BANK OF ISRAEL
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Press Release

From the forthcoming *Recent Economic Developments*:

Price gaps between Israel and developed countries

- **The level of private consumption prices in Israel in 2010 was high in comparison with other OECD member countries. This is taking into account the fact that per-capita income in Israel is less than the average for OECD member countries. The high price of consumer goods in Israel reflects a combination of the strong shekel and particularly high prices for certain consumer goods.[1]**
- **Food prices in Israel in 2008 were more than 15 percent higher than the expected of a country with per-capita income similar to Israel's. Prices of dairy products, fish and non-alcoholic beverages are particularly notable for their high price in international comparison. In 2008, the gap between their price in Israel and that to be expected of an economy with per-capita income similar to Israel's, was over 30 percent. An analysis of the development of consumer price indices, exchange rates and growth shows that these gaps widened between 2008 and 2011. The gap in food prices between Israel and OECD countries derives *inter alia* from an uncompetitive market structure for certain products and from the high VAT (in international comparison) on food products.**
- **The openness of the clothing and footwear market to imports and the competition in that industry contribute to competitive price levels by international comparison in this component of private consumption. However, prices at hotels and restaurants, and prices of culture and leisure services and private vehicles are high in international comparison.**

Discussion of the price gap between Israel and abroad was a major issue in the protest that erupted in Israel and peaked last summer. Press coverage comparing the prices of fuel and of dairy products in Israel and abroad provided support for the organizers of the protest, and backed the claim that a

[1] The data are based on PPP (Purchasing Power Parity) comparative data that are published by the OECD and Eurostat. The latest figure on the private consumption aggregate is for 2010. Comparative price data for private consumption items are published once every three years, and the latest figure is for 2008. The PPP data calculated by the OECD and Eurostat are regarded as relatively good, and are generally accepted in the literature for the purpose of international comparison of price levels. It should however be noted that these data are not flawless, because when compiling price indices it is necessary to overcome problems such as comparing prices of different consumption baskets (which are not the same from country to country) or comparing goods of differing quality. The difficulty comparing goods of differing quality is especially notable in the case of non-tradable goods. These flaws could lead to a deviation in the indices, particularly with consumption baskets that differ to an exceptional extent from country to country. Nevertheless, it can be assumed that these problems are not acute when comparing indices of price levels between OECD member countries. For details of how the index is calculated by the OECD and Eurostat, see: www.oecd.org/std/ppp/manual.

different economic policy would likely help reduce private consumption prices in Israel, and thereby benefit most of the country's citizens.

The literature widely acknowledges that the level of prices of output in the economy is coordinated with per-capita income. The relationship between these two variables derives from the higher wage levels in countries with higher per-capita income—wage levels that exert upward pressure on prices of non-tradable goods or services in which the productivity is relatively low.

OECD data show that the level of private consumption prices in Israel in 2010 was 20 percent higher than that to be expected based on the assumption of a linear relationship between the level of per-capita income and the prices of output (although this gap is not statistically significant). The high price of consumer goods in Israel reflects the combination of a strong shekel and particularly high prices for certain consumer goods, as compared to reasonable prices (in international comparison) for other goods. The international comparison of private consumption prices and of various components of private consumption is based on Eurostat and OECD comparative data. These data are published once every three years. The last year for which they were published was 2008.

It was found that food prices in Israel in 2008 were 15 percent higher than the average for OECD countries. An estimate based on a linear regression indicates that food prices in Israel in 2008 were nearly 20 percent higher than that to be expected in an economy with a per-capita income similar to Israel's (although this gap is not statistically significant). Based on the development of prices, the shekel-euro exchange rate, and the development of per-capita GDP in Israel and Europe between 2008 and 2011, it can be assumed that food prices in Israel became ten percent more expensive in the last three years compared with eurozone countries. With regard to the US, food prices in that period did not change to any major extent. While it is reasonable to assume that the lack of a reduced rate of VAT on food products in Israel (apart from fruit and vegetables, which are exempt from VAT) contributes to the relatively high price of food products, other contributing factors exist. These are connected with the market structure for specific food products. Prices of dairy products, fish and non-alcoholic beverages are particularly notable for their high price in international comparison. In 2008, their price in Israel was more than 30 percent higher than that to be expected of an economy with per-capita income similar to Israel's. Although the strong shekel contributed to this result to some extent, the main reason for the relatively high price of dairy products, fish and non-alcoholic beverages derives from other factors. Based on the development of the nominal exchange rate, the CPI, and per-capita GDP between 2008 and 2011, it can be assessed that the price gap with eurozone countries for dairy products, fish and non-alcoholic beverages widened by 5–15 percent over the last three years.

Dairy products would appear to be unique in terms of the protection and subsidies provided for them in various OECD economies. In Israel, customs duty on milk and butter is 150 percent and the duty on cheese is also high. From this aspect, the milk market in Israel is closed and prices of dairy products are affected by a milk market structure that is not competitive, and in which supervision over prices to the consumer is limited. The fish products market is also constricted by high customs duty and low competition. Like the milk market, the fresh meat products market is also not open to competition from abroad. The duty on fresh meat (beef and chicken) is very high, and effectively prevents competition from imported fresh meat. Demand for kosher products, which are unique in their type, and the difficulty for non-kosher products to compete freely in the market constitute another barrier to competition from imports.[2] By hindering competition, these barriers support

[2] Most marketing chains in Israel are kosher, which makes it difficult to distribute non-kosher products and for importers to compete in the market.

relatively high prices for part of the food products sold in Israel, With respect to non-alcoholic beverages, the main problem contributing to their relatively high price would appear to be the lack of competition in the industry, which is controlled by three large producers. In contrast to the high price of dairy products, fish and non-alcoholic beverages in the food basket, fruit and vegetable prices in Israel are slightly lower than abroad. Major contributory factors in this respect are the VAT exemption on fruit and vegetables and the large number of foreign workers employed in the agricultural industry.

Clothing and footwear prices in Israel are not high by international standards. It can be assumed that these goods' considerable exposure to imports and the competition in the industry keep down their price. In contrast to prices of clothing and footwear, prices of consumption at hotels and restaurants, and prices of culture and leisure services in Israel are high. Prices of private vehicles are also high by international standards. Although prices of telecom services in Israel in 2008 were slightly lower than their average price in OECD countries, between 2008 and 2011 their price in Israel rose by 20 percent compared with the eurozone and by 10 percent compared with the US.