

GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

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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 a basic document supplied by the Government of Israel (BOP/54) and a report on economic developments and changes in the restrictive system, dated 20 October 1965, 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 25-26 October 1965.

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 a background paper on Israel dated October 20, 1965. The Fund expects to conduct a consultation with Israel under Article XIV of the Fund Agreement in 1966 and to transmit to the CONTRACTING PARTIES the Executive Board decision relating to that consultation when it becomes available."

Opening statement by the representative of Israel

4. The opening statement of the representative of Israel was as follows:

Nineteen hundred and sixty-four was a worrying year for Israel's foreign trade. Imports of goods increased sharply by \$150 million from \$646 million in 1963 to \$790 million in 1964. On the other hand exports of goods rose by only \$15 million in 1964, from \$537 million in 1963 to \$550 million in 1964. The deficit on goods account, which had narrowed from \$405 million in 1962 to \$312 million in 1963, jumped up to \$440 million, and this out of a total import of \$790 million. Taking goods and services together, the deficit rose from \$404 million to \$528 million.

Reserves of foreign currency at December 1964 were \$646 million as compared with \$615 million at December 1963. This has to be compared with total imports of goods and services of \$1,177 million, or approximately six months supply. In view of the high level of Israel's dependence on imports, and her special security position, these reserves are a bare minimum.

As against the increase in reserves of \$30 million there was an increase in foreign debt of \$132 million, and this in spite of refunds on account of maturing loans. Total foreign debt on 31 March 1965 stood at \$1,100 million.

In the first eight months of 1965 exports of goods reached \$300 million as compared with \$255 million in the same period of 1964. Imports were \$560 million as against \$570 million in January/August 1964.

The fall in imports in 1965 is explained by a fall in import of ships. Imports other than ships rose by \$4 million in the period January/August 1965 as compared with January/August 1964. The increase in exports is explained by an increase in citrus, diamonds, fertilizers and potash.

The growth potential of all of these products is limited.

Lack of water, and uncertainty of outlets, restrain citrus expansion. The market in diamonds, of the specification Israel exports, has almost reached saturation. The increase in exports of fertilizers and potash is due to production from extensions of plant during the past few years. Further extensions have been planned, but the total contribution from this source by 1970 can only be of the order of \$60 million. Special attention is being given to the quickest possible expansion of fertilizer and potash production, but this must supplement, not replace, other industrial development.

Exports of manufactured industrial goods, which must make the main contribution to closing the trade gap, rose only very slightly.

Economic activity continued at a high level, causing on the one hand a continued high level of imports, and on the other pressure by the Israel market to consume manufactures which might otherwise have been exported. The continued worsening of Israel's competitive position in her main markets, because of the progress towards removal of tariffs among the member States of the European Economic Community, and of the European Free Trade Association, strengthened this tendency.

The commercial agreement between the EEC and Israel provided certain concessions which have to some extent eased the tariff changes introduced by the Community. However the agreement leaves citrus, Israel's largest single export: in great uncertainty and in danger of having to face new levies whose effect could well be a serious dislocation of the market.

The concessions granted, mainly in the industrial sector, have inevitably been limited because of the obligation to multilateralize under the most-favoured-nation clause: they still leave Israel's manufactured products in a difficult competitive position as compared with those of member or associate States of the Community.

No special agreement exists between Israel and EFTA, and here too, exports of such products as made-up textiles and knitted goods, metal products, tyres and plywood are having to face increasing competition.

There have been as yet no practical results from the Kennedy Round, which would to some extent have offset the worsening of competitive position in these areas.

There is, therefore, reluctance among investors and manufacturers to press on with investment in manufacturing industries, training of skilled manpower, development of design and creation of fashion and quality standards which are basic to the expansion of those industries on whose exports Israel's future depends.

In spite of the improvement in the balance of trade in the first part of 1965 the deficit remains high as compared with imports (almost 60 per cent), and the prospect for an improvement in exports is difficult.

Both the expansion of exports, and the maintenance of stable prices in the home market depend on the increasing efficiency of industrial production. To this purpose, the policy of liberalization of imports by removal of individual licensing requirements which was commenced in 1963 has continued. The review of all industrial products, planned for completion by October 1965, should be completed by November, by which date well over 80 per cent of industrial imports will have been freed from restriction.

It is then planned to undertake the second stage of the liberalization programme, which comprises a review of tariff rates on all products and reconsideration of those products not yet liberalized.

It is the Government's belief that if this policy is matched by meaningful tariff reductions and removal of other barriers to trade by the main purchasers of Israel's products, real progress can be made towards balancing Israel's foreign trade.

Balance-of-payments position and prospects

5. Several members of the Committee thanked the representative of Israel for the documentation and information supplied and expressed their satisfaction that in the period since the last consultation Israel had been able to extend the scope of liberalization, to expand exports and even to increase foreign exchange reserves somewhat. They noted that Israel has made considerable progress in removing quantitative restrictions. The Government of Israel has reported that about 400 commodities, representing nearly 50 per cent of total imports, are already free of restrictions and that less than 15 per cent of imported products are still under the "Individual Licensing System". The Committee understands that by the end of November 1965 all products for which licensing requirements still exist will have been reviewed and the number of products remaining under licensing substantially reduced. After the first round of review has been completed a second look will be had at the restrictions that remain. The hope was expressed that in the case of products on which import restrictions are removed tariff rates will not be raised so as to impair the beneficial effect which liberalization might be expected to have in reducing inflationary pressures and in promoting greater productivity and efficiency in local industry. Members of the Committee also felt that notwithstanding real difficulties which confront Israel in resolving its balance-of-payments problems, account should be taken of the considerable resilience which the economy has had in the past. It could be that prospects for further export increases and the continued inflow of capital were a little more encouraging than the representative of Israel had indicated and provide a basis for further liberalization. Reference was also made to the fact that foreign capital investment in Israel seems to have continued to increase through 1964.

6. The representative of Israel, in reply, maintained that pessimism was the more prudent outlook on Israel's export prospects. The small increase in foreign exchange reserves in 1964 had been made possible by an increase in the foreign debt and by certain transfer payments which are likely to be reduced shortly, including certain reparations payments; while it is hoped that a further increase in exports may replace this source of foreign exchange, a close examination of Israel's exports indicates that there are definite limitations in at least two of the three major export categories, agriculture and diamonds. Lack of both land and water are becoming important limitations on further expansion of agriculture, and while Israel has done well in the market for small diamonds, this market is not one that is likely to grow to any extent. Thus, most of the \$400-\$500 million gap would have to be covered from increased exports of manufactures. Heavy investments have been made in fertilizers and in the Dead Sea works which are already beginning to yield substantial income that may increase from a present \$14 million to \$70 million by 1970, but this will by no means fill the export gap. Consequently, Israeli authorities are also looking to the development of quality articles and skilled services, since Israel is not a low-wage country but does have skills which might facilitate development of high-quality export products.

Under this heading Israel thinks of fine made-up textiles and leather goods, where the skill of Israeli craftsmen would be an advantage, as it has been in diamonds, though here again it would be necessary to rely on imported materials. Similarly there seem to be machine tools, made to special order, which can better be produced in a workshop than in a mass production industry, and similarly there are fine chemicals and electronics products for specialized use which lend themselves to small-scale production. Among services, Israel is hoping in particular to develop further its shipping, which is already of considerable importance. Insurance may also offer some possibilities. Because of their great importance to Israel's trade balance it is particularly significant that manufactured goods exports as a whole increased by more than 20 per cent annually in 1959-61, but that more recent annual increases have been 14 or only 12 per cent. Domestic consumption has increased and may have had the effect of slowing export growth, but it would be difficult to assert that such increased consumption was the only cause of slower growth of exports. The rate of growth of exports to the EEC and EFTA countries was much slower than to other markets, and there it appears that difficulty of access arising from differential treatment is becoming an important limitation on exports. A slowing down of foreign and domestic investment may also be either a cause or an effect of the export outlook. The representative of Israel also noted that some of his country's exports must in fact be expected to experience declining demand as the less-developed country markets to which Israel has been supplying development goods like cement, tyres and irrigation pipes begin to be supplied from within those countries themselves. Already Israel provides know-how to help in the establishment of such industries in developing countries of Asia and Africa.

7. Concerning the level of tariffs on liberalized goods, the representative of Israel explained that tariff levels are fixed by a committee composed of representatives of consumers, manufacturers, agriculture and Government. A decision to remove the licensing requirement is the occasion for consideration of the tariff level by this committee, where decisions are usually taken unanimously. The Government's objective is to stimulate efforts of industry to become more competitive but not to create a flood of imports. A second review of these rates is planned beginning early in 1966, when it might be decided either to fix a regular time-table according to which annual reduction in rates would take place or to agree to review the rates annually. It would be considerably easier to persuade those concerned of the desirability of an automatic plan, to which there is some opposition, if more had been accomplished in the Kennedy Round; absence of visible results up to now makes it difficult to urge a more vigorous unilateral programme.

8. The question was also asked whether Israel had fully considered the possibilities of increased tourism as a solution to the balance-of-payments problem. The representative of Israel stated that tourism had indeed been the subject of a great deal of consideration, though so far with rather limited

results. Israel does well to attract 250,000 tourists a year, while Spain receives 13 million. By 1964 the income from tourism amounted to some \$70 million and Israel would very much like to see the figure increase by more than 15 per cent a year as in the past. However, there seem to be a number of problems which would make it rash to count on an increase of the order needed to close the trade gap. For one thing, travel from Western Europe to Israel costs at least twice what travel to Spain costs Europeans. There is also a lack of suitable medium-priced hotel accommodations which it seems difficult to fill given present costs of construction of new hotels.

Alternative measures to restore equilibrium

9. Members of the Committee expressed interest in knowing whether the Government of Israel had considered the possibility of moderating the recent rapid rate of activity of the country and of putting more emphasis on liberalization of trade. The representative of Israel said that in fact his Government was well aware of this problem and had taken drastic steps to curtail building, both public and private.

10. The question was also asked what steps the Government of Israel is taking to keep the increase in consumption within something like $3\frac{1}{2}$ per cent a year, as it would like to do. The representative of Israel acknowledged that this was of course a most difficult objective to implement. Since 1964 a Productivity Board had been established with representatives of industry, trade unions and Government. An effort was being made, on the basis of operations of this Board, to relate wage increases to productivity increases. An attempt is also made to avoid price increases through a committee on which Government, industry and consumers are all represented. No price fixing orders are issued, but considerable efforts have been made to persuade manufacturers not to increase prices; this effort has been successful to a considerable extent in manufactured goods but has also perhaps tended to result in greater increases in prices of construction, which is not included within the range of the Committee's work. In Israel there is an automatic link between wages and prices in the cost-of-living allowance agreement, which formerly called for quarterly adjustments in wages to match price increases. More recently the interval has been set at six months and in 1964 agreement was obtained to delay an increase from July to October. The beneficial effect which delay in the cost-of-living allowance increases might have had has been somewhat offset by changes in the tax structure which have had the short-term effect of increasing disposable income, particularly of the low-income group.

11. In response to a question about the development of Israel's campaign to interest the public in internal lending to Government and industry, the representative of Israel explained that this form of investment, which had been very popular in 1959 and 1960, had recently become less attractive. More recently costs had been rising more rapidly than prices, perhaps accentuated by the Government's efforts to limit price increases. Prior to 1962, there had been considerable success in interesting the public in the purchase of equities or in

lending to the Government, but since the devaluation in 1962, people have tended more and more to invest in housing or to purchase durable consumer goods rather than to postpone consumption through saving, notwithstanding interest returns offered by the Government at a higher rate on short-term loans or linked to the cost-of-living index on long-term loans. The Government was making great efforts to press the saving campaign.

System and methods of the restrictions

12. In response to two questions concerning developments in the liberalization of imports, the representative of Israel explained that there has been no change since last year in the composition of the free list. The list of goods for which licences are issued automatically has been extended continuously through the year. The formality of licensing is retained mainly in order to retain some control over the prices at which imports are sold, since a country importing relatively small quantities as Israel does may otherwise find that its importers have been able to pick up small lots of goods at exceptionally low prices. Retention of licensing control is felt to be simpler than switching over to use of the anti-dumping and countervailing duty legislation, which is cumbersome. There remains the category of goods subject to individual licensing. The breakdown of imports into these three categories for 1964 is as follows with percentages of imports falling into those categories for 1964 and 1963.

Imports in 1964, by licensing categories, with comparable percentages for 1963

<u>Imports in \$ million</u>	<u>Per cent 1964</u>	<u>Per cent 1963</u>
Free 402	48.7	45.2
Automatic licensing 253	31.8	33.6
Individual licensing 160	19.5	21.2

The main effort in liberalization has been made on the industrial side and the process of reviewing all imports has been nearly completed. Gross industrial production in Israel in 1964 was I\$5.9 billion, of which 0.9 billion was in export industries and one billion was in products which are not traded in international trade (e.g. gravel and sand). Of the remainder, I\$2 billion had been reviewed by the end of 1964 and another I\$500 million has been reviewed in 1965, leaving a residue of some I\$1.2 billion, mainly in processed foods. Items accounting for I\$300 million of non-agricultural production are thus all that remain to be reviewed, and it was hoped that this review would be completed within a month or so.

13. Responding to a question when a negative list of items still under restriction might be published, the representative of Israel said he was not in a position to give an undertaking in this respect but confirmed that work would be started on such a list soon, as it appeared to him that such a list would in any case be necessary for the review of remaining restrictions which would be carried out in the second stage of liberalization.

14. Members of the Committee expressed concern that Israel has continued to trade by arrangements which involve tying of trade to a particular trade partner, notwithstanding the consultation decision of the IMF last year and comments by members of the Committee on Balance-of-Payments Restrictions. Israel was urged by these members to move away from bilateral agreements which, in their view, prevent the most economic conduct of world trade. The representative of Israel replied that all bilateral agreement imports amount to no more than 4 per cent of Israel's imports. The arrangements are by no means dictated by Israel, but are made with countries that normally trade in this manner, in order to promote exports to these countries. He added, when asked about future prospects, that Israel has in fact been considering turning trade of this kind over to private or quasi-private corporations and had had some discussion with trade partners on the matter. He added that this trade was all based on international prices and that he did not believe the trade would necessarily go to suppliers in other countries even if there were complete freedom of choice of source.

15. It was asked whether special consideration for regions in which more development was wanted meant that licences were granted less freely for products which might be manufactured in such a region, and whether items might be deliberalized in order to promote development. Inquiry was also made whether Israel's system makes provision for granting token licences on goods subject to individual licensing. The representative of Israel assured the Committee that development plans have been made well in advance so that there is little likelihood that an item once removed would be restricted again. The whole movement over the last two years has been to liberalize and much progress has been made. As for token licences, it is normal for the Israel restriction, if any, to touch only a part of the tariff item; on the parts of items not restricted, automatic liberalization is granted. Members of the Committee expressed interest in knowing something of the method by which licences are allocated and the time taken to grant licences, especially as concerns automobiles. The representative of Israel said that there might be some delays during the first month after liberalization has been approved, as it takes perhaps six to eight weeks to issue the necessary administrative instructions. Concerning automobiles he thought there should be no difficulty, however, as these had been liberalized since 1959. The only requirements are that an importer must be willing to bring in at least 100 cars per year and must satisfy the authorities that garage and repair facilities will be available to service the cars.

Effects of the restrictions

16. Members of the Committee expressed concern that infant industries enjoying high protection through quantitative restrictions or high tariffs might not move as rapidly as possible toward maturity and inquired what safeguards exist to ensure that they do mature as rapidly as possible and what precautions are taken to avoid the establishment of industries which might not become viable. The representative of Israel acknowledged that in the case of textile spinning, still

protected by licensing requirements, there may be a case of an industry which would have to continue with licensing. It was established, historically, some ten years ago as a means of introducing recent immigrants to industrial life and the intention is to move gradually to the more advanced stages of production. But in any case all industries will come under the continuing review of tariffs and licensing which will serve to encourage them to develop increased efficiency, as protection is reduced. This general rule might have to be reviewed if it were necessary to provide large-scale employment if mass immigration again occurred.

General

17. The representative of Israel was thanked for his very helpful and full replies to the questions of the Committee. The consensus was that while Israel has made much progress toward liberalization, maximum benefit to the Israel economy called for continuing efforts to make production more competitive both through continuing removal of licensing requirements and reduction of other barriers to trade.