

GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

BOP/R/21
13 May 1968

Limited Distribution

REPORT OF THE COMMITTEE ON BALANCE-OF-PAYMENTS RESTRICTIONS ON THE CONSULTATION WITH ISRAEL

1. In accordance with its terms of reference the Committee conducted the consultation with Israel. The Committee had before it basic documents supplied by the Government of Israel (BOP/79 and Add.1 and Corr.1) and material supplied by the International Monetary Fund.
2. In conducting the consultation, the Committee followed the plan of discussion for consultations recommended by the CONTRACTING PARTIES (BISD, Seventh Supplement, pages 97-98). The consultation was held on 29 April 1968.

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 customary 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 April 24, 1968, taken at the conclusion of its recent Article XIV consultation with Israel, particularly to paragraphs 2, 3 and 4, which read as follows:

'The inflationary pressures in the Israel economy were brought to a halt by mid-1966. Since then prices and wages have been stable but in both 1966 and 1967 the rate of growth of the gross national product slowed down to 1 per cent and unemployment rose markedly. Under the impact of more expansionary economic policies, there was a new upswing in the economy in the second half of 1967 but wage and price stability has continued to prevail. A flexible monetary policy played a key rôle in both dampening excessive activity and later in stimulating a revival. Another important element in bringing about price stability was the negotiated standstill in wages that has existed since mid-1966. The trade deficit has decreased steadily over the last three years, and despite a sharp increase in 1967 in overseas defense spending, the goods and services deficit was unchanged from 1966 to 1967. There was a large increase in transfer payments and long-term capital inflow in 1967, and the gold and foreign exchange holdings of the Bank of Israel increased by \$94 million. At the end of that year, they stood at \$715 million, which is equal to about one year's imports.

'In the course of 1968 the upswing is expected to continue and yield a substantial rise in the gross national product. In order to obtain a sustainable rate of growth of the GNP and to further strengthen the balance of payments on current account, it is essential that measures be taken in time to prevent the re-emergence of inflationary pressures as these would prevent Israel from gaining the full benefit of the stabilization policies of recent years and of the devaluation of November 1967. The Fund notes that the authorities are alert to this danger and welcomes their readiness to modify existing fiscal and monetary policies promptly should the situation warrant it.

'Only a small proportion of imports remains subject to quantitative restrictions. Israel has reduced tariffs on a wide range of imports and further reductions are to be made during 1968. The Fund believes that these moves to expose domestic industry to more foreign competition should encourage efficiency and a rational allocation of resources. The Fund regrets, however, that Israel has not made progress in reducing the number of bilateral payments agreements with Fund members, and urges the Israel authorities to reconsider their continued resort to these agreements.'"

Opening statement by the representative of Israel

4. In his opening statement, the full text of which appears in an annex, the representative of Israel described the further development of the recession which had been discussed at the 1966 consultation with Israel. Until mid-1967 growth remained at a very low rate, unemployment remained high and, as a consequence of the slack internal activity imports had also declined. Exports had continued to make good progress although the increase had not by any means been sufficient to bring balance into the current account. Hence there had been continued dependence on foreign borrowing and grants. It also followed that Israel was as anxious as ever to bring about further increases in exports, and that task was rendered more difficult by the fact that Israel was not a member of any trade bloc. Meantime, Israel's import system had continued to evolve toward wider liberalization, tariffs had been reduced on a number of items both before and again following the devaluation of November 1967. Israel also intended to continue along this course and hoped to reach a point in its economic development at which quantitative restrictions would no longer be necessary.

5. At the close of his formal statement the representative of Israel added that to expedite the process of liberalization the Government of Israel had decided that within a year the presumptions would be reversed with respect to the question whether a particular product should enjoy restrictive licensing or automatic licensing versus free treatment. Only what could be shown to merit restriction would be entitled to such protection and similarly only what was

positively shown to require automatic licensing status would enjoy that status. This was the contrary of the system employed up to now, where items were liberalized only to the extent that a case had been made to that effect.

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

6. Members of the Committee expressed their appreciation for the statement presented by the representative of Israel and were gratified to note the progress made in liberalization as well as the news that a new negative list would be forthcoming. More generally, they felt that Israel presented an example of a country which had made much progress in development whilst turning in a good performance on the difficult job of maintaining price stability. They specifically commended Israel for its sustained improvement on current account since 1964. It was to be hoped that liberalization would continue, that exports would continue to grow and that the trade deficit might continue to decline. Not all members considered it a mark of weakness that external balance depended to some extent on continued capital inflow and it was noted that relatively little of the foreign liabilities consisted of short-term debt. Others, however, commended Israel's efforts to reduce reliance on borrowing and expressed interest in hearing about measures being taken to lessen this need. It was pointed out that the quite remarkable inflow of capital from abroad, as well as the progress in expanding exports provide a sound basis for more vigorous action to liberalize restrictive measures on imports and Israel was encouraged to continue its programme of eliminating quantitative restrictions. There was rather more agreement that a worrisome aspect of Israel's current position lay in the various indications that inflation would again increase if care was not taken. In this connexion members enquired why Israel preferred bank financing of the Government's deficit to the increased taxation which other countries had found to be a less inflationary way of proceeding. It was also noted that the level of Israel's exchange reserves was sufficient to enable it to ride out any foreseeable short-run deterioration in its balance of payments. Members also expressed interest in learning more of the effect which devaluation was expected to have, particularly on exports, and on learning of the prospects and possible balance-of-payments effects of future immigration. The recent resumption of a strong rate of growth in gross national product, the vigorous recovery in investment, increasing returns from tourism were all noted as favourable factors, although for some it was difficult to understand the need for continuation of restrictions even on imports of a residual 10 per cent of imports when foreign exchange reserves were as large as Israel's.

7. The representative of Israel dealt first with the question of his country's needs for reserves. First, he noted, services as a whole regularly accounted for a large net debit item in Israel's balance of payments. He also noted that the deficit on services was sometimes of about the same order as the deficit on trade, as shown in Annex V of the basic document.

Foreign exchange reserves had to cover both, and Israel therefore felt that it was entirely proper to measure foreign exchange reserves in terms of the number of months' total needs of goods and services which reserves would cover; in 1966 terms, he noted, present reserves would barely cover six-months' needs. As for the level of the external debt, he noted that a decline in incoming payments of various categories was almost certainly in store, so that even if reliance on the total of remittances and borrowing declined, it might still be necessary to increase in future the extent of borrowing, with an unfavourable effect on Israel's future liabilities. It was this shift in the structure of the inflow of capital which Israel was anxious to avoid. The immediate outlook for capital receipts in 1968, about which a question had been asked, was hard to judge because of the many changes that had occurred as a result of the June War.

8. As to how reliance on transfer payments and capital inflow might be reduced in balancing its continuing trade deficit, the representative of Israel acknowledged that this was a very difficult problem. Success would depend on a restructuring of industry, and in a country with a small internal market that meant chiefly seeing to it that all industries were geared from the start to export at least half their output. Previously, the need for all industries to rely heavily on export markets had not been fully realized, and shorter-term objectives such as the absorption of unskilled labour had been given much priority. It was now seen, however, that while additional capital and know-how were still needed, Israel should give more priority to acquiring marketing skills and should concentrate on selection of high-productivity industries which could pay their workers well and make a significant addition to the value of materials used. Attention to these factors would enhance the ability of the industries selected to expand Israel's export earnings. Even in the textile industry, which had been established early and on a mass basis, it was now seen that there must be a restructuring to emphasize production of fine fabrics and high-fashion products. To be sure, such emphasis in new industry might leave the Government with a long-term residual problem of training the relatively large group of unskilled workers who formed a part of past immigration waves. In the long run, however, it was hoped to meet the social needs of Israel, consistently with emphasis on education and research and also to reduce needs for imports whilst maximizing export returns and reducing reliance on capital inflow.

9. With respect to immigration, about which a question had been asked, the representative of Israel said that some increase might occur as compared with recent very low levels, but that it was not expected that the levels of 1965 would be attained again. For Israel, an important question was what kind of immigrants could be expected, for if immigrants came without bringing capital or skills, they could be a burden to the country for some years after their arrival.

10. Reverting to the question why the Government of Israel had preferred in the immediate past to resort to bank financing to meet the difference between expenditures and revenues, in preference to increasing taxes, the representative of Israel agreed that deficit financing had inflationary implications of which his Government was well aware. Nonetheless Israel had found on some past occasions that tax increases were rapidly transmitted into price increases and also discouraged initiative. They had felt that on the whole internal borrowing had less inflationary effect than did new taxation. What was sought was an optimum combination of taxation and internal borrowing.

11. Turning to the questions raised concerning foreign trade, the representative of Israel noted that Israel had consistently moved as rapidly as possible to liberalize trade and reduce tariffs, even during the recession of 1965-67 when these policies had been anything but easy in the face of rising unemployment. To some extent the disappointment of potential suppliers over their failure to sell more following liberalization might be traceable to the slow growth in those years, and this would be particularly true with respect to products like lumber where demand was closely associated with the new construction and new investment which had been particularly sluggish in the recession period. Israel had also reduced tariffs for most items in the period following devaluation, precisely to avoid price increases. On the export side it was still a little early to say to what extent devaluation might stimulate exports, though it began to look as though the effect would be less than had at first been hoped. A more active domestic market had had some stimulating effect on imports, but prices of some exports had been lower, so that returns were not much larger even where quantities exported increased in the first quarter of 1968. Elsewhere, especially in diamonds, demand had been poor. In all, it was doubtful that the earlier forecast increase of 15 per cent would be realized.

12. Members of the Committee expressed some concern as to whether the Government of Israel might not be continuing for too long to think in terms of the recession through which the country has passed in 1965-67 and they inquired more particularly concerning steps which could be taken to control inflation if it should prove that surplus capital, devaluation, the defense expenditures of last year and export expansion efforts combined to bring about too great an upswing, especially in prices. It seemed to them that in a community with high welfare aims, where wage negotiations played an important rôle, a situation might easily come about in which quick controls might be wanted to curb inflation at its source, whether that were on the demand side or from excessive investment. The question was raised as to what the attitude of the Government should be if a labour shortage developed, and with it demands for wage increases in excess of productivity increases.

13. The representative of Israel acknowledged that these were problems which had resisted solution in a number of countries. It was in fact difficult enough to persist in deflationary policies, as Israel had done in 1965-67. It might prove even more difficult to match policy to needs on the upswing, but Israel felt obliged to go ahead with its major export-based industrial development projects and would have to do its best to cope with the resulting pressures on the internal market. The hard core of unskilled workers who might not be absorbed into the labour market even when shortages developed in skilled labour posed an extra problem. As for other contingency measures, he recalled that tariffs had been reduced when devaluation was decided on, precisely to reduce the risk of inflation. The 1966 agreement with the trade union federation, the Histadrut, was also a helpful development as it broke to some extent the link that had existed up to then between price increases and wage increases. There were also ways in which discretion could be exercised in the rate of public spending and in practices and requirements as to bank liquidity. He assured the Committee that the risk was well appreciated and that developments were being carefully watched.

14. Noting that Israel had already achieved export increases that would have seemed inconceivable only a few years ago, members asked whether more specific details could be given concerning ways in which exports were being promoted. It appeared that the Law for the Encouragement of Capital Investment had recently been amended in such a manner as to permit greater protection for new investments, and there was a five-year development plan which also opened up new perspectives. The representative of Israel replied that his country was seeking by every means to sell in new markets. They had recently held a conference of industrialists and market experts whose advice had been sought on export expansion. Israel had seen that there were great untapped markets for many things, such as fertilizers, in the developing countries, and had been trying to solve problems connected with financing additional sales in such markets. Shipping had proved to be something that could be developed to advantage and of course reduction of trade barriers was of great interest to Israel in this connexion. Israel would continue to give help in order to get new industries started, though not to the extent of giving monopoly privileges. It was to underline their need to be competitive from the start that Israel told new enterprises they must look to export markets.

System and methods of the restrictions and effects of the restrictions

15. Members of the Committee inquired about the procedure for transferring products from one list to another where infant local industries were involved. They also expressed concern that even when products had been put on the so-called "automatic approval" list there might be various conditions concerning minimum quantities and price to be met; it was not clear whether applications for licences were treated equally regardless of source or whether there might not be a preferred treatment for proposals to import from bilateral sources. Obviously,

extensive administrative interference must be implied in this "automatic" system. In any case, it appeared that the considerations involved had a good deal more to do with the ability of local industries to compete than with the overall balance-of-payments needs of the country. At best, Israel's import licensing procedure continued to be quite time consuming, and a question was raised as to what steps were contemplated to expedite decisions regarding the acceptance or rejection of import applications.

16. The representative of Israel replied that when it was proposed to derestrict a product which had enjoyed protection under restrictive licensing, the automatic approval list offered a transitional situation which reassured the domestic industry affected and enabled a step to be made toward complete freedom sooner than otherwise. He knew of only a few cases where the retrograde step had been taken of transferring an item back to restriction, yet the possibility of surveillance had been very helpful in obtaining acceptance of the move to automatic licensing. Clearly the system was not ideal and did involve administrative machinery but especially when domestic demand had been slack this device had been helpful in keeping up progress toward liberalization. There would be another round of review when undoubtedly more items would be made free; at that time, as he had stated, the presumption would be that the product should be free unless a case to the contrary could be made.

17. The point was made that if in fact 90 per cent of Israel's imports were free, it was remarkable what a number of important products were still subject to restriction. One member noted that about 90 per cent of his country's exports fell within that restricted 10 per cent, including canned meat and fish, preserved fish, fruit, flour and products, paper and wood products. The representative of Israel replied that as he had noted earlier lumber had been liberalized recently whilst paper products were under active consideration. As to agriculture, Israel had the same problems that many others did and though fully aware of the problems had had no greater success than others in solving them.

18. Members of the Committee noted that there seemed to be a tendency in Israel to increase tariff rates at the same time that products were put on automatic approval, and many locally-produced goods still tended to be protected by substantial import duties. The representative of Israel said that this was true and represented another way of offering reassurance when restrictive licensing was discontinued.

19. With respect to imports made by State-trading enterprises, members of the Committee expressed interest in learning more about the use of this form of trading and asked for confirmation that restriction was not practised by such enterprises. They also enquired how the agencies decided upon the source from which to buy and whether State trading was used as a mechanism to fulfil undertakings in relation to reports of agricultural surpluses. Had there been any progress towards moving commodities out of State trade and into private trade, and if so to which import list were the goods transferred?

20. The representative of Israel replied that the main function of State trading was not to restrict imports but to direct arrivals in accordance with consumption needs. Consumption was in most cases rising much more steadily than the annual figures might indicate, because the timing of bulk shipload arrivals might obscure long-term consumption increases. He stated that in some cases efforts had been made to transfer this trade to private hands, as for example with respect to meat, but that various difficulties had been encountered. Few private traders were willing to handle the large stocks which the Government wished to hold within the country, and there was a problem in some cases of ensuring compliance by suppliers with dietary laws. In regard to dried milk, the unevenness in imports reflected the fact that imports performed a residual function when domestic supplies of liquid milk were short. The Government had tried to liberalize cheese in the Kennedy Round but had been unable to obtain adequate concessions in return from the supplying countries; butter was in fact a problem of the kind familiar to other countries. Wheat was imported to fulfil needs after the domestic crop had been taken up, and wheat imports were likely to pick up again as the low figures shown in Annex II reflected to some extent the exceptionally large crop of 1967. The policy of holding very large reserve stocks within the country was to be continued and purchases would be made where supplies were cheapest. The construction of new silos at Eilat was being considered; this would widen the choice of sources from which purchases could be made. Concerning the other products involved - soyabeans, edible fats and sugar, purchases were made from the most economical sources on the basis of tenders, supplemented in some cases by purchases from bilateral trading partners. It was hard to predict what the import treatment of the goods would be if they were turned over to private hands and treatment would no doubt vary from case to case. Because of the stocks problem, this was a somewhat hypothetical question, but it might be foreseen that where home production was involved, as was the case with milk, butter, cheese and sugar, there would likely be some restriction. United States Public Law 480 disposal programmes took care of some of Israel's needs of products which were State traded but in fulfilment of their commercial quota obligations in relation to wheat Israel was careful to purchase from the cheapest sources.

21. A further question concerning State trading sought clarification on the method by which State-trading agencies obtained bids when purchases were contemplated. In one country there had been complaints that supplier firms found it difficult to learn in good time of bidding and so tended to lose possible sales. The representative of Israel reminded the Committee that in this trade very large purchases were the rule, so that relatively few firms were in a position to supply. The State-trading agencies were acquainted with the relatively few possible suppliers and were accustomed to contact them on an ad hoc basis, without necessarily publicizing the matter unless that was required by United States law as when Public Law 480 purchases were involved. Members of the Committee commented that this practice seemed somewhat restrictive from the point of view of new potential suppliers. The representative of Israel added that where procurement for construction was involved, tenders were of course published.

22. Members of the Committee expressed concern at Israel's continued use of bilateral trade and payments agreements despite the strong views put forward at the last consultation. They indicated complete agreement with the regret expressed by the International Monetary Fund concerning Israel's continued resort to these agreements and urged that Israel make progress in reducing the number of these agreements. The representative of Israel replied that there were one or two points on this subject not very well brought out in the IMF decision but which he believed the Fund representative could confirm. Israel was convinced that in some cases bilateral agreements had outlived their usefulness and tended to put trade in a straitjacket, but in relation to some countries it was only possible for small countries like Israel to trade if there were a bilateral trade agreement. It was notably a fact that in 1967 Israel had given up two bilateral payments agreements with non-Fund members, and it was also a fact that in two other instances Israel had proposed allowing payments agreements with Fund members to lapse but the partner in question had been unwilling. In cases of that sort, even if Israel were convinced that bilateral payments had become a straitjacket, there was little Israel could do. He did not however want to convey the impression that Israel agreed with the position that bilateral agreements were always or necessarily harmful. In his country's experience there were circumstances where undoubtedly the agreements had enabled Israel to carry on trade that would otherwise not have been possible, owing to one factor or another, and from Israel's standpoint the main thing was to ensure as much trade as possible. On the other hand, Israel also had no preconceived position in favour of bilateral trade, and probably as time went on practices of others would evolve to the point where Israel terminated the agreements of her own accord and because she found that to be in her best interests. Members of the Committee felt that Israel was still too much inclined to enter into bilateral arrangements and to retain them.

23. The representative of the IMF noted the importance of distinguishing between bilateral agreements which contained payments provisions and those which did not. The Fund had consistently sought the termination of agreements, particularly between Fund members, when payments provisions in the agreements were actually or potentially discriminatory. Efforts to facilitate the termination of bilateral payments agreements were a regular feature of Fund consultations and ad hoc meetings were arranged among Fund members to resolve the particular problems which often existed, especially where the agreements were of long standing. In the most recent Fund consultation with Israel it was noted that some of its bilateral trading partners were reluctant to terminate existing agreements as envisaged by Israel. The Fund was in full accordance with the stated policy of Israel of terminating the agreements in question and was confident that Israel would continue its efforts towards that end.

24. Members of the Committee mentioned that there appeared to exist one or two cases in which Israel had concluded preferential tariff agreements with African countries in contravention of Article I of GATT. It was urged that any agreements which provided for the exchange of preferential tariff concessions should be notified to the CONTRACTING PARTIES. Enquiry was made as to when Israel intended so to notify the agreements. The representative of Israel replied, concerning the trade agreement with the Ivory Coast which had been mentioned, that it had been concluded on the assumption that it would lead to a customs union. It had remained inoperative during 1965 and 1966. Israel was willing to extend the concessions granted to the Ivory Coast to other developing countries in the spirit of Part IV of the GATT under procedures being worked out in the Committee on Trade Negotiations among developing countries. The present agreement would come to an end in eighteen months and the parties would then have to decide about their further relations and whether these required regularization within the GATT.

25. Members of the Committee were not satisfied that the use of bilateral agreements did not have adverse effects upon their trade in the actual working of Israel licensing practices. One example which was brought to the Committee's attention concerned spruce lumber, a product which had supposedly been placed on automatic licensing but with respect to which it had proved difficult for a North American supplier to enter the market. This experience tended to confirm the feeling that Israel depended more than most countries on bilateral trading and that the influence continued even when products had supposedly been placed on a fully competitive licensing basis. The representative of Israel replied that in the particular case it should be recalled that the lumber could, in the first place, not arrive in Israel from North America earlier in the year than May or June because the St. Lawrence seaway was closed during the winter months. Second, demand for this product had been suffering ever since the fairly recent liberalization action from the decline in construction which characterized the recent recession. Further, even when a supplier had obtained licences he had the further problem of offering competitive sale terms. Undoubtedly established suppliers in bilateral countries would make their best effort to keep the business after the market was opened to other suppliers, and it was entirely possible that they would adjust their prices to meet new competition. The Government had done all it could appropriately do in opening up the market, and the rest was up to the traders concerned.

26. Another specific trade question which was mentioned in the consultation was a requirement that imported tractors incorporate a minimum percentage of value representing value added in Israel. The representative of Israel said he was aware of this problem and had previously asked that the question be put to him in writing in order that he might take it up with the authorities directly concerned. He repeated his request to have the question in writing and it was agreed to handle this matter outside the Committee.

Conclusion

27. The Committee thanked the representative of Israel for the very full and frank answers which had been given to their questions. They reiterated their gratification at the way in which Israel's policies seemed to reflect increasing awareness that export promotion offered better insurance of growth with stability than did a system of restrictions on imports which would allow inefficient allocation of resources. They believed that GATT had helped to strengthen Israel's determination to follow this course and were impressed at the performance achieved. They found it especially encouraging that full recognition was given to the need to concentrate on export industries requiring relatively low import components, given Israel's shortages of raw materials. At the same time, the Committee stressed the need for Israel to take all necessary measures to contain within tolerable limits inflationary pressures that appeared likely to develop in the years ahead. The Committee expressed the view that if these potential pressures were contained, the level of Israel's foreign exchange reserves should prove sufficient to enable Israel to ride out any foreseeable deterioration in its balance of payments without the need to resort to further restrictions on imports. Indeed, the Committee felt that even more rapid liberalization of imports would assist in containing inflationary pressures. The Committee also expressed concern at the difficulties Israel had encountered in reducing the number of bilateral trade and payments agreements with which it was associated and urged the Israel authorities to take all possible further steps to reduce or eliminate the remaining agreements. The representative of Israel thanked the Committee for the sympathetic attention given to Israel's problems and promised to convey to his Government the views which had been expressed.

ANNEX

Opening Statement by the Representative of Israel

The period 1966-67 was characterized by the economic slow-down which led on the one hand to structural unemployment and stagnation in economic development but which, on the other hand, brought about a significant improvement in Israel's balance of payments.

Imports decreased in 1967 by \$66 million as compared with 1966, whereas in 1966 they had remained at the same level as in 1965. Exports of goods increased at an average annual rate of 13 per cent for the two years and, as a result, the deficit on trade account declined from \$390 million in 1965 to \$215 million in 1967.

On the other hand there was a deterioration in the balance of services: the deficit increased from \$145 million in 1965 to \$270 million in 1967.

Whilst in 1966 the deficit on current account fell to \$448 million from \$535 million in the previous year, it rose to \$485 million in 1967. This gap was closed by unilateral transfers as well as by long- and medium-term loans, and as a result Israel's foreign indebtedness increased from \$1,226 million in 1965 to \$1,584 million in 1967.

During the period between the end of 1965 and mid-1967, the Government of Israel undertook vigorous measures to curb inflationary pressures, for example by imposing considerable cuts in public expenditure. The aim of this policy was to bring about structural adjustments in the economy and in particular a transfer of resources from the over-inflated building sector and the service industries to export-oriented industries and import substitution branches.

However, the latter industries found themselves unable to absorb the redundant labour force at the required rate. In this respect the economy was up against the basic problem of an as yet insufficiently developed industrial sector. As a consequence, for the first time in a decade there was a substantial rise in unemployment. This situation continued until the middle of 1967 after which the employment position began to improve.

The measures taken by the Government to maintain price stability and the ensuing unemployment led to a sharp reduction in the previously very high rate of growth (1-2 per cent in 1966/1967 as compared with an annual average of 10 per cent for the decade 1956-1965). These developments reflected the conflict facing the Government in following the twin objectives of growth on the one hand, stability on the other.

In 1966, net unilateral transfers declined from the previous annual average of some \$350 million to about \$300 million. The main factors contributing to this decline were the termination of German reparations and the lull in personal remittances owing to the declining level of immigration. However, during the latter half of 1967 there was a considerable increase in the institutional remittances due to an emergency collection after the June War. This item increased from \$105 million in 1966 to 290 million in 1967.

Net capital inflows increased in 1967 by \$40 million as compared with 1965, after an interim decline in 1966, the main net increase in 1967 being in Independence and Development Bonds. However, decreases were registered in United States and International Bank for Reconstruction and Development loans, other loans and in investments.

Increasing external loans and foreign indebtedness cannot be a satisfactory answer to the problem of closing the gap in the balance of payments within the next few years. Israel has already reached the highest per capita level of external debt in the world, which imposes and will impose in the future a very heavy burden on the economy.

Foreign exchange reserves decreased during 1966 and the first half of 1967. However, during the latter part of 1967 they began to rise and at the end of the year reached a figure of \$715 million, which covers roughly six months of import requirements - a relatively modest figure in the light of Israel's special situation.

The improvement in the balance of payments during the period under review was achieved, as has been stated, at the expense of a decline in the rate of economic development. This trend manifested itself particularly in a substantial decline in the import of investment goods and equipment. The resumption of activity and the gathering of momentum of the economy will necessarily bring about in the first instance a worsening in the balance-of-payments situation. It is the policy of the Government to stimulate in particular the export-oriented industries.

Most of Israel's present exports are of a type more easily marketable in the developed industrialized economies. These include citrus fruit and citrus products, diamonds, clothing and fashion goods, plywood, chemicals, leather goods and others. It is natural therefore that the greater part of Israel's exports go to Western Europe and North America. In 1967 these two regions absorbed some 70 per cent of total exports (of which the European Economic Community accounted for 29 per cent, European Free Trade Association for 23 per cent and the United States for 16 per cent).

Many of the new branches which Israel is endeavouring to develop will also find a more ready outlet, in the first instance, in the developed industrialized economies. I have in mind science-based industries such as electronics and petrochemicals, specialized agricultural products such as "off-season" fruits and vegetables, printing and craft and fashion industries.

On the other hand, Israel has also been developing certain branches whose products could find expanding markets in the developing countries. These include: fertilizers (such as potash and phosphates) and industries connected with agriculture such as pesticides, irrigation equipment, agricultural machines and equipment for the poultry and dairy industries. During 1967, some progress was made both in Asian and in African markets.

Israel is not a member of any of the regional economic groupings and consequently she finds herself at a disadvantage in most of her major markets vis-à-vis the exports of the member countries of these groupings and vis-à-vis the many countries associated with them. In view of the smallness of our domestic market it can be seen that this constitutes a serious stumbling block to the development of our export industries. This was one of the basic factors underlying our application for associate membership of the EEC in October 1966.

In the light of these factors it can readily be understood that the successful conclusion of the Kennedy Round was of considerable importance to Israel and for this reason we took an active part in the negotiations. As a developing country we were not called upon to give full reciprocity. However, in order to secure concessions for products in which we have a vital interest, we did grant reductions on products which were of major interest to principal supplying countries and we also undertook to bind existing rates on a large range of other commodities.

In the field of tariff negotiations and trade liberalization, Israel attaches greatest importance to the successful outcome of the negotiations in UNCTAD for a general preference scheme in favour of developing countries. Israel is also taking an active part in the negotiations for tariff reductions amongst the developing countries under the auspices of GATT.

On the question of liberalization of the imports, the Government has, during the last two years, continued to pursue its policy of relaxation of administrative controls. Thus, during the period under review a further 120 items were removed from the list of restricted imports, whilst some 140 items will be added to the Free List as from June 1968. All these items are listed in Annexes III and IV of the Basic Document prepared for the present balance-of-payments consultations.

Parallel with the process of freeing imports from administrative controls, the Israel Government has also been carrying out a policy of gradually reducing the general level of customs tariffs. In November 1966, a tariff reduction of 10 per cent was implemented on some 330 items. In November 1967, following the devaluation of the Israel pound, a further reduction of customs duties at the rate of 15 per cent to 20 per cent was applied on almost the whole of the customs tariff.

A new revised customs tariff incorporating these reductions as well as two fifths of the tariff cuts resulting from the Kennedy Round is in preparation and will be made available to the members of the Committee. This volume will also include information on the changes in the import régime to which I have referred earlier.

In conclusion, I would like to assure the Committee that the Government intends to pursue further the policy of liberalization in the hope of reaching the point in the economic development of the country where restrictions will no longer be necessary.