# CHAPTER VI

# PRICES

## 1. Main Developments

THE YEAR reviewed saw a noticeable sharpening of the inflation which began in 1970. The consumer price index rose 26 percent, while other indexes (wholesale prices of industrial output and residential construction inputs) advanced even more precipitately; these rates compare with 11–13 percent in the two preceding years. During the first nine months of 1973 the consumer price index climbed by a seasonally adjusted 17 percent, or at an annual 24 percent pace.

These rises eclipsed anything ever experienced before, including previous boom periods. It should be emphasized in this context that the world inflation grew stronger in 1973, and this of course had repercussions on an open economy like Israel. But it is important to note that in Western Europe and the United States prices went up by only 8–12 percent. Furthermore, calculations made on the basis of import coefficients show that in Israel prices rose by much more than can be attributed to the dearer imports (assuming that all the extra costs were passed on to the customers).

**Table VI–1**

**AVERAGE RISE IN PRICES OF RESOURCES AND USES, 1961–73**

(percentages)

| | Average 1961–65 | 1970 | 1971 | 1972 | 1973[a] |
|---|---|---|---|---|---|
| Private consumption | 7.0 | 7.5 | 12.5 | 15.5 | 18.5 |
| Public consumption | 10.5 | 8.0 | 16.5 | 18.5 | 17.5 |
| Gross capital formation | 8.5 | 11.0 | 13.5 | 16.5 | 22.0 |
| Total domestic uses | **8.0** | **8.5** | **14.0** | **16.5** | **19.0** |
| Exports | 13.0 | 4.0 | 15.5 | 16.0 | 19.0 |
| Total uses | **8.5** | **7.5** | **14.0** | **16.5** | **19.0** |
| Imports | 11.0 | 4.0 | 16.0 | 21.0 | 17.5 |
| Gross national product | 8.0 | 9.5 | 13.5 | 14.0 | 20.0 |
| Total resources | **8.5** | **7.5** | **14.0** | **16.5** | **19.0** |

NOTE: Figures are rounded off to the nearest half percent.
[a] January-September, 1973 compared with the corresponding period in 1972.
SOURCE: Central Bureau of Statistics.

It may therefore be concluded that the aggravation of inflation in this country in 1973 was largely due to internal economic developments. Unemployment fell to an all-time low, indicating that production capacity was fully exploited (this, however, does not rule out the possible appearance of bottlenecks or surplus capacity in certain areas due to a change in the composition of demand). Together with the monetary developments of the previous two years, this leads to the conclusion that the predominant cause of the acceleration of inflation in 1973 was the marked excess demand prevailing in the economy. The accumulated effect of this factor since the onset of inflation in 1970 and the approach of the economy to a full factor utilization rate found expression in a steep jump in prices and the widening of the import surplus.

Examination of the various commodity and service groups reveals that dwelling prices were the principal item which did not move up faster than in 1972. What is more, for the first time since 1967 it even lagged behind the rise in building costs—a trend which, however, was reversed at the beginning of 1974.

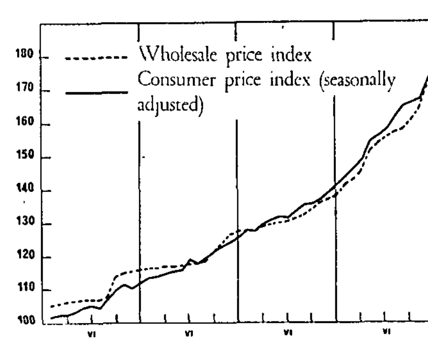
Controlled commodity prices advanced in the first nine months of 1973 at double the rate recorded in the corresponding period of 1972—8.5 vs. 3.8 percent. It is noteworthy that control-free services behaved similarly, jumping by 20 percent as against 12 percent. This development was significant, for the import component of this group is negligible, the main input being labor.

The sharp upswing in prices at the beginning of 1973 forced the Government to clamp a tight control on certain items, with the intention of easing it toward the end of the year. The underlying assumption was that the price rise was bound to slow down, and that the stabilization of the level, even if accomplished administratively, would very likely weaken expectations of a continued rapid increase. But because of the strong demand pressure prevailing throughout the year, these administrative measures could not cool prices for any length of time. At any rate, the developments at the end of 1973 preclude corroboration of this assumption.

In the last quarter of the year the price advance grew stronger, especially in the case of controlled commodities and services. The relative price of controlled items displays a long-run downtrend, due to institutional considerations. This has an adverse effect, tending to result in a distorted allocation of resources. The correct timing of institutional increases is of great importance: when the economy is beset by demand

**Figure VI–1**

**WHOLESALE PRICE INDEX AND CONSUMER PRICE INDEX (SEASONALLY ADJUSTED), 1970–73**




SOURCE: Central Bureau of Statistics.

**Table VI–2**

**RISE IN VARIOUS PRICE INDEXES, 1971–73**

(percentages)

| | Annual average | | | December levels | | | Jan.-Sept. | | | July–Sept. | | | Oct.–Dec. | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1971 | 1972 | 1973 | 1971 | 1972 | 1973 | 1971 | 1972 | 1973 | 1971 | 1972 | 1973 | 1971 | 1972 | 1973 |
| Consumer price index | | | | | | | | | | | | | | | |
| General | 12.0 | 12.9 | 20.0 | 13.4 | 12.4 | 26.4 | 7.9 | 6.4 | 15.8 | 3.2 | 2.6 | 4.0 | 5.0 | 5.6 | 9.1 |
| Excl. fruit and vegetables | 12.0 | 13.1 | 19.3 | 12.9 | 12.0 | 26.6 | 8.9 | 7.9 | 16.5 | 4.5 | 2.4 | 3.6 | 3.7 | 3.7 | 8.7 |
| Excl. fruit and vegetables and housing | 11.9 | 11.5 | 16.5 | 12.7 | 9.6 | 23.3 | 8.7 | 5.9 | 13.9 | 4.4 | 1.7 | 2.7 | 3.7 | 3.5 | 8.3 |
| Wholesale price index of industrial output | 9.9 | 11.6 | 19.1 | 9.5 | 9.6 | 29.6 | 5.2 | 6.2 | 16.6 | 3.5 | 2.9 | 3.6 | 4.1 | 3.2 | 11.1 |
| Index of road construction input prices | 12.6 | 14.1 | 20.0 | 16.1 | 12.5 | 37.0 | 15.8 | 9.5 | 17.9 | 7.8 | 2.1 | 5.3 | 0.3 | 2.8 | 16.2 |
| Index of residential construction input prices | 10.5 | 16.0 | 28.5 | 13.3 | 17.1 | 39.8 | 13.1 | 14.4 | 31.4 | 5.2 | 3.7 | 9.2 | 0.2 | 2.3 | 6.4 |
| Index of input prices in agriculture | 12.3 | 13.4 | 18.0 | 13.6 | 7.5 | 26.1 | 14.1 | 9.6 | 21.1 | 10.2 | 2.6 | 4.0 | –0.4 | –1.9 | 4.1 |

SOURCE: Central Bureau of Statistics.

inflation a decision to up prices may possibly ease and weaken the inflationary process.

## 2. Causes of the Inflation

### (a) *The first nine months of 1973*[1]

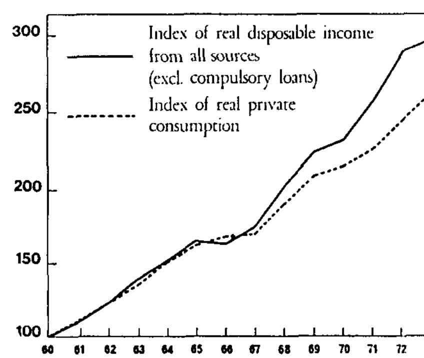
The sharpening of inflation in the year reviewed encompassed most commodity, service, and factor prices. In only a few instances did they move up at about the same rate as in 1972.

The index of residential construction input prices (which includes labor) soared 31 percent during the first three quarters of 1973. If wages are excluded, the rise was slightly milder. On an average, the increase in the index during this period as compared with the same period the year before was similar if calculated with or without wages.

The more rapid spiralling of final commodity and service prices, which accompanied the even sharper price rise of factors of production (labor and investment in equipment and buildings) and raw materials, must be viewed against the severe demand pressure prevailing in the economy for the fourth consecutive year. Conspicuous signs of such pressure were the drop in the unemployment rate to an unprecedented low and the accelerated growth of total uses (excluding direct imports). Yet another indicator is the notable expansion of imports, both direct imports for final uses and intermediates (the latter more or less accorded with current production requirements, while the former far outpaced the expansion of private consumption).

Figure VI–2

**INDEXES OF REAL DISPOSABLE INCOME FROM ALL SOURCES AND PRIVATE CONSUMPTION, 1960–73**




The two main reasons for the generation of excessive demand in the past three years were the enormous surge of private sector transfers from abroad and the domestic demand surpluses of the public sector, with the relative importance of these factors varying from one period to another. They expanded real demands not only directly, but indirectly through the resulting sizable monetary expansion; in fact, in 1971 and 1972 monetary expansion was faster than the

[1] Most of the discussion in this chapter will deal with the period from the beginning of 1973 until the outbreak of war in October. In some instances developments in the whole of 1973 will be compared with those in previous years. The causes of the upward price movement in the postwar months will be discussed separately.

growth of the national product.[2] Part of the additional liquidity flowed to the securities and real estate markets, thereby easing some of the pressure on the

Table VI–3

**PRICE RISES IN BRANCHES COMPETING WITH IMPORTS[a] AND IN OTHER BRANCHES, ACCORDING TO WHOLESALE PRICE INDEX OF INDUSTRIAL OUTPUT, 1971–73**

(1968=100)

| | Branches competing with imports | Other branches |
|---|---|---|
| | **Price index** | |
| Weight in index (1968) | 211.1 | 459.3 |
| 1971 December | 128.4 | 125.4 |
| 1972 September | 141.2 | 132.7 |
| December | 145.6 | 137.3 |
| 1973 September | 172.5 | 157.5 |
| December | 191.6 | 176.7 |
| | **Percent increase** | |
| 1972 January–September | 10.0 | 5.8 |
| July–September | 3.7 | 3.3 |
| October–December | 3.1 | 3.5 |
| 1973 January–September | 18.5 | 14.7 |
| July–September | 2.9 | 3.8 |
| October–December | 11.1 | 12.2 |
| Annual average | | |
| 1971 | 13.5 | 8.4 |
| 1972 | 12.4 | 10.9 |
| 1973 | 21.3 | 18.1 |
| December levels | | |
| 1971 | 10.0 | 8.7 |
| 1972 | 13.4 | 9.5 |
| 1973 | 31.6 | 28.7 |

[a] Branches in which the value of imports was equal to or exceeded 50 percent of the total value of domestic production plus imports. In most of these branches imports amounted to 80–100 percent of the total, and in the noncompeting branches to 0–20 percent of the total.
SOURCE: Based on Central Bureau of Statistics data.

[2] The expansion of the money supply (or total liquid assets held by the public), less the rise in real GNP, may serve as an indicator of excess liquidity in the economy. According to this, excess liquidity grew by an average of 17 percent per annum in 1971–73. For the sake of comparison, it should be noted that during the prerecession boom the figure averaged about 8 percent per annum. Excess liquidity is likely to find expression in price rises, increased imports, and/or a heavier volume of transactions in other markets, such as real estate. In 1971–72 the additional excess liquidity was not fully felt in the commodity and service markets or in imports. The balance presumably contributed to the buildup of excess liquidity in 1973, thereby accentuating the already severe demand pressure.

commodity and service markets. Indeed, the circulation velocity of the money supply, in relation to the product and to total uses (as it is generally measured), declined somewhat in these two years. In the first nine months of 1973 monetary expansion, as conventionally measured, was more sluggish than in the two preceding years, but the inflation became much more rampant.

Several reasons can be advanced to explain this. The first is that theoretically the velocity of circulation of money should be calculated in relation to total transactions in the economy and not just to GNP (or total end-uses). In the first nine months of 1973 the real estate market apparently cooled off somewhat, with the growth rate sagging noticeably; as a result, the expansion of total transactions was milder than that of GNP. In other words, during these months much of the incremental liquidity was channeled to the commodities market. Secondly, with inflation virtually becoming a permanent feature of the local scene, the definition of liquidity should be revised in order to render it more meaningful for purposes of economic analysis. This would probably result in significantly different conclusions; indeed, the inclusion of bonds in the definition materially alters the picture of monetary expansion (see the detailed discussion in Chapter XIII).

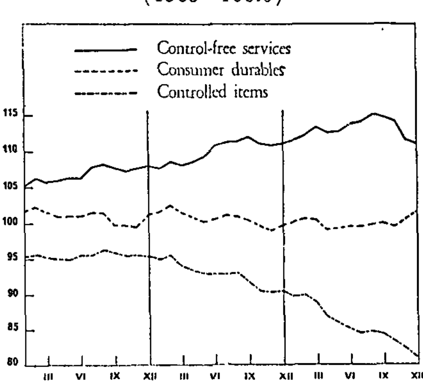
The aggravation of inflation in 1973 did not bypass the branches exposed to the competition of imports. In these branches there is a potential limit on how high prices can rise in the domestic market, namely the increase in the price of imports plus import taxes. Prices of these products climbed 18.5 percent between January and October 1973, as contrasted with 10 percent during the corresponding period of 1972. The sharper advance was mainly due to dearer imports, but obviously if domestic demand had been ebbing, the rise would have been more moderate than that of international prices. Under the prevailing conditions of strong demand pressure prices in the competing branches tended to move up at a similar pace as international prices during the year reviewed. What is more, even though imported commodities became much dearer in 1973, they were purchased in much larger quantities.

While price movements in the exposed branches are largely influenced by changes in the cost of imports, branches that do not have to compete with foreign brands (i.e. those that are protected by a high tariff barrier) are less affected by such changes, and therefore price rises here are mainly due to

Figure VI-3

PRICE INDEXES OF SELECTED GROUPS RELATIVE TO CONSUMER PRICE INDEX (EXCL. FRUIT AND VEGETABLES), 1971–73

(1969=100.0)



internal economic developments. Prices in these branches rose 15 percent in the first three quarters of 1973, as opposed to 6 percent in the same period the year before; the acceleration was doubtless due primarily to the intensification of the already strong demand pressure.

Prices also rose more steeply during this period in competing industries. These industries are marked by a relatively low degree of monopoly power, and therefore their pricing may be expected to be largely influenced by, or adjusted relatively quickly to, changes in market forces. Between January and September 1973 their products became 16 percent dearer, compared with less than 8 percent in the corresponding period of 1972. In the noncompeting branches, where

**Table VI-4**

**PRICE RISES IN COMPETING AND MONOPOLISTIC BRANCHES, ACCORDING TO WHOLESALE PRICE INDEX OF INDUSTRIAL OUTPUT, 1971-73**

(average 1968=100)

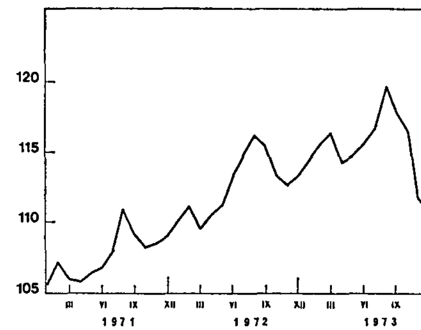
| | Competing branches | Monopolistic branches |
|---|---|---|
| | **Price index** | |
| Weight in index | 51.3 | 17.0 |
| 1971 December | 128.1 | 122.7 |
| 1972 September | 137.8 | 129.0 |
| December | 143.9 | 129.9 |
| 1973 September | 166.7 | 147.6 |
| December | 180.2 | 161.6 |
| | **Percent increase** | |
| 1972 January–September | 7.6 | 5.1 |
| July–September | 3.3 | 3.1 |
| October–December | 4.4 | 1.0 |
| 1973 January–September | 15.8 | 13.3 |
| July–September | 3.5 | 2.9 |
| October–December | 8.1 | 9.5 |
| Annual average | | |
| 1971 | 9.0 | 8.5 |
| 1972 | 12.5 | 9.7 |
| 1973 | 19.8 | 14.5 |
| December levels | | |
| 1971 | 9.3 | 8.7 |
| 1972 | 12.4 | 6.2 |
| 1973 | 25.2 | 24.0 |

NOTE: The branches were classified as competing or monopolistic according to the index of concentration, with the former group having a relatively low concentration. The index was calculated according to the share of the three largest enterprises in the branch in its total sales. Exposure to competing imports was taken into account in calculating the index.
SOURCE: Based on Central Bureau of Statistics data.

there is a relatively high degree of monopoly power, prices rose by an appreciable 13 percent during this period. However, this was not quite as steep as in the other branches, a fact probably ascribable to price control. The products of these branches are relatively easy to locate, which makes it difficult for them to avoid control. On the other hand, the committee handling this does not immediately authorize a requested price hike, but only after a certain period. The fact that there was some lag in adjusting prices upward is evidenced by the increases that occurred in the post-war months of 1973 (see Table VI-2).

Figure VI-4

CONTROL-FREE SERVICE PRICES RELATIVE TO CONTROL-FREE COMMODITY PRICES (EXCL. FRUIT AND VEGETABLES), 1971-73




The price advances in 1973 encompassed nearly all commodities and services. At one end of the spectrum were very steep rises in such basic commodities as rice (103 percent) and crude oil (95 percent). A 50 percent increase was recorded for meat and meat products, gasoline, and honey. At the other end of the spectrum were relatively mild increases of about 10 percent in some controlled services, such as property tax, Sick Fund services, school fees, and local and foreign travel. There were similar hikes in such staples as bread, oil, margarine, cheese, tea, and coffee. By contrast, milk and eggs held steady.

(b) *Impact of costlier imports on local prices*

Import prices moved up more rapidly in the first nine months of 1973 than in the same period the year before, the average advance amounting to 21 percent. Commodity prices, at 24 percent, scored the fastest rise, while services went up 11 percent (see Chapter III, Table III-2).

The rise in import prices, particularly of commodities, exerted pressure on domestic prices from the costs side, although the actual increases were higher, as may be seen from Table VI-6. In other words, most of the upward thrust on the domestic price level came not from the costs side but from the extremely buoyant demand. The prices of total private consumption and all component items, of investment, and public consumption advanced by more than can be attributed to the more expensive imports.

In calculating the price increases induced by the dearer imports no allowance was made for the moderating influence of the heavier subsidization and the trimming of customs duties in the first nine months of 1973. Not all import cost increases were reflected in the local prices. In some cases, such as basic commodities, the Government subsidized the extra cost, while in others it was offset by the cutting of customs in January 1973 (under the import liberalization program) and in February 1973 (in order to blunt the impact of the dollar devaluation). In several other instances, where the foreign price rises were particularly steep, the customs duty was pared repeatedly. Had these factors been taken into consideration, the price increases attributable to the dearer imports would have been milder. On the other hand, account must be taken of other import-related factors that pushed prices up. Because of the cost-of-living allowance agreement, wages and salaries are automatically upped when there is a price increase, even if due to developments abroad. For this reason the increase in domestic prices caused by higher international prices is greater than shown in Table VI–6. In addition, there are economic forces operating to partly depress the share of nonwage income in national income to its level prior to the payment of a cost-of-living allowance increment; these forces are associated with the mounting of international prices. But the more the first-round effects recede into the distance, the harder it is to isolate the cost from the demand factors. Thus, for example, if in the first three quarters of 1973 part of the profits reverted to their level before the price rises abroad, this was made possible by the expansion of the money supply.

Table VI–5

ACTUAL INCREASE IN DOMESTIC PRICES AND THAT ATTRIBUTABLE TO COSTLIER IMPORTS, JAN.-SEPT. 1972 TO 1973

| | Total expenditure Jan.-Sept., 1973 (IL million, at current prices) | Import component, 1972 (%) | Price rise attributable to higher import prices[a] (%) | Actual price rise (%) |
|---|---|---|---|---|
| Total private consumption[b] | 12,516 | 22.1 | 5.2 | 14.2 |
| Food, beverages, tobacco | 4,208 | 35.0 | 8.9 | 18.6 |
| Consumer durables | 1,965 | 48.3 | 10.4 | 16.7 |
| Other commodities | 2,619 | 34.2 | 7.8 | 14.7 |
| Services and miscellaneous | 3,724 | 10.4 | 2.3 | 8.1 |
| Investment | 10,009 | 43.0 | 9.7 | 22.6 |
| Public consumption | 7,816 | 54.6 | 11.9 | 18.2 |

[a] Weighted averages of the commodity import price increases, with the weights being the total import components (at the effective rate of exchange). The import price rise will not increase domestic prices proportionately because some customs duties and purchase taxes are levied on a specific and not an ad valorem basis. While this is not taken into account in the calculations here, the conclusions are not significantly affected because of the low weight of the specific customs duties and purchase tax.

[b] Excluding housing and nonprofit institutions.

SOURCE: Col. (1) and (4)—Central Bureau of Statistics; Col. (2)—Bank of Israel input-output calculations.

## Table VI–6

### INCREASE IN SELECTED GROUPS OF COMMODITY AND SERVICE PRICES, ACCORDING TO CONSUMER PRICE INDEX, 1971–73

(percentages)

| | Weight in index (in thousands; 1969=100.0) | December levels | | | 1971 | | | 1972 | | | 1973 | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 1971 | 1972 | 1973 | Jan.–Sept. | July–Sept. | Oct.–Dec. | Jan.–Sept. | July–Sept. | Oct.–Dec. | Jan.–Sept. | July–Sept. | Jan.–Dec. |
| Controlled items | 298.0 | 12.4 | 6.3 | 13.6 | 7.5 | 4.8 | 3.2 | 3.8 | 1.0 | 2.4 | 8.5 | 2.4 | 4.6 |
| Services[a] | 200.9 | 12.9 | 8.1 | 12.6 | 7.6 | 4.1 | 4.1 | 4.8 | 0.9 | 3.1 | 8.8 | 3.4 | 3.5 |
| Other[b] | 97.1 | 11.5 | 2.5 | 15.6 | 7.3 | 6.5 | 1.4 | 1.7 | 1.2 | 0.7 | 8.1 | 0.3 | 7.0 |
| Uncontrolled services[c] | 105.6 | 17.7 | 15.0 | 26.5 | | 5.9 | 3.9 | 11.9 | 3.4 | 2.8 | 20.3 | 4.3 | 5.2 |
| Consumer durables[d] | 124.4 | 11.6 | 10.1 | 29.1 | 6.2 | 3.4 | 5.1 | 7.0 | 2.2 | 2.9 | 16.7 | 3.8 | 10.6 |
| Other items, excl. fruit and vegetables and housing | 252.3 | 12.6 | 10.8 | 29.7 | 8.7 | 3.7 | 3.5 | 5.0 | 1.2 | 5.5 | 15.2 | 1.5 | 12.6 |
| Total index, excl. fruit and vegetables and housing | 780.3 | 12.7 | 9.6 | 23.3 | 8.7 | 4.4 | 3.7 | 5.9 | 1.7 | 3.5 | 12.9 | 2.7 | 8.3 |
| Uncontrolled commodities[e] | 376.7 | 12.2 | 10.6 | 29.4 | 7.8 | 3.6 | 4.1 | 5.6 | 1.6 | 4.7 | 15.7 | 2.3 | 11.9 |

[a] Rent, electricity and water, transportation and communications, insurance and taxes, Sick Fund services, education (excluding private lessons, lectures, advanced studies, and books and study equipment), and domestic help.

[b] Fuel, eggs, milk and dairy products, alcoholic beverages, sugar, cigarettes and tobacco, grains and flour products (other than biscuits, cakes, and some other confectionery goods).

[c] Housing services, private medical care, dental care, other public services, personal services other than domestic help, shoe repair, sewing and tailoring, business services, and hotels.

[d] Furniture, solar water heaters, gas cooking stoves and hot plates, domestic electrical appliances, radios, phonographs, etc., and cars.

[e] The total of consumer durables and "other items, excl. fruit and vegetables and housing".

SOURCE: Based on Central Bureau of Statistics data.

### (c) *Price developments in the postwar period*

With the outbreak of war, economic activity was thrown into low gear. Following the extensive mobilization of manpower and equipment, the supply of commodities and services shrank in most markets. The pattern of demand also underwent a change, with an expansion in some cases and a slackening in others. Prices were therefore influenced from two directions: a contraction of supplies and changes in demand.

Where the drop in supply was accompanied by heavier demand prices might have been expected to climb precipitately. Outstanding examples are the metal and electronic industries, where demand grew due to large noncivilian orders. Basic metal prices soared 22 percent in the last quarter of 1973—the fastest rise in all industry. In those branches where diminished supply coincided with the ebbing of demand, more moderate price rises might have been expected. Yet another direction from which the level was affected was institutional decisions to adjust prices, and exogenous factors such as costlier imports.

In the last quarter of 1973 prices spiralled upward at a fairly rapid pace compared with the preceding quarter. In fact, the advances were higher than in any other quarter of the year and occurred in most areas. Consumer prices rose in the last three months by a seasonally adjusted 7 percent, compared with 5 percent in the preceding quarter, while wholesale industrial prices went up by 9 as against 4 percent.

It may reasonably by assumed that the war-induced slump in demand did not have any great effect on price movements, since it was generally considered to be a passing phenomenon. On the other hand, institutional decisions to up prices (e.g. fuel) and advancing prices abroad have a strong impact, and they contributed to the sharp postwar rises. It is interesting to note that the relative price of control-free services and of housing slipped during this period. The same had happened in 1966, with mounting production costs being mostly responsible; possibly the same occurred in the final quarter of 1973.

## 3. Relative Price Developments

### (a) *Commodity prices*

Commodity prices included in the consumer price index, which account for 55 percent of the general index, spurted 26 percent in 1973, after moving up 10 percent the year before. In the prewar months the curve ascended fairly evenly, by 3–5 percent in each of the three quarters. But in the final quarter it jumped 12 percent, accounting for almost half the year's total commodity price rise. Both retail agricultural and industrial prices shared in this development. The increase in fresh fruit and vegetables was especially striking—on an annual average they soared 33 percent in 1973, as opposed to 9 percent the year before.

Particularly conspicuous was the movement of controlled commodity prices, namely those that are largely subject to Government influence, such as bread, milk, sugar, and fuel. These rose by an appreciable 16 percent in 1973—six times as fast as in 1972. Despite this strong upswing, controlled commodity prices still lagged well behind both the average level and other commodity groups (see Table VI–5). To illustrate this, it should be pointed out that the decline in their relative price (i.e. in relation to the average level) from 1969 to the end of 1973 totalled more than 20 percent.[3]

The lagging of controlled commodity prices well behind the general level —which is due to the Government's subsidy policy—has important implications for the economy, as it results in a greater distortion of resource allocation. Some of the controlled items are imported by the Government, such as wheat; the relatively low domestic price of this commodity (compared with its steeply higher foreign price) results in its wasteful use.

Another aspect of controlled commodity prices is the timing of institutional decisions to raise them. Needless to say, the pricing of these products is not determined—at least in the short run—by market forces, but by the intensity of institutional pressures. In the long run, however, they have to be brought more or less in line with the average level of market prices or the level associated in some degree or other with the market forces, if the distortion in resource allocation due to unreasonable prices is to be reduced to a minimum. If prices are upped when demand is flagging, this will further dampen demand. On the other hand, if such a step is taken during a period of inflation, it will help to ease inflationary pressures. In this respect the years 1972 and 1973 were a suitable time to adjust controlled prices to the accelerated advance.

In the final quarter of 1973 controlled commodity prices rose 7 percent. While this failed to match the increase in other commodity groups, such as durables, it overtook the rate of increase in uncontrolled services (discussed above).

A comparison of the movement of controlled and uncontrolled commodity prices (i.e. items largely influenced by market forces) is also of interest. The latter soared nearly 30 percent during 1973; this was twice as fast as the advance in controlled prices, and almost matched the increase in the average level. The domestic demand pressure and the sharply higher import prices help to explain this.

In comparing consumer prices with those to the producer (as reflected in the wholesale price index of industrial output) we find some divergence in their rates of increase—26.6 vs. 29.5 percent. In the food industry retail prices outraced producer prices—28.5 as against 18.5 percent; in chemicals and petroleum products the figures were 37 and 23 percent respectively. By contrast, in elec-

[3] At the end of 1973 the consumer price index reached 180 (1969=100), while the index of controlled commodity prices stood at only 140.

Table VI–7

CHANGES IN INDUSTRIAL COMMODITY PRICES TO THE PRODUCER AND TO THE CONSUMER, 1973

(percentages)

| | Dec. 1972—Dec. 1973 | | First quarter | | Second quarter | | Third quarter | | Fourth quarter | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Consumer price | Producer price | Consumer price | Producer price | Consumer price | Producer price | Consumer price | Producer price | Consumer price | Producer price |
| Total industrial commodities | **26.6** | **29.5** | **2.8** | **5.2** | **8.4** | **7.0** | **2.2** | **3.6** | **11.2** | **11.1** |
| Food | 28.5 | 18.5 | 4.2 | 4.7 | 9.9 | 8.3 | 2.6 | 0.8 | 9.4 | 3.7 |
| Clothing and textiles | 21.1 | 20.3 | –4.5 | 1.5 | 10.4 | 2.7 | –0.9 | 3.7 | 15.8 | 11.1 |
| Leather, rubber and plastics | 16.5 | 33.1 | –0.1 | 5.1 | 5.5 | 5.6 | –0.6 | 2.7 | 11.2 | 17.3 |
| Wood and wood products | 39.1 | 46.2 | 9.1 | 13.0 | 7.5 | 8.4 | 9.0 | 8.1 | 8.8 | 10.5 |
| Metal products and machinery | 23.4 | 39.0 | 2.4 | 7.0 | 5.5 | 9.2 | 2.5 | 4.4 | 11.5 | 13.7 |
| Transport equipment | 19.5 | 14.2 | 4.4 | 3.2 | 4.3 | 2.2 | 4.1 | 2.2 | 5.5 | 6.0 |
| Electrical and electronic equipment | 22.5 | 30.2 | 3.4 | 6.6 | 4.6 | 4.1 | 1.3 | 4.1 | 11.8 | 12.7 |
| Chemicals and petroleum | 37.3 | 32.4 | 4.4 | 5.3 | 7.3 | 6.9 | 3.3 | 4.3 | 19.0 | 12.8 |

SOURCE: Central Bureau of Statistics.

trical equipment, metal and machinery, leather products, and rubber and plastics producer prices rose relatively faster. The difference stemmed partly from the disparate weights of these items in the consumer and producer price indexes. Another factor was the extra stocks kept on hand by retailers, which were sold at the old prices, while manufacturers had to raise their prices because of costlier raw materials and imports.

In addition, it is possible that certain other components of the retail price (such as transport and packaging) go up more slowly than the wholesale price of the product. In some cases where the retail price went up faster the basic reason was probably that, whereas retailers can immediately respond to a change in demand, wholesale prices are usually determined some time in advance, being based more on longer-term contracts or orders.

(b) *Service prices*

The services item in the consumer price index rose 18 percent in 1973, compared with 11 percent the year before; during the first nine months of 1973 the rise was 13 percent, as against 7 percent in the corresponding period of 1972. Despite their accelerated uptrend in the year reviewed, these prices did not go up as fast as the general level of consumer prices (discussed in the previous section). This is explained by developments in the postwar months. Before the war services moved up more or less in step with commodities. That commodity prices did not lag behind and even slightly outpaced service prices in the prewar period was due to the jump in import prices, which affected commodities more than services because of the relatively higher import component of the former. At a time of demand inflation service prices can generally be expected to rise faster, but the impact of mounting production costs (in the case of commodities) offsets this factor. A similar development occurred in the past after a devaluation, a Government decision to up the prices of controlled commodities, or an increase in import prices, under conditions of strong demand pressure.

In the last quarter of 1973 service prices moved up to roughly the same extent as in the corresponding period the year before—4 as against 3 percent. By contrast, commodity prices soared 12 percent in the three postwar months. The drastic decline in the relative price of services during this period was chiefly due to the weakening of demand for them, whereas commodity prices were influenced by rising production costs: higher import prices and the raising of controlled commodity prices. Apparently the cost inflation began to be felt at the outbreak of war. The fact that the money supply was deliberately expanded in order to stave off a wartime decline in employment reinforces this assumption.

## (c) *Housing*

Private dwelling prices were up 26 percent in 1973, compared with 33 percent the year before. This development stands out conspicuously when compared with that in other commodity, service, and factor prices. Whereas in the case of most commodities and services the price rise accelerated notably, the uptrend in private dwelling prices slackened, though it was similar to the increase in the average level of consumer prices.

With the outbreak of hostilities this trend grew more pronounced, signifying that its inflationary effect stemmed not so much from demand-pull as from cost-push. As can be seen from Figure VI–5, a similar development occurred in the past when the economy began to retreat in 1965. At that time dwelling prices started to slip compared with residential construction input prices.[4]

Figure VI–5

**DWELLING PRICES RELATIVE TO RESIDENTIAL CONSTRUCTION INPUT PRICES, 1965–73**

(October 1964=100.0)

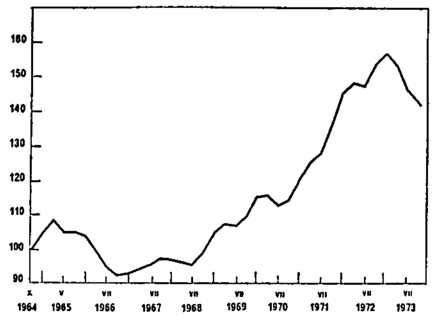



Table VI–8

**INCREASE IN DWELLING PRICES AND RESIDENTIAL CONSTRUCTION INPUT PRICES, 1968–73**

(percentages)

| | Increase over previous period | |
|---|---|---|
| | Residential construction input prices | Dwelling prices |
| January 1968-September 1968 | 3.5 | 2.3 |
| July 1968-March 1969 | 0.8 | 6.6 |
| January 1969-September 1969 | 1.3 | 7.0 |
| July 1969-March 1970 | 2.7 | 7.3 |
| January 1970-September 1970 | 7.6 | 10.1 |
| July 1970-March 1971 | 4.4 | 7.0 |
| January 1971-September 1971 | 4.9 | 13.2 |
| July 1971-March 1972 | 6.8 | 18.9 |
| January 1972-September 1972 | 8.4 | 13.7 |
| January 1972-March 1973 | 8.1 | 13.7 |
| January 1973-September 1973 | 16.7 | 12.3 |

SOURCE: Central Bureau of Statistics.

[4] This comparison should be accepted with some reservation, since the downturn in the relative price of services after October 1973 stemmed from wartime economic conditions, whereas during the recession of 1965–67 it was due to internal economic developments.