

## CHAPTER V

### DOMESTIC INVESTMENT

#### 1. MAIN DEVELOPMENTS

AFTER PICKING up strongly in 1968 with the recovery of the economy from the recession, gross domestic capital formation increased more slowly in the year reviewed. The growth (in 1969 prices) of fixed capital formation amounted to about IL 700 million, or 22 percent, compared with nearly IL 800 million (36 percent) in 1968. These notable increases in the last two years stand out conspicuously compared with the drastic cutback in 1966-67, when the level tumbled by more than IL 1,100 million.

Despite occasional fluctuations, investment demand has grown steadily since the second half of 1967, accelerating sharply during the last six months of 1969. As in 1968, investment in the year reviewed was both stimulated by the buoyant rate of economic activity and contributed to it. The higher output and sales of the last three years were accompanied by steadily mounting profits in the private sector in general and in industry in particular. Such changes generally engender expectations of a further growth of profits and largely determine the level of investment demand.

Factors largely exogenous to the economy have also influenced investment demand since the recession and the Six-Day War, but it is impossible to quantify them. Rising immigration (from a gross figure of 18,000 in 1967 to 38,000 in 1969) and tourism, coupled with the belief that the upswing would persist, spurred investment in residential and public buildings, in educational, health, and immigrant absorption institutions, and in hotels and facilities in other sectors supplying the additional population. The Government continued to encourage investment, mainly in industry, by providing IL 60 million in grants during the past two years, supplying loan capital (net long-term industrial credit granted through financial institutions was stepped up by 60 percent in 1969), and by other concessions. The expansion of local defense production also helped to augment investment demand.

The outstanding difference in investment activity between the last two years was the shifting in emphasis from nondwelling to dwelling investment. Whereas the former went up by 19 percent in 1969 as against 43 percent in 1968, investment in housing rose by 33 percent in 1969 as against 16 percent the year before. The area of residential starts expanded by approximately 45 percent in 1968 and 50 percent in 1969. The slow revival in starts with the pickup in residential construction was apparently due to the existence of a large stock of

**Table V-1**  
**GROSS AND NET INVESTMENT, 1965-69**  
(IL million, at current prices)

|                                    | 1965  | 1966  | 1967  | 1968  | 1969  | Percent annual real change |      |      |      |      |
|------------------------------------|-------|-------|-------|-------|-------|----------------------------|------|------|------|------|
|                                    |       |       |       |       |       | Average<br>1961-65         | 1966 | 1967 | 1968 | 1969 |
| Gross fixed nondwelling investment | 1,957 | 1,700 | 1,455 | 2,223 | 2,776 | 10                         | -15  | -15  | 43   | 19   |
| Less: Depreciation                 | 741   | 832   | 898   | 994   | 1,119 | 12                         | 10   | 6    | 3    | 9    |
| Net fixed nondwelling investment   | 1,216 | 868   | 557   | 1,229 | 1,657 | 10                         | -30  | -36  | 106  | 28   |
| Gross investment in dwellings      | 977   | 787   | 532   | 657   | 934   | 13                         | -19  | -32  | 16   | 33   |
| Less: Depreciation                 | 249   | 273   | 292   | 325   | 364   | 10                         | 9    | 7    | 4    | 5    |
| Net investment in dwellings        | 728   | 514   | 240   | 332   | 570   | 14                         | -29  | -53  | 30   | 60   |
| Total gross fixed investment       | 2,934 | 2,487 | 1,987 | 2,880 | 3,710 | 11                         | -16  | -21  | 36   | 22   |
| Change in inventories              | 143   | 118   | 52    | 284   | 122   |                            |      |      |      |      |
| Total gross investment             | 3,077 | 2,605 | 2,039 | 3,164 | 3,832 | 11                         | -12  | -22  | 47   | 15   |
| Less: Depreciation                 | 990   | 1,105 | 1,190 | 1,319 | 1,483 | 11                         | 10   | 6    | 3    | 8    |
| Total net investment               | 2,087 | 1,500 | 849   | 1,845 | 2,349 | 11                         | -23  | -43  | 106  | 19   |

SOURCE: Central Bureau of Statistics and Bank of Israel.

unsold dwelling units erected during the recession, time-lags inherent in construction, and organizational difficulties in expanding publicly financed housing.

The nondwelling capital stock (gross and net) increased by some 9 percent during 1969, following a rise of 8 percent in 1968. These figures reflect increases in gross investment of 19 percent in 1969 and 43 percent in the previous year.

In recent years the growth of the industrial capital stock has fluctuated widely, from 2 to 3 percent a year during the recession to 11 percent in 1969—a rate exceeding the annual average for the period before 1966. The structure of industrial investments also changed during the last two years, being concentrated chiefly in the metal industries (including mobile transport equipment) and textiles, while the share of new capital put into the food, mining, and non-metallic mineral industries contracted.

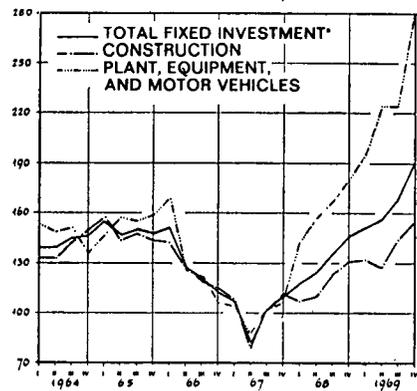
In 1969 the public sector<sup>1</sup> financed 47 percent of total new investment—another drop from the peak of 67 percent reached in 1967, but still above the 40 percent average of the prerecession years. The 1969 figure reflects the relatively slow growth of public financing in comparison with the rapid expansion of investment.

## 2. QUARTERLY DEVELOPMENTS

Fixed capital formation continued upward in 1969, in line with a trend begun in mid-1967, but the rise during the year was not even. During the first half the level advanced only slightly, but in the third quarter—and even more so in the fourth—it accelerated sharply. Between the last quarter of 1968 and the end of 1969, total expenditure on fixed assets other than ships and aircraft went up by some 31 percent, while the increase in the average annual level was about 27 percent.

The most rapid expansion since 1967 has been in imported plant, equipment, and transport vehicles (excluding ships and aircraft), whereas the value of non-residential construction put in place increased at a sluggish rate throughout the entire period (see Table V-2). Between the recession year 1967 (average for the four quarters) and the last quarter of

Figure V-1  
GROSS FIXED INVESTMENT,<sup>a</sup>  
QUARTERLY, 1964-69  
(Quantitative indexes; quarterly average  
for 1967=100)



<sup>a</sup> Excluding ships and aircraft.

<sup>1</sup> Public sector financing consists of the direct fixed investments of the Government, local authorities, and National Institutions; development budget loans and grants provided by the public sector for investment purposes; and the purchase of company shares by the Government.

1969, imported equipment more than trebled, locally manufactured equipment more than doubled, residential construction expanded by 74 percent, while other construction went up by only 42 percent.

In the short run, the influence exerted by investment on economic activity is reflected in its import and product components. A glance at Table V-2 shows that in the year reviewed it continued to have a stimulative effect on GNP and employment on the one hand and on imports on the other. Between the end of 1968 and the end of 1969 the import component of investment increased by one-third, and the product component by over one-quarter. The latter rose strongly in the second half of the year, after holding steady in the first half, whereas the import component moved up at a steady rate.

**Table V-2**  
**GROSS FIXED INVESTMENT,<sup>a</sup> QUARTERLY, 1965-69**  
(Quantitative indexes: quarterly average for 1967=100)

| Quarter | Total fixed investment <sup>a</sup> | Housing | Other construction | Plant, equipment, and vehicles |          | Import and product components of investment <sup>a</sup> |                      |
|---------|-------------------------------------|---------|--------------------|--------------------------------|----------|--|----------------------|
|         |                                     |         |                    | Locally manufactured           | Imported | Import   | Product <sup>b</sup> |
| 1965 I  | 155                                 | 197     | 133                | 144                            | 150      | 150  | 155                  |
| II      | 147                                 | 187     | 115                | 128                            | 183      | 162  | 143                  |
| III     | 150                                 | 177     | 129                | 134                            | 173      | 159  | 145                  |
| IV      | 148                                 | 174     | 124                | 142                            | 174      | 164  | 144                  |
| 1966 I  | 151                                 | 168     | 127                | 153                            | 184      | 159  | 145                  |
| II      | 127                                 | 157     | 107                | 111                            | 140      | 133  | 125                  |
| III     | 120                                 | 139     | 106                | 119                            | 122      | 120  | 119                  |
| IV      | 112                                 | 128     | 107                | 113                            | 101      | 110  | 114                  |
| 1967 I  | 107                                 | 115     | 103                | 108                            | 101      | 104  | 108                  |
| II      | 81                                  | 77      | 81                 | 83                             | 89       | 86   | 80                   |
| III     | 102                                 | 104     | 100                | 102                            | 102      | 102  | 102                  |
| IV      | 110                                 | 104     | 116                | 107                            | 108      | 108  | 110                  |
| 1968 I  | 118                                 | 104     | 108                | 127                            | 159      | 135  | 110                  |
| II      | 124                                 | 115     | 107                | 120                            | 191      | 155  | 113                  |
| III     | 136                                 | 121     | 125                | 148                            | 184      | 161  | 126                  |
| IV      | 146                                 | 124     | 136                | 133                            | 224      | 177  | 133                  |
| 1969 I  | 151                                 | 134     | 130                | 178                            | 213      | 178  | 138                  |
| II      | 156                                 | 148     | 112                | 153                            | 289      | 210  | 133                  |
| III     | 169                                 | 162     | 135                | 198                            | 248      | 205  | 153                  |
| IV      | 190                                 | 174     | 142                | 221                            | 326      | 242  | 168                  |

<sup>a</sup> Excluding ships and aircraft.

<sup>b</sup> At factor cost.

SOURCE: Central Bureau of Statistics and Bank of Israel calculations based on an input-output study updated to 1968.

Following these developments, the share of total revenue from income tax and

### 3. INVESTMENT, BY TYPE OF INVESTOR<sup>1</sup>

Between 1967 and the end of 1969 private investment doubled, while capital outlays by the public sector and its companies increased by about 50 percent (see Table V-3). A differentiation of the figures for 1968 and 1969 is not feasible, being considerably blurred by the arbitrary timing of the recording of ship acquisitions<sup>2</sup> (it is largely a matter of chance whether a ship is delivered at the end of one year or the beginning of the next).

Aggregate investment of the Government, local authorities, and Government enterprises (such as the Post Office and Israel Railways) did not fluctuate significantly during the recession period, and this relative stability continued in 1968 and 1969.

Much the same is true of investment by nonprofit institutions. Over 80 percent of their capital expenditure in the last two years was on education (chiefly higher education) and health. The extent of these investments is largely determined by the volume of capital transfers from abroad (donations) and the availability of Government development budget financing.

Investment by public sector companies, which depends both on factors affecting private enterprise and on Government decisions, displayed a strongly rising tendency in 1968 and 1969. By contrast, from 1965 through the recession period the level had dropped sharply. Thus we see that as a rule fluctuations in capital spending by public sector companies and by private business enterprises reveal a similar pattern. The principal projects undertaken by public sector companies during the last two years were the Eilat-Ashkelon oil pipeline, the chemical complex at Arad, the Reading "D" electric power station in Tel Aviv, the purchase of ships by Zim and aircraft by El Al and Arkia, and the development of the aviation and other military industries.

Private business investment reacts sharply to economic booms and slumps; after dropping by half from 1965 to 1967, it doubled between 1967 and 1969. This sector accounts for a considerable proportion of the capital put into industry, farms, commercial vehicles, hotels, commerce, and private services.

Private residential construction began to expand in 1968, the uptrend gaining momentum in 1969. By contrast, publicly financed residential construction contracted in 1968 but soared 43 percent in 1969. The faster reaction of the private sector to the brisk housing demand stands out conspicuously, but a contributory factor was the purchase by the Ministry of Housing of a large number of units from private contractors—particularly in 1969—in order to turn them over to immigrants.

<sup>1</sup> The reference is to the sectors purchasing the capital assets, i.e. the final owner.

<sup>2</sup> Fixed investment of the private sector other than in ships increased by 35 percent in 1969, after a rise of 50 percent in 1968. The difference between these data and those cited in Table V-3 reflects purchases of ships by private companies, in the amount of IL 200 million in 1968 but only some IL 22 million in 1969.

Table V-3

## GROSS FIXED INVESTMENT, BY TYPE OF INVESTOR AND INITIATING SECTOR, 1965-69

(IL million, at 1969 prices)

|  | 1965         | 1966         | 1967         | 1968         | 1969         | Percent annual increase or decrease (-) |            |            |           |           |
|--|--------------|--------------|--------------|--------------|--------------|---|------------|------------|-----------|-----------|
|  |              |              |              |              |              | 1965                                    | 1966       | 1967       | 1968      | 1969      |
| <b>Nondwelling investment, by investing sector<sup>a</sup></b> |              |              |              |              |              |   |            |            |           |           |
| Government, local authorities, and<br>National Institutions    | 381          | 348          | 398          | 425          | 441          | 15                                      | -9         | 14         | 7         | 4         |
| Government enterprises <sup>b</sup>                            | 244          | 236          | 197          | 210          | 218          | 17                                      | -3         | -17        | 7         | 4         |
| Public sector companies <sup>c</sup>                           | 364          | 313          | 257          | 440          | 660          | -31                                     | -14        | -18        | 71        | 50        |
| Total public sector investment                                 | <b>989</b>   | <b>897</b>   | <b>852</b>   | <b>1,075</b> | <b>1,319</b> | <b>-7</b>                               | <b>-9</b>  | <b>-5</b>  | <b>26</b> | <b>23</b> |
| Nonprofit institutions   | 146          | 162          | 151          | 172          | 205          | -3                                      | 11         | -7         | 14        | 19        |
| Private business enterprises <sup>d</sup>                      | 1,109        | 854          | 620          | 1,082        | 1,252        | 7                                       | -23        | -27        | 75        | 16        |
| Total private sector investment                                | <b>1,255</b> | <b>1,016</b> | <b>771</b>   | <b>1,254</b> | <b>1,457</b> | <b>6</b>                                | <b>-19</b> | <b>-24</b> | <b>63</b> | <b>16</b> |
| Total nondwelling investment                                   | <b>2,244</b> | <b>1,913</b> | <b>1,623</b> | <b>2,329</b> | <b>2,776</b> | <b>—</b>                                | <b>-15</b> | <b>-15</b> | <b>43</b> | <b>19</b> |
| <b>Investment in dwellings, by initiating sector</b>           |              |              |              |              |              |   |            |            |           |           |
| Public   | 395          | 294          | 173          | 167          | 239          | 5                                       | -26        | -41        | -4        | 43        |
| Private  | 714          | 601          | 432          | 536          | 695          | 9                                       | -16        | -28        | 24        | 30        |

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

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

#### 4. INVESTMENT, BY ECONOMIC SECTOR

Total fixed nondwelling investment increased by 19 percent in 1969, compared with approximately 43 percent the year before. During the recession the level dropped in absolute terms—from IL 2,200 million in 1965 to IL 1,600 million in 1967 (at 1969 prices). But by 1968 the economic upswing had pushed nondwelling capital outlays past the peak year of 1965, and in 1969 they advanced by another IL 450 million. Approximately three-quarters of the increase in gross nondwelling capital formation from 1967 to 1969 was in industry and transportation.

Industrial investment doubled in 1968 to reach the level of the prerecession year 1964, and it went up by a further 36 percent in 1969. In absolute terms, the increase in 1969 came to IL 180 million, with three branches heading the list (as in 1968): textiles, chemicals (including the complex at Arad) and oil refining, and metal products (including the military industries). These branches also accounted for some 55 percent of total industrial equipment imports. The weight of the food and the nonmetallic mineral products branches in new investment declined. Following the completion of the second stage of the Dead Sea Works expansion program, capital spending on mining and quarrying did not change significantly in the year reviewed.

The branch distribution of the grants given by the Investment Authority to approved enterprises under the Law for the Encouragement of Capital Investments reveals a similar picture. The total amount granted to industrial enterprises reached some IL 31 million (compared with IL 28 million in 1968), and constituted 5–7 percent of total investment in industry (but, of course, a much greater proportion of capital put into approved enterprises only). About 20 percent of all grants went to textile enterprises, another 20 percent to the chemical and oil refining industry, approximately 12 percent to metal fabricating firms, and some 13 percent to the motor vehicle industry. About two-thirds of the grants were given to investors in development areas, and the remaining third to enterprises located elsewhere. In addition to the outright grants and other concessions provided under the investment law,<sup>1</sup> the rising trend in industrial sales and profits also stimulated investment. Various indicators show that, after declining during the recession, industrial profits<sup>2</sup> began to move up steadily in mid-1967. Expectations of a continuation of this trend gave an added spur to capital spending in 1969, as did the fears of devaluation current toward the end of the year, which undoubtedly induced the advancing of orders and purchases of equipment from abroad. Another stimulating factor has been the gradual switching of military equipment purchases from foreign to domestic manufac-

<sup>1</sup> For a more detailed description see Bank of Israel, *Annual Report 1967*, p. 109.

<sup>2</sup> The rate of return per unit of capital, with the return defined as the difference between the value of the product and its wage cost.

**Table V-4**  
**CHANGES IN FIXED INVESTMENT, BY SECTOR, 1965-69**

(IL million, at 1969 prices)

|                                    | 1965<br>to<br>1967 | 1967<br>to<br>1968 | 1968<br>to<br>1969 | 1967<br>to<br>1969 |
|------------------------------------|--------------------|--------------------|--------------------|--------------------|
| Agriculture                        | -16                | 6                  | 17                 | 23                 |
| Irrigation                         | -9                 | -13                | -19                | -32                |
| Industry                           | -186               | 232                | 179                | 411                |
| Construction                       | -68                | 57                 | 8                  | 65                 |
| Electric power                     | -35                | 19                 | 23                 | 42                 |
| Transportation and communications  | -216               | 312                | 127                | 439                |
| Commerce and services              | -91                | 93                 | 112                | 205                |
| Total fixed nondwelling investment | <b>-621</b>        | <b>706</b>         | <b>447</b>         | <b>1,153</b>       |
| Dwelling investment                | -504               | 98                 | 231                | 329                |
| Total fixed investment             | <b>-1,125</b>      | <b>804</b>         | <b>678</b>         | <b>1,482</b>       |

turers, which has encouraged investment not only by the military industries themselves but also by many of their suppliers.

The growing volume of industrial investment during the past two years was accompanied by marked structural changes. This is brought out by Table V-5, which shows the branch distribution of new investment in 1968 and 1969, and compares it with that of the gross capital stock at the end of 1967. Although the data are provisional, they point up several of the outstanding changes in the development of the various branches discussed above.

Investment in transportation and communications also increased considerably under the impact of special projects, especially the Eilat-Ashkelon oil pipeline (the bulk of the expenditure took place in 1969). On the other hand, outlays on such public-sector projects as roads, harbors, posts, and the railway were on about the same scale as in 1968. This type of investment is not directly connected with current economic activity (though it can serve the Government in regulating economic activity), and it did not fluctuate greatly during the recession. During the five years 1965-69 the amount of capital put into projects of this kind averaged about IL 300 million per annum (at 1968 prices).

Because of the fortuitous element in the timing of ship deliveries (discussed on p. 75), little significance should be attached to the amount of investment recorded in a particular year. Between 1968 and 1969 investment in ships and aircraft decreased from IL 190 million to IL 91 million, even though Israel's marine and air fleets were undergoing rapid expansion. A number of passenger ships and freighters were sold in 1969, while some of the ships and aircraft ordered during the past two years will not be delivered until 1970 or 1971.

Table V-5

**BRANCH DISTRIBUTION OF GROSS INDUSTRIAL CAPITAL STOCK  
AT END OF 1967 AND INVESTMENT IN 1968-69**

(percentages)

| Branch                                     | Distribution<br>of capital<br>stock at end<br>of 1967 | Distribution<br>of invest-<br>ment in<br>1968-69 |
|--|---|--|
| Food and tobacco products                  | 16  | 11   |
| Textiles                                   | 15  | 16   |
| Mining and quarrying                       | 14  | 10   |
| Chemical and refined petroleum products    | 10  | 11   |
| Metals                                     | 10  | 18   |
| Nonmetallic mineral products               | 8   | 2  |
| Machinery, electrical equipment, and misc. | 7   | 9  |
| Transport equipment                        | 6   | 8  |
| Paper and printing                         | 5   | 4  |
| Rubber and plastic products                | 4   | 6  |
| Wood and carpentry                         | 3   | 2  |
| Clothing and leather goods                 | 2   | 3  |
| Total                                      | <b>100</b>  | <b>100</b>                                       |

SOURCE: Distribution of gross capital stock—provisional estimates of the Bank of Israel; distribution of investment—data on equipment imports, 1968 Survey of Industry, and Central Bureau of Statistics data on investment in plants under construction or in the running-in stage.

The increase of two-thirds in acquisitions of motor vehicles is explained by the stepping-up of activity in various sectors of the economy, such as construction and industry, and by expectations of price increases in the wake of another devaluation or revision of taxes. Vehicle purchases may also have been influenced by the larger number of old cars and trucks scrapped, the lengthening of the domestic transport routes, and the greater volume of economic activity and defense work in the administered areas.

Investment in agriculture expanded somewhat in 1969, but this did not signal a reversal of the downtrend that has persisted for more than a decade. As regards orchards, the level continued to fall, reaching a very low IL 20 million, after having averaged some IL 50 million annually during the early sixties. This reflected an anticipated weakening of demand as well as constraints in the supply of the main productive factors, land and water. Land reclamation and afforestation work was on a somewhat smaller scale than in 1967 and 1968, and was apparently concentrated in the northern areas of the country, including the Golan Heights. The growth in agricultural investment was confined to machinery and equipment for replacing worn-out implements (which have been increasing steadily), for use in new settlements, and for replacing manpower.

**Table V-6**  
**GROSS FIXED INVESTMENT, BY SECTOR, 1960-69**

(IL million, at 1969 prices)

|                                   | 1960  | 1961  | 1962  | 1963  | 1964  | 1965  | 1966  | 1967  | 1968  | 1969  |
|-----------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Agriculture                       | 234   | 220   | 207   | 184   | 201   | 187   | 163   | 171   | 177   | 194   |
| Thereof: Agricultural output      | 108   | 99    | 100   | 86    | 91    | 82    | 65    | 82    | 69    | 65    |
| Irrigation                        | 93    | 109   | 150   | 161   | 113   | 84    | 79    | 75    | 62    | 43    |
| Industry, mining, quarrying       | } 363 | 441   | 378   | 451   | 489   | 448   | 337   | 262   | 494   | 673   |
| Construction equipment            |       |       | 76    | 68    | 70    | 76    | 26    | 8     | 65    | 73    |
| Electric power                    | 74    | 83    | 103   | 74    | 67    | 112   | 119   | 77    | 96    | 119   |
| Transportation and communications | 286   | 415   | 363   | 405   | 721   | 674   | 533   | 458   | 770   | 897   |
| Ships and aircraft                | 127   | 195   | 75    | 59    | 206   | 108   | 55    | 53    | 190   | 91    |
| Motor vehicles                    | 59    | 92    | 121   | 162   | 206   | 200   | 147   | 88    | 168   | 292   |
| Other items                       | 100   | 128   | 167   | 184   | 309   | 366   | 331   | 317   | 412   | 514   |
| Commerce and services             | 354   | 407   | 422   | 498   | 588   | 663   | 656   | 572   | 665   | 777   |
| Housing                           | 612   | 747   | 939   | 933   | 1,035 | 1,109 | 895   | 605   | 703   | 934   |
| Total fixed investment            | 2,016 | 2,422 | 2,638 | 2,774 | 3,284 | 3,353 | 2,808 | 2,228 | 3,032 | 3,710 |

SOURCE: Central Bureau of Statistics.

Expenditure on water projects continued downward, a trend that began with the completion of the National Water Carrier in 1964. Compared with some IL 160 million in 1963, total investment in local and regional water projects during 1969 came to only about IL 43 million.

Investment in electric power increased by some 24 percent, because of the doubling of expenditure on the Reading "D" power station.

In commerce and services investment expanded at the relatively slow rate of about 16 percent in each of the last two years; however, it should be pointed out that during the recession it had not declined to any significant extent. The 1969 growth rate was the net result of two opposing developments: Expenditure on the construction of business and office premises dropped in absolute terms for the second consecutive year, since the enormous stock accumulated as a result of overbuilding in previous years supplied most of the incremental demand accompanying the expansion of economic activity. On the other hand, capital spending on educational, health, and nonprofit institutions rose steeply. Investment in hotels was down somewhat in 1969, after a strong rise the year before. These and other investments in tourism have on the whole expanded very rapidly since the Six Day War, stimulated by the big influx of foreign visitors and the growth of domestic tourism.

## 5. INVESTMENT, BY TYPE OF ASSET

Continuing a trend begun in 1968, the weight of machinery and equipment within total nondwelling fixed investment, which had been about 41 percent

**Table V-7**  
**GROSS FIXED INVESTMENT, BY TYPE OF ASSET, 1965-69**  
(IL million, at 1969 prices)

|                               | 1965         | 1966         | 1967         | 1968         | 1969         | Percent annual increase<br>or decrease (-) |            |           |           |
|-------------------------------|--------------|--------------|--------------|--------------|--------------|--|------------|-----------|-----------|
|                               |              |              |              |              |              | 1966                                       | 1967       | 1968      | 1969      |
| New construction              | 2,166        | 1,843        | 1,447        | 1,722        | 2,063        | -15  | -22        | 19        | 20        |
| Housing                       | 1,109        | 895          | 605          | 703          | 934          | -19  | -32        | 16        | 33        |
| Nonresidential structures     | 623          | 568          | 455          | 525          | 567          | -9   | -20        | 15        | 8         |
| Other construction            | 434          | 380          | 387          | 494          | 562          | -12  | 2          | 28        | 14        |
| Assets from                   |              |              |              |              |              |  |            |           |           |
| farm output                   | 82           | 65           | 82           | 69           | 65           | -21  | 26         | -16       | -6        |
| Machinery and equip-          |              |              |              |              |              |  |            |           |           |
| ment                          | 797          | 698          | 558          | 883          | 1,199        | -12  | -20        | 58        | 36        |
| Produced locally              | 304          | 289          | 253          | 319          | 442          | -5   | -13        | 26        | 39        |
| Imported                      | 493          | 409          | 305          | 564          | 757          | -17  | -25        | 85        | 34        |
| Motor vehicles                | 200          | 147          | 88           | 168          | 292          | -26  | -40        | 91        | 74        |
| Ships and aircraft            | 108          | 55           | 53           | 190          | 91           | -49  | -4         | 258       | -52       |
| <b>Total fixed investment</b> | <b>3,353</b> | <b>2,808</b> | <b>2,228</b> | <b>3,032</b> | <b>3,710</b> | <b>-16</b>                                 | <b>-21</b> | <b>36</b> | <b>22</b> |

during the recession period and averaged 45 percent before that, rose from 46 to 52 percent in 1969. This development is partly explained by the changed composition of investment in favor of sectors that are heavy users of equipment—such as construction (the reference is solely to construction equipment), industry, and electric power—at the expense of sectors investing relatively more heavily in structures, such as commerce and irrigation. Several reasons can be advanced for the difference in the pattern of investment between the two types of assets:

(a) The relative prices of new buildings and equipment changed, and were expected to change more in the future. Construction prices rose over the last two years rather faster than equipment prices, and even more important, expectations of a devaluation and higher prices in 1969 caused the advancing of equipment purchases from abroad, even when buildings to house the equipment were not ready. Also, the grants given under the Law for the Encouragement of Capital Investments finance a larger percentage of the cost of equipment than of buildings—in development areas 33 as against 20 percent.

(b) During the last two years a stock of business, office, and industrial premises (built chiefly for renting) was left empty because of overbuilding during the prerecession years.

(c) There was apparently a shift to more expensive equipment relative to the value of buildings required for its installation (the reference is to such items as computers, electro-optical equipment, and other intricate equipment and machinery).

(d) Investors were more cautious after their experience during the recession, some preferring to install additional equipment in existing buildings, or in buildings rented from other sectors—in fact even in temporary sheds—and to postpone the construction of new premises.

Although the expansion of investment in plant and equipment remained faster than that in buildings in 1969, it was somewhat below the exceptionally strong growth rate in the immediate postrecession period. Concurrently, the sources of machinery and equipment also shifted somewhat in favor of imports. Direct purchases of equipment from abroad increased by 34 percent in 1969, after soaring 86 percent in 1968, the latter development following a sharp contraction during the recession. In contrast to this, domestic production of machinery and equipment was up 39 percent in 1969, after a 26 percent gain in 1968. Most of the increase was in machinery and equipment for industry (including electric power, construction, and water), but even in this sector the proportion of locally manufactured equipment was still lower in 1969 than during and before the recession (see Table V-8). The weight of equipment produced in Israel, including commercial motor vehicles, in total equipment purchases did not increase at all.

Investments immediately create—both directly and indirectly—income and employment in the country, as reflected by the level of current economic activity. The total value added (or product) attributable to new investment decreased by some IL 850 million (at 1969 prices) during the recession, while

Table V-8

SHARE OF TOTAL OUTLAY<sup>a</sup> ON CAPITAL GOODS<sup>b</sup> SUPPLIED FROM LOCAL PRODUCTION, BY SECTOR OF DESTINATION, 1964-69

(percentages)

|  | 1964-65 | 1966-67 | 1968 | 1969 |
|--|---------|---------|------|------|
| Agriculture                                    | 57      | 64      | 58   | 57   |
| Industry                                       | 29      | 32      | 23   | 26   |
| Construction equipment                         | 23      | 37      | 11   | 15   |
| Electric power and water                       | 25      | 25      | 26   | 35   |
| Transportation and communications <sup>c</sup> | 43      | 48      | 45   | 42   |
| Commerce and services                          | 53      | 52      | 54   | 52   |
| Total, excl. ships and aircraft                | 41      | 45      | 37   | 37   |
| Total, incl. ships and aircraft                | 35      | 42      | 31   | 35   |

<sup>a</sup> At constant 1969 prices.<sup>b</sup> Machinery, equipment, and mobile transport equipment.<sup>c</sup> Excluding ships and aircraft.

SOURCE: Central Bureau of Statistics.

during the boom of 1967-69 it increased to a similar extent, thus regaining its 1965 level (see Table V-9). However, in recent years the share of the product component in new investment has been slipping—from about 62 percent in 1966 and 1967 to 55 percent in 1969. This is explained by the changes in the types of capital outlay discussed above—the growing weight of equipment, which has a relatively high import component, and the declining weight of construction, where the product component is dominant.<sup>1</sup>

Changes in employment attributable to new investment have traced a similar path to that of fluctuations in the product component. The sharp cutback in capital spending during the recession was the main cause of the large-scale unemployment, while during the subsequent boom period the growth of such spending was largely responsible—along with the expansion of exports and public consumption—for the overall growth of product and employment.<sup>2</sup>

Analysis of the import component of investment completes the picture. During the last two years the total import component of construction, equipment, and transport vehicles reached an estimated 33 percent of the value of new investment (at 1969 prices), compared with an average of approximately 26 percent in 1966-67. An idea of the magnitude of this change can be gained from the fact that the growth of the import component of investment accounted for nearly half of the total increase in the balance of payments deficit in 1967-69.

<sup>1</sup> For a detailed discussion of this subject see A. Bregman, "The Influence of Changes in Investment on Product and Employment in Boom and Slump Periods in Israel (1965-68)", *Bank of Israel Bulletin*, No. 34, June 1970.

<sup>2</sup> See also Chapter IX.

**Table V-9**  
**COMPONENTS OF INVESTMENT, 1965-69**  
(IL million, at 1969 prices)

| Component            | 1965         |            | 1966         |            | 1967         |            | 1968         |            | 1969         |            |
|----------------------|--------------|------------|--------------|------------|--------------|------------|--------------|------------|--------------|------------|
|                      | IL m.        | %          |
| Import               | 939          | 28         | 736          | 26         | 584          | 26         | 1,034        | 34         | 1,213        | 33         |
| Taxes                | 389          | 12         | 337          | 12         | 258          | 12         | 333          | 11         | 442          | 12         |
| Product <sup>a</sup> | 2,025        | 60         | 1,735        | 62         | 1,386        | 62         | 1,665        | 55         | 2,055        | 55         |
| <b>Total</b>         | <b>3,353</b> | <b>100</b> | <b>2,808</b> | <b>100</b> | <b>2,228</b> | <b>100</b> | <b>3,032</b> | <b>100</b> | <b>3,710</b> | <b>100</b> |

<sup>a</sup> Value added.

## 6. PRICES

Investment prices rose sharply during the past two years in comparison with prices of other domestic uses—by some 6.5 percent in 1968 and 5.5 percent in 1969. The increase in 1968 was partly due to the devaluation of November 1967, which made machinery and equipment more expensive, whereas the rise in 1969 was associated with the rapid growth of construction output and the appearance of excess demand in the housing market. Construction prices went up by an estimated 7 percent approximately, while machinery and equipment prices rose only 4 percent.

The excess demand for housing and some types of earthwork was not a general phenomenon, but was limited to certain parts of the country, such as Jerusalem, where there was an exceptionally heavy demand for housing, or the border areas, where considerable defense construction was carried out. There may also have been difficulties in obtaining skilled labor or in organizing construction in certain localities, but it should be stressed that the technical problems connected with the inherently lengthy construction process preclude a rapid adjustment of supply to changes in demand. Consequently, there were striking interregional differences in the rates of increase in housing prices.<sup>1</sup>

Among the construction inputs, prices of imported materials and metal products rose most steeply, owing to the substantially higher prices charged abroad in the year reviewed. The increase in wages (per standard man-day) is estimated at approximately 6 percent, but there is no suitable price index to confirm this estimate.

Prices of equipment are largely determined by the effective rate of exchange and by price changes abroad, since the import component of this investment

<sup>1</sup> Changes in housing prices are not strictly comparable with changes in investment prices, because the former also cover secondhand dwellings and the imputed value of the land on which the buildings are standing. For further details on this point, as well as residential construction in general and input prices, see Chapter XII, "Construction and Housing".

item is high. In 1969 the effective exchange rate held steady, and the average price increase of about 5 percent was due to inflationary developments in certain European countries and in the United States—Israel's main suppliers. Wholesale prices of locally manufactured products went up to a smaller extent.

## 7. CAPITAL STOCK

The gross nondwelling capital stock expanded by 9 percent in real terms in 1969. Over the past four years growth averaged about 7 percent per annum, roughly the same rate as for GNP. In 1960–65 these two aggregates went up by an average of 10–11 percent per annum.

Industry recorded an exceptionally strong expansion of real capital stock in 1969—about 11 percent, compared with only 2 percent in 1967 and an average of 9 percent during the prerecession period. This big increase in the sector's production capacity will permit the rapid growth of industrial output in the years ahead. The notable expansion of industrial production in the last two years was largely made possible by the utilization of capital stock idle in 1966–67.

**Table V-10**  
**GROWTH OF REAL GROSS CAPITAL STOCK,<sup>a</sup> BY SECTOR, 1960-69**  
(percentages)

| Period                       | Agri-<br>culture | Irri-<br>gation | Industry<br>and<br>con-<br>struc-<br>tion<br>equip-<br>ment | Electric<br>power | Trans-<br>portation<br>and<br>commu-<br>nications | Com-<br>merce<br>and<br>services | Total<br>non-<br>dwelling<br>capital<br>stock | Dwell-<br>ing<br>stock | Total<br>capital<br>stock |
|------------------------------|------------------|-----------------|---|-------------------|---|----------------------------------|---|------------------------|---------------------------|
| Annual aver-<br>age, 1960-65 | 5                | 9               | 9   | 8                 | 15  | 16                               | 11  | 10                     | 10                        |
| 1966                         | 3                | 5               | 3   | 8                 | 9   | 12                               | 7   | 7                      | 7                         |
| 1967                         | 3                | 4               | 2   | 4                 | 7   | 10                               | 5   | 4                      | 5                         |
| 1968                         | 3                | 3               | 8   | 5                 | 13  | 10                               | 8   | 5                      | 7                         |
| 1969                         | 3                | 2               | 11  | 6                 | 13  | 10                               | 9   | 6                      | 8                         |

<sup>a</sup> Between the beginning and the end of the year.

Unutilized production capacity is reflected by the capital/product ratio;<sup>1</sup> this was especially high during the recession, declined in 1968, and in 1969 fell almost to the prerecession level (see Table V-11).

The stock of capital assets per employed displays a long-run upward trend

<sup>1</sup> The gross capital stock represents the estimated potential production capacity of the economy at a given time, but not the amount of capital actually utilized in production.

in all sectors of the economy. Fluctuations in this ratio also depend on the extent to which productive factors (capital and labor) are utilized.

The sectoral structure of the economy's capital stock changed significantly during the past decade. The share of agriculture and irrigation fell from 31 percent at the end of 1959 to 21 percent at the end of 1969, and there was also a decrease, though a smaller one, in the share of industry. On the other hand, the weight of transportation and communications and the commerce and services sector increased, reaching about half of the economy's total nondwelling capital stock in 1969.

A breakdown of the capital stock increment in 1969 indicates a continuation of the downtrend in agriculture and irrigation and a further rise in the weight of transportation and communications and of commerce and services. However, the weight of industry in the increment may signal a possible change in the declining trend of this sector (see Table V-12).

The growth of the gross capital stock reflects both gross investment and discards (the value of assets scrapped because of obsolescence). During the last two years scrapping amounted to approximately 20 percent of total gross nondwelling investment. In agriculture it came to nearly half the value of new investment, but in industry, transportation and communications, and commerce and services the proportion was about 15 percent.

**Table V-11**  
**CAPITAL/PRODUCT RATIO AND CAPITAL PER EMPLOYED, 1960-69**

|  | 1960 | 1961 | 1962 | 1963 | 1964 | 1965 | 1966 | 1967 | 1968 | 1969 |
|--|------|------|------|------|------|------|------|------|------|------|
| <b>Capital/product ratio</b>                 |      |      |      |      |      |      |      |      |      |      |
| Incl. dwellings                              | 2.23 | 2.21 | 2.20 | 2.20 | 2.19 | 2.24 | 2.42 | 2.53 | 2.33 | 2.22 |
| Excl. dwellings                              | 1.52 | 1.51 | 1.51 | 1.50 | 1.50 | 1.54 | 1.67 | 1.75 | 1.60 | 1.52 |
| <b>Capital per employed, excl. dwellings</b> |      |      |      |      |      |      |      |      |      |      |
|  | 13.9 | 14.5 | 15.3 | 16.6 | 17.3 | 18.7 | 20.6 | 23.2 | 22.2 | 23.1 |

The gross capital stock by and large reflects the current production capacity of the economy. Capital stock net of depreciation represents the estimated production potential of the capital assets during their economic life. Real changes in the net capital stock in the last two years were similar to those in the gross capital stock, but there was a marked disparity between the two rates of change during the recession, when the net nondwelling capital stock increased more slowly than the gross stock. In industry, the net capital stock even declined in 1967, when depreciation exceeded gross investment in the sector (i.e. net

Table V-12

## GROSS CAPITAL STOCK, BY SECTOR, 1969

(IL million, at 1969 prices)

|  | Capital stock at beginning of 1969 | Gross investment in 1969 | Discards in 1969 | Incremental capital stock in 1969 | Capital stock at end of 1969 | Weight in total capital stock (end of year) |            | Weight in incremental capital stock in 1969 |
|--|------------------------------------|--------------------------|------------------|-----------------------------------|------------------------------|---|------------|---|
|  |                                    |                          |                  |                                   |                              | 1959  | 1969       |   |
| Agriculture                            | 3,760                              | 194                      | 85               | 109                               | 3,869                        | 22  | 14         | 5   |
| Irrigation                             | 1,883                              | 43                       | 8                | 35                                | 1,918                        | 9   | 7          | 1   |
| Industry and construction <sup>a</sup> | 5,628                              | 746                      | 128              | 618                               | 6,246                        | 26  | 23         | 28  |
| Electric power                         | 1,535                              | 119                      | 31               | 88                                | 1,623                        | 7   | 6          | 4   |
| Transportation and communications      | 5,675                              | 897                      | 144              | 753                               | 6,428                        | 18  | 24         | 34  |
| Commerce and services                  | 6,276                              | 777                      | 153              | 624                               | 6,900                        | 18  | 26         | 28  |
| Total nondwelling capital stock        | <b>24,757</b>                      | <b>2,776</b>             | <b>549</b>       | <b>2,227</b>                      | <b>26,984</b>                | <b>100</b>                                  | <b>100</b> | <b>100</b>                                  |
| Dwellings                              | 14,582                             | 934                      | 35               | 899                               | 15,481                       |   |            |   |
| Total stock of fixed assets            | <b>39,339</b>                      | <b>3,710</b>             | <b>584</b>       | <b>3,126</b>                      | <b>42,465</b>                |   |            |   |

<sup>a</sup> Includes industry, mining, quarrying, and construction equipment.

SOURCE: Based on estimates of Dr. A. L. Gaathon. For definitions and explanations see A. L. Gaathon, *Capital Stock, Employment and Output in Israel, 1950-1959*, Bank of Israel, Jerusalem (1961), p. 2.

investment was negative); by contrast, in 1968 and 1969 depreciation amounted to only about half of new investment. These sharp swings in the ratio between depreciation and gross investment (or in net investment) stem from the fact that depreciation represents a more or less constant percentage of the gross capital stock, and hence fluctuates but slightly compared with the substantial annual changes in new investment. The small rise in the weight of equipment within the total capital stock in 1969 did not alter the weight of depreciation to any significant degree.

## 8. FINANCING OF INVESTMENT

The much larger investment by the private sector and public sector companies in 1968-69 was accompanied by a decrease in the proportion of such investment financed directly by the Government. Nevertheless, the relative share of public financing,<sup>1</sup> which began to fall in 1967, was still approximately 5 percentage points higher in 1969 than the average for the prerecession period (see Table V-13).

Besides direct financing, the Government provides loan capital through financial institutions, social insurance funds, and other institutions, in addition to budgetary funds granted through these institutions.<sup>2</sup> As a result, the Government exercises control over the allocation and terms of almost all credit provided

Table V-13

### SHARE OF GROSS INVESTMENT FINANCED BY THE PUBLIC SECTOR, 1961-69

(percentages)

|                                   | Average<br>1961-65 | 1966 | 1967 | 1968 | 1969             |
|-----------------------------------|--------------------|------|------|------|------------------|
| Agriculture and irrigation        | 85                 | 89   | 91   | 91   | 100 <sup>a</sup> |
| Industry and construction         | 20                 | 16   | 68   | 46   | 30               |
| Electric power                    | 25                 | 23   | 19   | 32   | 18               |
| Transportation and communications | 48                 | 70   | 77   | 56   | 44               |
| Commerce and services             | 44                 | 53   | 60   | 62   | 52               |
| Total nondwelling investment      | 45                 | 54   | 70   | 58   | 47               |
| Dwellings                         | 33                 | 36   | 61   | 47   | 48               |
| Total fixed investment            | 40                 | 48   | 67   | 55   | 47               |

<sup>a</sup> Public financing in 1969 exceeded investment in this sector.

<sup>1</sup> Consists of direct fixed investments by the public sector (but not by its companies), loans, grants, and purchases of company shares by the Government. For further details see Bank of Israel, *Annual Report 1968*, Chapter V, pp. 109-10.

<sup>2</sup> See Chapter XVI, "Financial Institutions".

in the economy. Most of the additional net credit granted by the financial institutions in 1969 was for financing housing and industry in the wake of the much heavier investment in these sectors.

A source of funds largely independent of the public sector is the enterprises' own means (including private financing from abroad). This source apparently increased appreciably during the last two years because of the rising profitability of private business. The volume of financing from other sources, such as social insurance funds and banks, was also greater in the year reviewed.

In 1969 the total amount of financing provided agriculture and irrigation by the Government and the Jewish Agency exceeded fixed investment in these sectors. Some of the funds were apparently used to put certain agricultural settlements on a sounder financial basis, and not solely for new investment.

In electric power generation, an additional major source of financing is loans from insurance companies. The latter purchased IL 25 million of Israel Electric Corporation bonds in the year reviewed, after having bought some IL 28 million worth in 1968 and IL 18 million in 1967. This source finances approximately one-fourth of the total fixed investment in this sector.