

## CHAPTER X

### PRICES

#### 1. MAIN DEVELOPMENTS

The rapid upward trend in prices, which has characterized the economy in recent years, continued into 1977. Prices rose during the years in most markets<sup>1</sup> by 40–50 percent, while the annual average increase of the product and service prices amounted to about 42 percent.

In the course of the year under review, price increases accelerated from an average monthly growth rate of about 1 percent in the Consumer Price Index during the first quarter; the pace quickened to 2.5 percent in the second quarter, despite the fact that with general elections in May, the pace of devaluations slowed and no subsidies were

TABLE X-1

**RISE IN PRICES OF RESOURCES AND USES, 1961–1977**  
(annual averages, percent)

	1968- 1970	1970- 1973	1973- 1977	1974	1975	1976	1977
Gross National Product	5.3	16.0	35.1	34.9	37.7	26.7	42.0
Imports <sup>a</sup>	5.3	18.5	39.6	42.7	42.8	32.0	41.1
Private consumption	4.7	15.8	35.6	38.2	40.3	28.8	35.5
Public consumption, excl. direct defense imports	6.0	17.5	38.4	36.3	38.6	30.6	48.6
Gross domestic investment, excl. ships and aircraft	7.9	18.5	35.0	40.7	33.9	24.7	41.5
Total domestic uses <sup>a</sup>	5.6	16.9	36.0	38.3	38.3	28.2	39.8
Exports	3.9	16.5	38.5	36.0	41.9	30.0	46.6
Total uses <sup>a</sup>	5.3	16.8	36.7	37.8	39.1	28.6	41.7

<sup>a</sup> Excluding ships, aircraft and direct defense imports.

SOURCE: Central Bureau of Statistics.

<sup>1</sup> The Consumer Price Index increased by 42.5 percent between December 1976 and December 1977, the Wholesale Price Index of industrial output for local destinations rose by 50 percent, and the Input Price Index for housing construction by 40 percent.

reduced. In the third quarter, in an attempt to overcome delay, creeping devaluations were carried out frequently, subsidies were reduced, and prices rose by 3–4 percent per month. At the end of October the exchange rate reform and other policy measures were introduced, and as a result prices climbed in the last two months of 1977 at a very rapid pace of 14–20 percent.

Just as in the preceding 2–3 years, inflation was caused mainly by cost pressures in 1977. Among the various components, the increase of salaries stands out in 1977 (and to a lesser extent in 1976 as well), when real growth reached an annual average of 8–9 percent. Along with the real increase of salaries, the rise of import prices continued by 41–42 percent, due mainly to devaluations and the increase of import tax rates. Net indirect tax rates were more or less stable compared to 1976, and their contribution to the increase of prices was smaller.

The real decline of capital return continued in the year under review, and it offset part of the pressures for price increases.

The year 1977, with its unique factors, can be considered as an additional chapter in the ongoing inflationary process. The great acceleration of prices initiated at the end of 1973 and 1974 by rapid increases in the prices of imports led in turn to a reduction of resources and a decline in the standard of living. The government acted to encourage exports and reduce domestic demand through a series of devaluations of the Israeli pound and an increase in the rates of indirect taxes. These measures contributed to an additional and sustained rise of prices from 1974 onwards.

The rapid inflation inherent in price-raising factors, which has accompanied the economy since 1973/74, is the consequence of the policy measures chosen by the government for the reduction of demand and the improvement of the balance of payments. It would apparently have been possible to slow the pace of inflation by creating greater unemployment, or by means of direct actions for reducing demand, mainly by a cut in the State Budget, instead of increasing indirect taxes.

Over the course of the inflationary process, there were years in which real salaries declined (1974 and 1975), but it is clear that the organized power of workers can prevent a continued real decline in their wages. Against a background of no overt unemployment and a widening of demand in the export sector, combined with general elections in the middle of the year which weakened the bargaining position of the government, pressure for wage increases grew, so that wages increased by 8–9 percent in real terms during 1977 after their decrease had already halted in 1976. The increase of salaries this year entirely offset the previous decrease, and pressures were exerted for advance payments in anticipation of future price rises. Although the year 1977 is characterized by salary

TABLE X-2

**RISE IN VARIOUS PRICE INDEXES, 1965-1977**  
(percent)

	Average				1974	1975	1976	1977
	1965- 1967	1969- 1970	1971- 1973	1974- 1977				
Consumer Price Index	18.2	11.0	14.9	36.2	39.7	39.3	31.3	34.6
Excl. fruit and vegetables	18.7	10.8	14.8	36.0	40.6	38.5	31.5	33.7
Wholesale Price Index of industrial output	10.1	9.4	13.9	40.2	51.5	40.8	30.9	38.6
Index of agricultural input prices	7.5	17.5	14.5	41.3	55.1	46.5	33.1	31.6
Index of housing construction input prices	16.0	18.5	18.1	33.6	47.2	30.6	26.5	30.9
Index of road construction input prices	—	18.1	15.5	39.9	49.8	49.1	26.0	36.3

SOURCE: Central Bureau of Statistics.

increases as a significant factor in the process of rising prices, it constitutes but one chapter in a continuing process in which salaried workers attempt to maintain the real value of their wages.

A considerable injection of money occurred in 1977, based mainly on a public sector injection of great magnitude. The monetary injection, which caused a real increase in the money supply during the first half of the year<sup>2</sup>, made it possible to pass on increased costs without affecting the volume of economic activity. It should be noted that the growth of the money supply was faster than the nominal increase of product and uses, and was accompanied by a reduction in the rate of price increases at the beginning of the year and increased activity on the stock market.

<sup>2</sup> Real money supply balances stabilized in July–October 1977 and dropped after the reform.

## 2. PRICE DEVELOPMENTS IN 1977

Most price indexes rose during 1977 (i.e. December 1977 compared with December 1976) by 40–50 percent. The development of prices was not uniform in the course of the year with the year divided into two main periods, from January to October, a period in which the main price indexes rose at a rate of about 2.5 percent per month, and the second, from the reform to the end of the year, when price increases reached a monthly average of 6.5–9.5 percent.

During the first period, there was an acceleration in the rate of price increases which was evidenced in the Consumer Price Index. In the early months of 1977, the rate increase was very low (in January stability, in February, the index increased by one percent), while between March and June the rate of price increases accelerated to 2–2.5 percent per month. It should be mentioned that subsidies were not reduced from the beginning of the year until the general elections in May, and only three creeping devaluations were carried out. After the elections, between the second half of May and the end of October in an attempt to make up the delay, seven creeping devaluations were introduced, subsidies to basic commodities were cut in July, and fuel and public transport prices were increased. These steps led to an accelerated rise of the Consumer Price Index. In the months August–October, the index rose by 3.5–4 percent per month.

Economic policy introduced at the end of October 1977 included many measures, the central ones being the liberalization of foreign currency control, the unification of exchange rates, the floating and devaluation of the Israeli pound, and increases in indirect tax rates and prices of controlled products. These measures were expressed in a very rapid rise of prices in the last two months of the year: 14 percent in the Consumer Price Index and 20 percent in the Wholesale Price Index of industrial output for local destinations. This rapid growth can be explained by the following factors:

	Increase or (-) decrease (percent)	Effect on private con- sumption prices (percent)
A. Change in official exchange rate of the pound (from IL 10.30 to the dollar to IL 15.25 to the dollar)	48	
Cancellation of import levy	-15	
Customs reduction	-2	
Domestic import price rise	26	
B. Weight of imports in private consumption	28	7.5
C. Rise in Value Added Tax, cancellation of indirect taxes and changes in subsidy rates on various products		3.0
Total effect of the reform		10.5

According to this calculation, and making allowance for estimation errors, the October policy measures in themselves were intended to cause a 10-12 percent increase in consumer prices. In fact, prices increased faster after October, due to the effect of supplementary factors: between October 1977 and April 1978 consumer prices rose by 29.5 percent. These price increases originate partly from the effect of the reform, partly from the pound devaluation during this period, and partly from the cost of living allowances paid in October 1977 (8.8 percent) and January 1978 (12 percent).

The rapid increase of prices that occurred at the end of the year was expressed only to a slight extent in annual averages, and they are therefore lower than the increase during the year. The rapid increase of prices at the end of 1977 will cause a significant average price increase in 1978: if prices in 1978 were to remain stable at the level that prevailed in December 1977, the average level of prices in 1978 would be 24 percent higher than that of 1977.

The prices of uses increased at an annual average of about 42 percent in 1977, as against an increase of about 30 percent in 1976. There was a drop in relative private consumption prices (35 percent in private consumption as against 42 percent in total uses). In exports, the relative price increase continued, by 53 percent<sup>3</sup>, as opposed to an increase of 41 percent in domestic business output prices<sup>4</sup>. Between 1974 and 1977, relative prices of exports improved by about 10 percent.

Public consumption prices, excluding direct defense imports, increased in 1977 at a relatively rapid pace (49 percent as against 41 percent in domestic uses). This increase stems mostly from the increase of wages during this year, partly as a result of retroactive payments (for previous years).

### 3. INFLATION AND ITS CAUSES

In 1971, prices in the Israeli economy started to rise at a rapid pace. At the end of 1973 and in 1974 their growth rate accelerated to unprecedented proportions: between 1973 and 1977, GNP prices rose by 230 percent, private consumption prices by 240 percent, etc.

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<sup>3</sup> For a detailed analysis see Chapter V.

<sup>4</sup> This price change is based on a nominal change in the net domestic business product, in production factor prices, and a real change in the net domestic business product at market prices.

The beginnings of the rapid inflationary process lie in price increases on world markets (prices of oil, sugar, grain and other basic commodities), which worsened the Israeli terms of trade. These price increases brought about both domestic price increases and a deterioration of the balance of payments. To these was added the increase in public defense consumption following the Yom Kippur War. The aggravation of the balance of payments problem induced the government to take economic steps aimed at reducing domestic uses and imports while encouraging exports. One of the results of the steps taken<sup>5</sup> was a push to price increases. The deterioration of the terms of trade, when all other factors remain constant, should lead to a reduction of resources at the disposal of the economy, and in consequence, to a reduction in the return from work and/or capital, while the devaluations and the increases of indirect taxes comprised an attempt to bring about an internal change in the structure of the economy and the income distribution in it. It was clear from the beginning that the organized power of wage-earners could stay any significant continuous decline in the real value of wages (the cost of living allowance mechanism is the most notable, but not exclusive, instrument of the employees).

Subperiods were discernible in the development of real wages since 1973: at the beginning of the inflationary process – in the years 1974 and 1975 – wage increases fell behind the increase of prices (and this real decline in wages was assisted, as mentioned, by price increases abroad), however, in other periods, wages increased at a rate in which compensation for previous delays was concealed, as were attempts to obtain advance payments towards anticipated price rises.

In 1977, and to a lesser extent in 1976, it was wages that surged forward. The absence of overt unemployment, plus the growth of demand in the export branch, constituted a convenient backdrop for this surge. To these was added the combination of a continuing real decline of wages of public service employees and the timing of the general elections in the middle of 1977. When the public service employee obtained relatively

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<sup>5</sup> The main steps of the policy which influenced price increases were:

- a. The devaluation of the pound in November 1974 (the change of the exchange rate from IL 4.20 to IL 6.00 per dollar);
- b. The “creeping devaluations” of the pound, a series that started in the second half of 1975 (about 2 percent per month);
- c. The devaluation of the pound (from IL 10.35 to IL 15.25 per dollar), floating of the pound and unification of exchange rates in October 1977;
- d. The imposition of Value Added Tax in the middle of 1976, and the increase of its rate in October 1977;
- e. The increase of the prices of basic commodities and other controlled commodities, about twice yearly, from 1974 onwards.

large wage-hikes, the business sector was dragged into in a second wave of wage increases following the previous ones in the beginning of 1977.

In the year 1977 alone, wage increases figure prominently as an important factor in the inflationary process, and the government undertook additional devaluations to restore the "equilibrium". As mentioned, the year 1977 constitutes only one link in the chain by which employees endeavor to maintain their real wages, despite increases on international markets and the need for a structural change of the economy through the enhancement of exports.

In summary: the principal price-raising factors in 1977, pushing prices up at average rates of 35–40 percent, were an increase of about 47 percent in wages and the increase of import prices by about 41 percent – mostly as a result of devaluations. Beside these pressures for price increases, there was a continuation of the clear downward trend in real capital return, which offset part of the pressures for price increases.

#### A. THE CONTRIBUTION OF VARIOUS COMPONENTS TO PRICE INCREASES

The contribution of each component to the general price increase can be estimated by the weight of the main cost components in uses (labor, capital, imports and taxes)<sup>6</sup>.

##### 1. Wages

Average wages per employee position rose in the year under review by 47 percent from the previous year – 44 percent in the business sector and 54 percent in the public sector. This real increase in wages stems from output and employment developments in various

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<sup>6</sup> It should be emphasized that the contribution of each component is *a posteriori* and does not necessarily attest to the existence of a causal relationship. For example, the contribution of higher wages to total price increases can constitute an (exogenous) factor of inflation, but it may also be the result of a different price increase. Another example: the effect of an increase of import prices on various uses expresses the weight of imports in total costs, but its influence is in fact greater, since the increase of import prices leads (due to considerations of equilibrium) to a rise in tradeable products, even though their import component is small. If there is full employment in the economy, the increase of import prices will lead to an increase in prices of nontradeable products as well. In addition, a rise in import prices brings with it an increase in the payment of cost-of-living allowances and additional pressure for the increase of prices. This factor increased the effect of imports in 1977 by 6 to 12 percent (out of total price increases) in various uses. For detailed definitions, see: "The Development of Private Consumption Prices by Main Cost Components 1964 to 1977", Bank of Israel Review No. 48 (not yet published).

**TABLE X-3**  
**QUARTERLY RISE IN VARIOUS PRICE INDEXES, 1976-1977**  
 (percent)

	1976				1977			
	Jan.— March	April— June	July— Sept.	Oct.— Dec.	Jan.— March	April— June	July— Sept.	Oct.— Dec.
Consumer Price Index	4.6	10.1	7.6	9.5	4.3	6.5	7.9	16.8
Excl. fruit and vegetables	4.6	10.7	8.6	8.3	4.0	6.1	8.5	16.7
Excl. fruit, vegetables and housing	4.8	11.0	9.8	9.1	4.7	6.1	9.2	18.1
Wholesale Price Index of industrial output	5.1	9.1	11.9	7.9	6.2	6.4	8.7	17.7
Index of agricultural input prices	5.2	19.7	6.2	3.3	5.4	6.3	8.5	14.8
Index of housing construction inputs	3.3	11.9	8.3	3.1	3.9	8.7	11.0	9.5
Index of road construction input prices	4.2	7.5	5.3	5.0	5.0	7.6	14.1	21.7

SOURCE: Central Bureau of Statistics.

TABLE X-4

**CONTRIBUTION OF PRIMARY COST COMPONENTS TO THE PRICE INCREASE OF USES, 1973–1977**  
(percent)

	Price rises (for each year compared to the previous year)	Total	Labor	Capital	Imports	Net taxes	Housing
<b>Private consumption</b>							
1977	35.5	100	48	7	32	5	8
Average 1973–1976	35.6	100	34	14	33	6	13
Weight in 1976		(100)	(33)	(17)	(28)	(6)	(16)
<b>Public consumption (excluding direct defense imports)</b>							
1977	48.6	100	81	–3	17	5	–
Average 1973–1976	35.0	100	65	7	23	5	–
Weight in 1976		(100)	(67)	(9)	(20)	(5)	–
<b>Investments<sup>a</sup></b>							
1977	42.3	100	39	22	38	1	–
Average 1973–1976	33.0	100	36	14	45	5	–
Weight in 1976		(100)	(35)	(22)	(39)	(4)	–
<b>Exports</b>							
1977	46.6	100	32	24	43	1	–
Average 1973–1976	35.8	100	32	19	53	–2	–
Weight in 1976		(100)	(31)	(22)	(49)	(–2)	–

a Including imports of ships and aircraft.

SOURCE: Bank of Israel.

segments of the economy (see Chapter XIII) and from trade union pressures. Only about half of the increase stems from cost-of-living allowances and the contribution of the previous year, while the other half is the result of wage agreements and wage creeping. The weight of wage agreements in the public sector is higher than in the business sector, which stems partly from retroactive payments made in the course of 1977 creating an increase in the share of wages in the explanation of the rise of prices this year, by 38 percent in public consumption (out of price increases of 49 percent), as well as in private consumption (in which there is a nonprofit institution component where wages increase to an extent similar to that of employees of the public sector) – by 17 percent out of a price increase of 35.5 percent. The weight of wages in the interpretation of price increases in investments increased mainly compared to the years 1973 to 1976, and in exports it remained at a similar level.

## 2. Imports

The price of imports increased by 41–42 percent in 1977 from 1976. This increase stems from the rise of prices abroad (about 9 percent), from the change in the exchange rate of the pound (32 percent), and from a reduction of about 2 percent in tax rates. (This reduction is the result of the imposition of Value Added Tax in the second half of 1976 and the increase of its rate in 1977 together with the abolition of import levies, the reduction of customs duties, and the abolition of travel tax at the end of 1977, as well as a change in the composition of imports for the reduction of imports of tax-intensive goods.)

In the price increases of various uses, the increase of import prices constituted about a quarter of the total price increase of public consumption, about a third of that of private consumption, and about half of the price increases in exports and investments.

## 3. Taxes

Indirect tax rates were increased in November 1977, and their effect on the yearly average was therefore small; however, the imposition of Value Added Tax in the second half of 1976 affected the annual average for 1977.

The rate of indirect taxes (from the gross domestic business product) rose in 1977 from a total of 20.1 percent in 1976 to 21.1 percent. The rates of subsidies increased in the first half of 1977, but they decreased in July and at an annual average. Rates of subsidies increased from 6.0 percent in 1976 to 6.8 percent in 1977. Summing up, it can be said that there was no change in the net rate of taxes in 1977 and the contribution of taxes to the rise in domestic uses prices was small this year.

#### 4. Capital.

The combination of an increase of import prices and salaries and a low level of economic activity effected an additional decline in the relative prices of the average capital return for all uses. In private and public consumption, the contribution of capital costs to the total price increase was very small. In investments, the rise of capital costs was relatively fast, and its weight in total price increases of investments amounted to one quarter (its weight in price increases in the years 1973–1976 was much lower). In exports, which did not suffer a slowdown, capital return costs increased at a rate similar to the increase of labor costs.

Summing up: the contribution of the various components to the increase of prices in 1977 is similar to their contribution in the years 1973 to 1976, but the weight of labor increased and the contribution of imports and taxes decreased. As in the previous two years, the rise of prices can be defined as “cost inflation” caused by the rise of labor and imports costs.

An additional criterion confirming the fact that in recent years the pressure for price increases originated in costs is the distribution of income between labor and capital in the business sector. In demand inflation, income will be distributed according to the contribution of labor and capital to production, and the changes that occur in the short-term distribution of income will be minimal.

When cost pressures develop, and demand does not increase, an “absorption” of price increases will take place on the part of at least one of the production factors, and in this case a clear-cut change will occur in the distribution of revenues. The rise of import prices the cost-of-living allowance agreement, trade union pressures, the increase of tax rates and the lack of overt unemployment brought about a decline in the weight of capital return and the increase in the weight of labor in the business sector. In the years 1971–1972, return on labor constituted about 50 percent of the net business product in production factor prices<sup>7</sup>, a rate that increased in 1977 to 64 percent. The picture becomes more impressive when the wages of the self-employed are compared to the average wages of employees: the share of return on labor rises from 73 percent in 1973 to 94 percent in 1977. It should be emphasized that these data should be considered with caution, and a number of technical-statistical factors can be pointed out that contributed to this result, such as the recording of directors fees in the last two years as wages and not, as in the past, as income (see Chapter XIII). Despite this reservation, the data suggest an increase in the weight of wages.

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<sup>7</sup> According to estimates of the Central Bureau of Statistics.

An examination of the distribution of return on labor and capital in the various uses shows that the increase in the weight of labor grew in domestic uses, while in exports where demand is great, there was only a slight (and perhaps even negligible) increase in the weight of labor<sup>8</sup>.

#### 4. Various Price Indexes

##### A. CONTROLLED AND FREE COMMODITIES IN THE CONSUMER PRICE INDEX<sup>9</sup>

During 1977, subsidies to controlled products were cut twice: in July, subsidies to controlled products were cut by 25 percent, and prices of fuel, electricity, and public transportation were raised by 23–26 percent. At the end of October, prices of basic

<sup>8</sup> The calculation of the return on labor appearing in Table X--5, among other things, necessitates the deduction of productivity from labor costs. In 1976 and 1977, domestic productivity decreased, a phenomenon that augments the wage pressure on prices. It can be assumed that productivity in exports did not decrease (or it decreased less than average productivity). If we had at our disposal productivity indexes by uses, they would probably point to a smaller increase in the weight of labor in exports.

##### <sup>9</sup> Controlled and free items in the consumer price index and their weight:

	Controlled items	Free items
Commodities	Bread, Fish, dough products (except for cakes and biscuits) Eggs Carps Oil Margarine Frozen chicken Frozen meat Milk and milk products Sugar Electricity, fuel and water Cigarettes, tobacco Fuel and oil for vehicles	Furniture Apartment decorations Clothing and footwear Jewelry and watches Books Glasses Hobbies
Weight of commodities	156.7	131.3
Services	Property tax City rates Primary school Secondary school Higher education Urban travel Interurban Travel Postal Services Government levies and certificates	Restaurants and coffee shops Maintenance and improvement of housing Private medical services Dentist Repair of various appliances Haircut and cosmetics Business services Kiosk commodities, recreation and vocation
Weight of Services	58.4	98.5
Total weights	215.1	229.8

TABLE X-5

**WEIGHT OF LABOR COSTS IN THE BUSINESS SECTOR, BY USES, 1964-1977**  
(percent)

	1964- 1965	1966- 1967	1968- 1970	1971- 1973	1974- 1977	1974	1975	1976	1977
1) Private consumption	53	55	52	53	60	55	56	61	67
2) Investments	64	77	62	52	55	44	52	61	62
3) Public consumption	53	60	60	59	64	55	59	65	77
4) Exports	57	61	49	48	54	50	51	58	58
5) Total business sector	56	60	54	52	58	52	56	61	64
6) Total business sector <sup>a</sup>	56	58	52	52	58	54	53	60	64

<sup>a</sup> The source of these data – Central Bureau of Statistics.

NOTE: The calculations are based on the division of uses into primary components (labor, capital, imports and taxes). The results are based partly on temporary data.

SOURCE: Bank of Israel, Central Bureau of Statistics.

commodities and public transportation were raised by 15 percent, and prices of fuel and electricity by 25 percent. During the whole year, prices of controlled products increased by 41 percent, and the relative prices remained stable (in relation to the Consumer Price Index) throughout the year.

In recent years, prices of these products were raised together, two or three times a year. This method has a number of disadvantages, the most important being the "legitimization" and confirmation of price increases in other areas, neither directly nor indirectly related to the controlled products (see the Annual Report of the Bank of Israel for 1976, page 209, footnote 2).

#### B. WHOLESALE PRICES OF INDUSTRIAL OUTPUT FOR DOMESTIC DESTINATIONS

The Wholesale Price Index of Industrial Output increased by an average of 39 percent in 1977, and during the year, by 50 percent. The growth of the Industrial Output Price Index

TABLE X-6

CHANGES IN CONTROLLED AND UNCONTROLLED COMMODITY PRICES, 1973-1977  
(percent)

	Weight in index	December levels				1976				1977			
		1974	1975	1976	1977	Jan.— March	April June	July— Sept.	Oct.— Dec.	Jan.— March.	April June	July— Sept.	Oct.— Dec.
(base 1976 per 1,000)													
Controlled items	215.1	102.6	12.4	37.0	41.4	2.3	14.8	4.4	7.3	4.8	2.7	12.6	15.2
Uncontrolled items	229.8	48.2	27.2	44.0	45.3	5.1	11.4	11.7	10.4	1.3	7.4	6.9	21.0
Services	98.5	59.6	29.1	45.4	53.3	6.8	10.8	14.4	6.8	4.7	7.7	12.9	17.1
Goods	131.3	39.6	25.5	42.7	30.4	3.6	11.9	9.2	13.9	-1.5	7.2	2.1	24.5
Fruit and vegetables	62.2	31.5	48.6	39.9	37.2	5.6	3.3	-4.4	25.6	9.8	13.2	0.9	19.0
Other items	492.9	48.3	23.4	34.9	43.0	5.3	8.6	8.8	7.6	5.2	6.8	7.6	15.3
Total	1,000	56.2	23.5	38.0	42.5	4.3	10.1	7.6	9.5	4.3	6.5	7.9	16.9

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

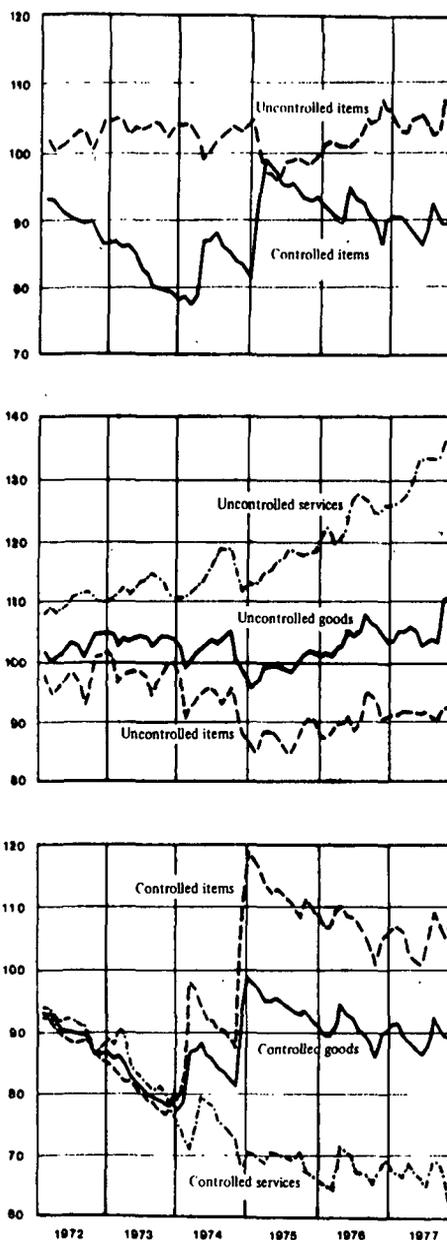
was more rapid than that of the Consumer Price Index because there is a larger import component in industrial output than in private consumption, and owing to a higher incidence of Value Added Tax on industrial output than on private consumption (vegetables and fruit are exempt from this tax, and its rate for nonprofit organizations is lower).<sup>10</sup>

### C. INDEX OF CONSTRUCTION INPUT PRICES AND INDEX OF HOUSING PRICES

The Index of Construction Input Prices rose in the course of the year under review by 40 percent, and at an annual average by 31 percent. Most of the increase was concentrated in inputs, excluding labor — 47.5 percent (December compared to December). The recession in the branch brought about a smaller increase of labor prices, 30 percent during the year, and 31 percent at an annual average.

The drop in the relative prices of apartments continued in 1977: the private apartment price index increased, according to estimates of the Central Bureau of Statistics, by 8–9 percent between October 1976 and October 1977. It seems that in the second half of 1977, and after the introduction of the reform in particular as well as at the beginning of 1978, there was a most rapid increase in apartment prices, especially in the prices of large apartments in prestige areas.

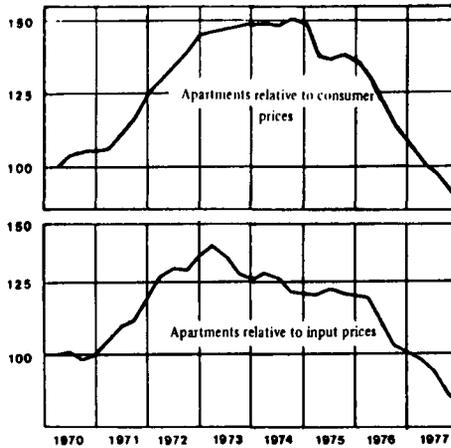
FIGURE X-1  
RELATIVE PRICES OF CONTROLLED AND UNCONTROLLED GOODS AND SERVICES, 1972–1977



<sup>10</sup> A comparison between growth rates of the Consumer Price Index and the Industrial Output Price Index in November–December 1974 and 1977 reveals that both indexes

FIGURE X-2

**APARTMENT PRICES RELATIVE TO  
CONSUMER PRICE INDEX AND  
HOUSING CONSTRUCTION  
INPUT INDEX, 1970-1977**  
(January 1970 = 100)



increased at a similar rate in 1974 (20.5 and 22.5 percent respectively), compared to a difference in 1977 – the Consumer Price Index lagged behind the increase of industrial output prices this year (14 and 20 percent respectively). The explanation for this difference is, in addition to the incidence of Value Added Tax, the reduction of subsidy rates in November 1974, which brought with it a rapid increase in the prices of controlled products (48 percent); on the other hand, there was a small change in the rates of subsidies in October 1977 (an increase of 16 percent in the index of controlled products).