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GENERAL AGREEMENT ON TARIFFS AND TRADE

REPORT OF THE COMMITTEE ON BALANCE-OF-PAYMENTS RESTRICTIONS ON THE CONSULTATION UNDER ARTICLE XIII:4(b) WITH ICELAND

1. In accordance with its terms of reference, the Committee has conducted the consultation with Iceland under Article XIII:4(b). The Committee had before it a basic document for the consultation (BOP/88) and documentation supplied by the International Monetary Fund.

2. In conducting the consultation the Committee followed the Plan for such consultations recommended by the CONTRACTING PARTIES (SISD, Seventh Supplement, pages 97-98). The consultation was held on 17 March 1969. The present report summarizes the main points of the discussion.

Consultation with the International Monetary Fund

3. Pursuant to the provisions of Article XV of the General Agreement, the CONTRACTING PARTIES had invited the International Monetary Fund to consult with them in connexion with this consultation with Iceland. In accordance with the agreed procedure, the representative of the Fund was invited to make a statement supplementing the Fund's documents concerning the position of Iceland. The statement made was as follows:

"The Fund invites the attention of the CONTRACTING PARTIES to the Executive Board decision of March 5, 1969 taken at the conclusion of its most recent Article XIV consultation with Iceland and particularly to paragraphs 2 to 5 which read as follows:

'2. Gross national income, which fell in real terms by 8 per cent in 1967, is estimated to have decreased by 5 per cent in 1968. The main reason for this sharp decline in income was a very substantial drop in exports. Exports of goods and services, which amounted to \$211 million in 1966, declined to \$180 million in 1967 and are estimated to have declined further to \$155 million in 1968. This very unfavourable development for Iceland was caused by a simultaneous fall in fish catches and a deterioration in export prices.

'3. With the devaluation of the Icelandic krona in November 1967, the Icelandic authorities had hoped that the profitability of the fishing industry would be restored. Export earnings, however, were considerably lower than expected and the need again arose for substantial support payments to the fishing industry. Although imports of general goods fell sharply, as a result of the devaluation and the decline in incomes, the current account deficit remained large. In the first ten months of 1968 the net reserves of the banking system deteriorated by a further \$23 million. In order to curtail imports, to restore the profitability of the traditional export industry, and to create incentives for the establishment of new industries, the Icelandic krona was devalued by a further 35.2 per cent on November 12, 1968.

'4. The Icelandic authorities have recognized the need to support this rate adjustment by effective internal measures and by efforts to ensure that nominal incomes do not rise excessively. The staff welcomes the intention of the Government to secure, over the next years, a budgetary surplus and urges the utmost restraint in the provision of central bank assistance to the banks and other financial institutions.

'5. As a temporary measure the Icelandic authorities in September 1968 imposed a 20 per cent levy on the c.i.f. value of imports and on the purchase of foreign exchange for travel abroad. With the adjustment in the rate of exchange in November 1968 this measure was rescinded. The Fund is pleased to note that the Icelandic authorities have not had recourse to intensified import restrictions notwithstanding the difficult balance of payments situation of the last two years.'

"Gross gold and foreign exchange holdings of the Central Bank including Iceland's gold tranche position in the Fund fell by \$22.7 million in 1967 and amounted to \$35.3 million at the end of that year; in 1968 they further declined to \$28.6 million at the end of the year. The Central Bank's current liabilities, including net bilateral balances, rose in 1967 and again in 1968 and amounted to \$15.6 million at the end of 1968. The Central Bank net gold and foreign exchange position worsened from \$51.7 million at the end of 1966 to \$26.6 million at the end of 1967 and to \$13.0 million at the end of 1968.

"At the present time the general level of restrictions of Iceland which are under reference does not go beyond the extent necessary to achieve a reasonable rate of increase in its reserves."

Opening statement of the representative of Iceland

4. The opening statement of the representative of Iceland, the full text of which is contained in an annex to this report, outlined the very serious deterioration in Iceland's balance of payments which had resulted from a steep decline in the volume and value of exports. He described the remedial measures, including two sizeable devaluations of the currency, which had been taken notwithstanding difficult social conditions and emphasized that in spite of the great strain on the foreign exchange position and unemployment during the past winter, the existing degree of trade liberalization of 90 per cent had been maintained with no introduction of new quantitative restrictions on imports.

Balance-of-payments position and prospects and alternative measures to restore equilibrium

5. Members of the Committee expressed their special appreciation for the difficulties confronting the Government of Iceland and wished to record their understanding for the complexity of the severe economic crisis through which Iceland was passing. They recalled how different the situation had been only a few years ago when the fish catch was good, prices were relatively favourable and Iceland's balance-of-payments situation had been growing stronger, and inquired concerning the outlook for 1969 and the next few years. They expressed particular interest in Iceland's new industrial investment projects, as these could obviously help, through diversification of exports, in overcoming Iceland's dependence on the one export item of fish.

6. The representative of Iceland replied that if general imports declined as expected from \$105 million in 1968 to some \$86 million in 1969 (including special imports, the corresponding figures would be \$132 million and \$100 million), and if exports increased from \$82 million to some \$90 million in the same period of comparison, the deficit on merchandise trade would be reduced to something of the order of \$10 million. On current account as a whole a deficit of some \$7 million might remain. No specific forecasts were available for later years, and any such estimate would obviously need to take into account many variables difficult to predict and beyond Iceland's control. In reply to a further question, the representative of Iceland stated that the six-week strike by fishermen which had occurred during the past winter would probably not cause any significant change in the 1969 export estimate since it had come before the major cod-fishing season began. The current catch was in any event proceeding well.

7. More generally, the representative of Iceland explained, it was clear that growth would depend very largely on the foreign-exchange value of Iceland's exports. It had for example been estimated that to achieve a 2 per cent gain in real per capita national income it was necessary to increase exports of goods and services by 6 per cent, and to achieve a 3 to 4 per cent gain exports would have to increase by at least 8 per cent. Iceland was well aware of the need to diversify, but obviously developments in the fish market would be decisive with respect to Iceland's ability to move in that direction in the immediate future, since at the present time over 90 per cent of Iceland's commodity exports were fish. The aluminium smelter, which was Swiss-owned, was to be completed in 1969; it was an important step towards industrialization and did in the construction stage contribute to the easing of the employment situation. The recently completed diatomite plant would also be a contribution in this respect, though smaller. Other investments with a foreign-exchange saving or export potential which were under discussion included a possible refinery for processing crude petroleum and a geo-thermal chemicals plant. There were also possibilities for increasing export earnings from processing of domestic materials such as wool and skins.

8. In reply to a question whether tourism might not offer some possibilities for increased earnings on current account, the representative of Iceland stated that there had in fact been some increase in tourism in Iceland but he noted that the summer season was very short, so that it would be difficult to expand facilities for a large tourist trade on a profitable basis.

9. With respect to the prospects for capital formation, about which a question was also asked, the representative of Iceland stated that a smaller inflow of foreign capital was to be expected in 1969 than had taken place in 1968, since the aluminium smelter was now complete and no other major projects were at the expenditure stage. The Government of Iceland would of course continue to try to attract capital as it was well aware of its essentiality for economic development of the country. The comment was made that Iceland's economy plainly was suffering from a lack of liquidity and that this circumstance would have adverse effects on new investment if imported capital also became scarcer.

10. With respect to fiscal and monetary policy, members of the Committee expressed their approval of the fiscal and other measures taken by the Government of Iceland to meet its balance-of-payments difficulties. They commented favourably on the way in which credit controls were being used, without recourse to import or exchange restrictions, to overcome the external crisis, and asked what measures had been used and what additional measures might be contemplated to restore balance-of-payments equilibrium. The representative of Iceland stated that there had actually been no recent change in the rediscount facilities

offered by the Central Bank, and no increase in the use of this facility, percentage wise, although the values in question were higher so that the amounts were larger. There was in fact a liquidity shortage, and without doubt the Central Bank would have to give some increased facilities to commercial banks, especially in the first half of the current year. This was to be done in a selective way, so as to support structural change toward increased activity by enterprises with export expansion potential. There would still be ceilings on total lending to banks and the policy would be kept under close review. He confirmed that it was intended, however, to utilize such policies rather than quantitative restrictions on imports to control the level of spending.

11. Members of the Committee also expressed interest in the efforts of the Government of Iceland to break the link between price increases and wage increases which had threatened to undermine efforts to achieve price stability. The representative of Iceland said it was by no means certain that the labour difficulties in the urban areas were over, as the negotiations with the labour unions were still in progress. The employers' federation had stated that they could not afford to grant any wage increases. The Government was using its influence to create an understanding for an incomes policy taking into account that the "herring boom" of the early 1960's was over and that lower real incomes were called for. The unions on the other hand were trying to maintain the status quo on real incomes. The outcome was not yet clear and much depended on the current negotiations. Meantime, fiscal restraint was being applied in that a budget had been approved which should yield a small cash surplus.

System and methods of the restrictions and effects of the restrictions

12. Members of the Committee expressed approval that the Government of Iceland had not intensified and did not intend to impose new import restrictions in dealing with balance-of-payments difficulties. They congratulated the Government of Iceland on its courageous policy of maintaining liberalization in the face of a serious economic crisis. It was appreciated that import restrictions had not been intensified at a time when pressures to do so must have been considerable. The Committee expressed the hope that the present difficulties would gradually be overcome despite the serious economic problems involved, and that Iceland would return to the stronger balance-of-payments position it had enjoyed for so many years.

13. Several questions were asked on Iceland's bilateral trade and payments agreements. With regard to the recent revised bilateral trade and payments agreement signed with Brazil, it was asked whether it contained any provisions for quotas in volume or value of specific commodities to be traded. The

representative of Iceland replied that there were no such commitments on either side. It was pointed out that imports under the five bilateral agreements Iceland had entered into, namely with Eastern Germany, Hungary, Romania, the Soviet Union and Brazil, had accounted for more than 10 per cent of Iceland's total imports during 1968. Settlements were apparently made in these cases through bilateral payments accounts. It was asked whether Iceland had any plans to reduce its reliance on such agreements in 1969. The representative of Iceland confirmed that his Government had bilateral trade and payments agreements with the countries mentioned, the agreement with Eastern Germany being a private one. However, similar trade and payments agreements with Poland and Czechoslovakia had been terminated. Even though Icelandic fish products exporters had complained that their position with regard to those two countries had deteriorated as a result of this step, such was not the view of the Government. On the other hand, in view of Iceland's difficult export position, it was not his Government's intention to change the form of its trade relations with the other Eastern countries. He referred to his opening statement in which he had said that a three-year agreement with the Soviet Union had been signed last August; this was by far the most important agreement of its type. Trade relations with State-trading countries in Eastern Europe were very important to Iceland. These countries supplied outlets for particular fisheries products for which there did not exist a market elsewhere. In the light of the present balance-of-payments position it did not appear desirable to his Government to change the form of these trade relations.

14. A member of the Committee remarked on the information given in document BOP/88, section C, page 3, to the effect that licences were granted freely upon application for imports of most commodities from countries with which Iceland had bilateral trade and payments agreements; to him, this indicated a degree of discrimination in favour of these countries. It was also pointed out that in that document two reasons had been given for maintaining import restrictions, namely the need to facilitate certain trade under bilateral agreements in order to protect Iceland's trade and payment relations with the Eastern European trading partners, and protection of domestic industry. Neither of these justifications were acceptable arguments under the General Agreement for maintaining restrictions, and it was asked what Iceland would do in this regard when it ceased to rely on Article XII. The representative of Iceland recalled that in previous years and particularly in the early 1960's much more extensive bilateral agreements had existed. This situation had greatly improved as Iceland had moved towards liberalization. Before 1960, one third of Iceland's trade had been on a bilateral basis; this proportion was now greatly reduced. The largest commodity group in this category of trade was composed of petroleum products. The bulk of Iceland's gas and fuel oil requirements, for which import licences were granted freely, came from the Soviet Union. Certain oil products were also imported from other countries. In this sector, his Government had come as close to the maximum liberalization it could afford. Eastern Europe was an important outlet for certain

products which could not be sold elsewhere, and deprived of such outlets, Icelandic exporters would be in serious difficulty. In its present balance-of-payments position, it was important that Iceland be able to import certain commodities on a bilateral trade agreement basis in exchange for those exports, thus reducing the strain on its current account. While recognizing that quantitative restrictions were bound to amount to protection of domestic industry - and that some sectors of the economy were protected - he stressed that the main reason for their application was to strengthen the balance-of-payments position. Whatever protection ensued was incidental.

15. Further to the announcement that monopoly trade in perfumes, essences and matches would probably be abolished, it was asked under what régime trade in these products would take place. The representative of Iceland said that the question had arisen whether monopoly trade for these products was the most satisfactory arrangement. If the sole right of the State Import Monopoly for Wine and Liquor to import perfumes, matches and essences was abolished these commodities would go through private firms. Imports of those commodities, like liquor and tobacco, were and would continue to be fully liberalized.

16. With reference to the question of purchases from the United States under a Public Law 480 agreement (BOP/88, page 2), it was asked on what credit terms these purchases took place. The representative of Iceland replied that credit facilities were extended to 70 per cent of the value of these purchases and that the repayment period was eighteen years.

17. It was remarked that, in the course of the previous consultation with Iceland, the Committee had been informed of a measure providing for discriminatory credit conditions in favour of importation of cars from Eastern European countries. The Committee had looked forward to an improvement of this situation. The representative of Iceland confirmed that there had been progress in this field. The period of credit allowed for automobile imports from Eastern European countries had been reduced from six to three months. The import licence fee, applicable to imports from all countries, had similarly been reduced from 90 per cent to 60 per cent.

18. It was asked whether the Icelandic Government contemplated any changes in its system of import restrictions during the coming year and whether, in the event the balance-of-payments position improved, it had plans for further liberalization of quantitative restrictions in 1969. The representative of Iceland recalled that his Government had recently drawn on the International Monetary Fund and said that the seasonality of Iceland's export earnings would cause reserves to fall until the autumn. On the optimistic assumption that wages would not rise, it was hoped that a slight improvement in exports and the reserve position would occur. With regard to plans for further liberalization, balance-of-payments position permitting, he said the present situation was not of a nature to induce his Government to draw up new plans for free lists.

19. It was remarked that tariff item ex 59.05.01, fishing nets made of polyethylene and polypropylene, which had figured in the list (BOP/76) submitted for the last consultation, had been omitted from Annex 1 of document BOP/88. The representative of Iceland confirmed that the fishing nets in question had been liberalized, as well as item ex 58.07.02, yarn and ropes of polyethylene and polypropylene.

General

20. Members of the Committee thanked the representative of Iceland for his excellent analysis and for his frank answers to their questions. Iceland was commended for its liberal import policy - over 90 per cent of imports were liberalized - despite serious economic difficulties. The Committee noted with pleasure that the Government of Iceland had not chosen a policy of restriction. Sympathetic understanding was expressed for the problems facing the Government and it was hoped that there would be improvement in the overall economic situation.

AnnexOPENING STATEMENT BY THE REPRESENTATIVE OF ICELAND

The last consultations with this Committee took place in January 1968 only two months after the devaluation of the Icelandic króna in November 1967. In the opening statement given by the representative of Iceland here in January 1968 the reasons for that devaluation were explained in detail. The main factors at work were the devaluation of the pound sterling, a heavy decline in fish prices on the world market together with a fall in our fish catches. The hope was expressed in our last consultations that the prices of Iceland's main export products would stabilize and even recover somewhat during the year 1968. Unfortunately, however, this did not prove to be the case and instead we experienced a further sharp deterioration of our export earnings last year. This necessitated a second devaluation of the Icelandic króna on 12 November 1968. The new parity of IKr 83 to the dollar represented a devaluation 35.2 per cent.

The gross national product fell by 2.8 per cent in volume the year 1967. Preliminary estimates suggest that there was a further fall of 5 per cent last year. But due to the decline in export prices national income has fallen considerably more; about 8 per cent in 1967 and close to 5 per cent in 1968. The value of fish exports decreased in dollars by 32 per cent 1967 and by a further 20 per cent 1968. The volume of the fish catch declined by 30 per cent last year. The total fish catch was about 600,000 tons 1968 or half of the total fish catch 1966. The main reason for this decline has been a fall in the herring catch. In 1967 there was a drop in the volume of the herring catch of 40 per cent compared with the year 1966. And last year the herring catch was only 30 per cent of the catch in 1967 or a sixth of the 1966 catch.

As I said before, the downward tendency of prices of our most important export products continued last year. The average price of frozen fish was 4 per cent lower in 1968 than at the end of the year 1967. The price on herring oil fell by 29 per cent and the fish meal price fell by 12 per cent. However the fish meal price rose somewhat, late in the year. The civil war in Nigeria has been a severe blow to our stockfish exports which normally represent 5 per cent of commodity exports. In the year 1967 about 70 per cent of the production of stockfish had to be stored domestically because of the Nigerian situation. Both production and exports of stockfish declined drastically in 1968.

When the devaluation took place in November 1967 the Government declared that if good results of these measures were to be expected wages would have to be unchanged during the year 1968. But a labour conflict broke out in March 1968 ending with an agreement on 18 March. According to the new agreement the workers received certain wage compensations because of price increases that followed the devaluation. The average increase from March 1968 to the end of that year is about 8 per cent.

Unemployment in Iceland - aside from what is due to seasonal swings in activity - has virtually been unknown for three or four decades. We have now seen the reappearance of the problem and the labour unions have been restive. Seamen on the inshore fishing fleet went on strike in the middle of January 1968 and the strike lasted six weeks. According to the new agreement they received a moderate compensation. Now there is again a danger of new labour conflict with the trade union asking for a cost of living wage compensation as was agreed upon last year.

The external economic development has been disappointing. There was a trade deficit in 1968 of \$49.7 million compared with the trade deficit of \$55.1 million in 1967. Merchandise imports declined by 21 per cent in 1968, measured in dollars, while at the same time commodity exports declined by 17 per cent. The foreign exchange reserves continued to decline during the year 1968. At the end of 1968 the net foreign exchange assets of the banking system amounted to \$3.5 million, the decline during the year having amounted to \$15 million. Foreign exchange reserves fell between the beginning of the year 1968 and early November by \$24 million but increased as much as \$9 million from then until the end of the year. At the end of February 1969 the reserves amounted to \$5 million.

Because of the unfavourable development of the balance of payments in 1968 the Government, as was notified to contracting parties, imposed on 3 September 1968 a 20 per cent provisional levy on merchandise imports with certain exceptions as well as on foreign travel. This provisional measure was abolished concurrently with the devaluation on 12 November. With respect to invisibles, it should be mentioned that from August 1968 until the end of the year transfers of inheritances and emigrants' assets, which had not been fully liberalized, were further restricted. Furthermore, from October the chartering of foreign vessels for maritime transport has been made subject to licence.

In spite of the great strain on the foreign exchange position throughout 1968 and unemployment during the wintertime the Government did not reintroduce quantitative restrictions on imports. The degree of liberalization of commodity trade has reached 90 per cent and there are only relatively few commodities licensed. The remaining restrictions are generally not applied in order to restrict the volume of imports but primarily in order to ensure continued trade with our trading partners in Eastern Europe. Of greatest importance in this connexion is the purchase of petroleum products from the Soviet Union, which in return is a large buyer of frozen fish fillets and salted herring.

On 26 August 1968 a new protocol on trade between the Soviet Union and Iceland for the next three years was signed in Reykjavik. According to the new protocol the volume of the trade between the countries will be similar to what it was before. Iceland considers the trade with Eastern Europe very important, and that is one of the main reasons for maintaining import restrictions on certain goods. General balance-of-payments considerations are another main reason for these restrictions.

In October 1968 a new payments agreement between Iceland and Brazil was signed. The new agreement is an important step towards convertibility. Every six months any debit balance shall be liquidated in free convertible sterling pounds. Iceland is now treating all transactions and payments vis-à-vis Brazil in the same manner as payments and transactions vis-à-vis other convertible countries. The only exception is that a single bank account is carried by the Banco Central in Rio de Janeiro in order to regulate mutual credit facilities.

In the beginning of March this year the special levy charged on the f.o.b. price of passenger cars was reduced from 90 per cent to 60 per cent. At the same time the levy on jeeps and taxis decreased from 30 per cent to 15 per cent.

The Government is now proposing to abolish the sole right of the State Import Monopoly for Wine and Liquor to import perfumes, matches and essences. It is expected that the Althing will pass the bill this session.

Iceland has, as you undoubtedly know, applied for membership in the European Free Trade Association. The application was presented in November 1968 and the negotiations opened in January. The EFTA countries are Iceland's most important trading area, accounting for about 40 per cent of its total foreign trade. It is our hope that an eventual membership in EFTA may facilitate sales of our fisheries exports which now meet with discrimination in EFTA markets and induce the development of a more diversified industrial structure and exports. It is the hope of the Icelandic Government that these negotiations may be concluded in the course of this year. An agreement, if reached, will of course be of interest to the contracting parties and will in due course be notified to GATT.

In this statement I have mentioned briefly the major aspects of the economic situation in Iceland. As you have heard we are in serious economic difficulties. The Government has not chosen the policy of restrictions and export subsidies but instead devalued the currency twice in order to restore the external balance.