

GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

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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/40; (b) International Monetary Fund documentation dated 9 October 1964; (c) the International Monetary Fund Executive Board Decision dated 30 October 1964, and (d) a list containing import items that are free of restrictions and a list of items under automatic licensing indicating specially those liberalized recently.
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 11 November 1964. 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 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 made was as follows:

"The International Monetary Fund has transmitted to the CONTRACTING PARTIES the Executive Board decision and background material from the last consultation with Israel under Article XIV of the Fund Agreement.

"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 invites the attention of the CONTRACTING PARTIES to the Executive Board decision of October 30, 1964 taken at the conclusion of its recent consultation with Israel, and particularly to paragraph 5 which reads as follows:

'Israel has further relaxed restrictions on imports. The Fund welcomes the intention to complete the process of formal liberalization of imports by the end of 1965 and urges Israel to reduce reliance on bilateral payments arrangements.'

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

Balance-of-payments position and prospects

4. In the opening explanatory statement, the full text of which is annexed to this report, the representative of Israel outlined the progress made in the liberalization of imports since 1963, the foreign exchange position of Israel, and the basic trend underlying Israel's foreign trade and their future policy.
5. The representative of Israel stated that during 1964, the policy of removing quantitative restrictions and administrative controls on imports had continued steadily, and Israel was in the process of reviewing all products at present under quantitative restrictions; this review was to be completed by October 1965. At present according to the import statistics, 80 per cent of imports were free from restrictions, or came under automatic licensing, and only 20 per cent remained subject to individual licensing. This 20 per cent amounted to \$140 million in 1963, and out of this amount, only \$48 million were in fact competitive with Israeli products.
6. During the first nine months of 1964 Israel experienced a serious increase in her trade deficit. Imports increased substantially during this period, and are expected to reach \$810 million for the whole of 1964, reflecting an increase of 21 per cent over 1963. It is estimated that exports for the whole of 1964 would reach \$360 million as against \$351 million in 1963. The relatively static position of exports for the year was only partly explained by the fact that in 1964 there had been a \$22 million drop in income from citrus exports, as compared with 1963. The representative of Israel said that to a certain extent tariff measures adopted by Western European countries in their integration would also have a limiting effect on the export possibility. Thus on total, taking goods and services together, the deficit in the balance of trade for 1964 would be approximately \$600 million, as compared with \$407 million for 1963, and \$455 million for 1962.
7. The foreign exchange reserves of Israel amounted to \$600 million in December 1963, and increased by \$34 million up to September 1964. It was estimated that the foreign exchange reserves would amount to \$650 million in December 1964. Thus the amount of foreign exchange reserves after an increase of \$50 million as compared with the reserves in December 1963, represented only 50 per cent of annual import of goods and services or six months' supply in comparison with the foreign exchange reserves in December 1963, which represented 60 per cent of the

imports of goods and services for that year, or seven months' supply. In considering these figures it is essential to remember that Israel is highly dependent on imports for both basic foods and essential raw material for industry, in addition to capital equipment for development. Furthermore, Israel's special trading position and security position necessitated maintenance of essential stocks of food and raw materials.

8. Israel's foreign debt increased more than the slight increase in the foreign exchange reserves in 1964 compared with 1963, and in September 1964 foreign debt amounted to one billion dollars. Israel's balance of payments in the past had been assisted by unilateral transfer payments of various kinds, including personal restitution and reparations from Germany and the proceeds of the sale of Israel Independence and Development Bonds. It was expected that both of these sources would decrease and no comparable increase was expected from other sources. The net income from restitution and reparations payments was \$169 million in 1963, while the estimated income for 1964/65 is \$135 million, and for 1965/66, \$115 million. Since 1963, repayments of Israel bonds have commenced, and it is expected that the net annual income from this source would drop by \$20 million.

9. On the export side, Government assistance was given for market research, design of new products, rationalization of industry and manufacture and supply of those products in which Israel might have a competitive advantage. In addition, the Government aimed to supply port services and export insurance at terms similar to those applicable abroad. It was the earnest hope of the Israeli exporters that the first cut in a general 50 per cent reduction of tariffs on industrial products, and on some agricultural products, would be taken at an early date.

10. The rapid rise in imports was attributed to the high level of economic activity, arising out of development. With the rise in incomes and prices, development activity in industry, agriculture and housing, had reduced reserves of manpower, almost to zero and had created a rising demand for both investment and consumer goods. The Government of Israel, recognizing the inflationary situation, was taking measures to limit the demand and divert resources into essential investment and development. However, there was no intention to limit imports by quantitative restrictions or to abandon the policy of liberalization undertaken in 1962, as it was the Government's firm belief that this policy was essential to make Israel's production efficient by competition with foreign manufacturers and in this way to reduce prices in the home market and increase the export potential.

11. Members of the Committee thanked the representative of Israel for his clear and comprehensive statement. The Committee welcomed the liberalization measures taken by the Government of Israel but felt that in view of the steady inflow of capital and the increasing level of foreign exchange reserves further liberalization

was called for. In making clear the decision of Israel, the representative of Israel said that the Government was following a policy of liberalization which it had adopted in 1962 in expectation of better trade returns. In spite of an actual worsening of the overall balance-of-payments position in 1964, it was the intention of the Israeli Government to continue the liberalization programme. By October 1965 all restrictions would have been reviewed, and by then he foresaw only a small number of products still remaining under licensing as a protection to infant industry. The members of the Committee hoped, and urged, that the remaining items would be very few and would be truly of a hard-core nature. They expressed the hope that as restrictions were removed they would not be replaced by other kinds of protection.

12. The representative of Israel stated that it was not his Government's intention to increase protection and that in fact a decision had been taken to reduce present tariff levels. He stated that there had been considerable internal discussion on the timing of such reductions. He indicated that any tariff reduction would be applicable to all contracting parties to the GATT. Although it was planned to commence in October 1965 a review of tariffs with a view to their reduction, the rate at which tariffs were to be reduced was to be decided at a later stage, and in this the general progress achieved in the Kennedy Round would have some relevance.

13. In reply to a question, the representative of Israel indicated that the earlier estimate of a decrease in the goods and services deficit was based on preliminary estimates of exports and imports. Exports had barely reached their target, but imports had increased by more than had been estimated which reflects the continuing liberalization policy followed by Israel.

Alternative measures to restore equilibrium

14. The representative of Israel stated that the Government of Israel was aware of the rise in incomes and of the consequent pressure on available resources. Israel was taking measures to check demand inflation by limiting Government expenditure and by limiting private expenditure by savings schemes and other measures designed to restrain personal incomes. According to the recent budget announcement no new Government building projects are to be undertaken, and Government departmental expenditure is to be severely limited. With regard to restraining personal income, the Government of Israel had adopted a method of improved efficiency in tax collection in preference to increasing direct taxation. The Government was not in a position to increase sales tax because in Israel the wage system was linked to the cost-of-living index, so that imposition or increase of sales tax would create a wage price spiral effect. All these measures were undertaken in the spirit of making a start towards curbing the inflationary movement. It was also hoped that liberalization of imports would help in this direction.

15. A member of the Committee, referring to the recommendations of the Export Institute enquired whether the Government of Israel found it possible to follow the policy of linking wages to productivity. The representative of Israel stated that Israel had set up a joint body of the manufacturers association, trade unions and the Government to determine the increase in production as a guide to wage negotiations. In 1964, however, wages had increased more than productivity but it was hoped that the new body would have a restraining effect.

System and method of restrictions

16. The Committee recalled that the International Monetary Fund Executive Board decision urged that Israel reduce reliance on bilateral payments arrangements. A member of the Committee asked whether the future liberalization of imports would have an effect on Israel's volume of trade conducted under the bilateral arrangements. The representative of Israel indicated that total imports under bilateral arrangements amounted to 4 per cent in 1963, and he expected the same figure for 1964. He stated that bilateral arrangements offered a framework and a guide-line for trading only, as goods could not be imported into Israel at prices above prevailing international prices. Israel would be happy to reduce the number of bilateral arrangements if her exports could have easier access to other markets. He stated that there are two kinds of exports: (a) exports of manufactured goods, and (b) exports of development products. With respect to exports of development products they had found markets in Eastern Europe and Africa. There were bilateral agreements with Eastern European countries, but it was not the Israeli Government which determined their trading arrangements; it was the partner countries who decided the methods of trade. He said that he was not sure what would be the effects of the new interest of Eastern European countries in importing fertilizer from Israel.

17. A member of the Committee, pointing to the granting of individual licences as mentioned in the basic document, noted that the authorities granting these licences are said to take into account the necessity to protect infant industries. Article XII and Article XVIII:(B) do not authorize quantitative restrictions to ensure economic protection, but to help overcome a difficult financial situation of the country. Therefore he was happy to note that Israel was abandoning this policy, was liberalizing imports, and would not be open to criticism in this sense.

18. Referring to the recent increase in the tariffs on motor vehicles, a member of the Committee enquired whether the Israeli authorities foresaw any substantial increases in tariffs of this nature in connexion with the liberalization of quantitative restrictions. The representative of Israel replied that

the recent increase in the tariff rate on motor vehicles was an exceptional measure which was called for by a large increase in the number of imported cars, from 7,000 in 1961 to 13,000 in 1964, and confirmed that it was not the intention of his Government to increase tariff rates in this way. Furthermore, an increased internal tax had been imposed which broadly avoided any increased protection to domestic assembly of automobiles.

19. The representative of Israel informed the Committee that the publication of a negative list at present would have little meaning since the review of restrictions was to be completed by October 1965. Although 80 per cent of the trade was liberalized, a large number of tariff items, and particularly sub-items, would at present have to appear in a negative list. It was his hope that after the review was completed the negative list would be published and its extent would be minimal.

General

20. The members of the Committee thanked the representative of Israel for the very frank and detailed manner in which he had answered the many questions put to him, and they felt the consultation had thrown much light on import control policy and systems in force in Israel. They welcomed the efforts Israel had made in liberalizing imports and expressed the hope that following the review of 1965, there would be very few quantitative restrictions left and that the Government of Israel would avoid use of other measures to restrict normal trade, and the Committee urged that Israel would reduce use of bilateral arrangements.

21. The Committee welcomed the recent fiscal measures taken by Israel and hoped that further liberalization of imports would also help in reducing the pressure on domestic resources.

22. The representative of Israel thanked members of the Committee for their understanding and co-operation in the course of consultation. He stated that in spite of the difficult period which Israel faced, Israel would make every effort to reduce restrictions and liberalize trade.

ANNEX IOPENING STATEMENT BY THE REPRESENTATIVE OF ISRAEL1. Progress in liberalization since 1963

During 1964, the policy of removing quantitative restrictions and administrative controls on imports has continued steadily; and, as planned, the review of all products at present under quantitative restrictions will be completed by October 1965.

A full list of products transferred to the automatic licence list since mid-1962 (when the policy of removing administrative control began to be enforced) is distributed. Specially marked on it are those items freed since the last consultation in October 1963.

Attention has also been paid to products of other less-developed countries, and these are also specially marked on the list. The products under automatic licence are in addition to those on the free list, which has also been distributed.

1963 imports statistics show that 80 per cent of imports are free or come in under automatic licensing, and only 20 per cent are still subject to individual licensing. For 1963 this 20 per cent amounted to \$140,000,000. However, an analysis of this figure shows that it includes \$44,000,000 fuel and fuel products, and a further \$50,000,000 of essential food imports. Therefore there remains only some \$48,000,000 of imports under licence. This figure compares with a total import in 1963 of \$671,000,000. As stated all of these products will be reviewed by October 1965.

2. Foreign exchange position

There has been a serious increase in the deficit in the balance of trade during the first nine months of 1964. Imports, which for the whole of 1963 were \$671,000,000 reached \$618,000,000 in the first nine months of 1964; and are expected to reach \$810,000,000 for the whole of 1964, an increase of \$140,000,000 or 21 per cent.

Exports, however, in the first nine months of 1964 reached only \$274,000,000 as against \$267,000,000 in the first nine months of 1963, an increase of only 2.5 per cent. It is estimated that exports for the whole of 1964 will reach \$360,000,000 as against \$351,000,000 in 1963. Exports therefore, which had increased by 24 per cent in 1963 as compared with 1962 remained almost static in 1964 as against 1963. This is partly explained by a drop in income from citrus exports of \$22,000,000 in 1964 as against 1963, but even taking this into account, the rate of increase of exports has fallen well below the 20 per cent expected to improve the balance-of-payments position on the export side.

As far as goods are concerned therefore, it appears that there will be a worsening of nearly \$200,000,000 in 1964 as against 1953. Taking goods and services together, the deficit in the balance of trade for 1964 will approximate to \$600,000,000 as compared with \$407,000,000 for 1963 and \$455,000,000 for 1962.

Reserves of foreign currency in December 1963 were \$600,000,000, and at September 1964 stood at \$634,000,000. The estimated reserves for December 1964 are \$650,000,000. While this represents an increase of \$50,000,000 over the reserves in December 1963 it has to be compared with import purchases of \$810,000,000 for goods or an estimated \$1,220,000,000 for goods and services for the whole of 1964. Whereas therefore the reserves in December 1963 represented 60 per cent of the imports of goods and services for that year - or seven months supply, the reserves at the end of 1964 were only 50 per cent of annual import needs or six months supply. When considering these figures of reserves it is essential to remember that Israel is highly dependent on imports both of basic foods and of essential raw materials for industry, in addition to capital equipment for development. Furthermore, Israel's special trading position and security position necessitate maintenance of essential stocks of food and raw materials.

If the reserves at December 1964 have increased by \$50,000,000 as compared with December 1963, Israel's foreign debt at March 1964 was \$919,000,000 as compared with \$811,000,000 at March 1963, an increase of over \$100,000,000. The foreign debt at September 1964 exceeded \$1,000,000,000. The figure of \$919,000,000 at March 1964 consisted of \$789,000,000 long term debt, \$67,000,000 medium term, and \$63,000,000 short term.

Israel's balance of payments in the past has been assisted by unilateral transfer payments of various kinds including personal restitution from Germany and the Israel independence and development bonds. It is expected that both of these sources will decrease while no comparable increase is expected in other sources. The net income from restitution and reparations payments was \$169,000,000 in 1963, while the estimated income for 1964/1965 is \$135,000,000 and for 1965/1966 \$115,000,000. Since 1963 repayments of Israel bonds have been commenced, and it is expected therefore that the net annual income from this source will drop by some \$20,000,000.

3. Analysis of foreign trade statistics and outline of future policy

The rapid rise in imports is due mainly to the high level of economic activity, arising out of development. To combat inflation the Government has, in co-operation with the manufacturers, worked to carry out a policy of price stabilization and has succeeded in restraining price increase. However, development activity in industry, agriculture and housing has reduced almost to zero, reserves of manpower, and has created a rising demand for both investment and consumer goods.

The measures now being undertaken by the Government are intended to limit this demand and divert resources into essential investments and development. They include a severe limitation of public building other than new immigrant housing in development areas; a selective investment policy based on the establishment or expansion of industry working for the export market; and a cessation of borrowing from abroad for other purposes. In addition Government departmental budgets will be frozen, and the Government will work for a budget surplus both by increasing the efficiency of the revenue departments and by a vigorous savings campaign.

There is however, no intention to limit imports by quantitative restrictions, or to abandon the policy of liberalization undertaken in 1962. It is the Government's firm belief that this policy is essential to make Israel production efficient by competition with foreign manufacturers, and in this way to reduce prices in the home market and increase the export potential.

On the export side, local demand has to some extent caused a diversion of goods from exports to the local market. But in addition to this the competitive position of Israel's exports to its main markets in Western Europe (which account for more than 60 per cent of Israel's foreign trade) has been worsened as a result of the tariff and other policies adopted by Western European countries in furtherance of their economic integration.

Since land and water in Israel are limited, the main outlet for development is industry. In view of the small local market Israel is unable to compete in mass produced goods. The comparative advantage for Israeli industry can only be in the manufacture of more advanced industrial goods, the markets for which are the developed countries; and these products have to meet the competition of manufacturers in those countries. The worsening relative position of Israel and other countries as regards conditions of entry of goods into the countries of Western Europe create doubts in the minds of industrialists and investors, both at home and from abroad, as to the economic feasibility of increased investment because of uncertainty of entry into the traditional and natural markets. This uncertainty may lead capital away from essential investment into real estate or durable consumer goods.

The agreement signed in June 1964 between the European Economic Community and Israel represents a small ray of light - limited tariff concessions were given on a number of industrial goods of importance to Israel. It is too early to estimate the results of this agreement but it is a tentative first step in the direction we desire - that is a gradual removal of all barriers to trade between Israel and her trading partners bearing in mind the relative stages of development. Unfortunately the agreement contains no solution to agricultural problems and thus leaves the continued export of citrus fruit and by products, which are by far the main exports from Israel to the countries of the Community, in danger.

On the export side, Government assistance is given for market research, design of new products and rationalization of industry to manufacture and supply those products in which Israel can have a comparative advantage. In addition, the Government aims to supply port services and export insurance at terms similar to those applicable abroad.

Israel exporters have been looking forward eagerly to the practical commencement of the Kennedy Round - it has been their earnest hope that January 1965 would see the first cut in a general 50 per cent reduction on industrial products and some agricultural products. But it is clear that these hopes at any rate for that date are disappointed. The developed countries of Western Europe have advanced the dates of their own internal integration of customs duties, but have not proceeded with the same rapidity to the promised reductions of their tariffs as applicable to third countries.

GATT insists on the removal of quantitative restrictions on imports except where essential temporarily for balance-of-payments purposes, or for protection of infant industry in the early stages of development. It aims also at the reduction of tariff walls. This policy is one which the Israeli Government has adopted in so far as its development needs permit - and it is the conviction of the Israeli Government and their hope that all GATT members will proceed vigorously to the removal of barriers to trade because the success of the efforts of the small countries, newly industrializing depends in large measure on the policies of the major trading powers of the world, who too are signatories to the GATT agreement.

ANNEX II

International Monetary Fund Executive Board Decision
taken at the Conclusion of the Fund's Consultation
with Israel on 30 October 1964

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.

In 1963 the real gross national product rose substantially. Continued large inflow and conversion of foreign exchange receipts and, to a lesser extent, a further expansion of bank credit, caused a sharp increase in the money supply. In the fiscal year 1963-64 the ordinary budget showed a substantial surplus; revenue was higher, reflecting increased economic activity, improved tax collection methods, and the introduction of new and upward revision of existing taxes. However, capital expenditures were also higher and the Government's net borrowing increased. Despite continuing immigration, full employment prevailed and shortages of certain skilled labor persisted. Wages rose considerably more than productivity. Prices remained relatively stable but mainly owing to administrative action. The increase in incomes and in consumption expenditures, both private and public, led to continuing pressure on resources.

The balance of payments deficit on goods and services account amounted to \$404 million in 1963 against \$456 million in 1962. The improvement was mainly attributable to increased earnings from exports of goods and services which rose sharply until mid-1963; subsequently the increase in commodity exports slowed down. Net receipts on capital account, including transfer payments, were slightly smaller than in 1962. The gold and net foreign exchange reserves of the Bank of Israel rose by \$95 million to \$515 million at the end of 1963. The rising trend in imports, evident in the second half of 1963, was accentuated in the first half of 1964, while exports declined slightly. However, as a result of continued capital inflow, the gold and foreign exchange reserves of the Bank of Israel continued to rise between January and May 1964, but by less than in the corresponding period of 1963; thereafter, they declined, partly reflecting seasonal factors.

In 1964 a substantial further rise in incomes, combined with capital inflow from abroad, has increased the pressure on available resources. The Fund believes that additional fiscal and monetary measures, together with a more effective incomes policy, are required to reduce demand and cost pressures and to prevent a continuing increase in the trade deficit.

Israel has further relaxed restrictions on imports. The Fund welcomes the intention to complete the process of formal liberalization of imports by the end of 1965 and urges Israel to reduce reliance on bilateral payments arrangements.

In concluding the 1964 consultations, the Fund has no other comments to make on the transitional arrangements maintained by Israel.