1. The Government of Iceland has consulted the Fund under Article XIV, Section 4, of the Fund Agreement concerning the further retention of its transitional arrangements.

2. In recent years fish catches have increased rapidly and the Icelandic economy has achieved a high rate of growth. The current account of the balance of payments showed a deficit in both 1963 and 1964, but there would have been a sizable surplus in 1964 had it not been for unusually large imports of ships and planes. There was some inflow of capital in both years and the net foreign exchange reserves increased to $37 million at the end of 1964.

3. Large wage increases were granted in 1963. In the 18-month period ended June 1964 the cost of living index rose by 27 per cent. In June 1964 a one-year general agreement was reached which was designed to limit further wage increases, but an automatic link was reintroduced between wages and a modified cost of living index. Following an agricultural price review in September, agricultural incomes were raised substantially. Moreover, as a result of boom conditions, wages also rose. Prices, however, were kept virtually stable until the end of the year by a substantial increase in consumer subsidies. Since then, the cost of living index has increased and wages were adjusted upwards by 3 per cent as of March 1, 1965.

4. In 1964 government expenditures rose more rapidly than revenue, due largely to increased consumer subsidies and government assistance to the fishing industries. Central Bank financing of the budget deficit and the rise in the foreign exchange reserves led to a substantial increase in bank liquidity. Bank lending rose by 12 per cent in 1964 as compared to 15 per cent in 1963. To counter inflationary tendencies, the sales tax was raised and a substantial reduction in import restrictions was carried out early in 1965. The Fund believes that further measures to improve the fiscal position are urgently needed to restore economic stability.

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5. In addition to reducing import restrictions, Iceland has virtually eliminated restrictions on payments for current invisibles. The Fund welcomes these measures and believes that the balance of payments permits Iceland to make further progress in reducing restrictions. The Fund reiterates its view that the early termination of the remaining bilateral payments agreement with a Fund member country is feasible and desirable.

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