1. In accordance with its terms of reference, the Committee has conducted the consultation with Iceland under Article XII:4(b). The Committee had before it a basic document for the consultation (BOP/76) and documentation supplied by the International Monetary Fund, as mentioned in paragraph 3 below.

2. In conducting the consultation the Committee followed the Plan for such consultations recommended by the CONTRACTING PARTIES (BISD, Seventh Supplement, pages 97-98). The consultation was held on 17 January 1968. The present report summarized 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 CONTRACTING PARTIES had invited the International Monetary Fund to consult with them in connexion with this consultation with Iceland. In accordance with the agreed procedure, the representative of the Fund was invited to make a statement supplementing the Fund’s documents concerning the position of Iceland. The statement made was as follows:

"The Fund invites the attention of the CONTRACTING PARTIES to the Executive Board decision of November 8, 1967, taken at the conclusion of its most recent Article XIV consultation with Iceland.

"Shortly after the conclusion of that consultation countries which are at the same time important markets and competitors of Iceland changed their par values. This came after a period in which the international reserves of Iceland had declined, from a peak of US$62 million at the end of February 1967 to US$35 million at the end of November 1967. To correct the resulting fundamental disequilibrium in its balance of payments, the Government of Iceland, with the concurrence of the Fund, changed the par value of the Icelandic krona from IKr 43 per US$1 to IKr 57 per US$1, effective November 27, 1967. This change should make it possible for the Government of Iceland through appropriate measures to restore internal and external balance in the Icelandic economy, while at the same time reducing reliance on restrictions on current payments and imports".

1For the text of this Decision see the Annex.
Opening statement by the representative of Iceland

4. The opening statement was as follows:

Since the last consultations with this Committee took place in November 1966 the economic conditions of Iceland have significantly worsened. Already in 1966 there occurred a drastic fall in the prices of the major export products because of excessive supply of fish meal, fish oil and frozen fish fillets on the world market. In 1967 the prices of these products declined still further. In addition to that, the fish catch was poor and the value of exports thus decreased in the first eleven months of 1967 by 26 per cent. One has to go back to the world depression of the early 1930's to find a comparable fall in export prices of Icelandic products. The consequences were severe and far-reaching for the whole economy and the balance of payments.

Although these developments have been highly unfavourable they have not been catastrophic because the four previous years 1962-1965 had been a period of strong economic growth and accumulation of foreign exchange reserves. During this period the real gross national product rose at an average rate of 6.4 per cent annually. The growth of the gross national income at constant prices was even greater, or 8.3 per cent, because of the improvement that occurred in the terms of trade, particularly in 1964 and 1965. The growth rate for the gross national product and gross national income slowed down to 3.5 per cent in 1966. In 1967 the gross national product is estimated to have actually declined by 2.8 per cent and the gross national income by 6.8 per cent, the difference being accounted for by the adverse terms of trade.

The Icelandic Government tackled the adverse developments with a policy of freezing all domestic prices for a whole year from November 1966, which had the intended effect of stopping wage and cost increases. It was possible to carry out this policy by increasing consumer subsidies and by granting aid to the white fish industry. As a result a substantial budgetary deficit emerged in 1967 which consequently increased the pressure on the external balance.

The total trade figures for 1967 are not yet available but in the first eleven months merchandise imports rose by 7.5 per cent, while at the same time commodity exports declined by 26.2 per cent. There was a trade deficit of $46.3 million in the first eleven months of 1967 compared with a trade deficit of $11.5 million in the corresponding period of 1966.

The foreign exchange reserves declined in the first ten months of 1965 by $21.8 million or 38 per cent. At the end of October 1967 they amounted to $36.2 million which corresponds to about three months import requirements.
The economic situation was therefore already critical at the time when the pound sterling was devalued. There was no doubt that the Icelandic krona would follow the pound sterling. The question was how much additional devaluation was necessary to restore the economic equilibrium. On 24 November the new parity was announced which represented a devaluation of 24.6 per cent against the United States dollar and 12 per cent against the pound sterling.

In order to reduce the effect of the devaluation on the cost of living the Icelandic Government has decided to introduce fairly far-reaching reductions. This week the Government is submitting a bill to the Althing (Parliament) which represents more than 10 per cent reduction in the total tariff revenue. The items affected are mostly consumer goods and household appliances. The tariff reductions negotiated in the Kennedy Round are included in the Government bill. They, however, represent only a small part of the proposed tariff reductions, but will become effective in one stage as soon as the legislation has been passed, except for the tariffs on office machinery which will now be reduced from 60 per cent to 50 per cent and later gradually to 35 per cent.

In spite of the great strain on the foreign exchange position and the difficulties of the domestic industry throughout 1967 the Government did not take any steps to reintroduce quantitative restrictions. The extensive liberalization that has been carried out gradually every year since 1960 was not only maintained but also increased in January 1967. The remaining restrictions are not generally applied in order to restrict the volume of imports, but primarily in order to ensure the continued trade with certain bilateral trading partners. Of greatest importance in this connexion is the purchase of petroleum products from the Soviet Union, which in return is a large buyer of frozen fish fillets and salted herring. Iceland's trade with the state trading countries is still important and has in recent years taken on a freer form as convertible payments have been introduced in the trade with Czechoslovakia of Poland.

As the European marketing organizations have gradually been reducing tariffs internally, Icelandic interests have become more adversely affected. This is in particular due to the relatively high Common External Tariff on fish and fishery products in the EEC. The EFTA countries are, however, Iceland's most important trading area accounting for about 40 per cent of its total foreign trade. The Government is now studying the possibility of applying for membership in EFTA, but it is too early to say when a decision will be taken.

After the basic document was prepared the global quotas for the year 1968 have been issued and are now being submitted. No significant changes have been made from last year's quotas except for the rise in Kronur amounts because of the devaluation.

In this statement I have touched briefly on the major aspects of the economic situation in Iceland. It is too early to evaluate the long-term effect of the devaluation, but it is expected that economic growth will be resumed and the draining of the foreign exchange reserves stopped during this year. I will not, however, venture any further on the slippery path of prediction, but shall be pleased to answer any questions that may be raised.
Balance-of-payments position and prospects and alternative measures to restore equilibrium

5. Members of the Committee thanked the representatives of International Monetary Fund and Iceland for their helpful statements. They expressed regret that Iceland had experienced such a difficult year in 1967 and hoped that the situation would improve in 1968. In the circumstances they found it particularly gratifying that Iceland had maintained and even extended liberalization despite the balance-of-payments difficulties of the last several years. Gratification was also expressed that a facility had been available, in the compensatory financing arrangements of the IMF, to extend aid to cover the temporary shortfall in export earnings experienced by Iceland as a result of the price fall and poor catch of fish in 1967. It was also noted as an encouraging factor that Iceland had completed its negotiations for full accession as a contracting party and would soon become a full party to GATT.

6. A question was put to the representative of Iceland as to what relationship there might be between Iceland's recognized balance-of-payments difficulties and the continuance of discriminatory licensing of certain products as a means of keeping certain Eastern European markets for fish products. It was difficult not to feel that the contribution of the restrictions to the amelioration of the balance of payments was very small and that they merely appeared to serve to reserve a share of the import market for some products of bilateral countries. To this the representative of Iceland replied that there was a very direct connexion between the balance-of-payments situation and the restrictions in that retention of the Eastern European markets was highly essential so long as the overall balance-of-payments position was difficult. The Eastern European countries naturally wanted some assured benefit in exchange for their willingness to buy Icelandic fish, and if Iceland wished to retain that market, as she did, especially in view of the difficulty of developing alternative markets and her need for more rather than less export earnings, there was no alternative but to provide the needed assurance by restricting imports of a few products from convertible currency countries whilst leaving their importation free from the East.
7. Favourable mention was made of Iceland's success in stopping the upward drift of wages and prices, with resulting increased stability during the year 1966-67, but concern was expressed lest cost increases might continue, notably in the fisheries sector, with resulting continued pressure on prices and threatening the newly attained stability. Accordingly, interest was expressed in hearing more about what was planned in regard to the central question of wages policy. The representative of Iceland confirmed that in 1966-67 wage stability had been attained, but only at great cost through the provision of governmental subsidies. This had created a large budget deficit which could not be tolerated on a continuing basis, so the subsidies were reduced late in 1967. As expected, prices and wages did rise again beginning in November, attaining a 3 per cent increase in that one month. Meantime, when the devaluation had been decided upon, it had been possible at the same time to modify Icelandic law so as to remove the mandatory link between wages and prices. Thus, there might now be a possibility of arresting the upward spiral, but whether that possibility would be realized would depend on the attitude of the labour unions in their bargaining with employers. The link was still a matter of great concern to them and it was by no means sure that ending the legal requirement would necessarily end the practice of linking wages to prices. In order to influence the distribution of income and wage development price controls had become more intensive and stricter.

8. Members of the Committee also expressed the view that Iceland should be devoting considerable attention to the introduction of greater diversification into her export trade so as to reduce dependence upon the very unstable fish market. In such diversification, Iceland would naturally give priority, they hoped, to developing a few viable industries specialized in export marketing, since it was no doubt inevitable that with a small internal market most goods would always be more effectively supplied by imports. The representative of Iceland agreed that diversification was fully desirable and recalled that, as had been mentioned in earlier consultations, various projects were under way for that purpose. An aluminium smelter was being built, and its completion was scheduled for 1969. Hydro-electric power capacity was being increased also, partly to supply power for the aluminium smelter, which was being constructed with Swiss capital. A project to establish processing facilities for diatomaceous earths was recently completed. Nevertheless, Iceland recognized that the fisheries would inevitably remain the main source of exports and was consequently giving much thought to increased and more varied production of processed fish products. Unfortunately canned fish was generally subject to rather high tariffs not much reduced in the Kennedy Round; in fact improved access of canned fish to good export markets was an important benefit which Iceland would hope to obtain from accession to EFTA should that course be taken.
9. With respect to the fish catch of 1967, members of the Committee enquired what had been the nature of the difficulty. The representative of Iceland explained that there had been two main factors which had reduced the volume of the catch, by a total of some 25 per cent. The more valuable catch of white fish (the varieties which were sold for consumption as food) had been affected by weather, whilst the runs of the herring used mainly for meal and oil had not come nearly as close as usual to Iceland, so that much longer than normal voyages had been necessary to bring in that part of the catch. In reply to a further question whether there had not also been price changes which had had an adverse effect on Iceland's exports in 1967, the representative of Iceland confirmed that white fish prices had indeed fluctuated greatly. High prices in 1964-65 had brought a number of new suppliers into the market, leading to a decline in prices of the order of 8 cents from a high of 29 cents per lb. When higher-cost suppliers dropped out at the lower figure, there had then been some adjustment back to a present figure of 24-25 cents per lb. for the white fish fillets in question. In that market however there were also changed demand conditions traceable to a recent change in the position of the Roman Catholic Church toward "meatless Fridays". More recently there had also been sharp declines in prices of fish oil and meal, partly due to large recent catches of fish off Peru. Markets for fish oil were in some cases unreasonably limited by requirements, such as a United States Food and Drug Administration regulation, prohibited the use of fish oil in the manufacture of margarine in the United States, notwithstanding that herring oil was used in that way in many other countries.

10. Mention was also made of a decline in Icelandic agricultural production and the question was asked what plans Iceland had for development of agricultural production. At the same time it was noted that a surplus of production of dairy products had increased at the expense of wool, lamb and mutton and it was queried whether this was desirable at a time of general world dairy surpluses. The representative of Iceland explained that Iceland had no expectation or hope of expanding agricultural production in general beyond her own domestic consumption needs. Unfavourable weather had accounted for unusually low output in 1967 and prices of wool had also been unfavourable. Iceland had reaped some temporary benefit from the exceptional demand for lamb and mutton in the United Kingdom resulting from the epidemic of disease there, but did not view that trade as having any long-term potential.

System and methods of the restrictions and effects of restrictions

11. Members of the Committee again expressed appreciation for Iceland's maintenance of policies of liberalization, notwithstanding the difficulties of the past year, and hoped that this would continue to be the case. They then reverted to the question of bilateral agreements and enquired whether there were not great danger that restriction would continue more or less indefinitely against certain imports from convertible currency countries whilst importation remained free to Eastern suppliers. In this connexion they associated themselves with the International Monetary Fund which, in the decision that had been cited, had hoped
that a bilateral agreement with a Fund member would be eliminated as soon as possible. The representative of Iceland acknowledged that the working of the system was as described, but he pointed to actual progress by Iceland in extending the positive list as evidence that the situation was evolving. At present only a very few products were still under restriction to convertible currency suppliers, only those essential to preserving the position of Eastern countries. Moreover, two bilateral payments agreements, with Czechoslovakia and Poland, now included a provision for settlement of balances in convertible currency and were working fairly satisfactorily despite some decline in trade. He felt that in view of Iceland's accomplishment in this direction it might have been more appropriate to congratulate Iceland on progress rather than to emphasize remaining restrictions. The representative of the Fund noted that the Fund's comment had been confined to the one bilateral agreement which Iceland maintains with another Fund member, although progress in multilateralizing agreements with non-Fund members was of course welcome. He confirmed that progress had been made in the latter case through settlements in convertible currencies. In the case of the bilateral agreement with the Fund member it was up to both partners to try and eliminate the agreement. The representative of Iceland added that Iceland had in fact been studying the payments agreement with Brazil to which the International Monetary Fund had referred. It might be possible, they felt, to place payment of excessive balances accruing under it on a convertible basis. This information was welcomed by the Committee. The hope was expressed that multilateral settlement features might be introduced into such bilateral as needed to be retained, and that further progress would be made as rapidly as possible toward decreased reliance on bilateral agreements having discriminatory features.

12. A member of the Committee noted that in the interval since the last consultation, a troublesome discrimination in favour of automobiles supplied by Eastern countries had been altered in such a way as to reduce the incidence of the discrimination. He looked forward to complete elimination of the differential credit facilities in the near future. Reference was also made to a fee of ½ per cent which appeared to be charged on all licences issued for imports from convertible currency countries only; the question was asked what justification there might be for such a discrimination if it existed, since it appeared that proceeds of the fee must be used in part at least to pay for administration of the restriction. The representative of Iceland confirmed that the licensing fee worked as described and that the proceeds of the fee were used to cover administrative expenses. He stated that licensing of Eastern imports was in fact purely a formality but conceded that the fee might perhaps be re-examined to see whether there were some way in which its incidence might be redistributed.
13. The representative of Iceland was then asked what was the basis for the statement he had made concerning the adverse effects of the Common External Tariff on Iceland's exports of fish to the European Economic Community; in particular he was asked whether statistical data could be supplied showing a decrease in fish exports from Iceland to the EEC. The representative of Iceland replied that it would be difficult to supply statistics and that in any case commercial policy considerations would have to be taken into account as well. Frozen fish was particularly a case in point as it accounted for one fourth of Iceland's commodity exports and was the domestic industry's main growth sector. Prior to the Treaty of Rome the tariff structure was approximately as follows: 0 per cent in the Benelux countries, 5 per cent in Germany, 18 per cent in Italy and 33 per cent in France. At the time the EEC was established, a substantial flow of exports was developing towards the Netherlands and new investments were planned to exploit this growing market. But progressive implementation of the Common External Tariff soon proved to have such negative effects on this trade flow that the envisaged investments projects were abandoned. Further, the level of the Common External Tariff - 18 per cent, reduced to 15 per cent as a result of the Kennedy Round, had stimulated this industry within the Community with further damage to Iceland's exports. With respect to fresh fish on ice, where Germany was a main market for Iceland, the Common External Tariff posed another threat which had not been corrected by the Kennedy Round modifications. Before the Common Tariff was established, Germany allowed fresh white fish to enter free of duty in the autumn months and at a duty of 10 per cent during the spring, but this was changing with the gradual implementation of the Common External Tariff toward a duty generally of 15 per cent throughout the autumn and winter; even though Germany had been authorized to import under a tariff quota, that quota was not bound in the schedules in the Kennedy Round negotiations and might disappear at any time. For fresh and frozen herring the bound tariff quota did not correspond to trade flows and could pose problems similar to those for fresh white fish.

14. In answer to another question the representative of Iceland said that the State monopoly had been abolished in May 1967 for radio receivers. It continued still for perfumes, but it was envisaged to reduce the tariff rate from 125 per cent to 80 per cent in the context of the extensive duty reduction previously mentioned, which was planned to restrain internal prices after the devaluation.

General

15. Members of the Committee complimented Iceland on its efforts to diversify its export trade and took a favourable view of the fiscal and budgetary measures which were being implemented, including in particular the continuance of liberalization already achieved and the decision to reduce tariffs beyond commitments made in GATT. These policies were welcomed not only for their favourable effects for trade partners, but for the beneficial effects which they would have on the Icelandic economy. The representative of Iceland promised to convey the views which had been expressed to his Government and thanked the members of the Committee for their interest.
Annex

INTERNATIONAL MONETARY FUND EXECUTIVE BOARD DECISION
TAKEN AT THE CONCLUSION OF THE FUND’S CONSULTATION
WITH ICELAND ON 8 NOVEMBER 1967

1. This decision is taken by the Executive Directors in concluding the 1967 consultation with Iceland, pursuant to Article XIV, Section 4 of the Articles of Agreement.

2. After four years of rapid growth, gross national product rose by only 2½ per cent at constant prices in 1966 and is estimated to decline by 1-1½ per cent in 1967. This is largely the result of a sharp fall in the prices of Iceland's main export products and a disappointing fish catch. Imports in 1967 continued to rise somewhat but there was a large fall in the value of exports and the current account deficit has widened substantially. Despite a large capital inflow, official reserves of gold and convertible foreign exchange declined sharply during 1967.

3. In an effort to bring to a halt the rise in costs, prices and municipal tax rates were frozen in December 1966 at their November 1966 level through October 1967. Wage rates were not increased during the first nine months of 1967, but there was a large increase in consumer subsidies. Partly for this reason the budgetary position weakened substantially. Because of the deterioration in the balance of payments, the liquid assets in the hands of the banks and the public declined substantially.

4. In order to strengthen the budgetary position, the Government has proposed a substantial reduction in consumer subsidies and increases in taxation mainly to take effect in October 1967 and the budget proposal for 1968 envisages a slight surplus. In addition, public investment financed out of extrabudgetary funds is to be much reduced in 1968. The Central Bank has indicated that notwithstanding the financial difficulties of industry, it will continue to pursue a very restrictive monetary policy. The Fund believes that the policy of the Government should facilitate the rationalization of industrial production and thereby help to bring about a rise in productivity. With some improvement in the fish catch and prices, the Icelandic economy would, on the basis of these policies, show a moderate rate of growth in 1968.

5. The Fund welcomes the termination of the bilateral payments agreements with Czechoslovakia and Poland and the further liberalization of imports that has recently taken place. It hopes that the remaining bilateral payments agreement with a Fund member will be eliminated as soon as possible and that efforts will continue to be made to reduce reliance on restrictions on current payments and imports.