

# GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

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## Committee on Balance-of-Payments Restrictions

### REPORT ON THE CONSULTATION WITH ISRAEL

1. In accordance with its terms of reference, the Committee has conducted a consultation with Israel on its balance-of-payments import restrictions. In conducting the present consultation the Committee had before it a basic document for the consultation (BOP/96), a Decision of the Executive Board of the International Monetary Fund dated 10 September 1969 (see Annex I), and a background document supplied by the Fund dated 4 August 1969.
2. The Committee generally followed the plan for such consultations recommended by the CONTRACTING PARTIES (BISD, Seventh Supplement, pages 97-98). The consultation took place on 17 November 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 the consultation with Israel. In accordance with the agreed procedure, the representative of the Fund was invited to make a statement supplementing the Fund's documentation concerning the position of Israel. The statement was as follows:

"The Fund invites the attention of the CONTRACTING PARTIES to the Executive Board decision of September 10, 1969 taken at the conclusion of its most recent Article XIV consultation with Israel and particularly to paragraphs 2-5 which read as follows:

2. Following a period of slow growth, the Israel economy began to recover swiftly toward the end of 1967 in response to reflationary policies, a sharp rise in public sector expenditure, and the 14.3 per cent devaluation of the currency in November 1967. The growth of GNP reached 13 per cent in 1968 and is expected to rise again substantially in 1969. In contrast to earlier experience, the current upswing has been characterized by cost and price stability. Exports recorded an increase of 16 per cent in 1968 but commercial imports rose by 41 per cent and defence imports remained high with the result that the balance of payments remained under pressure. Foreign exchange reserves of the Bank of Israel declined by about \$50 million in 1968 and have continued to fall in the first half of 1969. At the end of June 1969 they amounted to \$543 million which is equal to about three months' imports of goods and services.

3. 'As the slack in the economy was taken up and pressure on the balance of payments became apparent, the Bank of Israel in May 1968 introduced measures to reduce the rate of monetary expansion. The money supply expanded by 26 per cent in 1967 and by 14 per cent in 1968; in early 1969, the rate of increase showed a further decline. The Fund regards the maintenance of tight monetary policy as appropriate, particularly since fiscal policy continues to exert a strong expansionary influence on the economy.

4. 'A major task confronting economic policy in Israel is the restoration of a satisfactory external payments position. The Fund believes that the accomplishment of this task and the preservation of internal stability call for most determined efforts to adjust the growth of internal demand. The Fund hopes that the authorities will review fiscal policy at the earliest opportunity with a view to reducing the large public sector deficit.

5. 'As a result of progressive liberalization, few imports remain subject to quantitative restrictions. Some progress has been made in reducing tariffs and the Government has announced a timetable for further tariff cuts over the next few years. The Fund welcomes this policy of increasing progressively the exposure of local industry to foreign competition as a means of encouraging economic efficiency. The Fund also welcomes the termination since the last consultation of three bilateral payments agreements with Fund members and notes that the need to maintain the remaining agreements will be kept under review.'

"International reserves of Israel declined further and stood at \$477 million at the end of September 1969 compared with \$663 million at the end of December 1968.

"At the present time, the general level of restrictions of Israel which are under reference does not go beyond the extent necessary to stop a serious decline in its monetary reserves."

Opening statement by the representative of Israel

4. In his opening statement, the full text of which appears in Annex II, the representative of Israel analyzed the various elements that had contributed to Israel's adverse balance-of-payments position. While the gross national product had risen by 13 per cent in 1968 and industrial output had risen by no less than 33 per cent in the same year, the expected increase in 1969 would be 10 per cent for gross national product and over 20 per cent for industrial output. The problem of unemployment which had beset the country in 1967 had been eliminated by early 1968 and a severe shortage of labour had developed which hampered continued economic expansion. Simultaneously, an unprecedented growth in defence needs had imposed a heavy burden both on foreign exchange resources and on the Government's local currency budget. Total expenditure on defence had topped 20 per cent of the gross national product. The period 1968-1969 had also seen a

great inflow of immigration, causing further growth in demand and placing renewed pressure on the building sector. These developments had adversely affected the balance of payments. It was feared that in 1969 the deficit on current account would reach \$900 million, a substantial part of which could be attributed to direct and indirect defence imports. Part of the deficit, about 60 per cent, was covered by unilateral transfers of capital, and a further part by increasing the foreign debt which had now reached the amount of \$2 billion, i.e. about \$800 per capita. Capital imports had not been sufficient to cover the deficit in the balance of payments and, between December 1967 and September 1969, Israel's foreign exchange reserves had fallen by \$215 million and were down to the level of \$500 million, equivalent to the value of only three months of imports. This was considered to be a critical level.

5. Summarizing the Government's foreign trade policy, the representative of Israel recalled that in the past two years the Government had pressed ahead with import liberalization. Many administrative restrictions, as well as other barriers to trade, had been removed and protective tariffs had been lowered. The Government had altered its approach to import restrictions; whereas previously all items had been considered to be restricted unless they were included in the lists of free or automatically approved imports, since 1 January 1969 all items were considered to be automatically liberalized unless specifically included in the list of restricted items. Some customs duties had been temporarily increased in order to cushion the impact of liberalization for some developing industries and in this connexion Israel had been authorized to renegotiate some forty bound items under Article XXVIII:4. Two fifths of the Kennedy Round tariff reductions had been implemented and autonomous tariff reductions had also taken place. The Five-Year Plan to lower tariffs to an average level of 35 per cent was to be implemented over the years 1970-1975 in order to end the "hot house" conditions in which Israel's infant industries produced. On the subject of bilateral agreements he pointed out that four of Israel's nine bilateral payments agreements had been terminated since the last consultation. In the field of exports the Government's policy was to increase the level of investment in export-oriented industries and to develop marketing and export promotion facilities.

6. As a small developing country with no neighbouring markets, Israel sought to overcome this handicap by integrating into a larger regional grouping. In pursuance of this policy, the Government was negotiating with the European Economic Community, the member countries of which constituted Israel's major traditional trading partners. At the same time Israel hoped that a generalized scheme of preferences would come into effect and would help to improve access to her export markets. Import liberalization measures were based on the firm expectation that Israeli exports would not be hampered by her trading partners. However, certain industrialized countries were now threatening to erect new trade barriers. Israel could not be expected to continue its policy of import liberalization while restrictions continued to operate against her exports.

7. Israel's intention to pursue a policy of liberalization had thus been consistently pursued. As regards the future, lowering of tariffs and removal of non-tariff barriers could only be carried out if Israel acquired freer access to markets for its export products.

Balance-of-payments position and prospects and alternative methods of restoring equilibrium

8. Members of the Committee congratulated the representative of Israel for the comprehensive and clear statement he had presented. It was realized that Israel was faced with a wide range of difficulties, which had led to a decline in her foreign exchange reserves. Members were gratified to note the removal of administrative restrictions and the termination of four bilateral agreements, and commended Israel for the tariff cuts which had taken place as well as the plans for future tariff reductions. It was felt that Israel's efforts to pursue a policy of trade liberalization was particularly courageous in its present economic situation. One member of the Committee felt that the rapid progress made by Israel in such a short time was a noteworthy example for developing and developed countries alike.
9. Several members of the Committee were interested in having detailed forecasts of the balance-of-payments position for 1969 and later years. One member of the Committee pointed out that Israel's balance-of-payments position had always been characterized by a large deficit on goods and services account, more than compensated by a larger capital inflow, mostly in the form of unilateral transfers. While there had been an impressive export growth, in excess of 16 per cent, the rise in imports had unfortunately been even greater. Moreover, some of the elements contributing to Israel's progress towards balance-of-payments equilibrium appeared to be fragile, especially receipts from tourism and from the transport services which were vulnerable to changing events. Interest was expressed by members of the Committee in the Government's plans for dealing with the recurrence of the balance-of-payments deficit and particularly with the increased deficit on current account. Other questions asked related to the level of foreign capital inflow and unilateral transfers needed to offset the deficit on current account. While it was felt that an increase in exports would be a more solid means of offsetting this deficit, some concern was expressed at the prospects of maintaining the present level of capital inflow. Another member of the Committee recalled that the Israeli Deputy Minister of Finance had expressed the hope that Israel would obtain a constant influx of foreign investment capital amounting to some \$100 to \$150 million per annum, and enquired whether this figure could be reached and by what means.
10. The representative of Israel replied that the estimate of \$100-\$150 million for capital transfers in the form of foreign investment was not high, being at the same level as pre-recession (1965-1966) figures. The recent economic revival as well as Israel's closer relationship with the European Economic Community was expected to promote foreign investment. As for unilateral transfers, the components of this figure were of a fixed nature and were not expected to fluctuate significantly. Personal restitutions were expected to make up \$160 million, possibly a little more owing to the revaluation of the deutsche mark; donations from Jewish institutions throughout the world were expected to bring in some \$200-\$250 million; and personal transfers, mainly deriving from immigrants, would amount to \$100-\$150 million. These figures

were taken into account in forward-planning. Tourism had brought in \$50 million in 1966 and \$100 million in 1968 and this income was not expected to fall. The estimates for 1969 were even higher, and an annual growth of 10 per cent was generally expected. Income from transportation had also grown, from \$65 million in 1966 to \$84 million in 1968. However, total income from foreign sources did not cover the deficit, and foreign borrowing would have to be resorted to through the sale of national bonds, for which good terms could be obtained, through international assistance, for which the terms would hopefully not be too hard, and if those two sources were not sufficient, loans would be sought on commercial terms.

11. A member of the Committee asked whether the representative of Israel had not been too pessimistic with regard to prospects for capital inflow. He recalled that at the previous consultation the Israeli representative had expected one or the other element of capital inflow to decline. This had not happened, with the exception of development bonds, and the present level was still higher than the 1966 level. He enquired whether there were not negotiations under way for obtaining capital from governmental and other sources which might lead to an improvement of the figures before the end of the year. In reply the representative of Israel said that his Government had drawn on its gold tranche and its first credit tranche from the International Monetary Fund, amounting to \$45 million, and further use of the Fund's resources might be sought. He hoped that the Special Drawing Rights, when they were activated in 1970, would also be a contribution. The Government had also asked to have its quota increased in the International Monetary Fund. Negotiations were under way with the International Bank for Reconstruction and Development and it was hoped \$100-\$150 million might be obtained from this source for investment projects for the next five years; negotiations were also under way with the IFC. Israel was also in contact with different governments, and in particular with the United States Government, with a view to obtaining assistance and credits. As the bulk of the Israeli Government imports were planned to come from the United States, it was hoped that more credits would be obtained from that country. The representative of the IMF pointed out that while the drawing of the gold tranche from the International Monetary Fund was automatic, drawing of the first credit tranche required approval by the Fund. The approval had been granted only after the Fund had satisfied itself that the plans under way in Israel were adequate and suitable for the purposes on hand.

12. In reply to questions on the prospects for expanding exports, the representative of Israel said that exports were expected to amount to \$730-\$740 million in 1969 - an increase of \$100 million over the 1968 figure of \$635 million. Imports in 1969 were expected to reach \$1,200 million. It was evident that the gap was not closing. In 1970 exports were expected to continue to rise by 13-15 per cent, despite the wage pressure which would be felt in 1970. The effects of 1967 and 1968 investments were expected to be felt by 1970, when more goods would be available for export. There would also be a change in the structure of the exports; various raw materials such as chemicals were being diverted to domestic industries, and new and higher-cost products were finding their way on the export market. Israel's exports in 1969 should have a higher added value than in previous years.

13. One member of the Committee remarked that wages and prices had remained relatively stable as the economy approached full capacity; a round of wage agreements to be negotiated in early 1970 could prove critical to national price stability. Questions were raised as to whether the Government believes wages and prices can remain relatively stable in view of the expansionary situation prevailing in Israel, and what further measures the Government might take if present programmes and policies are not adequate to reduce private consumption. Questions were also raised as to whether new internal measures, similar to the increased sales tax put into effect in May 1969, were envisaged. The representative of Israel said that the Government had managed to contain inflation in the past three years because: (a) up to 1967 there had been a recession and unemployment, which had lessened upward pressures on wages; (b) the rapid growth of the economy in the past two years had unemployed manpower resources so drawn on; (c) there had been an increase in productivity; and (d) the inflow of immigrants and Arab workers had helped to meet the demand. The labour force was now fully occupied and pressure for wage adjustments would be felt in the coming year. It was likely that a rise in wages following the new wage negotiations would lead to a rise in prices. The Government might have to impose new taxes; while the Government had foreseen certain measures, it was not opportune to disclose in advance any changes in fiscal policy. 1970 was expected to be a difficult year in this respect and was likely to see a tightening of credit.

14. Commenting on the deficit on the current account, a member of the Committee pointed out that one of its components, "Government", which appeared to be linked to defence imports, represented more than the entire deficit on services account. The figure of 20 per cent of the Gross National Product for defence expenditure had been quoted by the representative of Israel. The representative of Israel confirmed that the component "Government" included defence imports.

15. Commenting on the Government's plan for lowering of protective tariffs over the five-year period of 1970-1975, a member of the Committee asked whether the tariff cuts envisaged would be co-ordinated with industrial investment. Questions were also asked on the prospects for export growth. The representative of Israel said that tariff cuts and investments plans were not directly linked although they were parallel and aimed at the same objective. There was no micro-planning, product by product in Israel but rather planning by branches of industry. The textile industry, for example, would be brought into line with the rest of the economy by 1975. Assistance to industry would be drastically reduced and protective duties would be lowered over the next five years. It was the intention of the Israeli Government not to grant the textile industry more protection than other industries. Another member of the Committee remarked that further export incentives and promotion did not seem to offer much prospect for significant results without causing a misallocation of resources. The representative of Israel stated that no new export incentives were envisaged. Growth of exports could only be achieved through investment in export-oriented industries in order to create sufficient surplus production available for export. However, any increase of exports was closely linked with the level of domestic

consumption. It was expected that more investment, as well as more manpower, would be diverted to export-oriented industries in order to achieve this goal. There were pressures to renew import controls but the administration had resisted them because it felt that physical control of imports could not lead to a real solution of the structural problem of meeting Israel's defence needs and demand for imports derived from investment, immigration, housing, etc. Syphoning off domestic demand by erecting new barriers to imports would lead to a distortion of the economy.

16. A member of the Committee enquired about the creation of free ports or free zones and on their possible effects on the balance of payments. The representative of Israel confirmed that a new law had been prepared and had been tabled for discussion in Parliament. This law provided for three free-zone ports: Haifa, Ashdod and Eilat, which were expected to handle not only the Mediterranean traffic but would also service a free-zone area for the "land-bridge" which was beginning to operate between the harbours of Ashdod and Eilat, mainly carrying goods from East Africa to South-East Europe. The long journey via The Cape would be avoided. In this connexion, preliminary arrangements had been made with Mediterranean countries, the Black Sea area and countries in East Africa. Feasibility studies had shown that the scheme of a "land-bridge" was economically sound, even after the reopening of the Suez Canal. Facilities for transit, packaging and processing would be available. However, the ultimate success of the project would depend upon the initiative of the traders. It was too early to forecast any effect it could have on the balance-of-payments position of Israel.

#### System and method of the restrictions and effects of the restrictions

17. Members of the Committee welcomed progress made in Israel's programme of tariff reductions and elimination of quota and licensing restrictions, and expressed the hope that there could be continued progress toward liberalization. They also welcomed the adoption by the Israeli Government of the "negative list" method of import restriction, as had been advocated by the CONTRACTING PARTIES for many years. A member of the Committee asked whether licences were granted indeed automatically under the existing automatic licensing system. Another member noted that a number of items of potential interest to his country's exporters, and which were fully competitive, continued to be excluded from the Israeli market. Particular reference was made to the continued restrictions on many agricultural items (list "c" in particular), and to an additional group of items (list "f-1") currently "under review". Questions were also asked on the Government's intentions to further liberalize imports in the near future, and with regard to whether assurances could be given that licences will be granted as a matter of course under "automatic licensing". The representative of Israel confirmed that licences were granted freely to any product in the automatic licensing list. This automatic licensing régime had been maintained in order to satisfy local manufacturers who could thus turn to the Appeals Committee when the volume of imports appeared to be excessive or in cases of dumping. The Appeals Committee met once a month; requests for measures to restrict imports had been turned down except in cases of dumping. He recalled that since Israel's last balance-of-payments consultation, significant liberalization had again taken place. Referring to the various lists contained in Annex I of BOP/96, he made the following comments: the items in list "a-2", "Products whose imports are to be

liberalized shortly" were to be liberalized very soon; with respect to list "c" - "Products for which administrative protection will continue for reasons of Kashruth (Jewish dietary laws)", he explained that there were sensitivities concerning some of these items which had to be taken into account and each item would have to be examined individually; list "e", "Products under administrative protection according to the decision of the Ministry of Commerce and Industry" would remain under that régime for the time being; concerning list "f-1", "Products still under review", he said that it was hoped that in a large part this list would be liberalized in December 1969; the items in list "f-2", "List under review by the Ministerial Appeals Committee" would continue to be under review. In 1968, a number of items had been moved from the automatic licensing list to the free list.

18. Members of the Committee drew attention to the fact that transfers of items from one list to another were not always given adequate publicity. The representative of Israel said in the customs tariff published in early 1969, an indication was given against each item of the import treatment to which it was submitted: "F" for free, "A" for automatic licensing and "R" for restricted. This tariff was now being brought up to date. He took note however of the shortcomings pointed out and would seek improvement.

19. The representative of Israel added that as imports were liberalized increasing pressure for protection was exerted by industry. The Appeals Committee, which had a very balanced representation (including importers) would be active in 1970 and on the other hand the Ministry of Commerce would continue to examine products for possible removal from the automatic licensing list to the free list.

20. The Committee welcomed the tariff reductions effected in October 1968 and January 1969. One member asked when it could be confirmed that further tariff reductions were planned for the period 1970-1975, with a goal of reducing average tariffs to a range of 30 per cent to 60 per cent over the five-year period and an eventual goal of 25 per cent to 35 per cent. Indications were asked as to the commodities these tariff cuts would affect and on the extent of the cuts. The representative of Israel said that in the spring of 1970 his Government would publish the details of the Five-Year Plan providing for tariff reductions on industrial products. He explained that following the tariff reductions in the past year, the Economic Cabinet of Israel had recently approved the plan aimed at continuing to lower the customs tariff while ensuring a fair level of protection for local industries. Under this plan, import duties would be scaled down in equal annual stages in 1970-1975, to a level where effective duty protection would stand at approximately 35 per cent. Whereas in the recent past tariff reductions had taken the linear form and applied to the tariff across-the-board, the planned action would involve differential adjustment for individual products. This was necessary not only because the existing duty rates were different for different products but because the desired resulting rates would also have to be differential. In order to arrive at the same level of effective protection, the nominal tariff rates would have to be higher for products having a high proportion of value added and would be lower for items in which the imported input represented a substantial part of the final price. The tariff cuts for 1970 were already in preparation. A member of the Committee noted that the plan did not include agricultural products and urged the Israeli Government to consider this sector of the economy for future liberalization.

21. One member of the Committee asked whether the entry into force of anti-dumping legislation would be followed by the removal of the requirement for automatic licensing, and asked for details on the anti-dumping law in preparation. The representative of Israel agreed that although the entry into force of the anti-dumping law would make automatic licensing largely unnecessary, the Government might find it difficult to remove automatic licensing immediately. This list would certainly be narrowed down and might be eliminated by 1975. The anti-dumping law in preparation would conform to the provisions of Article VI of the General Agreement as well as the Anti-Dumping Code. Israel was not a signatory to the Agreement on the Implementation of Article VI but expected to be in a position to accept it when the new law came into effect. Members of the Committee welcomed this intended move which would make Israel a member of the GATT Committee on Anti-Dumping.

22. Referring to the list of products subject to Government trading, some members of the Committee queried the necessity for Government purchase rather than private importers' purchase of some of the goods listed. It was also asked what the prospects were for transfer of this Government trade to private firms. The representative of Israel said that staple items such as wheat, soyabeans and sugar were purchased by and stored by the Government for a number of reasons, including security reasons. A Committee had been appointed some two years ago to examine the relevance of Government purchasing of meat; the Committee had agreed to keep this item under Government import régime because the technical problems involved, and the financial burden involved in maintaining four-five months' stocks. He said that they took note of the query concerning Government imports of butter, eggs and skimmed milk powder and would have the matter examined with a view to ascertaining why these sectors were not handed over to private importers.

23. A member of the Committee questioned the desirability of the practice whereby Government departments or Government financed agencies, when passing large contracts for supplies from overseas, tried to obtain related orders for Israeli exports. The representative of Israel said that this attempt to use Israeli purchasing power abroad to enhance demand for Israeli export goods had had only very limited results.

24. One member of the Committee recalled discussions in past consultations with Israel and noted that while imports of soft-wood lumber into Israel had indeed been liberalized, there appeared to be cases in which preference was given by Israeli importers, the largest of which are Government Ministries, to suppliers of this product with which Israel had bilateral trade and/or payments agreements. The representative of Israel denied that any such preference was given by the authorities and said that it was his understanding from past discussions on the subject of timber that, should any problem arise, it could be taken up directly with the Ministry of Commerce. His Ministry had not been approached and he therefore concluded that no problem existed.

25. Turning to the question of bilateral agreements, members of the Committee commended Israel for having terminated four of its nine existing bilateral payments agreements. It was noted that the percentage of imports covered by bilateral agreements had declined and some members of the Committee expressed the hope that the remaining bilateral payments agreements would be terminated at an early date. Some members of the Committee expressed particular concern regarding the recently renewed agreement with the Ivory Coast, and asked when Israel planned to notify the CONTRACTING PARTIES about it. They asked how many bilateral agreements Israel had negotiated, including bilateral agreements with developing countries, and whether any of these agreements contained provisions which were inconsistent with GATT rules. It was suggested that the contracting parties should be informed of all such agreements. In response, the representative of Israel stated that the International Monetary Fund papers and the basic documents reported only on bilateral payments agreements as only these were relevant for the discussion. No attempt had been made exhaustively to enumerate all the treaties of commerce providing for most-favoured-nation treatment or trade agreements containing no more than an indicative list of imports and exports without substantive provision involving concrete obligations. All payments agreements to which Israel was at present a party were shown in the documents in question. With the recent termination of four such agreements, only five remained. Three of them would also have been terminated had the opportunities been available for the necessary negotiation. In reply to specific questions, he said that there were at present no such agreements with either Romania or Cuba. As regards to the agreement with Ivory Coast, the latest version had been signed on 20 October 1969. This agreement contained an indicative list of goods to be exchanged over the next five years; it was neither a tariff agreement nor a payments agreement. In the previous agreement with the Ivory Coast, there had indeed been a clause concerning tariffs, but in the negotiations which had led up to the conclusion of the recent commercial agreement, the Israeli Government had proposed that any further bilateral tariff agreement with the Ivory Coast would be concluded in full accordance with the General Agreement on Tariffs and Trade. These negotiations were not yet concluded and would be resumed before 20 January 1970 when the present agreement expired. After that date the tariff clause would either be annulled or if renewed, would be brought before the CONTRACTING PARTIES.

26. Commenting on recent measures in the field of credit restriction, which appeared directly to affect imports, one member of the Committee said that it was understood that as from 9 November 1969, an Israeli importer, after receiving an import licence from a commercial bank, had been required to use his own resources for 40 per cent of the necessary foreign exchange, the bank providing the remaining 60 per cent. Previously, the importer was able to obtain credit for the full amount of the exchange necessary for the imports. It was asked whether any other such measures were planned, as such credit restrictions could to some extent nullify the benefits of recent import liberalization measures. The representative of Israel confirmed that this measure had been put into effect. He explained that it was part of the liquidity squeeze imposed not only on importers but on domestic demand as a whole.

27. Turning to the question of taxation, a member of the Committee remarked that a purchase tax was levied in Israel on certain items imported into or produced in Israel. In general, the rates ranged from 2 per cent to 60 per cent of the wholesale value, but in some cases the tax seemed to exceed 100 per cent. An increase of up to 60 per cent in the tax on a wide range of consumer goods had taken effect in May 1969. He expressed concern that on certain items, including electrical appliances and automobiles, this purchase tax was applied at a higher rate on imported goods than on comparable domestically-produced goods. The purchase tax on large automobiles was particularly discriminatory, as the tax on cars assembled in Israel was based on value while motor size and weight were the criteria for taxing imported cars. It was asked what stage the Israeli Government had reached in its plans for the replacement of its present system of indirect taxation and whether the elements of discrimination against imports would be eliminated. It was also asked whether any further increases in the purchase tax were contemplated in the near future. The representative of Israel recalled that what discriminatory taxation still existed on imported goods was covered by Part II of the General Agreement, as taxation being in force before Israel became a contracting party. He pointed out that the difference between taxes on imported goods and domestic goods was narrowing down. The increase in the purchase tax enforced last May had been proportionately less on imported goods than on domestic goods in order to narrow down the difference. There was no discrimination against large foreign automobiles in favour of domestic automobiles as production of large cars had been stopped in Israel. Tariffs on automobiles were fixed on an ad valorem plus a weight basis. Thus large cars paid a higher duty on the weight basis. Israeli preference for small cars was not discriminatory but based on their advantages in traffic, consumption of fuel and suitability for the terrain.

### Conclusions

28. Members of the Committee expressed appreciation for the considerable progress that had been made in the liberalization of imports and in the improvement and simplification of the import control system including the changcover to the "negative list" method. It was felt that the increasing liberalization, especially if accompanied by the progressive reduction of customs duties as was being planned by the Israeli Government, would further contribute to the attainment of economic efficiency. The hope was expressed that further improvement in the balance of payments would enable the removal of substantially all import restrictions in the foreseeable future and the discontinuance of bilateral trading arrangements.

29. The representative of Israel thanked members of the Committee for their sympathy and understanding and said that the views expressed by them at this consultation would be conveyed to the Israeli authorities for consideration.

ANNEX IInternational Monetary Fund Executive Board  
Decision Taken at the Conclusion of the Fund's  
Consultation with Israel on 10 September 1969

1. This decision is taken by the Executive Directors in concluding the 1969 consultation with Israel, pursuant to Article XIV of the Articles of Agreement.
2. Following a period of slow growth, the Israel economy began to recover swiftly toward the end of 1967 in response to reflationary policies, a sharp rise in public sector expenditure, and the 14.3 per cent devaluation of the currency in November 1967. The growth of GNP reached 13 per cent in 1968 and is expected to rise again substantially in 1969. In contrast to earlier experience, the current upswing has been characterized by cost and price stability. Exports recorded an increase of 16 per cent in 1968 but commercial imports rose by 41 per cent and defense imports remained high with the result that the balance of payments remained under pressure. Foreign exchange reserves of the Bank of Israel declined by about \$50 million in 1968 and have continued to fall in the first half of 1969. At the end of June 1969 they amounted to \$543 million which is equal to about three months' imports of goods and services.
3. As the slack in the economy was taken up and pressure on the balance of payments became apparent, the Bank of Israel in May 1968 introduced measures to reduce the rate of monetary expansion. The money supply expanded by 26 per cent in 1967 and by 14 per cent in 1968; in early 1969, the rate of increase showed a further decline. The Fund regards the maintenance of tight monetary policy as appropriate, particularly since fiscal policy continues to exert a strong expansionary influence on the economy.
4. A major task confronting economic policy in Israel is the restoration of a satisfactory external payments position. The Fund believes that the accomplishment of this task and the preservation of internal stability call for most determined efforts to adjust the growth of internal demand. The Fund hopes that the authorities will review fiscal policy at the earliest opportunity with a view to reducing the large public sector deficit.
5. As a result of progressive liberalization, few imports remain subject to quantitative restrictions. Some progress has been made in reducing tariffs and the Government has announced a timetable for further tariff cuts over the next few years. The Fund welcomes this policy of increasing progressively the exposure of local industry to foreign competition as a means of encouraging economic efficiency. The Fund also welcomes the termination since the last consultation of three bilateral payments agreements with Fund members and notes that the need to maintain the remaining agreements will be kept under review.

ANNEX II

Opening Statement by the Representative of Israel

1. The main features of economic development

In contrast to the economic slow-down which prevailed during the years 1965-1967, the period 1968-1969 in Israel was characterized by accelerated economic activity. This manifested itself in an overall increase in employment, investments and exports. At the same time, a relative stability in the level of prices, wages and production costs was maintained. However, the revival of the economy, together with growing defence needs, brought about a substantial increase in imports, thereby widening the trade gap and reducing foreign exchange reserves.

Consequent on the accelerated pace of economic activity, the Gross National Product rose by 13 per cent in 1968 while industrial output rose by no less than 33 per cent. In 1969, we expect an increase of over 10 per cent in the Gross National Product and of over 20 per cent in industrial output. By the beginning of 1968, the problem of unemployment which had characterized the previous two years had been eliminated and a severe shortage of labour had developed which hampered continued economic expansion. This shortage was alleviated by the raising of productivity and the inflow and employment of immigrants and Arab workers.

The intensification of economic activity encouraged new investments in all sectors of the economy. The overall volume of investment reached 830 million dollars in 1968, 44 per cent higher than in the previous year. Of this, 470 million dollars, or about 60 per cent, was invested in industry, both in new projects and in the re-equipment of existing plants.

Simultaneously, there took place an unprecedented growth in defence needs, and these imposed a heavy burden both on the foreign exchange resources and on the Government's local currency budget. Total expenditures on defence topped 20 per cent of the Gross National Product.

Another area of great significance for the development of the economy is immigration. During the years 1965-1967, immigration remained at a relatively low level, but during the past two years it has again increased, causing a further growth in demand, and renewed pressure on the building sector of the economy.

All these developments adversely affected the balance of payments. Although in 1968 exports of goods and services increased in a most satisfactory manner to 1.2 billion dollars (a rise of 19 per cent), imports of goods and services recorded an even bigger increase of 27 per cent and reached 1.9 billion dollars. The deficit on current account grew to 700 million dollars and has continued to grow rapidly during the present year. It is feared that in 1969 the deficit will reach almost 900 million dollars. A substantial part of this growing deficit can be attributed to direct and

indirect defence imports. A part of the deficit (about 60 per cent) was covered by unilateral transfers of capital, i.e., private transfers, donations and personal restitutions. A further part has been covered by increasing the national foreign debt, and this has now reached the amount of around 2 billion dollars, i.e., about 300 dollars per capita. Owing to the present high interest rates on the international money market, this new borrowing has imposed still heavier burdens on the economy.

However, these various types of capital imports did not prove sufficient to cover the deficit in our balance of payments. Consequently, from the beginning of 1968 to September of this year, our foreign exchange reserves have fallen by 215 million dollars and are now down to the level of 500 million dollars. This amount, which is equivalent to the value of only three months of import, is considered to be a critical level and measures are being considered by the administration aimed at bringing about a reversal of this trend.

## 2. Foreign trade policy

I should now like to turn to foreign trade policy, beginning with the question of imports.

During the past two years, the Israel Government has pressed ahead with its liberalization policies. These have involved both the removal of administrative restrictions, and other non-tariff barriers, and the gradual lowering of protective tariffs.

These measures are particularly appropriate in a period of high economic activity when it is far easier to expose the home industries to foreign competition. Thus import liberalization may be seen not only as a means of bringing about a reallocation of productive resources in favour of the more efficient industries, but also as a weapon in the fight against inflation. In light of the above, in 1968, we carried out the following important steps in our liberalization schemes.

In regard to import restrictions, as promised in my statement to the Balance-of-Payments Committee last year, we have brought about a complete reversal in our approach to restricted items. Whereas previously all items were considered to be restricted unless they were included in the lists of free or automatically approved imports since 1 January 1969 all items are considered to be automatically liberalized unless they are specifically included in the list of restricted items.

In the course of implementing this policy of dismantling administrative restrictions, we resorted to temporary tariff increases in order to avoid too sudden a shock to some developing industries. In so far as tariffs bound in GATT were affected (in all some forty items amounting to less than 3 per cent of our imports) we received authorization from the Contracting Parties for re-negotiation under Article XVIII/4.

In July 1968, two fifths of the total reductions embodied in the tariff concessions granted during the Kennedy Round were implemented according to schedule.

In addition we have carried out two further rounds of autonomous tariff reductions. On 1 October 1968, a 15 per cent decrease of the customs rates of nearly 400 items came into effect to be followed on 1 January 1969 by a further reduction of 10 to 30 per cent of the existing duty on 600 products. These reductions applied to items on which the customs rates exceeded 35 per cent.

Most important of all, we have adopted a long-term, five-year plan of lowering customs rates on industrial products down to an overall level of 35 per cent, to be implemented in annual stages from 1970-1975.

These measures will bring to an end the "hot house" conditions in which Israel's infant industries were nurtured during the first stages of their development. During the coming five years these industries will have to adjust themselves gradually to the tough environment of free international competition.

Lastly, during the period under review, four of our nine bilateral payments agreements were either terminated or not renewed and trade with the countries concerned is now carried out in freely convertible currency. At the present time, only five bilateral payments agreements are still in operation.

In regard to export policy, our efforts have gone in two main directions. On the one hand we have endeavoured to increase the level of investment in our export industries, and on the other hand we have striven to improve marketing and export promotion facilities.

Turning first to the question of investments in the export-oriented industries we have endeavoured to encourage those industries most likely to compete successfully on the world market, such as for example: science-based industries, electronics, fine chemicals, etc. In order to implement this policy we carried out the following important steps: in 1968, we convened an Economic Conference in Israel in which the principal participants were industrialists, bankers and heads of marketing concerns. They expressed their willingness to assist us in mobilizing investments for these industries and to contribute their know-how in the technology, management and marketing fields. Following the Economic Conference, various regional professional committees were set up headed by prominent industrialists and financiers abroad. These committees constitute a permanent framework within which investments are promoted, know-how is regularly supplied and the proper marketing of Israeli exports assured.

In the field of export promotion, we are trying to improve existing methods and encourage new schemes. Among the more important ones, I would like to mention the following:

Firstly, we have established in the United States a corporation for the promotion of Israeli goods in the United States market. Its staff is composed of market consultants who are acquainted with the United States market and these provide every possible assistance to Israeli manufacturers who are in search of market outlets.

Secondly, we have improved transportation facilities. In particular trade through Eilat port to East Africa and the Far East has been greatly facilitated by the expansion of regular shipping lines to those markets.

Lastly, we have intensified our participation in fairs and exhibitions throughout the world and organized "Israeli Weeks" in department stores and fashion shows in major cities of Europe and America. Being unable to compete with low-cost countries, we invest great efforts in promoting our high-quality and high-value goods.

### 3. Conclusion

In conclusion, I should like to make the following remarks:

Since Israel is a small developing country which has no neighbouring markets, the handicap of smallness can only be overcome if we can find the means of integrating our economy into a larger regional grouping. In pursuance of this policy, we are at present carrying out negotiations with the European Economic Community, the member countries of which constitute our major traditional trading partners. At the same time, we hope that the UNCTAD generalized scheme of preferences will come into effect and will help to improve access to our export markets.

Our import liberalization measures are based on the firm expectation that our exports will not be hampered by our trading partners. We anticipate that the industrialized countries with whom we trade will allow us free access to their markets in order to develop our exports and they in turn will benefit from the same access to our market. However, certain industrialized countries are now threatening to erect new trade barriers. It is difficult to understand how we can be expected to continue our policy of import liberalization while restrictions continue to operate against our exports. Furthermore, it is difficult to foresee how we shall be able to complete our five-year plan for the lowering of tariff protection if we are unable at the same time to give our manufacturers and exporters convincing proof that our markets abroad will be opened to them.

Last year, I concluded my statement by assuring the Committee of our firm intent to pursue further the policy of liberalization. Now I am happy to state that in spite of the severe balance-of-payments situation, we have more than fulfilled this promise. However, at this moment I must sound a more cautious note regarding the future. We, on our part, are determined not only to continue but to accelerate the process of liberalization: lowering tariffs and removing non-tariff barriers. However, we can carry this out only if, parallel to our efforts, we acquire freer access to markets for our export industries. In our traditional and natural markets, we hope to enter into arrangements that will lead our small country to becoming eventually a part of a bigger free-trade area. In other industrialized markets, we expect at least not to have to face new restrictions and limitations to our exports. We firmly believe that all the policy goals I have outlined above accord both in the letter and the spirit to the principles of the General Agreement on Tariffs and Trade.