

GENERAL AGREEMENT ON TARIFFS AND TRADE

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

I S R A E L

1. In accordance with its terms of reference, the Committee conducted the consultation with Israel. The Committee had before it (a) a basic document (BOP/29); (b) International Monetary Fund background material dated 11 June 1963 and (c) an International Monetary Fund Executive Board decision (see Annex).
2. In conducting the consultation, the Committee followed the Plan of Discussion for Consultations recommended by the CONTRACTING PARTIES. The consultation was completed on 2 December 1963. This report summarizes the main points discussed.

Consultation with the International Monetary Fund

3. Pursuant to the provisions of Article XV of the General Agreement, the CONTRACTING PARTIES had invited the International Monetary Fund to consult with them in connexion with this consultation with Israel. In accordance with 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 International Monetary Fund has transmitted to the CONTRACTING PARTIES the Executive Board decision relating to the last consultation with Israel under Article XIV of the Fund Agreement and the background material prepared in connexion with that consultation.

"With respect to Part I of the Plan for Consultations, relating to balance-of-payments position and prospects, and with respect to Part III, relating to system and methods of the restrictions, the Fund calls the attention of the CONTRACTING PARTIES to the Executive Board decision of July 17, 1963, taken at the conclusion of its recent consultation with Israel, and particularly to paragraph 5 which reads as follows:

'Israel has relaxed restrictions on imports and on invisible transactions. Discrimination on imports and bilateralism have again been reduced. The Fund welcomes these steps, but, in view of the strong reserve position, urges Israel to take further measures to reduce reliance on restriction and bilateralism'

"With respect to Part II of the Plan for Consultations, relating to alternative measures to restore equilibrium, the Fund draws attention to the decision taken at the conclusion of its last Article XIV consultation with Israel. The Fund has no additional alternative measures to suggest at this time."

Balance-of-payments position and prospects

4. The Committee discussed with the representative of Israel the basic trade trends underlying Israel's balance of payments, the composition of Israel's foreign exchange reserves and their adequacy in relation to imports and foreign debt. The information noted in the following paragraphs was supplied in response to the questions and comments by various members of the Committee.

5. The representative of Israel informed the Committee that it was expected that in 1963 Israel's imports of goods would be \$630 m and services \$370 m, giving a total of \$1,000 million and that exports would amount to \$320 m. Exports had risen in the first half of 1963 and were, in this period, 33 per cent higher than those in the same period of 1962. However, the improvement in exports during the first six months of 1963 was largely fortuitous. Israel for example had had a particularly good citrus crop at a time when other major exporters had suffered setbacks for climatic reasons. Developments in the diamond trade had had their impact on the exports of Israel. At present diamonds were the most important individual item in Israel's exports, but the net value added in diamond cutting was around 15 per cent of the total value, as raw diamonds were imported. Israel's exports of diamonds would increase by between \$20 to \$30 million in the next two to three years and then would level off. On the future prospects for exports, the Export Institute had made a number of recommendations as to ways and means of increasing export earnings. These measures pertained to export credit insurance, transport fees, the linking of wages to productivity, fiscal charges, etc. The Israeli Government was currently studying the proposals of the Institute.

6. Members of the Committee noted that at the end of April 1963 reserves of the Bank of Israel, standing at that time at \$546 million, represented nearly one year's imports of goods by Israel. The representative of Israel pointed out that this was a gross reserve figure and that, in his view, imports of services as well as commodities should be taken into account when judging the adequacy of Israel's reserves. In 1962 Israel's commodity imports amounted to \$598 million and payments for services totalled \$314 million. It was this combined total of \$912 million which ought to be measured against reserves. In his view, it would also be relevant to compare reserves with Israel's annual deficit on goods' and services' account, which, in 1962, amounted to \$416 million. It was estimated that in 1963 Israel's imports of goods and services would exceed those in 1962 by about 12 per cent and gross reserves of all banks at the end of 1963 would exceed those at the end of 1962 by about \$100 million, an increase of about 21 per cent.

7. As regards Israel's gross foreign exchange reserves (gross reserves of all banks), the representative of Israel estimated that these would be about \$600 million at the end of 1963 as compared with \$497 million at the end of 1962 and \$366 million in 1961. These reserves included foreign exchange holdings by Israeli residents known as PAZAK and TAMAM accounts (these two types of accounts are described in detail on pages 62 and 63 of the IMF background material). The representative of Israel explained briefly that PAZAK accounts were held for fixed periods and were generally only convertible into local currency. More freedom of action was permitted to holders of TAMAM accounts. The reserves included capital imports of a temporary nature such as short-term loans and temporary foreign exchange deposits by non-residents in Israeli banks. In the view of the Israeli Government these temporary items ought to be excluded in any assessment of the adequacy of the reserves. Thus, taking reserves at the end of 1962, the Israeli authorities had calculated that the net reserves, after deduction of short-term liabilities, amounted to \$369 million as compared with the gross figure of \$497 million.

8. The representative of Israel informed the Committee that Israel's foreign debt stood, at the end of March, in rounded figures, at \$811 million of which \$675 million was long term, \$76 million medium term and \$59 million short term.

Alternative measures to restore equilibrium

9. In reply to a question, the representative of Israel stated that since the foreign exchange reform in February 1962, Israel had been able to contain price increases fairly satisfactorily. In 1962, prices had increased by between 7 and 8 per cent but, in 1963, the increase was only 1.5 per cent. This latter, fairly modest, price increase could be attributed to the fiscal and monetary policies of the Government and the progressive relaxation of import restrictions. Moreover, the possibility of further relaxation had a psychological effect on the pricing policy of local producers. Members of the Committee suggested that one of the effective ways to stabilize prices was to free imports so as to eliminate any pressures on prices arising from shortages. The Israeli representative said that his Government fully recognized the importance of keeping prices and costs down in order to maintain the competitiveness of Israel's exports.

10. A member of the Committee enquired whether, as a result of the containment of prices, it had been possible to prevent inflationary wage increases. The representative of Israel explained that wage increases in his country could be divided into two elements. The first related to increases attributable to the increase in productivity and the second to other factors. In the case of piece-work, wage increases, in the absence of changes in piece rates, naturally related to higher productivity. In order to facilitate wage negotiations, the Trade Union Federation and Manufacturers' Association had recently agreed to establish a Scientific Research Institute which would determine the rate of change in productivity. As regards wage negotiations, the representative of Israel informed the Committee that these were the subject of discussions between (a) the Manufacturers' Association and the Federation of Trade Unions and (b) the Government and its employees. Wage rates for 1964 were currently being negotiated and it was too early to say what would be the outcome.

11. In response to questions the representative of Israel confirmed that duties had been imposed on certain items at the time of their liberalization. These duties were applied for protective or fiscal reasons and were subject to review at six monthly or yearly intervals. In general, however, Israel had reduced duties following the foreign exchange reform of February 1962. There were now no duties in force on the imports of capital goods or raw materials. The value of imports subject to customs duties in the fiscal year 1 April 1961 to 31 March 1962 amounted to \$238 million but in the following twelve months' period had fallen to \$138 million.

12. Replying to comments on the justification of maintaining licensing requirements on products not subject to effective restriction the Israeli representative explained that the automatic licensing procedure had been maintained mainly in order to protect Israeli industries from any threat of dumping. Israel had no anti-dumping legislation at present. Anti-dumping legislation had been recommended by the Export Institute and the Government was considering the enactment of a new law but this was unlikely to be introduced in the near future. The need to retain the Automatic Approval System would naturally be reviewed as soon as such legislation existed.

System and methods of restrictions

13. In response to questions, the representative of Israel informed the Committee that Israel was continuing to relax its import restrictions. Each month, the Israeli authorities considered between ten and fifteen items for liberalization and past experience had shown that about 60 per cent of these items were either fully liberalized or placed under automatic approval. Between July 1962 and October 1963, liberalization had been introduced in respect of about 200 products. Recently, Israel had liberalized a further thirty to forty items and the list would be forwarded to the secretariat for circulation in the normal manner. It was the intention of the Government of Israel to complete the first cycle of the current process of revision of its import restrictions in 1964. A further study of the remaining restrictions would then be undertaken and it could be expected that substantial liberalization would eventuate.

14. A member of the Committee enquired whether, in view of the fact that 80 per cent of Israel's imports were now either fully liberalized or under automatic approval, it would be possible for the Government of Israel to issue a "negative list" of remaining restrictions. The representative of Israel replied that although 80 per cent of the trade was liberalized, less than half the items and sub-items in the tariff were liberalized so that in his view there would be no clear advantage at present in publishing a negative list. He informed the Committee, however, that the publication of a negative list would be considered at the time of the 1964 review of remaining restrictions.

15. The Committee recalled that the International Monetary Fund Executive Board decision suggested that Israel should take further measures to reduce reliance on bilateralism. The representative of Israel pointed out that by extending liberalization the Government of Israel had, ipso facto, reduced the scope for discrimination. In reply to questions, the representative of Israel indicated that imports under the "agricultural surplus disposal" scheme had amounted, in the years 1962 and 1963, to \$27 million. In 1962, imports from "earmarked sources" had totalled between \$25 and \$30 million. He pointed out, however, that the Israeli Government had increasingly taken prices into consideration in making imports of items covered by the agricultural surplus and "earmarked sources" arrangements. As a result, countries supplying on purely commercial terms could, if their prices were very competitive, export to Israel at the expense of imports from bilateral sources. Israel had, on occasion, decided not to utilize tied loan resources because goods were not available from the lending country at competitive prices.

16. As regards the scope of trade covered by bilateral agreements, the representative of Israel explained that these covered about 5 per cent of Israel's total foreign trade. A number of the bilateral agreements were with State-trading countries but Israel also had such agreements with other countries including Brazil, Portugal, Greece and Turkey. The agreement with Brazil covered only \$260,000 worth of trade; and that with Portugal was conducted largely under convertible currency terms. The agreements with Greece and Turkey were important to Israel as a means of facilitating the disposal of industrial products. Israel found it difficult to consider the termination of these agreements at present when it was faced with growing difficulties, as a result of regional integration, in its western European markets. Price considerations, however, play their part in the administration of bilateral agreements and in some cases recently Israel had refused to take imports from bilateral trading partners because of unsatisfactory prices.

17. A member of the Committee noted that, during the last consultation, the representative of Israel had expressed the intention of his Government to move away from bilateralism and commented that this did not appear to have occurred. Another member of the Committee noted that, although imports under bilateral agreements appeared to be steady, Israel's exports under such agreements had grown from \$24 million in 1961 to \$30 million in 1962. The representative of Israel pointed out that the fact that imports under the bilateral agreements had not kept pace with exports under these agreements was indicative of the extent to which Israel sought to bring its bilateral suppliers into competition with international sources of supply.

Effects of the restrictions

18. A member of the Committee enquired as to whether the remaining restrictions maintained by Israel would principally be applied to agricultural items. The representative of Israel replied that Israel in many cases had not found it necessary to restrict imports of agricultural products since Israel did not produce them; in other cases, Israel was competitive and had no need to resort to restrictions. Another member of the Committee referred to restrictions applied to certain industrial products coming into production in Israel, notably ethylene, carbon black, detergent alkalate, acrylic fibres, synthetic rubber as well as prefabricated houses. These were capital-intensive industries, the viability of which was dependent on the acquisition of the necessary technical know-how and availability of skilled personnel. By their very nature these industries should not need protection through either import restrictions or temporary duties as appears to be the case in Israel in respect of other similar secondary manufacturing industries. The representative of Israel pointed out that production of these items had either only just begun or had not yet commenced, and that the industries involved had to be regarded as "infant industries". Nevertheless, it was notable that the manufacturing concerns involved were prepared to see the liberalization of these items subject to reasonable customs protection and with the safeguard of the automatic approval procedure to prevent dumping in a field where it was prevalent. He agreed that it was desirable that the new industries should be subject to competition from imports to assure competitiveness.

General

19. A member of the Committee asked whether the consultations with Israel should be regarded as being conducted under the provisions of Article XII or Article XVIII. The Committee agreed that the question of under what Article any contracting party was maintaining its balance-of-payments restrictions was a matter which fell within the competence of the CONTRACTING PARTIES.

20. The Committee thanked the representative of Israel for the frank and detailed manner in which he had answered the many questions posed. In their view, the consultation had been most useful in revealing a number of facts concerning import control policy and systems in force in Israel. They congratulated the representative of Israel on his country's success in increasing its exports and foreign exchange reserves following the reforms of February 1962. They welcomed the steps taken by Israel to increase the liberalization of imports and to limit the area of discrimination. They indicated their expectation that Israel, taking account of the favourable development of its reserves, would find it possible to extend liberalization and further reduce discrimination.

21. The representative of Israel thanked the members of the Committee for their understanding and co-operation in the course of the consultation and undertook to bring to the attention of his Government the views they had expressed.

ANNEX

International Monetary Fund Executive Board Decision
Taken at the Conclusion of the Fund's Consultation
with Israel on 17 July 1963

1. The Government of Israel has consulted the Fund under Article XIV, Section 4, of the Fund Agreement concerning the further retention of its transitional arrangements.
2. In 1962 gross national product continued to rise substantially, enabling the economy to absorb a considerable increase in immigration while maintaining full employment. There was some pressure on resources and shortage of skilled labor, and wages increased. After the immediate effect of the devaluation had been absorbed, price increases tended to level off. Since November 1962, the cost of living index has remained stable. Money supply increased sharply in 1962, partly in response to the devaluation, but also as a result of a sizeable increase in foreign exchange reserves and some expansion of bank credit. The government budget yielded a substantial surplus, which was used to reduce government debt to the central bank.
3. Earnings from exports of goods and services rose appreciably. Nevertheless, the balance of payments on goods and services account deteriorated slightly owing mainly to increased defense outlays. The inflow of capital rose further and there was again a substantial increase in foreign exchange reserves, which, at the end of April 1963, stood at \$546 million, representing nearly one year's imports.
4. Although substantial progress has been made toward achieving the aims of the New Economic Policy instituted at the time of the exchange reform of February 9, 1962, the situation calls for caution. The recently established price stability faces the threat of continuing pressures. Despite an important agreement that there should be no increase in basic wage rates in 1963, there are indications that wage increases will exceed the increment in productivity, and that personal incomes will be augmented by substantial transfers from abroad contributing to pressure on available resources. The Fund believes that the continued success of the New Economic Policy depends on the strengthening of internal stability. It notes that the monetary authorities have further tightened restrictions on credit, but it believes that there is still considerable scope in the fiscal sphere for action to ease the pressure on resources. It urges Israel to take all appropriate measures to this end.
5. Israel has relaxed restrictions on imports and on invisible transactions. Discrimination on imports and bilateralism have again been reduced. The Fund welcomes these steps, but, in view of the strong reserve position, urges Israel to take further measures to reduce reliance on restriction and bilateralism.
6. In concluding the 1962 consultations, the Fund has no other comments to make on the transitional arrangements maintained by Israel.