demand surplus rose more mildly, from about IL 1,300 million to IL 1,350 million. The reliability of these figures, however, is impaired by the fact that the difference between the indirect and the residual estimates of the private sector demand surplus amounted to IL 344 million in 1970 and IL 540 million in 1971 (see Table XV-2).

Assuming that the errors and omissions in 1970 and 1971 can be apportioned equally among the different sectors, it follows that the private business sector demand surplus financed by other sectors (excluding households) grew very little in spite of the more vigorous expansion of economic activity and the rapid rise of the price level. This finding may be explained by either or both of the following factors: (a) the relatively large increase in business saving in 1971; (b) the relatively large increase (compared with 1970) in household credit to private business firms. Even if both factors were at work, it would appear that the influence of the second was dominant, primarily because of the 1971 growth in down payments to contractors and building companies – an inevitable outcome of the expectation of a further rise in housing prices. Thus it may be concluded that in 1971 the demand surplus of the private business sector expanded appreciably.

While the change in the private sector surplus was for the most part deflationary because of the compulsory loans imposed during the year, the real transactions of the public sector and the public sector companies and the demand surplus of nonprofit institutions developed differently.

After a 40 percent growth in 1970, the public sector demand surplus went up in the year reviewed by only some IL 200 million to IL 3,800 million. Although this relative stability implies a decline in real terms (because of the rapid rise in prices during the year), it should not be deduced from this that the change in the sector's demand surplus had a deflationary effect. To be sure, the compulsory loan collections during the year, which are recorded *in toto* as a credit transaction, contain a substantial tax element (which if taken into account would undoubtedly reduce the demand surplus of the public sector). On the other hand, much of the housing credit granted by the public sector (which also increased notably during the year) was actually for financing the stock of finished dwelling units and units under construction belonging to the public sector, so that it would have been more correct to include this part (if it could be isolated) with real

9. This estimate is deficient because it does not reflect transactions between private business and households.

transactions. Nor should it be overlooked that the stabilization of the measured demand surplus of the public sector was accompanied by an increase of IL 2,500-2,700 million in its transfer receipts from domestic sectors (taxes) and in net purchases from and transfers to these sectors. It should be stressed that the dampening effect on aggregate demand of one pound of taxes is outweighed by the stimulative effect of one pound of expenditure. Thus the marked growth in the public sector's real transactions in itself had an inflationary impact.

Public sector companies shared in the accelerated expansion of economic activity. Their demand surplus shot up in the year reviewed, reaching IL 700 million as compared with IL 375 million and IL 350 million in 1970 and 1969 respectively. By far the greater part of the 1971 increment is explained by heavy imports of ships and aircraft (these were ordered in previous years and hence do not reflect current changes in domestic demand). The stepping up of the companies' current operations in 1971 can, however, be seen in the 26 percent increase in purchases and sales on current account.

The demand surplus of nonprofit institutions rose 25 percent (as in 1970) to stand at approximately IL 455 million.

To sum up, the balance between the demand and supply of real resources among the various sectors (in flow-of-funds terminology, the identity between the magnitude of the supply and demand surpluses) was achieved together with a vigorous expansion of the national product. Nevertheless, the latter development was not on a scale sufficient to meet all of the additional demand, so that the advance of prices during the year must be attributed in part to the demand pressure in the economy. Government policy, aimed at reducing the supply surplus of the rest-of-the-world sector (by boosting export incentives, the introduction of an import surcharge, and the devaluation of the Israeli pound) made imperative the adoption of complementary measures – the diminution of the public sector demand surplus (which was at an inordinately high level) by augmenting its revenue or cutting down on expenditure, and braking the growth of the demand surplus of the public sector companies, private business, and nonprofit institutions. The latter could have been attained thanks to the public sector's control over the capital market (see the discussion in Chapter XVI, "Financial Institutions", section 2) and the volume of capital imports from abroad (this enables it to regulate the amount of financing supplied to the various sectors, without which they are unable to realize their demand for real resources).

But these steps were not taken. Instead, the public sector acted to check private consumption, thereby contributing to the growth of the household supply surplus. But, as noted, this failed to prevent demand pressure from driving up prices.

4. Financing the Demand Surpluses

The year reviewed witnessed a marked change in the financing of the aggregate demand surplus of the economy,[10] although the surplus itself held virtually steady at approximately IL 4,300 million. There was a much heavier inflow of personal cash remittances

10. The demand surplus of the economy as a whole is financed by unilateral transfers and net credit from abroad.

from abroad, which increased the volume of unilateral foreign transfer receipts from IL 2,300 million in 1970 to IL 3,000 million and their share in the financing of the import surplus from 53 to 69 percent.

Nonetheless, net credit from abroad (which the Government can determine, or at least strongly influence, because of its foreign currency control) remained at about the same level as in 1970. The outcome was that net foreign borrowed receipts exceeded the amount needed to cover the import surplus, and foreign currency reserves in the banking system swelled by IL 670 million. Although the steep increase in foreign unilateral transfer receipts was largely exogenous to the system, it may be concluded that this "overborrowing" from abroad in 1971 was the result of deliberate Government policy, since the growth in these transfer receipts was distributed over all four quarters of the year, and the competent authorities were thus in a position to modify the flow of credit from abroad during the year. That no appropriate measures were taken to counteract the inflationary impact of this accumulation of foreign currency is attested by the fact that the public sector demand surplus held practically steady in 1971.

A glance at Table XVI-3 shows that the most striking changes in the financing of demand surpluses in the year reviewed took place in public sector companies and nonprofit institutions.

The public sector companies experienced a drop in net credit from domestic financial sectors and a rise in net credit from abroad. Whereas in 1970 the public sector companies were net lenders to the rest of the world (net repayment of loans) to the tune of IL 92 million, in 1971 they received IL 430 million in net credit from this source. With respect to domestic financial sectors, in the year reviewed the public sector companies repaid them a total of IL 16 million, whereas in 1970 there was a net credit flow of IL 224 million in the other direction. This drastic change in the manner of financing the demand surplus of the public sector companies in 1971 was connected with the composition of their sharply higher investment in 1971: the acquisition of ships and aircraft from abroad involved the receipt of large foreign credits. Thus it may be concluded that, in spite of the sizable expansion of the public sector companies' demand surplus in 1971 (after the growth rate had sagged in 1970), they did not contribute to the demand pressure on domestic resources and their influence in this respect was apparently less inflationary than in 1970.

The nonprofit institutions received much more net credit from the domestic real sectors in the year reviewed – IL 290 million as against IL 82 million in 1970. As regards the domestic financial sectors, a net credit inflow of IL 66 million from this source in 1970 turned into a net credit outflow of IL 103 million in 1971 because of the repayment of debts (mainly to the banking system). This change in the composition of the institutions' financing, which was proportionately greater than the growth of their demand surplus, is explained by two factors:

(1) A change in Government policy. After drastically curtailing the flow of credit to the nonprofit institutions in 1970 (by about IL 36 million), as part of the policy of restraining inflationary pressure in the economy, the Government permitted an expansion (IL 113 million) in 1971.

Table XV–3

FINANCING OF SECTORAL DEMAND SURPLUSES, 1970–71[a]

(IL million)

	Transfers from abroad	Net credit received or granted (–)					Errors and omissions	Demand or supply (–) surplus (1 + 6 + 7)
		From abroad[b]	From domestic sectors: Financial[b]	From domestic sectors: Real	From domestic sectors: Total (3 + 4)	Total net credit (2 + 5)		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)[c]
Business and households								
1970	1,266	380	–1,286	–6	–1,292	–912	–344	10
1971	2,031	322	–2,067	–318	–2,385	–2,063	–541	–573
Public sector								
1970	782	1,683	1,445	–306	1,139	2,822	–	3,604
1971	715	1,688	1,640	–255	1,385	3,073	–2	3,786
Public sector companies								
1970	–	–93	224	230	454	361	14	375
1971	–	429	–16	283	267	696	–2	694
Nonprofit institutions								
1970	225	–	66	82	148	148	2	375
1971	262	–	–103	290	187	187	7	456
Social insurance funds and insurance companies								
1970	–	–8	–486	482	–4	–12	9	–3
1971	–	–10	–751	738	–13	–23	–5	–28
Banking system								
1970	–	299	174	–446	–272	27	–39	–12
1971	–	–667	283	489	772	105	–50	55
Financial institutions								
1970	–	88	312	–485	–173	–85	53	–32
1971	–	157	468	–681	–213	–56	7	–49
Rest of the world								
1970	–2,273	–	–379	–1,970	–2,349	–2,349	305	–4,317
1971	–3,008	–	520	–2,439	–1,919	–1,919	586	–4,341

[a] Data for 1970 were revised and reclassified.
[b] From Table XV–4.
[c] From Table XV–1.

(2) The easy liquidity situation in the economy in the year reviewed, which enabled the institutions to obtain much more financing from the private sector.

These two factors made it possible for the nonprofit institutions to erase the unprecedented 1970 bulge in their short-term indebtedness to the banking system and to revert to their normal pattern of financing, with most of the requisite funds being supplied by the domestic real sectors and the rest of the world (unilateral transfers).

The public sector showed no significant change in its mode of financing. As in 1970, it resorted largely to inflationary means, with net credit from abroad and from the domestic banking system together covering 80 percent of the demand surplus.

The private sector, as already noted, accumulates most of the errors and omissions in the system as a whole – an unavoidable consequence of the roundabout way of calculating how the sector's demand surplus is financed. As for the other domestic sectors, even when errors and omissions are detected in the course of the analysis, the problem can generally be resolved without making arbitrary decisions, since direct information is available on these bilateral flows. But this does not hold for the private sector. In the past two years errors and omissions were of considerable proportions (IL 344 million and IL 541 million in 1970 and 1971 respectively – see Table XV-3); this precluded the drawing of reliable conclusions and made it necessary to resort to conjecture. (The source of these errors and omissions is the balance of payments of the economy, where this item has grown to an unprecedented extent in the past two years). Apart from pointing to the marked growth in unilateral transfers from abroad, which were partly of a nonrecurrent nature and contributed to the creation of a supply surplus, whatever else may be said is pure speculation. Along with the creation of a supply surplus in 1971, the sector presumably experienced a net decline in credit from abroad and from the domestic real sectors.

5. Intersectoral Credit Flows

Credit-flows tables give a schematic presentation of the network of intersectoral financial relationships accompanying the saving-investment process and make it possible to trace the changes that occur in the pattern and size of the flows.

It is the character of the various sectors that largely determines the direction of their credit flows. The financial institutions, which are secondary financial intermediaries, obtain most of their funds from the financial sectors and transfer them to the real sectors. The social insurance funds and insurance companies are primary intermediaries, receiving credit from the real sectors and transferring it chiefly to the financial sectors. Among the domestic real sectors there is only one that grants more credit than it receives – households. The rest-of-the-world sector also supplies much more credit than it receives. The other real sectors – the public sector, private business, public sector companies, and nonprofit institutions – are all credit recipients. In addition to its real transactions, the public sector fulfills the function of financial intermediation – both directly, as reflected in the credit-flows tables, and indirectly by channelling most of the resources of the social insurance funds and insurance companies to the financial institutions, where it controls the allocation of funds.

Table XV–4

GROSS INTERSECTORAL CREDIT FLOWS, 1970–71[a]

(IL million)

Borrowing sector / Lending sector	Public sector	Public sector companies	Non-profit institutions	Business	Households	Total credit to domestic real sectors	Rest of the world	Banking system	Social insurance funds and insurance companies	Financial institutions	Total credit granted
Public sector											
1970	xx	226	36	850	367	1,479	914	451	7	97	2,948
1971	xx	396	113	1,146	404	2,059	1,299	147	1	374	3,880
Public sector companies											
1970	180	xx	–	–	–	180	129	145	7	–4	457
1971	89	xx	–	87	88	264	85	137	1	60	547
Nonprofit institutions											
1970	53	–	xx	–	–	53	–	42	–	15	110
1971	–	–	xx	–	–	–	–	90	–	34	124
Business											
1970	519	125	66	xx	b	710	507	163	86	17	1,483
1971	822	75	118	xx	b	1,015	924	383	138	126	2,586
Households											
1970	421	59	33	b	xx	513	43[c]	1,510	581	99	2,746
1971	893	76	59	b	xx	1,028	39[c]	2,001	890	196	4,154

Rest of the world											
1970	2,597	36	–	930	–	3,563	xx	881	–8	90	4,526
1971	2,987	514	—	1,285	–	4,786	xx	2,260	–10	187	7,223
Banking system											
1970	1,647	280	93	649	88	2,757	582	xx	–	230	3,569
1971	1,480	37	–9	784	–23	2,269	2,927	xx	78	191	5,465
Social insurance funds and insurance companies											
1970	61	42	4	53	39	199	–	226	xx	270	695
1971	83	66	5	70	68	292	–	455	xx	367	1,114
Financial institutions											
1970	292	50	26	295	46	709	2	178	10	xx	899
1971	599	79	25	565	203	1,471	30	97	–7	xx	1,591
Total credit received											
1970	5,770	818	258	2,777	540	10,163	2,177	3,596	683	814	17,433
1971	6,953	1,243	311	3,937	740	13,184	5,304	5,570	1,091	1,535	26,684
Errors and omissions											
1970	–	14	2		–344	–328	305	–39	9	53	–
1971	–2	–2	7		–541	–538	586	–50	–5	7	–

[a] The data for 1970 were revised and reclassified.
[b] Data on credit flows between these sectors are not available.
[c] Partial data – purchase of securities by households.

The intersectoral credit flows are often bilateral, and it is of interest to analyze each flow separately, even though the outflow must be set off against the inflow of each pair of sectors in order to determine which sector in the final analysis made funds available to the other.

The changes that took place in the structure of credit flows must be analyzed with considerable caution, especially in interpreting the 1970 and 1971 data for the private sector in general and its component segments in particular. As mentioned above, this is because of the largeness of the "errors and omissions" item in the flow-of-funds statement of the private sector and the residual method used for obtaining data on part of the sector's credit flows. Also, the boom in the housing market probably resulted in a larger volume of credit transactions between households and private business (down payments on homes), but this is not reflected in the credit-flows tables.

The principal changes that took place in the structure of credit flows in 1971 are as follows:

(1) A big increase in the amount of gross credit made available by households to other domestic sectors, in spite of the relatively small growth in the gross credit flow in the opposite direction. In 1971 gross credit to the public sector doubled (mainly because of larger compulsory loan collections); in addition, there was a marked rise in bank deposits of less than IL 50,000 (presumably these belonged to households). The larger volume of household financial savings also affected social insurance funds, insurance companies, and the mutual funds in the financial institutions sector.

(2) Private business enterprises received much more gross credit than in 1970, in the main from the public sector, financial institutions, and abroad. In short-term bank credit, on the other hand, there was only a relatively modest increase. These findings tend to bear out the assumption that in 1971 private business shifted from ordinary bank credit (which had become dearer) to low-interest credits granted at the direction of the public sector and to borrowing from abroad (under the foreign currency regulations the import of capital from abroad also requires a Government permit).

At the same time, private business also granted much more gross credit in the year reviewed. There was a striking growth in the flow to the public sector (increased compulsory loan collections) and to financial institutions (mainly deposits for the granting of loans and "other accounts").

(3) The sharply higher amount of gross credit received by the public sector from business firms (compulsory loans) was accompanied by an increased credit flow in the opposite direction – a result of both the larger volume of credit granted directly to the various domestic sectors in the year reviewed and the repayment of loans to contractors and building companies. The public sector stepped up its financial intermediation to an appreciable degree in 1971, as attested by the more than doubling of the gross credit flows (in both directions) between the public sector and the financial institutions.

The continued increase in the inflationary financing of public sector operations should also be noted here. This found expression in the growth of the net credit flow from the rest-of-the-world sector and from the domestic banking system.

(4) The sharply higher contractual savings of households in 1971 and the use of these

funds to provide more credit to the various economic sectors through the indirect intermediation of the public sector can be clearly seen in the increased flow of gross credit from households to social insurance funds, from the latter to the financial institutions, and from the financial institutions to the private business sector. However, part of the additional funds accumulated by the social insurance funds and insurance companies sector was channelled to the public sector through the banking institutions. Gross credit from households to social insurance funds and insurance companies rose from IL 581 million in 1970 to IL 890 million. This impressive growth enabled the latter sector to double the amount of gross credit supplied to the public sector through the banking institutions and to increase its lending to financial institutions by stepping up its purchases of their bonds. The heavier sale of bonds, together with the additional funds obtained from abroad and from the public sector, enabled the financial institutions to increase the flow of gross credit to private business from IL 295 million in 1970 to IL 565 million in 1971.[11]

11. The gross credit flows of the nonprofit institutions and the public sector companies are analyzed in the section dealing with the financing of these sectors' demand surpluses.