

GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

BOP/R/38
3 April 1970

Limited Distribution

Committee on Balance-of-Payments Restrictions

REPORT ON THE CONSULTATION UNDER ARTICLE XII:4(b) WITH ICELAND

1. In accordance with its terms of reference the Committee has conducted a consultation with Iceland under Article XII:4(b). The Committee noted that the previous consultation with Iceland under the same provisions had been held in March 1969 (cf. BOP/R/31 and BOP/83). In conducting the present consultation the Committee had before it a basic document supplied by the Government of Iceland (BOP/102) and a paper containing supplementary background material, dated 26 February 1970, supplied by the International Monetary Fund.
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 16 March 1970. 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 International Monetary Fund had been invited to consult with the CONTRACTING PARTIES in connexion with this consultation with Iceland. In accordance with the agreed procedures the representative of the Fund was invited to make a statement concerning the position of Iceland. The statement made was as follows:

"The Fund invites the attention of the CONTRACTING PARTIES to the supplementary background material dated February 26, 1970 which has been transmitted to the CONTRACTING PARTIES.

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

Opening statement by the representative of Iceland

4. In his opening statement, the full text of which is reproduced in the Annex, the representative of Iceland outlined the vicissitudes in his country's economic position and balance of payments in recent years, their prospects for the near future as well as the economic and commercial policies being pursued. The sustained boom of 1962-65 had been followed in 1967-68 by a serious decline in the volume of exports, aggravated by a decline in prices. The steep decline in exports and in per capita national income entailed two drastic devaluations of the currency in 1967 and 1968. It was gratifying that in the circumstances the policy of trade

liberalization had been maintained. As had been forecast, a recovery in the fisheries production, together with an improvement in the terms of trade, had brought about a rise in gross national product by some 2 per cent in 1969. While there had been a set-back in agricultural production, the increase in the volume of fisheries production had been substantial and production in manufacturing industries, other than fish processing, had also markedly increased. The devaluations of 1967 and 1968 had helped to eliminate the substantial deficit on the balance of payments which had occurred in both these years, and in 1969 there had been a surplus of about \$4 million on current account while the foreign exchange reserves had risen by \$19 million.

5. Present indications were that fisheries production would continue to expand which, together with improvements in prices, might lead to an increase in the value of these exports by 10 per cent this year. Exports of manufactures were expected to rise briskly as a result of industrial diversification, supplemented by the effects of the devaluations and the better conditions of access to the European Free Trade Association markets following Iceland's accession to that grouping. A rise in gross national product by 4 per cent might be expected for 1970.

6. Thanks to the vigorous fiscal and monetary policies being pursued, the Government had been able to continue trade liberalization. As a consequence of Iceland's accession to EFTA, import liberalization measures had been undertaken vis-à-vis all countries: the remaining quantitative restrictions on industrial products (except petroleum) would be removed totally by the end of 1974; a number of products had been added to the free list as from 1 March 1970; and global quotas had been enlarged for a number of products this year. As regards the customs tariff, duties on industrial raw materials had generally been reduced by 50 per cent and those on industrial machinery had been scaled down by a substantial margin to 7 per cent. These reductions on raw materials and machinery applied to imports from all sources, as did the reductions of certain other duties. Apart from these, there were also reductions of protective duties on imports from EFTA countries.

7. In conclusion, the representative of Iceland stressed the importance attached by his Government to the diversification of production and exports. The collapse of herring fishing in 1967-69 had clearly demonstrated the inherent vulnerability of the country's traditional economic structure. It was hoped that Iceland's accession to EFTA would contribute to a quickened pace of the country's industrialization and diversification, and to strengthening her economic basis, thus placing her on a sounder basis as a member of the international trading community.

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

8. Members of the Committee expressed special appreciation for the measures which had been taken by the Icelandic Government to meet the difficulties and the serious crisis it had confronted in 1967 and 1968. They were pleased to note the recent substantial improvements in current account and in the overall

balance of payments. They commended the Government of Iceland for the steadfast manner in which it had dealt with these difficulties and in pursuing a policy of liberalization. They also expressed the hope that the generally more favourable situation would continue to improve and that the process of liberalization could thus be resumed and accelerated.

9. In reply to questions on the prospects for further improvements in Iceland's balance-of-payments position and internal equilibrium in 1970 and thereafter, the representative of Iceland said that while no official forecasts were as yet available, some general indications could be given with regard to the long-run prospects of the fishing industry. Marine biologists were of the opinion that the fish stocks accessible to Iceland would certainly not yield any sustained increases in catches. Owing to the growing population and labour force, accelerated industrial diversification must be taken as of primordial importance. The foundations for such a policy had been laid in the Burfell/Straumsvik power project and the related aluminium smelter; and this policy had been supported by the economic measures taken in 1967 and 1968, the devaluations and related fiscal measures. Iceland's accession to EFTA had been motivated by the same objectives.

10. As regards the short run, the representative of Iceland thought that some factors in the external situation had also been promising: the fall in fish prices had been reversed; access to the United Kingdom and other EFTA markets had been obtained on a non-discriminatory basis for frozen fish and other products of interest to the fish industry. Among recent governmental measures the reduction in import duties on raw materials and machinery should aid export industries, and membership in EFTA, which opened up possibilities of industrial co-ordination and rationalization and of closer economic co-operation in general, should have the effect of facilitating and hastening industrial development in Iceland. All these would undoubtedly contribute to strengthening the balance-of-payments position of the country. It should also be said that for the immediate future, a successful development would seem to depend closely on Iceland's ability to maintain internal cost-price stability.

11. With respect to industrial diversification, it was asked whether concrete plans existed for the establishment of any new industries other than the aluminium smelting already mentioned. The representative of Iceland described the structure of the country and said that certain industrial development projects were under study and the following lines might be mentioned: the production of magnesium, salt, perlite, seaweed products and heavy water. Aluminium production was of course capable of substantial expansion. However, no concrete projects had as yet been decided upon. Diversification could also be pursued through the expansion of facilities for the processing or further processing of fish, wool and skins, the latter two having traditionally been mainly exported in unprocessed form. Useful information on these industrial opportunities was being disseminated by the Ministry of Industry, whose efforts were supplemented by those of the Federation of Icelandic Industries, which had set up a small promotional office to that end.

12. Noting the importance of wage and price stability to the maintenance of external equilibrium of Iceland, members of the Committee pointed out that while the necessary adjustments over the past year had not caused serious industrial stoppages, a great deal would seem to be at stake with respect to the forthcoming wage negotiations. Some concern was expressed over the inflationary impact of automatic wage adjustments and it was asked whether Iceland authorities would seek a greater degree of flexibility in the wage-price relationship in the course of the labour negotiations in May. The representative of Iceland recalled that the automatic link between wages and prices had been restored only last September. In the course of 1969, wages levels had risen by 12 per cent while prices had risen by 22 per cent over those of the previous year. While labour unions would undoubtedly present wage claims which would compensate as much as possible the rise in prices, the Government would do its utmost to ensure that the wage increases would be of manageable proportions.

13. In reply to a question on when the Fish Price Equalization Fund would start to function, the representative of Iceland said that the scheme was already in operation although detailed arrangements were still to be evolved.

14. A member of the Committee enquired as to the significance of the statement in the IMF background paper to the effect that business firms had been made subject to licensing and limited to Icelandic nationals. The Committee was informed that subsequent to the preparation of the IMF paper in question, the legislation had been amended so that such licences could be granted irrespective of the nationality of the applicant.

System and methods of restriction

15. In the course of discussion under this heading, members of the Committee recalled the various favourable developments which would seem to afford the Icelandic authorities greater scope for progressive action. In view of the persistent efforts made by the Icelandic authorities to maintain a liberal trade policy even in severely adverse circumstances, the recent improvements seemed to give hope for further significant progress in trade liberalization. In this context a member of the Committee expressed gratification over the abolition of the tax on motor vehicles in Iceland on 1 March 1970 which should help to reverse the drastic decline in such imports during the 1967-1969 recession and following the large devaluations of 1967 and 1968. Members of the Committee enquired whether the Icelandic Government had adopted or was formulating any concrete plans for the further liberalization of imports in the near future.

16. In reply, the representative of Iceland called attention to the fact that the Icelandic economy had only very recently emerged from severe difficulties which could very well have led to the adoption of policies severely restrictive of foreign trade. That the Government was anxious to resume and accelerate the process of liberalization at the earliest opportunity had been borne out by the various measures taken on 1 March as described in the basic document before the Committee: apart from the reduction of duties on industrial imports from EFTA countries, duties on raw materials and semi-manufactures for domestic

industries had been reduced by 50 per cent and duties on industrial machinery had been reduced substantially, both on a most-favoured-nation basis. Import restrictions had been removed for over twenty tariff items (see Annex III to the basic document) and import quotas had been substantially increased (cf. Annex II, ibid). While the present circumstances did not justify any steps beyond what had already been taken, it remained the Government's firm policy to remove the remaining restrictions as rapidly as possible; at any rate all restrictions on industrial products, other than petroleum and petroleum products, would be removed within the next five years, i.e. not later than the end of 1974.

17. In response to a specific question, the representative of Iceland stated that chocolate and sweets remained subject to import restrictions for the time being and that these restrictions were being maintained both on balance-of-payments considerations and for the purpose of assisting small domestic producers in a somewhat depressed industry which had enjoyed protection from foreign competition for many years. Imports of these products were, however, expected to be gradually liberalized during 1972-1974: global quotas would be provided as from 1972 and liberalization should be completed not later than the end of 1974. The representative of Iceland also undertook to convey to the attention of his Government certain comments made by a member of the Committee on the restrictions on coffee, a product of exclusive export interest to developing countries.

18. One member of the Committee enquired about the nature of any special undertakings Iceland might have accepted towards other EFTA countries with respect to quantitative restrictions and how these would affect Iceland's programme of trade liberalization. The representative of Iceland confirmed that trade liberalization in Iceland had proceeded and would continue to proceed on a non-discriminatory basis. The removal of restrictions on 1 March, although taken in consequence with Iceland's accession to EFTA, applied to imports from all sources; the same would apply to all future action to be taken between now and the completion of the process by 1 January 1975; all import quotas were also of a global nature and were available to all exporting countries.

19. Recalling the comments they had made during the last consultation with Iceland on the country's reliance on bilateral payments and trade agreements - in particular the then newly revised agreement with Brazil - members of the Committee observed that there still remained several such agreements all providing for bilateral clearing; that Iceland seemed to have continued to rely on this device for the maintenance of its markets for certain traditional fish exports; and that these arrangements seemed to account for over 10 per cent of Iceland's total imports (1968 basis). Invited to comment on this tendency and the prospects of a reduction in the trade coverage of such agreements, the representative of Iceland pointed out that there had been in the past ten years a consistent trend in Iceland to move away from the use of bilateral agreements; whereas as late as 1960 Iceland had had bilateral trading relations with ten countries, at present no more than five such agreements remained in force (the agreements with Finland, Israel, Spain, Czechoslovakia and Poland having been discontinued during this period). Among the existing agreements, the one with Brazil now provided for payments in a convertible

currency and contained no import quotas. The agreement with Hungary was likely to be discontinued this year. The current agreement with the USSR, covering the three-year period of 1969-71, contains indicative quotas for the exchange of Icelandic frozen fish, salted herring, woollen goods, canned fish products for Soviet petroleum products, iron and steel, automobiles and lumber. Iceland was unable to find sufficient alternative outlets for the export products mentioned and discontinuation of this arrangement would certainly accentuate her difficulties in present circumstances. Iceland was, therefore, desirous of continuing the present bilateral trading arrangement with the Soviet Union.

20. In amplification and clarification of the information given in the basic document, the representative of Iceland stated that, following the indication given by his delegation at the last consultation, the Government had abolished the State monopolies on perfumes and essences in 1969. The monopoly on matches had not been changed as had been intimated, the authorities having found it impractical to discontinue it at this juncture. As regards the other monopoly arrangements, fertilizers, wine, alcoholic beverages and tobacco were subject to State trading for fiscal, health and other legitimate reasons; in the view of the Icelandic authorities, these State-trading arrangements were in full conformity with the rules and criteria of GATT.

Conclusions

21. The Committee commended the Government of Iceland for the policies it had pursued and the steady progress made in coping with the balance-of-payments difficulties without recourse to additional import restrictions. The Committee expressed the hope that continued improvements in the balance of payments would enable Iceland to undertake further liberalization measures in the near future.

22. The representative of Iceland stated he had taken note of all the views and comments put forward at this consultation, which he would convey to his authorities for attention.

ANNEX

Opening Statement by the Representative of Iceland

In our last discussion with this Committee a year ago we had an occasion to discuss quite extensively the reversal of economic trends which took place in Iceland after 1966. As background, the main facts may be recalled very briefly. The years 1962-1966 had witnessed a sustained boom generated by record herring catches and favourable export prices. In 1967 and 1968, however, the herring fisheries failed almost completely, in itself a serious setback but which was aggravated by a decline in fish prices generally on world markets. Between 1966 and 1968 commodity exports fell by 45 per cent and the per capita national income by about 17 per cent. The correction measures to this near calamity entailed a devaluation of the currency of about 25 per cent in November 1967 and a further devaluation of about 35 per cent in 1968. I hope I am correct in interpreting the sense of our discussion last year in saying, that from a GATT point of view, there was general satisfaction from the fact that Iceland as an alternative did not take recourse in restrictions but emerged with an extensive trade liberalization intact.

Our cautious forecast for a slight overall improvement in 1969 turned out to be correct. The gross national product is estimated to have increased by 2 per cent last year. The average terms of trade improved somewhat, so the rise in real gross national income was about 3 per cent. This, of course, is rather disappointing compared with many other countries, but represents nevertheless a turning point from the previous two years' contraction of activity. The main factor contributing to the improvement was a better white fish catch for which export prices also improved. The herring catch, however, failed again, amounting to a mere 54,000 tons as compared with nearly 800,000 tons at the peak in 1965. On the whole the volume of fisheries production increased by about 20 per cent in 1969. Because of exceptionally bad weather conditions agricultural production decreased by some 6 per cent. Manufacturing industry, other than fish processing, on the other hand experienced a revival in 1969, after stagnation in 1968. The volume of industrial production is expected to have increased by some 8 per cent in 1969, not including the new export industries, aluminium and diatomite, which started production in 1969.

In 1967 and 1968 Iceland's balance-of-payments deficits on current account amounted to approximately \$50 million each year. The devaluations of 1967 and 1968 and related measures resulted in the elimination of this deficit. In 1969 there was a surplus on current account of about \$4 million. The foreign exchange position improved by some \$19 million in 1969, a drastic reversal from the two preceding years of depletion.

By the nature of things the forecasting of economic developments in Iceland is subject to a wide margin of errors. Several factors seem, however, to point to continued growth of fishery production, which, together with the recovery of export

prices, could lead to an increase in export value of fishery products by as much as 10 per cent in 1970. The industrial diversification, the incentive effects of the two devaluations, and perhaps to a limited extent the accession to EFTA, are beginning to pay off in a brisk increase in the export of manufactures. Fixed investment is expected to increase by at least 3-4 per cent and the gross national product may rise by some 4 per cent in real terms in 1970.

One of the main objectives of economic policy in Iceland in the past decade has been the removal of quantitative restrictions which prevailed extensively as late as the end of the 1950's. The institutional framework for the carrying out of a more vigorous fiscal and monetary policy has been strengthened. This policy has been successful in providing a basis for the expansion of exports, economic growth and trade liberalization. On the other hand success has so far not been obtained in the field of price stability and in the current year a major policy consideration will be to promote in so far as possible non-inflationary wage settlements due to be made in May.

Those Government measures taken since our last balance-of-payments consultation which are of greatest interest to contracting parties relate to Iceland's accession to EFTA. As members of the Committee will know Iceland's membership in EFTA will be the subject of a study by a special GATT Working Party established by the Council which is convened for a meeting in May. The full details of the EFTA accession agreement need perhaps not concern us here but it should nevertheless be pointed out that as a result of Iceland's EFTA membership important benefits in the trade field will accrue to GATT Members.

Firstly, the remaining quantitative restrictions on industrial imports except petroleum will have been removed globally by the end of 1974. Annex III to our basic document contains an important addition to the free list effective as of 1 March and in Annex II are shown the enlarged global quotas for 1970. As has been explained earlier in this Committee quantitative restrictions on petroleum and petroleum products are essential to maintain Iceland's bilateral trade with Eastern Europe, particularly the Soviet Union.

Secondly, Iceland has in addition to reductions of protective import duties vis-à-vis EFTA countries carried out extensive unilateral most-favoured-nation duty reductions on industrial imports. Protective import duties were reduced by 30 per cent. Duties on imports of raw materials for industry were generally reduced by 50 per cent and those on machinery from 25-30 per cent to 7 per cent. In addition duties on some other commodities were also reduced. According to 1969 imports the total reduction of import duties would amount to IKr 495 million or 17 per cent of the total duties and 7 per cent of total budgetary revenue in 1969.

Iceland's central objective in joining EFTA is to create conditions favourable to a diversification in production and exports. The risk inherent in the present economic structure has never been more obvious than after the collapse of the herring fisheries in 1967-1969 and the poor outlook in general for fish catches in the North Atlantic. It is felt that the accession agreement is favourable to such a development which should put Iceland on a sounder and stronger basis as a member of the international trading community.