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/47), 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 6 May 1965. The present report summarizes 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 International Monetary Fund has transmitted to the CONTRACTING PARTIES the Executive Board decision and background material from the last consultation with Iceland 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 April 28, 1965 taken at the conclusion of its recent consultation with Iceland. After a reference in paragraph 4 to "a substantial reduction in import restrictions...carried out early in 1965"., paragraph 5 of this decision reads as follows:
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.

"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 recent Article XIV consultation with Iceland and has no additional measures to suggest at this time."

Opening statement by the Icelandic representative

4. In his opening statement, the text of which is annexed to this report, the representative of Iceland described the evolution of the Icelandic restrictive system and of Iceland's efforts to move toward a liberalization of imports as part of a comprehensive stabilization programme. Two liberalization measures have been placed in effect since Iceland's provisional accession to the General Agreement last year and a further liberalization has been announced, to be effective 1 July 1965. As from that time, liberalization will apply to 79.2 per cent of actual imports in 1964. An additional 10.2 per cent of 1964 imports are under global quota, comprising chiefly lumber, certain wood products, iron and steel and sugar. The principal commodities which are imported under other licensing arrangements are petroleum products, wooden barrels and coffee. Arrangements for licensing of this last-mentioned group of products are generally designed to facilitate trade relations with seven bilateral trade partners which are important customers for Icelandic fish products.

5. Thanks to the stabilization programme of 1960, Iceland's balance of payments was favourable in 1961 and 1962. In 1963 and 1964 unusually large imports (especially of ships and planes in 1964) resulted in deficits, even though the gold and foreign-exchange reserves as of the end of 1964 did not decline because some important imports are being financed by foreign credits. Even so, reserves of gold and
foreign exchange are equal to four months imports, hardly adequate in view of the uncertain outlook for the economy, especially as concerns 1965 exports of fish and the possibility that wage negotiations in June may result in increased inflationary pressures. Iceland nevertheless intends to continue to liberalize as much of her trade as may be possible without risk of a subsequent need to retreat, with the view of gradually abolishing most import restrictions.

**Balance-of-payments position and prospects**

6. Members of the Committee thanked the representative of Iceland for his clear and informative statement and were pleased to note the improvement in Iceland's balance-of-payments position since 1961. If Iceland had recently run a deficit in her external accounts, it was at least welcome that her foreign exchange reserves had not been depleted and it was encouraging that further steps to liberalize imports had been taken this year. The question was raised however to what extent Iceland considers that quantitative restrictions contribute to an improvement in the balance of payments and what were the prospects for a further easing of restrictions. The representative of Iceland noted that the role of quantitative restrictions was of course a matter of judgment and indicated that he would not want to try to answer in detail. The importance of Eastern European markets for salted and frozen herring and frozen fish was very great and Iceland could not afford to place herself in a position of being unable to market all of a highly variable annual catch. Up to now other markets for the particular fish products currently sold in Eastern Europe were not sufficient to absorb the entire catch in a good fishing year. As for prospects for further liberalization in this sector, that would depend on other countries who might open their markets to Iceland's fish to a greater degree than they had so far done, but if that did not happen Iceland would need to continue to seek satisfactory trading arrangements with those countries which are now willing to buy.
7. Members of the Committee appreciated Iceland's heavy dependence on fish exports and her need to sell where there are buyers. They also expressed appreciation of the various steps taken in the last few years to narrow the scope of imports not yet liberalized. They felt, however, that the fact that the Eastern countries have accumulated substantial credit in Iceland over recent years might indicate that Iceland could liberalize some commodities currently restricted; it was not clear why Iceland reserved for import under bilaterals more than the equivalent of fish sold under the bilaterals. The representative of Iceland explained that the catch of the particular types of fish normally marketed in the East has been exceptionally short in recent years and that it would therefore not be prudent to reduce the scope of possible marketings in those countries as reduced markets there could present great difficulties in a year when there was a large catch of these particular fish.

Alternative measures to restore equilibrium

8. In looking at Iceland's economy as a whole, members of the Committee expressed some concern that notwithstanding the internal stabilization measures taken by the Government of Iceland, there was danger that inflationary pressures might have an adverse effect upon exports and lead to balance-of-payments difficulties if purchasing power in the hands of consumers were to expand further. Conceivably subsidies might be used to offset high costs of producing export commodities but, this would place a great strain on the budget. The better course might therefore be to hold wage increases to a minimum, and it was gratifying to note that this was a policy which seemed to be in the minds of the Icelandic authorities with respect to coming wage negotiations. In particular it would be desirable if the automatic link between price levels and wage increases could be abolished. The representative of Iceland agreed that a difficult situation would threaten if further cost increases were to occur under the wage agreements to be negotiated. He noted, however, that fears of the Icelandic authorities on this count had already proved groundless once earlier, though this was of course no reason for complacency. As to subsidies, he agreed that they could not well be increased further. In fact, because of anticipated budgetary deficit in 1965, investment expenditures of the Government had already
been cut by 20 per cent in March, and it was not yet known whether this cut would be sufficient to balance the budget. He agreed that it would be desirable to be free from the wage-price link, which in fact the Icelandic authorities had successfully resisted for a number of years, but noted that it had not been possible to avoid acceptance of it last year.

System and methods of restriction and effects of the restrictions

9. It was noted that Iceland uses State-trading companies to handle importation of certain products, and the representative of Iceland was asked what policies and criteria were followed with respect to purchase and resale of these commodities. He replied that so far as purchasing was concerned, the few commodities handled by State trading are bought on purely commercial considerations, both as to the choice of kinds and qualities of merchandise to be stocked and as to the sources of supply. In fixing resale prices, however, the primary consideration was revenue, and prices were set accordingly. The representative of Iceland stated that he believed the mark-up on wines might be lower than that on distilled spirits.

10. A member of the Committee enquired about restrictions which he believed had recently been imposed on the terms of credit on which imports might be purchased. The representative of Iceland explained that until late in 1963 importers had generally been allowed to purchase on credit of up to three months. At that time, however, in order to reduce imports at the time of balance-of-payments difficulties and to take some excess purchasing power out of circulation, more stringent regulations concerning payment had been introduced on select items; a principal item affected was automobiles. The proof that this measure had not hurt foreign suppliers unduly was that imports had continued high, though somewhat less so than before. While credit restrictions do now extend to certain other goods, machinery and capital goods may still be paid for over a period of up to one year. For more extended payment terms, Government approval is needed and is usually given only for large purchases having an export-producing potential, notably fishing vessels.
11. Another member noted at this point that his country has been involved in a problem concerning the exemption of certain automobile imports from a temporary licencing fee which was increased from 100 per cent to 125 per cent at the beginning of this year. The fee in itself appears rather burdensome, coming on top of a 90 per cent duty, but a special difficulty has been the exemption of some vehicles from this fee while similar vehicles are not exempt. Both exempt and non-exempt kinds were available for export from his country. The representative of Iceland confirmed that the fee had been increased as stated, for revenue purposes, though he emphasized that it had been even higher only two years ago and that imports were continuing at a high rate notwithstanding. As for the apparent discrimination among similar motor vehicles, he explained that the object was to favour farmers by allowing a utility vehicle to be imported subject to lower charges than those paid on regular passenger vehicles and that it was very difficult to find a dividing line which would not appear arbitrary to some. The existing regulation was based on length of wheelbase and he feared that any extension of the allowable wheelbase would immediately raise a complaint about exclusion of the next larger model from this special benefit.

12. The question of goods not liberalized was again raised, and one member of the Committee asked what might be the prospect for removal of some goods from the list of products licenced only for import from bilateral agreement countries. The representative of Iceland emphasized that non-liberalization should not be taken as tantamount to discrimination against convertible currency countries. He mentioned wooden barrels as a product imported entirely from convertible currency countries even though it was not liberalized as an illustration of use of control as a means of ensuring orderly marketing.

13. Another member of the Committee expressed interest in knowing what were the items on "the list" of products that had been mentioned as being licenced only for import from bilateral trading partners. The representative of Iceland said that the main products involved were petroleum products. Even within this range of products, aviation gasoline was imported from convertible currency countries. Of lesser importance are coal and potato starch.
14. Another member of the Committee suggested that Iceland might perhaps be a victim of a tendency sometimes noted for each of two bilateral trading partners to feel that the other wants to continue existing arrangements when in fact both might be happier with a more flexible arrangement moving away from the "classical" balanced trade and payments agreed. He urged Iceland to explore the possibility that some move toward flexibility might be acceptable without damage to essential export considerations. The representative of Iceland agreed to this general analysis of the situation as it sometimes occurs, but felt that fish might be harder to sell, as more readily available from alternative sources, than certain more elaborate items such as, for example, a chemical plant.

15. A member of the Committee referred to indications in the background material that products which Iceland is purchasing under PL 480 arrangements may only be imported from the United States and wondered whether this was in fact the case. The representative of Iceland confirmed that banks are authorized to restrict purchases of such products to United States sources; but the restriction is not in practice effective, he said, as private traders mainly prefer to buy those particular commodities from the United States so that there is no need to apply the restriction.

General

16. The Committee expressed appreciation for the frank and clear presentation made by the representative of Iceland in this first consultation with Iceland. Satisfaction was expressed at Iceland's progress in liberalization, which it was hoped might be maintained and extended in the year ahead as appeared to be within Iceland's possibilities, especially if domestic inflationary tendencies could be contained. Iceland's dependence on fish exports was recognized but the hope was nevertheless expressed that the marketing of these exports might be effected with progressively less dependence on methods involving discrimination against contracting parties.

The representative of Iceland promised to convey to his Government the views expressed by the Committee.