

CHAPTER IX

PRICES

1. MAIN DEVELOPMENTS

The rate of increase in prices took an upward leap in 1974: the prices of domestic uses rose by about 38 percent on an annual average, as against 20 percent in 1973 and an average of 7 percent between 1955 and 1965. From the aspect of the rate of increase in prices, 1974 is part of the inflationary process that began to develop in 1970 and 1971, although the factors that led to the inflation of 1974 are not identical with those of 1970-73.

Most of the price increases in 1974 were concentrated in the months of February-March and November, when the prices of most controlled products were raised. In November, in addition, the Israeli pound was devalued. The average annual increase in the Consumer's Price Index was 40 percent, but during the year (December 1973 to December 1974) the index, excluding fruit and vegetables, rose by 58 percent. The rise in product prices was much less, amounting to 32 percent on an annual average.

In the recent past, the inflation was mainly the result of demand pressures. In 1974, too, adequate demand existed, in the sense that the substantial price increases were absorbed without any increase in unemployment. The structure of the demand, however, was such that alongside the boom in a number of markets there was a sluggishness in the demand for the products of a number of branches. It appears that demand fell off in the second half of the year. One of the indications of this is the decline in productivity, which points to the development of invisible unemployment. The increased weight of factors on the costs side in 1974 is striking: the raising of the prices of controlled products by the Government, the rise in import prices, and the cost-of-living allowance that followed. Nevertheless, as we have noted, the demand in the economy was more or less sufficient to absorb the increase in prices that was bound to follow the rise in costs without creating visible unemployment. The timing of the price rises—February, March, and November—was determined by the costs factors.

The increase in demand stemmed principally from intensified demand on the part of the defense establishment and from the demand for private consumption. It should

be emphasized that part of the rise in demand resulted directly and indirectly from the increase of prices owing to the costs. This, because of the automatic mechanism of the c-o-l allowance, the mechanism of affluence provided by National Insurance and the social welfare services, and the hastening of purchases because of rising prices.

The prices of controlled products rose by 100 percent during 1974. In the past the increases in the prices of these products were slow, so that there was a steady decline in their relative prices. The increase in the prices of this group in 1974 contributed to restoring the relative price level of the controlled products to that of 1969-70.

Table IX-1
AVERAGE RISE IN PRICES OF RESOURCES AND USES, 1961-74
(percentages)

	Average		1971	1972	1973	1974
	1961-65	1969-70				
Private consumption	7.0	3.5	11.9	15.3	19.9	38.2
Public consumption	10.5	4.5	16.5	18.6	21.2	31.4
Gross capital formation	8.5	6.0	13.6	16.6	24.9	39.1
Total domestic uses	8.0	4.5	13.6	16.4	21.9	36.1
Exports	13.0	6.0	15.4	15.5	18.4	37.9
Total uses	8.5	4.5	14.0	16.2	21.2	36.5
Imports	11.0	6.5	16.2	20.2	20.4	41.1
Gross national product	8.0	3.5	12.7	14.6	20.9	33.5
Total resources	8.5	4.5	14.0	16.2	21.2	36.5

NOTE: Figures are rounded off to the nearest half percent.
SOURCE: Central Bureau of Statistics.

The relatively greater rise in the prices of the controlled products led to an especially large increase in the price of the basket of products bought by low-income families. In previous years the reverse was true: the price of the basket of higher-income families rose more rapidly than that of low-income families. This does not mean that in 1974 the relative position of the low-income groups worsened in comparison with 1973: the supplementary income provided by National Insurance and the social welfare services saw to that.

2. PRICE DEVELOPMENTS

The 1974 price rises were at a practically unprecedented rate, and in all areas. The prices of domestic uses rose by an average of 38 percent, export prices by almost 35 percent, and prices of imports by 42 percent. Since the establishment of the State, only in 1952 did the prices of domestic uses rise more rapidly. In the period 1954-74 the average annual price rise was 8 percent. Even in 1961-65—a period of full employment and rapid growth—the prices of domestic uses rose by only 8 percent a year.

The uniqueness of 1974 in the inflationary process that goes back to 1970 lies in the intensity of the increase of prices and in the great weight of factors on the costs side in comparison with previous years.

The price rises that occurred in 1974 are characterized by a large measure of irregularity. For the most part they resulted from activities of the Government in February and November, while the rest of them were concentrated in July.

The behavior of the main indexes in the course of the year was similar, and so our discussion will be devoted to only one of them: the Consumer's Price Index. In the

Table IX-2
RISE IN VARIOUS PRICE INDEXES, 1964-74
(percentages)

	Average			1972	1973	1974
	1964-66	1967-69	1970-72			
Consumer's price index						
General	6.9	2.1	10.3	12.9	20.0	39.7
Excl. fruit and vegetables	7.1	1.9	10.5	13.2	19.7	40.6
Excl. fruit and vegetables and housing	5.8	1.9	9.6	11.5	16.5	40.0
Wholesale price index of industrial output	3.6	1.9	9.2	11.6	19.1	51.5
Index of input prices in agriculture	5.9	4.5	10.4	14.8	14.2	55.1
Index of residential construc- tion input prices	6.8	2.3	12.5	16.0	28.5	47.2
Index of road construction input prices		2.9	11.4	14.1	20.1	49.8

SOURCE: Central Bureau of Statistics.

first quarter of 1974 this index rose at a rather rapid rate: by 66-67 percent in annual terms. For the most part this increase derived from activities of the Government at the end of 1973 and in January 1974. In November 1973 the import levy and purchase taxes were increased, following the raising of fuel prices in October. The effects of these measures were felt well into 1974. In January 1974 fuel and electricity prices were raised by 40-50 percent, and in February the prices of basic foodstuffs were increased on account of price rises abroad and the jump in subsidies that this entailed. Fares in public transport were also increased.

The 23 percent rise in the prices of controlled products in the first quarter of 1974 contributed directly to a 5 percent increase in the index; in this quarter the index rose by 13.5 percent. The direct contribution of the price increases of controlled products on the increase of the Consumer's Price Index was slightly more than one third of the total rise of the index. The total influence of the Government's measures was actually greater, owing to their indirect effects.

Price rises in the second quarter of the year were more moderate than in the first quarter, even though they came to 40-45 percent in annual terms. In this quarter, too, the Government's intervention was significant: the prices of controlled products rose by 12.5 percent, and their direct contribution was 28 percent of the total price increases. While this was not as great as in the first quarter, it is still a contribution to be reckoned with.

Beginning in June 1974 there was an appreciable deceleration in the rate of price increases although, again, it was still much higher than the economy had been used to in the past. Consumer prices in the third quarter came to 15-20 percent on an annual basis (the general Consumer's Price Index and the Consumer's Price Index excluding fruit and vegetables, respectively). This is a significant decline in comparison with the tempo of price rises in the first half of the year. In July another step in the Government's economic policy was activated, in the framework of which cigarette prices and purchase taxes on a number of products were increased; the effect of these measures on prices was not great, however. The import levy was likewise raised, but simultaneously customs duties were decreased as part of the policy of exposing local products to the competition of foreign-made goods. It can be said that the direct influence of the Government in the third quarter was negligible.

In the beginning of the fourth quarter there was an intensification of price increases; in October a rise of 2.5 percent was recorded (35 percent in annual terms). In this quarter the Government took unprecedented steps when it raised the prices of basic products considerably: bread, by 71 percent; milk, by 59 percent; sugar, by 200 percent; electricity, by 75 percent; and fuel, by 65-75 percent. These price rises were a continuation of the policy of bringing the prices of controlled products in Israel in line with their prices abroad. This policy had been initiated in October

Table IX-3
QUARTERLY RISE IN VARIOUS PRICE INDEXES, 1972-74
 (percentages)

	1972				1973				1974			
	Jan.- March	April- June	July- Sept.	Oct.- Dec.	Jan.- March	April- June	July- Sept.	Oct.- Dec.	Jan.- March	April- June	July- Sept.	Oct. Dec.
Consumer's price index												
General	3.1	2.6	0.8	5.2	5.0	7.0	3.4	7.1	13.7	9.2	3.5	15.2
Excl. fruit and vegetables	2.3	3.3	2.2	3.6	3.8	8.1	3.7	6.5	13.5	9.7	4.6	14.8
Excl. fruit and vegetables and housing	1.8	2.7	1.5	3.4	3.2	7.4	2.6	6.3	14.0	9.7	4.0	15.9
Wholesale price index of industrial output	1.8	1.6	2.1	3.6	4.4	7.1	3.6	8.2	15.9	12.9	8.0	15.7
Index of input prices in agriculture	5.1	1.3	3.6	-2.1	10.0	4.7	5.3	1.7	21.4	15.5	9.1	15.4
Index of residential construction input prices	5.2	3.6	7.6	-0.5	7.5	9.8	11.9	3.0	13.2	11.9	14.5	3.2
Index of road construction input prices	4.6	1.8	4.9	-0.3	5.8	6.0	6.9	9.1	16.1	5.8	10.5	22.7

SOURCE: Central Bureau of Statistics.

1973 and continued in February 1974. In November the Israeli pound was devalued: the increase in the effective rate came to 22 percent. The devaluation, of course had an immediate impact on prices. In addition, in the framework of this economic policy and in the wake of the devaluation, public transport fares were raised in the beginning of December and water rates were increased in the beginning of 1975.

This pattern in the rise of prices—acceleration in the first and last quarters and a significant deceleration in the third quarter—also characterized, as we have noted, the price indexes in other areas: the index of wholesale prices of industrial output and the index of input prices in agriculture. The indexes differ from one another in the intensity of the changes, particularly in input prices in agriculture, which rose more rapidly than did other indexes.

In input prices in residential construction there was no deceleration in the third quarter, largely on account of the seasonal pattern in this branch (the increased cost of labor inputs because of the shift to summer hours). In the last quarter—in contrast to other areas—there was no acceleration in the rate of price increases here (see Section 5 below and Chapter VII above).

3. THE INFLATIONARY PROCESS IN 1974

The year 1974 presents a complex picture of the inflationary process. Whereas in most years since the establishment of the State the causes of price increases—whether from the demand side or from the costs side—could be identified with a large degree of confidence, in 1974 the picture is not sufficiently sharp.

There were strong pressures for price increases on the costs side. These pressures were the result of the raising of the prices of the controlled products by the Government, price increases abroad, and price increases that were a delayed reaction to factors that operated in 1973. The pressures on the costs side were further strengthened by the c-o-l allowance, which adjusts wage increases to price increases even when the source of the latter is on the costs side.

In spite of the pressures from the costs side, the demand in the economy was adequate, more or less, for the price increases were absorbed without any rise in visible unemployment. The cumulative calculation of the price increases that were a function of costs pressures also shows that these increases were significantly lower than the actual rise in prices. It should be noted that complete information that

would enable us to estimate the extent of price increases that was necessitated by a rise in costs is not available, and there is reason to assume that the estimates are biased downward to some extent.

There are indications of an inflation of costs in 1974: there was a rapid rise in prices in a number of branches of industry, in construction, and in tourism, despite the sluggishness of demand, particularly in the second half of the year. This unusual development is explained by the fact that the vicissitudes in demand in 1974 differed from branch to branch. The fact that no visible unemployment appeared in 1974 proves that together with the sluggishness of demand in these branches there was a compensatory increase in demand in other branches. At the same time there are indications of invisible unemployment, which shows that all in all there was a falling-off in demand in 1974.

Thus, the picture for 1974 is one of demand adequate to absorb the steep rise in prices necessitated by the rise in costs. The costs factors, for their part, determined the times of the price rises during the year. It also appears that the costs factors strengthened during the second half of the year.

The expansion of demand in 1974 was nourished by the increase in demand by the Government (particularly the defense establishment), by the increase in the demand for private consumption, and by the automatic mechanism of the c-o-l allowance.¹

In the first half of the year, and particularly in the second quarter, there were demand pressures that apparently stemmed from the postponement of private consumption and investments from the end of 1973, from the hastening of purchases and investments owing to the price increases, and from the Government's intensified demand for defense purchases.

Among the domestic uses the most rapid increase was in public consumption, excluding direct defense imports. This increase amounted to 56 percent, as compared with a nominal increase of 52 percent in private consumption and of 43 percent in domestic investment.

There was a deceleration in the rate of increase in private consumption in 1974. In the first half of 1974, however, and particularly in the second quarter, there was a relatively rapid increase. On the other hand, demand for investments was sluggish.

An index of sorts of demand pressures on private consumption is the development

¹ The effect of the payment of the c-o-l allowance on the demand of recipients of the allowance in the public sector is obvious. In the private sector the payment causes a redistribution of income, and the rise in demand is created as a result of the difference in the tendencies to consume (in the private sector the allowance also exerts an influence on the costs side).

of the prices of uncontrolled services. These prices are determined by the market forces, and the extent of Government intervention in fixing the prices is negligible. The inputs of the uncontrolled services are for the most part labor input and to a lesser extent inputs from other branches or from import. True, even with respect to the uncontrolled services is customarily taken as an indicator for testing the the labor input, but these are undoubtedly small in comparison with other branches. In a large portion of the services no employees at all are employed, and in places where there are employees the extent of their organization is weak in comparison with other branches, such as the public sector. Hence, the development of prices of the uncontrolled services is customarily taken as an indicator for testing the existence of demand pressures.

Prices of the uncontrolled services rose by 60 percent in 1974. In other words, there was no change in their relative price. Every wave of price increases was followed by a rapid rise in the prices of the uncontrolled services. The adjustment of the prices of these services is not automatic and immediate, but is a process that is spread over a number of months. It is against this background that the decline in the relative prices of the uncontrolled services in the first and last quarters should be seen. This decline is not necessarily attributable to sluggishness in demand, for in the succeeding period the prices of the uncontrolled services continue to rise rapidly. In the third quarter of 1974, when there was a decided moderation in the general price rise excluding fruit and vegetables (the rise amounted to 5 percent), the prices of the uncontrolled services rose by about 9 percent. In the first quarter of 1975 their prices rose by 6 percent in comparison with an increase of 4 percent in the index as a whole without fruit and vegetables. (Until March 1975, however, the prices of the services did not keep pace with the general increase in the Consumer's Price Index since October 1974: the rates of increase were 21 and 26.5 percent, respectively).

As we have noted, the developments in a number of areas hint at the existence of pressures on the costs side. These developments will be surveyed below:

1. *Industry.* The consumer prices of industrial products rose more slowly than did the wholesale prices. This phenomenon can come about as a result of a change in the weight of the margins of trade and transport. In other words, the rapid rate of the rise of wholesale prices relative to consumer prices indicates a reduction of the margins of marketing and transport. This phenomenon may well hint at pressures on the costs side and at a certain weakness of demand.

Moreover, examination of the price rises of the industrial branches shows that the highest price rises were in the basic branches, whereas in the secondary and tertiary branches, i.e., in the branches that use the output of other branches as inputs, the price

Table IX-4
RISE IN CONSUMER AND WHOLESALE PRICES OF INDUSTRIAL OUTPUT MARKETED LOCALLY, 1970-74
 (percentages)

	1970		1971		1972		1973		1974	
	Con- sumer prices	Whole- sale prices								
Total industrial commodities	5.2	4.9	9.7	11.2	10.6	10.8	15.0	17.5	45.8	42.7
Food, beverages, tobacco	3.8	3.9	8.8	12.8	8.5	7.8	14.1	17.4	53.8	47.1
Clothing and textiles	4.9	2.2	8.1	10.1	10.1	12.4	15.8	18.4	39.2	29.2
Leather, rubber and plastics	3.8	4.1	6.7	7.3	11.7	18.7	18.3	15.3	51.1	32.1
Wood and wood products	5.9	8.3	10.4	11.8	13.4	17.0	23.0	28.8	42.5	46.4
Chemicals and petroleum	2.8	3.2	9.4	11.5	8.2	11.9	11.5	15.5	53.6	74.5
Metal products, machinery, and electrical equipment	8.4	9.6	13.3	9.0	14.1	10.5	13.8	11.9	33.0	31.7
Other industries	7.3	7.2	9.5	12.9	10.5	14.3	16.0	19.2	58.7	39.2

SOURCE: Central Bureau of Statistics.

rises were lower. This, despite the fact that the secondary branches require the output of the basic branches whose prices rose rapidly.² When we compare the price increases of the various branches with the changes in output we obtain a negative correlation between the changes in outputs and in prices. That is to say, in branches where there was stability or a decline in output the price rises were the highest, while in the branches where output rose (e.g., electronics and the branches that work for the defense establishment) the price increases were lower. Such a phenomenon does not jibe with demand pressures.

2. *Construction.* In the construction branch there was a definite slump in demand, except for a relative recovery in the second quarter. This fact is expressed in a decline in the number of flats sold and in the contraction of the number of building starts in private construction, which are sensitive to changes in demand. As a result relative prices of flats did not increase in 1974, and towards the end of the year there was an absolute decrease in the prices of flats. This phenomenon stands in contrast to the rapid rise in the relative prices of flats in previous years. Together with the falling off of demand there was a rapid rise in prices of inputs of the construction branch. It is reasonable to assume that under conditions of shrinking demand for flats the rise in the price of flats is explainable chiefly by the increased costs of the inputs.

3. *Tourism.* In this branch, too, there was a definite slump in demand in 1974, but prices rose nevertheless. There is no doubt that this price rise resulted from an increase in the prices of inputs: the index of input prices in hotels rose by 54 percent in the first nine months of the year, as compared with the corresponding period in 1973.

4. In the private sector, which is more sensitive to market forces, there was an absolute decrease in the number of employed. It is reasonable to assume that the private sector, which in previous years had competed with the public sector in the labor market, would have succeeded in 1974 if demand had been buoyant. The non-creation of unemployment, which is the classical test of inflation of costs, is explained by a number of factors (see Chapter XII).

5. Labor productivity rose in 1974 less than in previous years, a fact which hints at the existence of invisible unemployment as a result of a certain sluggishness in demand.

² See Chapter XIV, "Industry".

4. THE CAUSES OF THE PRICE INCREASES

(a) *The Government*

In the area of prices the activities of the Government in 1974 are striking. These activities took the form of direct intervention in the prices of controlled products (basic foodstuffs, fuel, public transport, etc.), in order to bring domestic prices in line with world prices. The Government also levied indirect taxes on domestic production and on imports, and it devalued the Israeli pound.

Prices of the controlled products rose by 103 percent during 1974, and this contributed a 22 percent increase in the Consumer's Price Index, out of a total increase of 58 percent. Hence, the Government's activities in 1974 contributed about 40 percent of the rise in the Consumer's Price Index. Owing to the concentration of the Government's activities in the end of 1974, the effect of the Government, averaged over the year, is slighter. "Only" 11 percent of the total price increase of 40 percent in private consumption is explained by the increase in the prices of controlled products (28 percent of the total increase in the index).

This estimate of the influence of the Government on the prices of private consumption is an underestimate, for the price increases of the controlled products have indirect effects by way of the production network of the economy, a fact that brings about further price increases. This is on the reasonable assumption that there was sufficient demand in the economy to absorb these price increases.

The import levy and purchase taxes of July 1974 and the reduction of the rates of the import levy in November led to a rise of about 1 percent in the prices of private consumption and of about one-half of 1 percent in the prices of total domestic uses. The influence of the devaluation of November 1974 on prices cannot be easily estimated.³ According to a rough estimate, the effect of the devaluation on the prices of private consumption was about half of 1 percent on an average for 1974, and about 3 percent during 1974. The increase in the average prices of domestic uses on account of the devaluation for all of 1974 is less than half of 1 percent (out of a general increase of 38 percent). During 1974 the devaluation contributed, according to these estimates, a rise of about 1-1/2 percent to the prices of domestic uses (to be

³ Theoretically, the effect of devaluation on prices should be estimated by multiplying the import component by the effective rate of devaluation. In such a calculation the assumption of a complete and immediate passing-on of the price increases is swallowed up. The trouble is that in November 1974 not only was the Israeli pound devalued, but the prices of imported controlled products were increased, at the various rates called for by the devaluation. Hence, from the total imports and domestic uses we should deduct the imported controlled products.

Table IX-5
RISE IN CONTROLLED AND UNCONTROLLED COMMODITY PRICES, 1972-74
 (percentages)

	Weight in index (in thou- sands)	December levels			1972				1973				1974			
		1972	1973	1974	Jan.-	April-	July-	Oct.-	Jan.-	April-	July-	Oct.-	Jan.-	April-	July-	Oct.-
					March	June	Sept.	Dec.	March	June	Sept.	Dec.	March	June	Sept.	Dec.
Controlled items	218.7	3.7	13.0	102.6	0.9	0.8	0.8	0.7	2.7	3.6	0.4	4.7	22.8	12.6	0.8	25.8
Services	90.4	5.2	7.6	48.6	0.9	2.0	-0.2	1.0	5.5	1.3	0.6	2.0	6.9	17.4	0	7.9
Goods	128.3	2.6	17.1	139.0	0.9	0	1.5	0.5	0.7	5.3	0.2	6.9	33.8	9.9	1.3	36.3
Uncontrolled items	250.2	14.9	25.5	48.2	2.0	4.8	1.7	6.6	2.6	8.5	3.1	7.4	9.5	11.7	6.0	11.5
Services	105.4	14.3	27.5	59.6	3.3	4.6	3.8	2.3	5.2	8.9	5.4	4.3	12.0	12.2	8.7	11.5
Goods	144.8	15.4	23.9	39.6	0.9	4.9	0.1	9.9	0.8	8.2	1.3	9.9	6.9	11.3	3.8	11.4
Total index, excl. fruit and vegetables and housing	780.3	9.6	30.8	60.6	1.8	2.7	1.5	3.4	3.2	7.4	2.6	6.3	14.0	9.7	4.0	15.9

SOURCE: Central Bureau of Statistics.

sure, this was the influence of the devaluation of 1974, while the bulk of the effect of the devaluation on prices would be expressed in 1975.)

If we summarize all these factors we shall see that, on the average, the Government contributed 12 percent out of an increase of 40 percent in the prices of private consumption, while in the course of the year its weight was slightly greater: 25 percent out of an increase of 58 percent. It should be emphasized once again that this is an underestimate of the influence of the Government, since it does not take account of the secondary effects of the price rises. This passing-on of prices is not negligible, and it should be kept in mind throughout the discussion that our estimates are biased downward.

Since in any case there was adequate demand in 1974, more or less, the activity of the Government prevented the rise of other prices and hence did not lead to a net increase in total prices. Moreover, from the aspect of the allocation of resources there was place for raising the prices of the controlled products even in 1973. Finally, by cutting the budget for subsidies the Government avoided the necessity of financing a larger budget, which would have intensified the inflation.

(b) *The rise in import prices*

In 1973 prices rose rapidly in the world markets, and, as a result the prices of imported inputs rose. During 1974 there was a great deceleration in the rate of price increases abroad. If the price rises abroad had been shifted completely to the domestic uses, they would have led to a price rise of about 13 percent (out of a total increase of 38 percent). In such a calculation there is duplication, since part of the imported products are controlled, so that there is no room for the assumption of complete shifting. If we deduct the effect of the rise in the prices of imports in the area of fuel and basic foodstuffs, it will be seen that the rise of prices abroad contributed to the increase in the prices of private consumption by about 3 percent. (The rise in the prices of the controlled products is attributable to the activities of the Government, and to the same degree to the increase in import prices. Since both of these factors operate on the costs side it is not particularly important to separate the influence of the Government from that of imports.) Some doubts exist regarding the estimates of the change in import prices. It appears that the estimates are downward biased, so that the effect of the increased prices of imports was greater than that stated above.

As we have noted, during 1974 there were signs of moderation in price increases abroad, so that the contribution of this factor in raising domestic prices declined in the course of 1974.

(c) *Wage increases*

The price increases reflected in the Consumer's Price Index entail payment of a cost-of-living allowance. For our purposes, only the price rises that stem from the Government's activities and from imports need be taken into account. These increases totalled 19-20 percent on an annual average in 1974. Owing to the manner of calculating the c-o-l allowance, however, there is a lag of six months, on the average, between the price rises and the payment of the allowance. In 1974, when prices rose rapidly throughout the year, this fact was of special significance. Thus, the prices of the controlled products—for which we have monthly data and for which a precise calculation can therefore be made—accounted for 11 percent of the rise in the index, on the average. But the c-o-l allowance, which was to have been paid on account of this increase, was only 7.5 percent of wages, owing to the slow increase in the prices of these products in the second half of 1972 and of 1973.

With respect to the other components—i.e., import levies, deposits, and the devaluation—refined estimates are not available, as they are for the controlled products. As for imports, which by our estimate contributed 3 percent of the increase in the prices of private consumption, account must also be taken of the rapid rise in import prices in 1973. If we sum up these factors (excluding the controlled products) we see that together they contributed, according to the roughest estimates, 3 percent of the wage increment. In other words, the total c-o-l allowance paid in 1974 on account of the increase in the prices of controlled products and of imports was about 10 percent of wages.

In order to evaluate the effect of this wage increase, we must consider only the share of labor in the private sector. If we assume that this share is one half, it follows that the costs pressures stemming from that were about 5 percent. It should be noted that in this estimate we did not take into account the effect of the c-o-l allowance on the increases that are bound up with raising of the prices of the controlled products and of imports, so that the estimate presented here is biased downward.

Another downward bias derives from the payment of the c-o-l allowance at fixed times. Since the prices rise very rapidly there is an "adjustment" of wages between the dates of the payment of the c-o-l allowance by means of wage agreements. When the c-o-l allowance is paid on time it constitutes further pressure on the costs side. In 1974, in contrast to previous years, the inclusion of the wage rise was allowed as a reason for raising prices in the framework of the price control committees. This contributed to increasing the pressures on the wage side.

Summing up the effect of costs in private consumption on account of the rise in the prices of controlled products, of imports, and of the wages derived from them, we get a price rise of about 20 percent. Even if we take account of downward

biases in the estimates, it does not appear that the increase in prices stemming from costs keeps pace with the actual price increases.

5. VARIOUS PRICE INDEXES

(a) *Commodities and services in the Consumer's Price Index*⁴

The prices of commodities in the Consumer's Price Index rose in 1974 by an average of 42 percent; the general increase in the index came to 40 percent, while in

⁴ Selected items in the Consumer's Price Index, controlled and free, and their respective weights:

CONTROLLED	COMMODITIES	FREE
Bread, cereals, and dough products (excl. cakes and cookies)		Furniture
Eggs		Interior decoration products
Carp		Clothing and footwear
Oil		Jewelry and watches
Margarine		Books
Milk and dairy products		Eyeglasses
Sugar		
Electricity, fuel, and water		
Cigarettes and tobacco		
Gasoline and motor oil		
WEIGHT 128.3		Weight 144.8
	SERVICES	
Property taxes		Restaurants and cafes
General municipal rates		Home maintenance and improvements
Elementary school		Hobbies
High school		Private medical service
University		Dental service
Urban transport		Repair of various appliances
Interurban transport		Haircuts and beauty parlors
Postal services		Business services
Fees and Government documents		Kiosk items
		Convalescence, vacations and excursions
		, Theater and other performances
WEIGHT 90.4		Weight 105.4
TOTAL WEIGHTS 218.7		Total weights 250.2

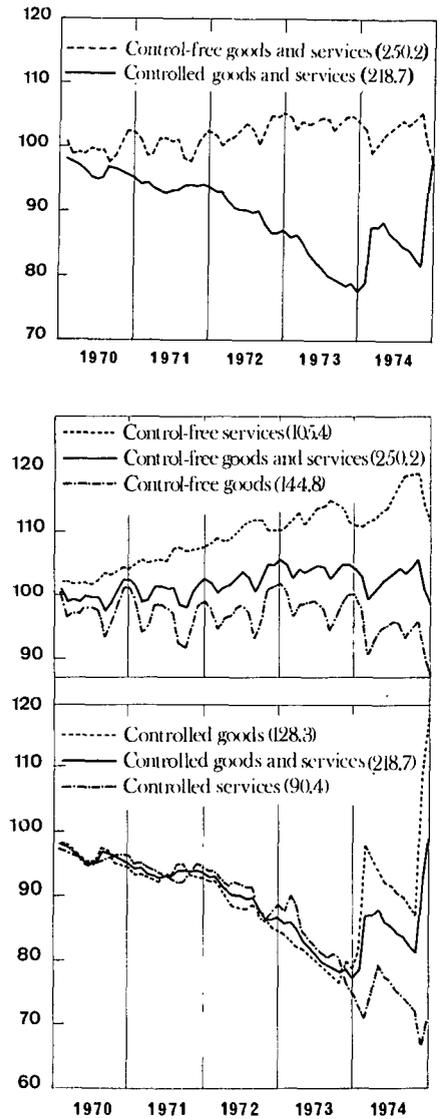
the prices of services it was 38 percent. The rise of the relative price of goods stems from the increased prices of controlled commodities by 69 percent. If we deduct this item, we find that the prices of commodities without controlled commodities rose by 35 percent. This is a decline in their price relative to the prices of uncontrolled services (a rise of 40 percent). The prices of controlled commodities—which have a weight of about 13 percent in the index—rose in 1974 by about 69 percent and during the year by 139 percent. These price rises at one fell swoop brought to an end the steady decline in the relative prices of controlled commodities. The rise in the prices of controlled items at the end of 1974 was 19 percent higher than the general rise in the Consumer's Price Index without fruit and vegetables, while at the end of 1973 their rise lagged 21 percent behind the index.

There are two aspects to the fixing of the prices of controlled commodities: the allocation of the resources of the economy, and the fiscal side.

From the aspect of allocation of resources it is important that the prices of controlled items be set in accordance with the cost. When there are temporary changes in price increases, justification can be found for maintaining price stability by granting a positive or negative subsidy in accordance with changes in world prices and in costs. When the change in the costs of these items is monetary, however, adjustment must be carried out in order to prevent their wasteful use in private

Figure IX-1

CONTROLLED COMMODITY AND SERVICE PRICES RELATIVE TO CONTROL-FREE PRICES, 1970-74



NOTE: Figures in parentheses are the weights in the consumer price index.

consumption, export, and the like. From this aspect, the Government did well to bring the prices of the controlled items in line with the changes in costs. Still, there was a considerable lag in making this adjustment to world prices, and this entailed large one-time increases.

In addition to the effect the raising of the prices of these items has on the Government's expenditures and receipts, there is the effect they have on real disposable income. It appears that the psychological effect of increasing the prices of the controlled products goes beyond their weight in the consumption basket. This psychological effect derives from a number of causes: (a) the increase in the prices of the controlled commodities is announced by all the communications media; (b) the consumption of the controlled commodities is a day-to-day affair and it encompasses all families; (c) the increase in the prices of the controlled products determines a norm for the increase of prices.

The prices of services, whose weight in the index is 43 percent, rose by an average of 38 percent in 1974. The prices of controlled services rose at a relatively slow pace in 1974 (only 26 percent), while control-free service prices rose by an average of 40 percent.

In the services group the rise in the prices of uncontrolled services is striking: these rose by 43 percent on an annual average and by 60 percent during the year.

(b) *Housing prices*

The trends in housing prices that began in 1973 continued in 1974. The relative prices of housing levelled off, more or less, thus ending the trend of the rise in the relative price of housing which began in 1968.

This levelling-off in relative prices stemmed from a decline in demand (except for some recovery in the second quarter), stability in the quantity of flats offered, and a rapid rise in the prices of construction inputs.¹

(c) *Price changes in relation to population groups*

The Consumer's Price Index represents the increases in prices relative to the basket of the average family of urban employees. When the price increases are uniform for all items of the index, i.e., when there is no change in relative prices, the Consumer's Price Index faithfully represents also the price changes in relation to each of the population groups. When there are sharp changes in the relative prices, however, changes are created in the price rises as between the various population

¹ For further details see Chapter XIII.

Table IX-6
RISE IN HOUSING PRICES, 1970-74

(percentages)

Middle of survey period	Rise in housing prices	Rise in construction input prices	Rise in consumer prices	Index of housing prices	Index of construction input prices	Consumer Price Index	Housing prices relative to:	
							Input prices	Consumer prices
April 1, 1970	5.4	6.6	3.3	105.4	106.6	103.3	98.9	102.0
July 1, 1970	4.1	8.9	1.9	109.7	113.5	105.3	96.7	104.2
Oct. 1, 1970	2.3	1.4	3.4	112.2	115.1	108.9	97.5	103.0
Jan. 1, 1971	5.1	-0.2	3.9	118.0	114.9	113.1	102.7	104.3
April 1, 1971	6.9	2.6	2.3	126.1	117.8	115.7	107.1	109.0
July 1, 1971	6.7	4.6	1.6	134.6	123.3	117.6	109.1	114.5
Oct. 1, 1971	10.2	3.3	3.7	148.3	127.3	121.9	116.5	121.7
Jan. 1, 1972	9.0	2.3	4.5	161.6	130.2	127.4	124.1	126.8
April 1, 1972	6.3	4.4	2.8	171.8	135.9	131.0	126.4	131.1
July 1, 1972	5.0	5.6	1.7	180.4	143.5	133.2	125.7	135.4
Oct. 1, 1972	7.9	3.4	3.0	194.7	148.4	137.2	131.2	141.9
Jan. 1, 1973	5.7	3.5	5.1	205.7	153.6	144.2	134.0	142.6
April 1, 1973	6.1	8.7	6.0	218.3	167.0	152.8	130.7	142.9
July 1, 1973	5.9	10.9	5.1	231.2	185.2	160.6	124.8	144.0
Oct. 1, 1973	5.3	7.2	5.3	243.4	198.5	169.1	122.6	143.9
Jan. 1, 1974	10.5	8.2	10.5	269.0	214.8	186.8	125.2	144.0
April 1, 1974	10.9	12.5	11.3	298.3	241.5	207.9	123.5	143.5
July 1, 1974	8.9	13.2	6.2	324.0	273.5	220.8	118.8	147.1
Oct. 1, 1974	7.3	8.4	9.5	348.6	296.6	241.7	117.5	144.2

groups owing to the different consumption baskets in these groups. In 1974 there was a rapid rise in the relative prices of the group of controlled products in relation to other products (103 percent as against 47 percent, during the year). Since the weight of the controlled products, commodities in particular, is higher among low income groups, they experienced more rapid price increases in 1974. The difference in price increases between the polar groups⁶ for all of 1974 amounted to 2-3 percent.

In connection with this development, it should be added that a monetary compensation was given to the low income groups on account of the more rapid increase in prices, so that their relative situation did not necessarily worsen in comparison with 1973. In previous years the rise in the price of the consumption baskets of the low income groups was slower than it was for the high income groups.⁷ According to our calculations the more rapid increase in the prices of the consumption of the low income groups in 1974 offset the decline in their relative prices in previous years, so that at the end of 1974 the relative prices of all population groups were equal to those of 1969.

⁶ The two lowest groups (28 percent of the total population) compared with the two highest groups (27 percent of the total population). The classification into groups is by expenditure.

⁷ See Y. Manzly, "Price Changes in the Consumption Baskets of Various Income Groups in Israel," Bank of Israel, *Economic Review*, No. 41 (April 1974).