

## CHAPTER VI

### PRICES

#### 1. MAIN DEVELOPMENTS

Prices rose steeply in 1971, even in comparison with the boom years before the 1966-67 recession. The various price indexes climbed by 10-13 percent, with the consumer price index going up 13.4 percent between December 1970 and December 1971 and by 12 percent on an annual average, as compared with increases of 10.1 and 6.1 percent respectively in 1970.

These price hikes are quite high, considering the relatively short period in which they occurred: from the second half of 1970 until the end of 1971 they amounted to about 23 percent. Apart from the early fifties, no such steep rises have previously taken place within so brief a span. The increases were especially pronounced after the imposition of import surcharges in August 1970 and the devaluation in August 1971, though the upward

Table VI-1  
AVERAGE RISE IN PRICES OF RESOURCES AND USES, 1961-71  
(percentages)

|                         | Average<br>1961-65 | 1969 | 1970 | 1971 |
|-------------------------|--------------------|------|------|------|
| Private consumption     | 7.0                | 3.5  | 7.5  | 13.0 |
| Public consumption      | 10.5               | 3.0  | 7.5  | 15.5 |
| Gross capital formation | 8.5                | 5.5  | 11.0 | 14.0 |
| Total domestic uses     | 8.0                | 4.0  | 8.0  | 14.0 |
| Exports <sup>a</sup>    | 13.0               | 4.5  | 3.0  | 14.0 |
| Total uses              | 8.5                | 4.0  | 8.0  | 14.0 |
| Imports <sup>b</sup>    | 11.0               | 5.5  | 4.5  | 15.5 |
| Gross national product  | 8.0                | 3.0  | 9.0  | 13.0 |
| Total resources         | 8.5                | 3.5  | 8.0  | 14.0 |

NOTE: Figures are rounded off to the nearest half percent.

<sup>a</sup> Valued at f.o.b. prices and at the effective exchange rate; including exports to the administered areas.

<sup>b</sup> Valued at c.i.f. prices and the effective exchange rate; including imports from the administered areas.

SOURCE: Central Bureau of Statistics.

movement persisted throughout the entire period and even carried over into the early months of 1972.

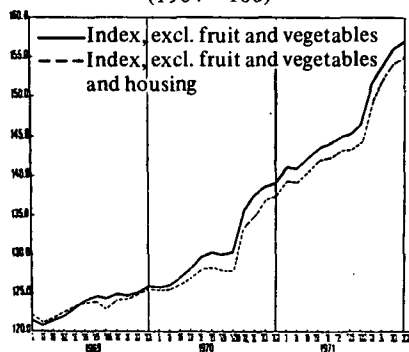
In analyzing price developments during the year reviewed two subperiods can be distinguished: from the beginning of the year until the August devaluation, when the level moved up 4 percent as the result of buoyant demand; and from August until year's end, when there was an even steeper 9 percent advance. During the first period the hikes were confined to a limited number of items: meat became dearer because of the sharply higher prices charged abroad, and the prices of housing and professional services rose because of growing demand pressure. The direct effect of the devaluation made itself felt during the second period, when both demand and cost pressures (the latter due to the dearer cost of imports) sent prices spiralling upward at a very fast tempo. Most of the impact of the devaluation had worked itself out by the end of the year, although price rises were staved off for a time thanks to the arrangement made with producers which permitted them to sell their stock at predevaluation prices in lieu of paying a surcharge at the rate of the devaluation.

The strong price rises in 1971 can be largely attributed, as already mentioned, to the intensification of demand pressure, the principal indicators of which are the decline in unemployment and the expansion of total resource use (less direct defense imports). The last two developments took place against the setting of the devaluation of the IL, the upward revaluation of several foreign currencies, mounting prices abroad, and the paring of subsidies — all of which added fuel to the inflation.

It is reasonable to assume that the devaluation was the dominant factor driving up prices in the second half of 1971 (during the four postdevaluation months the level moved up 8 percent).<sup>1</sup> Had production costs not increased, it is almost certain that prices would not have gone up so sharply, the demand pressures notwithstanding.<sup>2</sup>

Supporting this view is the fact that prices went up somewhat faster than the exogenous rise in production costs.<sup>3</sup> It may therefore be concluded that, along with swelling

Figure VI-1  
CONSUMER PRICE INDEX, EXCL.  
FRUIT AND VEGETABLES AND  
HOUSING, 1969-71  
(1964 = 100)



1. From August until the end of 1971 prices advanced 1.8 percent per month, about the same rate as in the second half of 1970 (1.5 percent). In contrast to this, the rate of increase during the prerecession boom years was 0.8 percent per month for the corresponding period. This is firm evidence of the influence of the formal devaluation on prices in the second half of 1971 and that of the effective devaluation (i.e. the imposition of import surcharges) in the second half of 1970.
2. Before the prerecession boom a price rise of over 20 percent — like that which occurred from August 1970 until the end of 1971 — was spread out over at least three years.
3. The term "exogenous" as used here refers to the increase in production costs due to political decisions or factors outside the Israeli economy.

demand, increased production costs contributed to the price advance during the year.<sup>4</sup> In certain items demand was unquestionably the dominant factor – for example, in housing and professional services, which soared 36 and 18 percent respectively. Here, and also in agriculture, prices moved up at a faster rate than the exogenous increase in production costs. The strong upward movement at the beginning of 1972 (which, however, was slower than in previous months) suggests that during this period demand pressure began to predominate.

It was the exceptionally rapid monetary expansion that augmented demand and fueled the inflation in 1971. However, because of the lagged effect of the monetary expansion, it was not fully felt in the year reviewed; in other words, the increase that took place in the second half of 1971 will affect prices in 1972 as well. In addition, part of the incremental means of payment flowed to the money and real estate markets, mainly because of speculative motives, thus easing some of the pressure on the commodity and service markets.

The 1971 devaluation and the 1970 import surcharge, which was levied chiefly on commodities, caused a deviation from the long-term rising trend in the price of services relative to that of commodities included in the consumer price index. Service prices began to slip relative to commodity prices in August 1970. The trend was reversed in the second quarter of 1971, and the relative price of services continued upward until the end of the year. This reflected the buoyant demand conditions, which enabled suppliers of services to up their prices appreciably.

## 2. CAUSES OF PRICE DEVELOPMENTS

The consumer price index rose 13.4 percent during 1971 – a slightly higher rate than in the previous year. The other indexes went up to a similar extent; the increase in wholesale prices of industrial output was 10.3 percent, compared with 11.3 percent in 1970. These changes far exceeded those of the preceding years of relative stability, and they even eclipsed the price rises of the boom years of 1960-65, when the consumer price index averaged 7-8 percent higher per year.

Such a sharp upswing within so relatively brief a period is unprecedented in the Israeli economy, apart from the first years of statehood when rationing and controls were imposed. Within a span of about one and a half years, from August 1970 until the end of 1971, prices spurted more than 20 percent. Most of the increase was recorded after imports became dearer. (It should be noted in this connection that for two years after the

4. The increase in exogenous production costs includes the effects of the devaluation of the Israeli pound, the upward revaluation of various foreign currencies, the wage hikes stipulated in the collective agreements, and the increase in profit margins proportional to this exogenous rise in wages and the higher price of imports. For private consumption the total exogenous increase for the year is estimated at 12.5 percent; for industry – 13 percent; agriculture – 10 percent; and construction – 9 percent. Deducting the productivity gain from these estimates gives the price rise which would have been warranted by the increased production costs. Because of the assumptions underlying the calculation, the disparity between the price increase attributable to higher costs and the actual increase can be regarded as significant only if it is quite large.

1962 devaluation there was also a rapid advance, although milder than in 1971.) This strong rise was the outcome of several major developments in the economy during the last two years: first, the easing of the restraints (mainly institutional) imposed on prices and wages; second, the appearance of formidable factors affecting costs; and third, the expansion of the money supply (up 28 percent in 1971 alone).

As regards the first development, the price and wage restraints were an outgrowth of the tripartite "package deal" and the activities of the Public Price Committee. One clause in the wage agreement signed in January 1970 between the Government, Histadrut (General Federation of Labor), and Coordinating Bureau of Economic Organizations (representing the employers) committed employers not to boost prices directly or indirectly because of the extra costs resulting from the wage hikes, purchases of compulsory loans, and various other outlays. But the wage hikes awarded during this period built up pressure on the price level, and this found expression in the sharp rises after the introduction of the import surcharge in August 1970 and the devaluation of August 1971.

The second of the aforementioned developments was connected with the increase in import prices in 1970 and 1971, which augmented production costs. The prevailing demand pressure, which was aggravated by the rapid monetary expansion, doubtless contributed much to the inflation. At the beginning of 1970 the economy reached full employment and the unsatisfied demand for labor gradually grew more pronounced. Against this backdrop of overemployment, the rapidly swelling demand – primarily for

**Table VI-2**  
**SHARE OF COMMODITY AND SERVICE GROUPS IN TOTAL**  
**RISE IN CONSUMER PRICE INDEX,<sup>a</sup> 1970-71**  
(percentages)

|                        | Weight<br>(1969=1000.0) | 1970          |               |               | 1971          |               |               |
|------------------------|-------------------------|---------------|---------------|---------------|---------------|---------------|---------------|
|                        |                         | Jan.-<br>Dec. | Jan.-<br>July | Aug.-<br>Dec. | Jan.-<br>Dec. | Jan.-<br>July | Aug.-<br>Dec. |
| Housing                | 144.3                   | 23.7          | 63.2          | 8.8           | 14.9          | 22.5          | 11.1          |
| Fruit and vegetables   | 75.4                    | 2.9           | -20.8         | 11.9          | 11.3          | -5.0          | 18.9          |
| Meat and meat products | 88.5                    | 2.6           | 1.5           | 2.8           | 14.9          | 32.5          | 6.7           |
| Uncontrolled services  | 111.4                   | 13.9          | 23.1          | 10.8          | 14.9          | 22.5          | 11.1          |
| Controlled items       | 298.0                   | 25.6          | 29.1          | 24.4          | 27.6          | 27.5          | 27.8          |
| Consumer durables      | 124.4                   | 15.7          | 15.1          | 15.7          | 10.4          | 10.0          | 11.1          |
| Other items            | 158.0                   | 15.6          | -11.2         | 25.6          | 6.0           | -10.0         | 13.3          |
| Total                  | 1000.0                  | 100.0         | 100.0         | 100.0         | 100.0         | 100.0         | 100.0         |

<sup>a</sup> The share of each group is calculated by multiplying its weight by the rise in its price and dividing by the overall rise in the index.

SOURCE: Based on Central Bureau of Statistics data.

investments and exports — pushed up prices to a greater extent than justified by the extra costs (there were also rises in items where costs were a minor factor). Nevertheless, it is almost certain that even without the increase in exogenous production costs a strong demand-inflation would have ensued, though it would have been spread out more.<sup>5</sup> Indeed, before the recession there was, as already noted, a similar price advance (more than 20 percent), but over a period of about three years. Thus the main effect of the cost pressure was to accelerate the rise of the price level.<sup>6</sup>

This analysis of price developments over a two-year period (1970 and 1971) rather than for 1971 alone is not coincidental. In August of both years import prices were officially raised by similar rates. In both years most of the price increases occurred after August, and the advance from this month until the end of December was also roughly the same each year. However, during the first month or two after the August 1971 devaluation prices went up less than during the same period in 1970 because of the inventory surtax exemption granted after the devaluation. The surtax was levied at a rate equal to the devaluation, and producers were requested to declare their inventories. But an arrangement was made which exempted from the tax all who continued to sell their existing stock at the old price.<sup>7</sup>

In addition, it was forbidden for producers, importers, and wholesalers to sell their goods or services for more than their predevaluation price.<sup>8</sup> With the introduction of price controls, permits for upping prices were granted only after the submission of appropriate cost calculations and a reasoned request.

The impact of this policy was felt for approximately two months after the devaluation, when it kept prices from rising as steeply as they otherwise would have in the general inflationary atmosphere (a natural outgrowth of devaluation). The aim was to prevent price rises not connected with the dearer cost of the import component or at a rate greater than otherwise warranted by the devaluation (the reference is to commodities only and not services — the latter went up sharply, as will be seen later). The basic flaw of this policy was that it created a period of artificial calm, after which a rise was virtually

5. Price projections for 1971 indicated a much smaller rise than actually occurred. This applies especially to the second half of 1971, whereas the forecast for the first half was close to the actual rise. These projections are based on the interrelationship of prices, unemployment, wages, imports, and the money supply.
6. This is evidenced by the general inflationary psychosis generated by devaluation, which as a rule tends to loosen the reins on all prices. In contrast, during other periods of growing demand pressure price hikes usually lead to some loss of business and other negative results.
7. The regulations stipulated that if the producer did not abide by the terms of the arrangement, in part or in whole, he had to pay the surtax according to the discretion of the competent official, appointed by the Ministry of Commerce and Industry. Producers were not obligated to come to an arrangement, and could instead opt to pay the surtax. This arrangement effectively kept the lid on prices until stocks were drawn down. The deferment of price increases, which is reflected in the data (see, for example, Table VI-3), stemmed solely from this arrangement, and was not influenced at all by market forces.
8. To be exact, the price prevailing on August 15, 1971. It should be noted that in the regulations the "price" includes sales and payment terms.

certain.<sup>9</sup> As a consequence, demand pressure mounted, but it hardly found expression in the price level.<sup>10</sup> Thus it is reasonable to assume that manufacturers' stocks fell below what they considered desirable, and this will probably lead to the replenishing of stocks.<sup>11</sup>

The deferment of a price rise after August 1971 is reflected in the various indexes (see Table VI-3). Wholesale prices of industrial output went up much less between August and October 1971 than in the corresponding period of 1970 (the difference was more than 3 percent), but toward the end of the year the tempo approached that of 1970. As to the consumer price index, by October 1971 the rise was already similar to that in the corresponding period of 1970, and in the final part of the year it even eclipsed the 1970 figure. Meat and the fruit and vegetables item were responsible for most of the difference.

During this period (from August 1971 onward) some items began to move up at a faster pace than in 1970, a development that is not apparent from the annual average figures.

As regards the increase in production costs, it should be noted that the dearer cost of imports (due to the devaluation, the rise in foreign prices, and the revaluation of several foreign currencies in relation to the dollar) was almost wholly exogenous, in the sense that it was the outcome of political decisions or factors outside the Israeli economy, and it had a direct impact on prices. By contrast, the higher labor outlay in 1971 mainly reflected the adjustment of wages to market forces (that is, the chief factor was the stronger demand for final goods), and was exogenous only insofar as it was influenced by the collective agreements and by wage demands made after the upping of prices due to the higher cost of imports.

As already noted, the fact that the rise in the price level somewhat exceeded that in exogenous production costs in itself attests to an accentuation of demand pressure in 1971. The extra production costs resulted from a combination of factors: the devaluation of the Israeli pound, the various currency revaluations, the wage increases awarded in the collective agreements, the attempt of producers to maintain their profit margins, and the dearer cost of imports. As regards private consumption, it is estimated that the devaluation added about 6 percent to costs; wage increases and the revaluations – 2 percent each; the profit margin factor – 1.5 percent; and import prices – 1 percent. These changes add up to approximately 12.5 percent, which constitutes the upper limit of their effect on production costs. Allowance must also be made for the gain in productivity, which has to be deducted from the incremental factor costs (capital and labor). This

9. This was not the usual case of an expected price rise, as there was no doubt that prices would go up once stocks were exhausted.

10. This period witnessed a spending spree, especially on durable consumer goods.

11. Two contrasting tendencies are at work here. The first is an expansionary effect – that is, the replenishing of stocks to the desired level increases the country's import bill. The second is the substitution effect – that is, the influence of the change in relative prices due to the devaluation, which tends to diminish imports. Had the first effect been prevented by allowing prices to rise immediately after the devaluation, this would have helped to curtail imports.

**Table VI-3**  
**RISE IN VARIOUS PRICE INDEXES, 1970-71**  
 (percentages)

|   | <u>Jan.-July</u> |      | <u>August</u> |      | <u>September</u> |      | <u>October</u> |      | <u>November</u> |      | <u>December</u> |      | <u>Aug.-Oct.</u> |      | <u>Aug.-Dec.</u> |      |
|---|------------------|------|---------------|------|------------------|------|----------------|------|-----------------|------|-----------------|------|------------------|------|------------------|------|
|   | 1970             | 1971 | 1970          | 1971 | 1970             | 1971 | 1970           | 1971 | 1970            | 1971 | 1970            | 1971 | 1970             | 1971 | 1970             | 1971 |
| Consumer price index                                  |                  |      |               |      |                  |      |                |      |                 |      |                 |      |                  |      |                  |      |
| General   | 2.6              | 4.0  | 0.5           | 0.5  | 4.0              | 3.2  | 2.0            | 2.1  | 0.0             | 1.6  | 0.7             | 1.2  | 6.6              | 6.0  | 7.4              | 9.0  |
| Excl. fruit and vegetables                            | 3.5              | 4.5  | 0.2           | 0.9  | 4.0              | 3.2  | 1.6            | 1.5  | 0.7             | 1.4  | 4.0             | 0.6  | 5.9              | 5.8  | 7.0              | 8.0  |
| Excl. fruit and vegetables and meat and meat products | 3.6              | 3.5  | 0.3           | 0.5  | 4.0              | 2.2  | 1.8            | 2.0  | 1.1             | 2.2  | 0.3             | 1.0  | 6.2              | 4.8  | 7.6              | 8.1  |
| Wholesale price index of industrial output            | 4.5              | 1.9  | 1.3           | 0.8  | 5.4              | 2.4  | 1.1            | 1.6  | 0.3             | 2.3  | 0.4             | 0.9  | 7.9              | 4.8  | 8.7              | 8.2  |

SOURCE: Central Bureau of Statistics

brings the figure down to 10 percent, which should be compared with the actual price rise as measured in the consumer price index (this amounted, as noted above, to 13.4 percent).<sup>12</sup>

In industry we find a similar difference between the actual price rise and that which the additional exogenous production costs would have warranted. But in construction, services, and agriculture the differences are striking, and hence nearly all of the rise can be explained by demand alone, especially in construction and services. Apart from these three sectors, the disparity was not particularly great, indicating that even had demand not been so buoyant, the cost pressure would nevertheless have driven up prices to almost the same extent as actually occurred.

Indeed, in the second half of 1971 the actual rise in prices was more or less similar to that attributable to the devaluation. This fact – the passing on of all the extra costs to the customer – is further evidence of the existing demand pressure which found expression in this period. It should be noted that there are some private consumption items whose short-run price development has no connection with demand – these are the controlled items whose prices are determined by the Government. They accounted for close to 4 percent of the overall rise in the consumer price index during the year, and together with meat, whose price is largely fixed by the Government, the figure comes to 6 percent.

In the year reviewed the monetary expansion grew more pronounced, as reflected by the 28 percent growth of the money supply. Such an expansion is liable to further

**Table VI-4**  
**RISE IN VARIOUS INPUT PRICE INDEXES, 1970-71**  
(percentages)

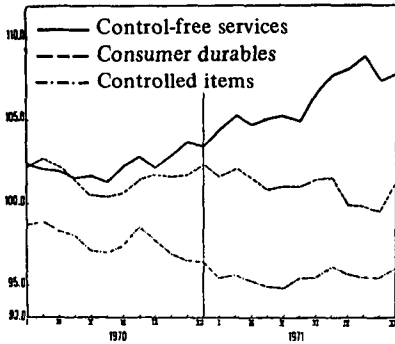
| Price index of<br>input in: | 1970          |               |               | 1971          |               |               |
|-----------------------------|---------------|---------------|---------------|---------------|---------------|---------------|
|                             | Jan.-<br>July | July-<br>Dec. | Jan.-<br>Dec. | Jan.-<br>July | July-<br>Dec. | Jan.-<br>Dec. |
| <b>Agriculture</b>          |               |               |               |               |               |               |
| Total                       | 4.0           | 8.1           | 12.2          | 3.5           | 9.8           | 13.6          |
| Excl. wages                 | 1.4           | 11.0          | 12.5          | 2.6           | 13.0          | 16.0          |
| <b>Construction</b>         |               |               |               |               |               |               |
| Total                       | 11.0          | 1.0           | 12.1          | 7.5           | 5.4           | 13.1          |
| Excl. wages                 | 4.0           | 6.9           | 11.0          | 1.0           | 9.5           | 10.5          |
| Road construction           | 6.6           | 3.3           | 10.0          | 7.4           | 8.6           | 16.1          |

SOURCE: Central Bureau of Statistics

12. The impact of the devaluation is calculated as the product of the effective import components, including purchase tax for 1970, and the rise in the effective exchange rates following the devaluation. The effect of the wage increases is computed by multiplying the wage-labor component by 6 percent. As for profit margins, it is assumed that producers tried to increase profits at a rate similar to the wage increments awarded in the collective agreements.



**Figure VI-2**  
**RISE IN RELATIVE PRICES,<sup>a</sup>**  
**1970-71**  
 (1969 = 100)



<sup>a</sup> The price of each group divided by the consumer price index excluding fruit and vegetables.

sharpen the inflationary trends, but it generally has a lagged effect. The impact of the increased money supply on prices was not fully felt in 1971. Presumably the lag amounts to half a year or so. In other words, the approximately 10 percent growth of the money supply during the second half of 1971 apparently had not affected the price level by year's end, and will leave its mark in 1972. On the other hand, there was a heavier demand for financial assets and real estate, which means that the incremental means of payment were partly channelled to other markets, sending prices spiralling there and thus keeping the consumer price index from climbing proportionately to the monetary expansion.<sup>13</sup>

Another question that arises is whether in 1972 there remained any upward pressure

on prices due to the 1971 increase in costs. If the wage hikes in excess of the collective agreements are added to the production costs calculated above, the total rise in the latter will come to 15-16 percent. But after deducting the productivity gain, the rise is roughly the same as that of prices. It may thus be inferred that there was no additional cost pressure on prices, indicating that the effect of the devaluation was largely spent by the end of 1971.<sup>14</sup>

It should be noted that in Israel demand inflation also results in a larger import. Excluding direct defense items, the level was up 19 percent in 1971, as against only 6 percent the year before. The rapid third-quarter advance recorded by consumer goods was particularly outstanding (as mentioned above, these were sold at the predevaluation prices, thereby absorbing part of the additional demand). From January through July most of the price rise was confined to a relatively small number of items, such as meat and meat products, water and electricity, and residential rents. Imports began to move up at an accelerated rate during this period, after slowing down in the second half of 1970. Thus part of the additional demand was probably diverted to imports, resulting in less pressure on domestic resources and the price level than would otherwise have developed.

Devaluation, by its very nature, alters relative prices: it makes imported commodities more expensive (this is discussed in the following section). But the devaluation of 1971 also affected the general price level — with all that this implies, especially concerning wage increases — for the following reasons: (a) because of the downward rigidity of prices, a rise in one group of commodities or services tends to push up the general level;

13. The boom in the real estate and share markets also absorbed much of the incremental money supply after the 1962 devaluation, with the result that in 1963 the price rise was far milder than in 1962.

14. Inclusion of 1970 in the analysis does not alter this conclusion.

(b) there were some groups, chiefly monopolies and suppliers of services, who in 1971 upped their prices even though there was no devaluation-induced increase in costs (see the discussion below of control-free service prices); (c) the growth of aggregate demand and liquidity – whose repercussions as a rule are not immediately apparent – exerted upward pressure on prices.

Finally, it should be noted that, while in the early months of 1972 prices were still advancing strongly, the pace slackened in comparison with the final months of 1971. Between January and March 1972 the consumer price index went up 3 percent – a rate similar to that in 1971 and higher than in the corresponding period of 1970.

### 3. SECTORAL PRICE DEVELOPMENTS

#### (a) *Development of commodity prices*

Commodity prices, whose weight in the consumer price index comes to more than half, soared 13 percent in the course of 1971, in contrast to 8.7 percent the year before. More than 60 percent of the increase occurred after the August 1971 devaluation, whereas in 1970 the post-August period saw 90 percent of the overall rise. The difference between the two years is explained by the stability of commodity prices between January and July 1970, when they inched up less than 1 percent, in contrast to a 4 percent rise in the corresponding period of 1971. Much of the latter increase was accounted for by meat. In the post-August period of 1971 prices of controlled items (milk, eggs, bread, etc.) went up more rapidly than in the same period in 1970 because of the cutting of subsidies. By contrast, durable goods moved up less after August 1971 than in the corresponding months of the previous year, and therefore their contribution to the rise of the index declined from 16 percent in 1970 to 10 percent in the year reviewed. The reason for the disparity lies in the deferment of price rises after devaluation and the more sluggish growth of demand after stocks were run down (see the discussion above).

#### (b) *Industry*

Consumer prices of industrial products rose 12 percent in 1971, compared with 9 percent in the previous year. Wholesale prices of industrial output climbed, as already noted, by 10.3 percent, paced by transport equipment, wood and wood products, chemicals and petroleum products, and foodstuffs.

These increases should be viewed in conjunction with the freezing of industrial prices through the imposition of controls immediately after the devaluation of the Israeli pound. It turns out that the freeze did not have much of a quantitative effect; at the most, it proved somewhat effective in restraining prices after the upping of wages, but the dearer cost of imported raw materials was recognized as a legitimate reason for revising prices. Most of the authorized rises were in the vicinity of 8 percent, and this is roughly the extent to which prices climbed after the devaluation. Examination of the development of prices over the year shows that those for industrial products trailed slightly behind GNP prices and were 4-5 percent below those of controlled services and 8 percent lower than uncontrolled service prices. The reference is to industrial prices in general; in

Table VI-5

**RISE IN SELECTED GROUPS OF COMMODITY AND SERVICE  
PRICES, ACCORDING TO THE CONSUMER PRICE INDEX, 1970-71**

(percentages)

|   | Weight in<br>index<br>(1969=<br>1000.0) | Rise in<br>December levels |      | 1970  |       | 1971  |       |
|---|---|----------------------------|------|-------|-------|-------|-------|
|   |   | 1970                       | 1971 | Jan.- | Aug.- | Jan.- | Aug.- |
|   |   |                            |      | July  | Dec.  | July  | Dec.  |
| Controlled items  | 298.0                                   | 8.6                        | 12.4 | 2.6   | 5.9   | 3.6   | 8.5   |
| Services <sup>a</sup>                                     | 200.9                                   | 8.5                        | 12.9 | 3.4   | 4.9   | 4.7   | 7.8   |
| Other <sup>b</sup>  | 97.1                                    | 8.8                        | 11.5 | 0.9   | 7.8   | 1.5   | 9.9   |
| Uncontrolled services <sup>c</sup>                        | 111.4                                   | 12.9                       | 17.8 | 5.5   | 7.0   | 7.7   | 9.3   |
| Consumer durables <sup>d</sup>                            | 124.4                                   | 12.6                       | 11.6 | 3.3   | 9.0   | 3.5   | 7.9   |
| Other items, excl. fruit<br>and vegetables and<br>housing | 246.5                                   | 7.4                        | 11.3 | -1.0  | 8.3   | 3.7   | 7.3   |
| Total index, excl. fruit<br>and vegetables and<br>housing | 780.3                                   | 9.5                        | 12.7 | 1.9   | 7.5   | 4.2   | 8.2   |

<sup>a</sup> 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.

<sup>b</sup> 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).

<sup>c</sup> Housing services, private medical care, dental care, other public services, personal services other than domestic help, shoe repair, and sewing and tailoring.

<sup>d</sup> Furniture, solar water heaters, gas cooking stoves and hot plates, domestic electrical appliances, radios and phonographs, and private cars.

SOURCE: Based on Central Bureau of Statistics data.

some items price control may have made it difficult for manufacturers to boost prices, and it is also likely that the controls were circumvented by lowering quality.

In this context it should be noted that industrial prices went up only a shade more than the rise in the exogenous production costs (less the productivity gain).<sup>15</sup>

### (c) *Agriculture*

The prices of farm products included in the consumer price index went up 13 percent on an annual average and by 18 percent between the beginning and the end of the year, as against only 6 percent in 1970. Fresh fruit and vegetables were mainly respon-

15. The increase attributable to devaluation is estimated at 7.5 percent; official wage rises - 2 percent; the profit margin factor - 1.5 percent; and the currency revaluations - 2 percent. After deducting the 5 percent increase in productivity, prices should have gone up 8 percent, whereas they actually rose 10 percent.

sible for the greater rise in the average annual level than in December levels, as they were 21 percent higher at the end of 1971 than at the end of the previous year, but moved up only 12.5 percent on an annual average.<sup>16</sup> On the other hand, exogenous production costs in agriculture rose 10 percent,<sup>17</sup> from which must be deducted the productivity increase in order to calculate the price rise attributable to the additional costs.

(d) *Service prices*

The service item in the consumer price index went up at a stronger rate during 1971 – 15 percent as opposed to 10 percent in 1970. Even though devaluation has only a fairly weak effect on such prices, it is noteworthy that the upward movement accelerated (reaching 2 percent a month) precisely after the 1971 devaluation, and far surpassed the rise after August 1970. The link between such prices and the dearer cost of imports seems to be more an indirect one: suppliers attempted to raise the relative price of services after it had fallen because of the devaluation. Such an attempt can succeed only when demand pressure is strong. It must be remembered that in this sector supply is relatively limited owing to the lack of competitive imports. In contrast, for most of the goods whose supply can be augmented from imports there exists a price ceiling – the price of the imports plus the taxes imposed thereon.

Figure VI-3

RISE IN SERVICE PRICES RELATIVE TO COMMODITY PRICES, 1970-71

(1969 = 100)

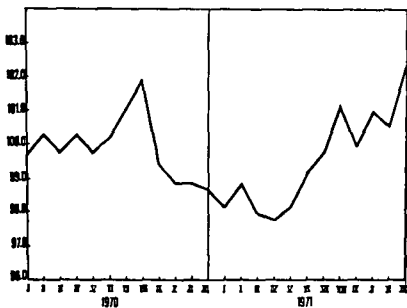
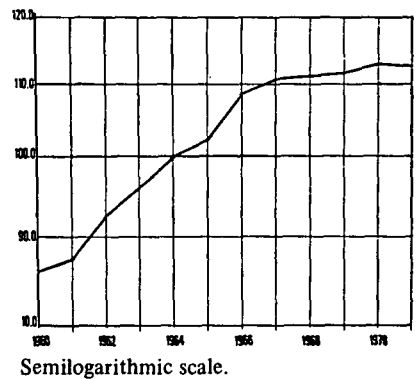


Figure VI-4

SERVICE PRICES RELATIVE TO COMMODITY PRICES, 1960-71

(1964 = 100)



16. Agricultural prices fluctuate during the year because of the fruit and vegetables item, and therefore it would be more appropriate to compare the rise warranted by the increased production costs with the actual annual average rise. Such a comparison reveals a considerable disparity between the two. At producer prices, fruit and vegetables registered a smaller increase than indicated above (see Chapter X).
17. The devaluation is estimated to have added 3.5 percent to the price (the total import component – 20 percent – multiplied by the 16.6 percent rise in the effective exchange rate for agriculture); official wage rises – 3 percent; the profit margin factor – 2 percent; and the currency revaluations – 1.5 percent.

There was a marked increase in prices of uncontrolled services, which accounted for half the total weight of the services item and 11 percent of the total weight of the index. They jumped 18 percent, as against the previous year's 13 percent, with more than half of the 1971 advance occurring between August and the end of the year.

In August 1970 the price of services relative to commodities included in the consumer price index began to dip owing to the import surcharge. It continued downward until the following April, when the trend was reversed (see Figure VI-3). The latter rise offset the previous drop, and on an annual average the relative price held steady. It should be remembered there is a long-run rising trend (interrupted during the 1966-67 recession) in the price of services relative to goods.

(e) *Housing*

The uptrend in dwelling prices grew sharper in 1971: on an annual average they soared 26 percent over the 1970 level, and from December 1970 until December 1971 by

**Table VI-6**  
**INDEX OF DWELLING PRICES AND KEY MONEY,**  
**ACCORDING TO SURVEY DATA, 1968-71**  
(1964 = 100)<sup>a</sup>

| Middle of survey period | Dwelling prices |   | Key money |   | Total |   |
|-------------------------|-----------------|---|-----------|---|-------|---|
|                         | Index           | Increase or decrease (-) as against previous period | Index     | Increase or decrease (-) as against previous period | Index | Increase or decrease (-) as against previous period |
| 1968 January            | 111.3           | 0.5   | 100.6     | -1.9  | 109.0 | 0.1   |
| April                   | 112.3           | 0.9   | 99.1      | -1.5  | 109.4 | 0.4   |
| July                    | 114.9           | 2.3   | 95.4      | -3.7  | 110.7 | 1.2   |
| October                 | 118.9           | 3.5   | 92.1      | -3.5  | 113.1 | 2.3   |
| 1969 January            | 123.3           | 3.7   | 93.3      | 1.3   | 116.8 | 3.3   |
| April                   | 127.9           | 3.7   | 99.2      | 6.3   | 121.7 | 4.2   |
| July                    | 131.4           | 2.7   | 98.9      | -0.3  | 124.4 | 2.2   |
| October                 | 135.9           | 3.4   | 99.2      | 0.3   | 127.9 | 2.8   |
| 1970 January            | 142.3           | 4.7   | 102.4     | 3.2   | 133.5 | 4.4   |
| April                   | 150.0           | 5.4   | 111.7     | 9.1   | 141.6 | 6.1   |
| July                    | 156.2           | 4.1   | 115.9     | 3.8   | 147.3 | 4.0   |
| October                 | 159.8           | 2.3   | 110.9     | -4.3  | 149.2 | 1.3   |
| 1971 January            | 167.9           | 5.1   | 108.3     | -2.3  | 155.2 | 4.0   |
| April                   | 179.5           | 6.9   | 111.3     | 2.8   | 164.9 | 6.3   |
| July                    | 191.5           | 6.7   | 100.9     | -9.3  | 170.5 | 3.4   |
| October                 | 211.0           | 10.2  | 110.1     | 9.1   | 187.4 | 9.9   |
| 1972 January            | 226.8           | 7.5 <sup>b</sup>                                    | 117.6     | 6.8 <sup>b</sup>                                    | 201.1 | 7.3 <sup>b</sup>                                    |

<sup>a</sup> For 1970, 1971, and 1972 the weights were updated, with 1969 serving as the base year.

<sup>b</sup> Preliminary estimate.

SOURCE: Based on Central Bureau of Statistics data.

36 percent. During the same period the prices of residential construction inputs rose only 11 percent. As in previous years, dwelling prices outraced input prices – a fact attributable to the swelling demand pressure, which was largely due to speculative reasons.

These developments in dwelling prices and key money are revealed by special surveys on the prices of housing units that have changed hands, as recorded by the Land Betterment Tax Office; each survey covers a six-month period. On the other hand, the housing item in the consumer price index also reflects the price increases in residential construction inputs during the months for which there are no survey data.<sup>18</sup>

According to the consumer price index, the housing item stood 13.8 percent above its level in 1970.

Since 1967, when there was a turnabout in the trend of dwelling prices, residential construction input prices have limped behind housing prices, in contrast to the situation during the recession. Calculation of the correlation coefficient between the two rises shows no link, or at the most a very weak one, between them<sup>19</sup> – a fact reinforcing the view that it was the rapidly swelling demand that sent dwelling prices soaring.

**Table VI-7**  
**INCREASE IN DWELLING PRICES AND IN RESIDENTIAL**  
**CONSTRUCTION INPUT PRICES, 1965-71**  
(percentages)

|                             | Increase or decrease (-) as against previous period |                 |
|-----------------------------|---|-----------------|
|                             | Residential construction<br>input prices            | Dwelling prices |
| April 1965–December 1965    | 4.1   | 2.6             |
| October 1965–June 1966      | 2.7   | -0.7            |
| April 1966–December 1966    | 5.4   | -2.6            |
| October 1966–October 1967   | -1.7  | -0.7            |
| July 1967–March 1968        | 0.8   | 3.9             |
| January 1968–October 1968   | 3.5   | 2.3             |
| July 1968–March 1969        | 0.8   | 6.6             |
| January 1969–October 1969   | 1.3   | 7.0             |
| July 1969–March 1970        | 2.7   | 7.3             |
| January 1970–October 1970   | 7.6   | 10.1            |
| July 1970–March 1971        | 4.7   | 6.8             |
| January 1971–September 1971 | 4.6   | 13.2            |

SOURCE: Central Bureau of Statistics.

18. For fuller details see Bank of Israel, *Annual Report 1970*, p. 126.

19. The correlation coefficient amounted to 0.3.