Committee on Balance-of-Payments Restrictions

DRAFT REPORT OF THE COMMITTEE ON BALANCE-OF-PAYMENTS
RESTRICTIONS ON THE CONSULTATION UNDER ARTICLE XII:4(b)
WITH ICELAND

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/59) 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 28 November 1966. 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:

"With respect to Parts I and III of the Plan for Consultations, the Fund invites the attention of the CONTRACTING PARTIES to the Executive Board decision of July 13, 1966, taken at the conclusion of its most recent Article XIV consultation with Iceland, and particularly to paragraph 4 which reads as follows:

\[\text{For the text of this Decision see Annex A.}\]
The Fund notes that further substantial progress has been made in reducing import restrictions and believes that an early further reduction in reliance on restrictions is feasible. The present balance-of-payments and reserve position justifies bolder steps in this sphere. The Fund notes the readiness of the Icelandic authorities to reconsider the need for the one remaining bilateral payments agreement with a Fund member.

The Fund does not see, in developments during recent months, reason to alter the appraisal of the situation contained in that decision.

"With respect to Part II of the Plan for Consultations, the Fund again invites attention to the decision taken at the conclusion of its most recent Article XIV consultation with Iceland. The Fund has no additional measures to suggest at this time."

Opening statement by the representative of Iceland

1. In his opening statement, the text of which is contained in Annex B to this report, the Icelandic representative gave a comprehensive account of Iceland's economic development over the last year. It was again marked by a rapid growth which was, however, accompanied by a steep rise in prices and costs. Increasing costs have partly been absorbed by rising production and prices. But recently declining export prices have given domestic price stabilization greater urgency. Iceland's exports have risen by 81 per cent since 1961, imports by 83 per cent. With the exception of 1963 Iceland has run a balance-of-payments surplus on current account over these years. This situation has been less favourable in 1966 since imports have risen at a considerably faster rate (17.9 per cent) than exports (6.4 per cent). Export prices of three major export goods representing half of Iceland's exports have over the last twelve months dropped substantially (frozen fish by 18 per cent, herring oil by 27 per cent and fish and herring meal by 21 per cent). This has led to a reduction in Iceland's foreign exchange reserves. If no recovery in these export prices is realized, a further deterioration of the balance-of-payments situation will be induced. Iceland's imports reached a liberalization standard of 84.5 per cent calculated on the basis of 1965 imports.
New liberalization measures in 1966 affected goods amounting to about 7 per cent of 1964 imports, especially iron and steel products, lumber, carpets and rugs, various textile products and rubber footwear. Prefabricated houses and some accessories were liberalized in order to ease demand pressure in the building sector.

2. Remaining restrictions which account presently for about 15 per cent of total imports are maintained less to restrict the quantity of imports than to direct imports as to their sources. Iceland still keeps a number of bilateral agreements with State-trading countries. To sell frozen fish and salted and frozen herring to these countries it has, in return, to buy their products. Further liberalization measures will enter into force on 1 January 1967. As of that date the Icelandic exchange banks will discontinue their control over the purchase of all feedgrains, which previously were purchased under a Public Law 480 agreement. The Government will also shortly abolish the State monopoly for radio receivers.

Balance-of-payments position and prospects

3. Members of the Committee thanked the representative of Iceland for his clear and full statement of Iceland's balance-of-payments position and welcomed the further progress which Iceland had been able to make in January 1966 toward liberalization of trade. Referring to the recent Decision of the Executive Board of the International Monetary Fund, they nevertheless urged Iceland to take bolder steps toward reduction of import restrictions which, in view of the present balance-of-payments and reserve position, appeared justified and feasible. It was also pointed out that with some 85 per cent of imports liberalized and most of the balance subject to a regulatory system which does not appear to limit imports so much as to direct a portion of the trade in particular directions, it was difficult to see how the remaining restrictions contributed in any very significant way to the solution of any balance-of-payments problem.
4. The representative of Iceland acknowledged that there were encouraging features in the situation of his country but said that although these considerations would be kept in mind, Iceland was obliged to take account of a recent sudden decline in export prices affecting half of Iceland's export trade and of the unsettled wage-price situation which could not be ignored even though domestic prices have been kept stable for some months past. It was of course true, he added, that a main purpose of many restrictions was to ensure continued trade with Eastern countries, and as this trade is of great importance to Iceland. Since most of these countries in the past had preferred to trade on a bilateral basis, Iceland had accepted this method of trading in order to safeguard her exports. Recently Czechoslovakia and Poland have, on their own initiative, indicated that they wished to go over to a multilateral system of payments. Iceland acceded to that wish, effective September 1966, but it remains at present a new feature. Iceland's markets are narrow with respect to the number of countries which purchase from her as well as with respect to the number of export products involved. Eastern countries offer important markets for products which could not be diverted as such to other markets without risking a collapse of prices affecting a much larger segment of total export trade. In addition there were other items, for instance salted herring, where no other equally profitable outlet was available. Moreover, Iceland was not, like some industrialized countries, in a position to offer to Eastern countries much sought-after industrial plant and equipment not easily obtained from alternative sources and could not, in consequence, insist on moving rapidly to multilateralization of payments and trade.

5. With respect to the longer-term outlook for trade with Eastern countries, the question was raised whether Iceland was well advised to rely on a market which might at best be static and which might even shrink if the trading partners themselves built up more substantial fishing fleets, as seemed to be happening with respect to the catch of certain fish such as herring. The representative of Iceland conceded that trade with Eastern countries had declined in relative terms but pointed out that there was a large potential market for fish among
peoples of Eastern countries, many of whom live far from sources of fresh fish and where population growth may very well offset some increase in fish production by those countries. Even if other markets were increasing faster, those were also markets in which great price fluctuations took place and where increasing use of new techniques, such as factory vessels, posed severe problems of competition. Hence markets in the East, where prices tended to be subject to less fluctuation, were all the more important to Iceland.

6. A question was also asked as to whether it was really necessary for Iceland to offer as any protection to Eastern goods against competition with goods coming from other sources. In many Western countries, Eastern goods are fully able to compete, especially on price, with imports from other sources and it seemed curious that the opposite should occur in Iceland. It was also noted in this connexion that Iceland's imports from Eastern areas seemed regularly to exceed in value her exports to those countries; this, together with the fact that some items which in theory were only to be imported from countries with which there were bilateral arrangements were imported almost entirely from multilateral sources, suggested that there was scope for at very least further partial liberalization. The representative of Iceland replied that habits of importers and consumers depend on a good deal more than price alone and that importers were influenced for example by their past habitual trade relationships, by availability of transport, delivery times and other considerations not directly related to price, where Eastern countries were usually fully competitive. The reason why Iceland's imports appeared to be larger than exports to these countries lay, in part at least, in the fact that imports were compiled on a c.i.f. basis, whilst exports were shown at f.o.b. values. That is, in addition to the export values shown there was an additional service credit for Iceland because most of the goods were shipped on Icelandic vessels. Nevertheless, Iceland had been in a true deficit position in trade with the USSR in the last two years.
7. Interest was also expressed in knowing what Iceland is doing to promote industrial diversification and what is being done to create a favourable climate for private foreign investment. The representative of Iceland indicated that a major project in this area was the construction of an aluminium smelter scheduled to be completed in 1969. A hydro-electric power plant designed to supply electricity for the smelter was also under construction. One other relatively small manufacturing plant, for treatment of diatomaceous earths, was also under construction. For the rest, Iceland was pressing forward with improvements and diversification of its plant and equipment for preparing and processing of fish in as broad a variety of final products as possible, since this must remain a primary concern of a country which earns 90 per cent of its export income from fish and fish products. As regards Iceland's approach to foreign investment, so far a rather cautious policy had been followed. In the main Iceland had preferred to borrow money rather than to encourage direct investment; its future policy would in part depend on its experience with the above projects.

8. It was noted that the progressive liberalization of import controls over the years appeared to have been beneficial to the Icelandic economy, and this had been reflected in part in a stronger foreign-exchange position. The question was asked whether the present trend in the trade balance might not be temporary, as the rapid rate of increase in imports in early 1966 reflecting the sharp increase in incomes granted in 1965 already showed signs of subsiding. The representative of Iceland felt that whether trade would evolve favourably depended on a number of unknown factors such as the outcome of current wage negotiations and the trend of fish prices.

9. Members of the Committee reverted to the subject of bilaterals, which they urged Iceland to eliminate progressively if complete elimination were not possible now. Iceland confirmed that it was still its intention to decrease its dependence on bilateralism where possible. Some detailed points mentioned in this connexion are reported below, in the discussion of the system and methods of Iceland's restrictions.
Alternative measures for restoring equilibrium

10. Members of the Committee noted that the problem of internal inflation is one which has been a preoccupation of the Iceland authorities over a period of years. They inquired whether consideration had been given to the rather high level of tariffs as a contributing cause and asked what consideration had been given to lowering tariffs as a means of fostering equilibrium. A recent EFTA study of the effect of tariff reductions on prices was noted. The representative of Iceland replied that Iceland had indeed reduced some of its tariffs and had had a more general study of the subject under way for some time. It was believed that reduction of tariffs did offer an important way of opening the economy up, but it would be considerably easier for Iceland to take action along these lines if some reciprocal reductions could be obtained from other countries in connexion with the Kennedy Round.

11. Members expressed interest in learning whether Iceland had established any institutions designed to assist in overcoming the wage-price difficulties. The representative of Iceland stated that his country had indeed been having discussions of incomes policies as other countries have had, and had even established recently an economic council comprising representatives of labour, management and Government in an effort to arrive at better understanding of economic problems, but it was too early to report any results from this effort. To a further question regarding problems in the agricultural sector, the representative of Iceland said that the question of the relative incomes of farmers and fishermen was indeed recognized as a difficult problem and had to be seen in the political context.

System and methods of the restrictions

12. As concerns the State-trading sector, one member of the Committee noted that whilst Iceland's imports of wines and liquors are sizeable, the figure shown for perfumes seemed very small, particularly if it included the whole range of cosmetic products. He asked about the rationale of State trading in perfume and about the conditions under which perfumes were bought and sold.
In reply, the representative of Iceland stated that the figures related to perfumes only and that he believed imports were purchased strictly on commercial considerations by the State monopoly. Some consideration had been given, he believed, to releasing the perfume trade, to private importation, but he did not know whether a definite decision had been taken.

13. The discussion then turned to Iceland's régime for purchases of commodities under a Public Law 480 agreement. It was noted that there was some confusion in the documentation as to whether exchange banks "restrict" the purchases or whether they "regulate" the purchases of these commodities. In any event, the forthcoming discontinuation of the system with respect to feedgrains was welcomed and the representative of Iceland was asked to clarify what régime will in fact apply with respect to imports of products in this category. In his reply, the representative of Iceland noted that, under Public Law 480 agreements, there was never a possibility of importing the whole of Iceland's requirement of any product from the United States, as this would in any event run counter to the United States intent in making these food supplies available. Iceland's concern was to utilize fully the possibilities of importing under the agreements, which was advantageous to seller and buyer alike, and the regulation was solely designed to make that possible. Of late, however, freight rates were no longer price-controlled so that bulk items, like feedgrains from the United States had become more expensive. This is the reason why feedgrains are being removed from the list of products on which Iceland exercises special regulations to ensure procurement under the special financing arrangements. Beginning on 1 January 1967, there will be no special regulation whatever of trade in feedgrains. Trade in wheat is not affected. As for the allocation mentioned on page 3 of BOP/59 for purchase of ocean transportation within the framework of the Public Law 480 agreement, about which a question was also asked, the representative of Iceland mentioned that recently there had been no regular sailings of United States vessels to Iceland so that, in spite of the requirement that 50 per cent of Public Law 480 shipments can be made in American bottoms, no use had been made of the allocation shown in BOP/59 for ocean transportation.
14. The discussion turned again to bilateral agreements maintained by Iceland. In answer to various questions the following information was provided by the representative of Iceland. Payments, other than under the two new agreements with Czechoslovakia and Poland respectively, have been in convertible currencies, although sterling has been used as the nominal currency of account. The new trade agreement with Czechoslovakia, under which payments are to be in convertible currencies, does not include any quotas for Iceland's imports from Czechoslovakia, at the latter's request; it only specifies quotas for Iceland's exports to Czechoslovakia, a precaution asked by Iceland in order to ensure that provision would be made for such trade in Czechoslovakia's trade plan. Iceland does maintain a bilateral payments agreement with Brazil, as does one other Scandinavian country. Iceland cannot well move alone to terminate this agreement but will be willing to do so when the other Scandinavian country does likewise.

15. With respect to the importation of products on discretionary licensing, members of the Committee sought clarification concerning criteria used for deciding which imports could be permitted. The representative of Iceland stated that conditions varied greatly from one product to another and that it would be impossible to formulate any general rules applicable to all. In some cases, he conceded, a purpose of the restriction was to reserve a market for Eastern goods, and when these proved not to be available in sufficient quantity, imports from the multilateral zone were sometimes permitted. Some such products have in fact been transferred to global quota, with no damage to the trade of Eastern countries and with benefit to Iceland. Iceland was urged to consider further action to liberalize these products, but the representative of Iceland said that this might be difficult as the restrictions also served to some extent as protection for local industry in some cases.
16. In answer to a question about licence fees, the representative of Iceland stated that while a $\frac{1}{3}$ per cent licence fee does not apply to automobiles, there is such a fee on imports of other restricted goods from multilateral countries to cover expenses of operating the restriction system. Difficulty concerning the taxation of jeeps, which had been discussed at last year's consultation, had been cleared up.

Conclusion

17. Members of the Committee again thanked the representative of Iceland for his full and frank replies to their questions. They recognized that some of Iceland's problems, notably the difficulty of achieving balance between wages and price movements, were not peculiar to Iceland and were difficult to solve. They noted the evidence cited by the representative of Iceland that his Government was taking steps to deal with these problems. They felt that Iceland would benefit from the further relaxation of restrictions and from a movement toward reduced reliance on bilateralism. In this way the economy could be opened to more competitive pressure from other countries. They expressed the hope that Iceland would, accordingly, give serious consideration to the various moves which they had suggested as ways of giving effect to that part of the decision of the International Monetary Fund which calls for an early further reduction in reliance on restrictions. The representative of Iceland promised to convey the views which had been expressed to his Government and emphasized that his Government fully shared these views, as objectives, but that the timing of implementation of further moves would naturally have to depend not only on internal developments within the country but also on export prices and, as emphasized in his opening statement, on results in the Kennedy Round which do not, unfortunately, appear promising for Iceland.