GENERAL AGREEMENT ON
TARIFFS AND TRADE

RESTRICTED
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9 December 1966

DRAFT 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 basic documents supplied by the Government of Israel (BOP/65 and Add.1) and material supplied by the International Monetary Fund, to which reference is made in paragraph 3 below.

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 6 December 1966.

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 customary 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:

"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 May 18, 1966, taken at the conclusion of its most recent Article XIV consultation with Israel, and particularly to paragraph 5 which reads as follows:

'Israel has further reduced its reliance on quantitative restrictions and in order to improve the productivity of industry and to restrain price rises, the Government has decided to reduce customs duties in several steps. The Fund welcomes this decision and stresses the beneficial effects competition from abroad will have both on moderating the rise in prices and on the efficiency of domestic industry. The Fund regrets the lack of progress in terminating bilateral payments agreements, and expresses the hope that the Israeli authorities will reconsider their continuous resort to these agreements.'

The full text of the decision appears in Annex I."
At the present time the general level of restrictions of Israel which are under reference does not go beyond the extent necessary to stop a serious decline in its monetary reserves.

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

Opening statement by the representative of Israel

4. In his opening statement, the full text of which is contained in Annex II, the representative of Israel described the evolution of Israel's balance of payments. As imports had remained fairly stable in 1965, whilst exports had increased by about 15 per cent, the trade gap had narrowed as compared with 1964, but this improvement was partially offset by a deterioration in the balance on services so that there still remained a very large current-account deficit. In large part this gap had been met by further long- and medium-term borrowing that had increased Israel's total indebtedness to a level which gave rise to concern with regard to the future. There had also been some outflow of reserves of the Bank of Israel, beginning in March 1966, a fact which would be less disquieting if the annual current-account deficit were not so large.

5. The Government had consequently concluded, late in 1965, that the time had come for vigorous steps to curb domestic inflationary pressures, even though painful readjustments would be involved. It was decided to put a halt to the increase of public spending, especially in building construction, and to begin a long-term shift of resources to increase emphasis on expansion of export-oriented industry. Further, the link between wages and the cost-of-living index was partially suspended and the piece-work system was given broader application in industry to promote efficiency. Also a freeze was placed on taxes, already heavy, as past increases appeared to have given rise to price increases. A first result of these measures was an increase in unemployment, which had affected 5 per cent of the working population by October 1966. Hence, in spite of the reduction of the trade gap, 1966 proved to be a very difficult year.
6. The Government had also offered certain new inducements to investment in the expansion of industries with export potential in which Israel appeared to enjoy a relative advantage. Efforts were also being made to intensify the cultivation of available land with a view to producing, where possible, an additional export crop. Certain other export promotion efforts were also being made, and these had to some extent helped relieve the domestic situation.

7. With regard to the external situation Israel had, however, come to the conclusion that continued economic growth would require still closer co-operation with, and even integration in, a large economic grouping. The commercial agreement with the EEC, which was discussed with the Committee last year, was a first move to implement this decision, and more recently the Israel Government had concluded that even that agreement might not take care of Israel's essential needs. Consequently, an application for association with the EEC had been made last October. In addition, however, Israel looked forward to increased opportunities for trade through the results of the Kennedy Round, which would have a direct effect on the direction of official thinking about the reduction of tariffs and non-tariff barriers by Israel. Israel itself had reduced tariff rates on over 300 items by 5 to 10 per cent on 1 November 1966, in accordance with the programme announced last year. Reductions on about sixty more products were to be made in May 1967. It was important that these steps become accepted as a part of a regular programme to reduce all tariffs on imported products by 5 to 10 per cent annually, but there was an obvious interrelationship between what Israel could do and what other countries did. For their part, the Government of Israel hoped that the Kennedy Round would succeed, since the solution to Israel's balance-of-payments problem could only come through a growth of both exports and imports in which exports grew at a quicker pace in order to bridge the wide external gap.
Balance-of-payments position and prospects

8. Members of the Committee thanked the representative of Israel for the information he had given and congratulated Israel on its improved export performance - an improvement which seemed to represent part of a secular trend toward matching exports to imports. They acknowledged the pressure on imports created by Israel's commitment to rapid industrialization, to development of new agricultural lands and to unrestricted immigration, which had no doubt been all the more difficult in the face of rising unemployment. They hoped that tariff reductions and relaxation of import restrictions would not be regarded as alternatives. They welcomed the progress made during the year toward increased liberalization and commended Israel for the domestic programme to ensure sustained economic growth. They did note, however, that Israel's reserves appear to be equivalent to about ten months' import needs, which should warrant some increase in the tempo of liberalization, which instead appeared to be slowing down. It was noted that many industrial materials, some of which could make a valuable contribution to the new drive to diversify and intensify industrial production, remained subject to restriction and that there were even some cases of reimposition of import control on products formerly liberalized. They noted too that no progress had been made in termination of bilateral payments agreements which had frequently been the subject of discussions in the Committee and in some cases were causing real problems to other contracting parties.

9. In reply to these general points, the representative of Israel noted that for the time being, Israel had been very happy to reach the second phase of its liberalization programme in beginning a process of tariff reduction. It had seemed best to begin to accustom industry and agriculture to the idea of regular reductions in tariffs, which had been carried through on about 8 per cent of dutiable imports. So far as the tariff was concerned, a high proportion of imports took place in categories which were free of duty and another large sector of imports were effectively imported free of duty because
they were to be used for re-export. Less than one sixth of all imports were subject to duties of more than 35 per cent ad valorem and most of this trade bore duties of less than 60 per cent. The recent reductions affected 300 dutiable products which account for imports of $20 million out of a total of $250 million subject to duty, and 80 per cent of the reductions affected goods dutiable at more than 35 per cent. The transfer of certain goods from the free list to automatic licensing or to the discretionary licensing list was connected with the process of industrial diversification to which he had referred in his opening statement. Though a careful screening process is carried out to ensure that permitted new industries are only such as have a good chance of becoming competitive on world markets within a relatively short period of time - three to five years - it was simply not possible to induce people to invest unless some temporary assistance was given. With regard to reserves, the representative of Israel referred to the judgment of the IMF on this point but added that current needs include not only what is required to pay for imports of goods but also requirements to pay for services, and on that basis the reserves as of 30 September 1966 were hardly sufficient to cover six months' needs, a much more modest figure for a country dependent on relatively few export products, some subject to the caprices of the weather, not to mention Israel's special geo-political position, as noted in the opening statement.

10. In this connexion the representative of Israel answered various specific questions. He noted that the unemployment rate he had mentioned resulted from the fact that out of a labour force of just over 800,000, 40,000 were unemployed in October 1966. Citrus picking would give at least temporary employment to some laid off in the building construction industry, but there were the usual problems of mobility in transferring workers from one industry to another. To another question he explained that Israel maintained several specialized export-promotion institutions, governmental or mixed government and industry, which served such functions as bringing buyers and exporters together, finding
new markets, providing information on trade regulations and restrictions, and handling Israel's representation at trade fairs. For a country developing new export products as well as new markets there was endless work of this kind to do. Concerning the export trade outlook, which the representative of Israel again said was far from telling the whole story, the first nine months of 1966 had seen favourable developments. Imports had increased but by less than the increase in exports, so that the trade gap, according to provisional figures, had been narrowed from $296.5 million in nine months of 1965 to $262.2 million in January-September 1966, and exports had been equal to 58 per cent of imports in the latter period as compared with 51 per cent in the corresponding months of 1965. However, these developments were mainly due to good exports of citrus and diamonds (where the value added by manufacture in Israel is small) rather than to performance in the new and difficult industrial area on which Israel's future hopes depend. The optimum level of production of both these major exports, especially oranges, will soon be reached, so that most of the future expansion of Israel's export trade would have to come from elsewhere, and it was the new industries which would also have to provide the stability which the export trade now conspicuously lacked.

11. Members of the Committee noted the continued capital inflow which, with the improved trade balance, seemed a good basis for the start that had been made on tariff reductions. In reply, the representative of Israel noted that both personal restitutions and investment capital from abroad had declined in 1965 as compared with 1964. The difference had been made up mainly by heavier borrowing which would, if continued on the present scale, create very heavy repayment obligations within a few years. In answer to a question about per capita income in 1965, the representative of Israel noted that in 1965 gross national product had increased over 1964 by 7 per cent and that in 1966 a further increase of between 5 and 6 per cent was estimated to be taking place.
12. Concerning the choice of new industries with good export prospects, about which a question was also asked, the representative of Israel mentioned that raw materials found within the country, mainly in the southern region, were the basis for much new investment. There, potash, rock phosphates, natural gas, copper cement had all been developed within the past decade. One new plant, by the Dead Sea, at Arad, would produce phosphoric acid and concentrated fertilizers. At the Weizmann Institute fine chemicals were being developed, some of which were already being exported. In many cases not only capital but also know-how was being sought from abroad, and a recent change in the law on foreign private investment accorded foreign investors a grant of up to 20 per cent of their installation costs if they could sell 50 per cent of their output for export. This appeared to be more effective than the former system of tax credits as an incentive to added investment.

Alternative measures to restore equilibrium

13. The point was made that many Mediterranean countries have developed an important source of foreign exchange by encouraging tourism, and the question was asked how much revenue tourism brings to Israel and what were the prospects for further increase. In reply, the representative of Israel noted that tourism had indeed been very much in the minds of the Government authorities and that receipts from this account had increased to perhaps $60 million as compared with $56 million in 1965. Revenues had not increased as much as numbers of tourists, however, and it would seem that future expansion would likelier be in catering to the many tourists with smaller budgets. For this reason, Israel was now developing moderate-priced hotels and motels and was trying to attract more group tourists.

14. Another question concerned regulations on terms of payments for imports, which it was understood could not now exceed 180 days in the case of raw materials required for export industries, special permission being needed for longer credit which was very rarely given. The question was asked whether some relaxation of this regulation would be considered consistent with Israel's
general trade liberalization programme. The representative of Israel replied in the negative. To allow longer periods for payment of raw materials and consumer goods would undoubtedly increase foreign exchange costs, particularly because interest rates in Israel were much higher than in Western Europe or North America and many import firms would increase their reliance on credits obtained from abroad. This would not only imply a greater drain of foreign exchange but risked adding to the inflationary pressures and distorting the pattern of imports. At best, Israel would be paying more and more to service debts now being contracted, and to obtain more credit would only increase the payments gap. Except for investment goods, where longer payment terms were allowed, Israel would not consider longer payment terms desirable.

15. Members of the Committee reverted to the question of diversification of industry and inquired how the screening of industries was carried out and what experience Israel had had in persuading industries once established to give up the protection they first enjoyed. In this connexion the question was also asked how the import restriction was administered when new industries were authorized and granted some protection, and the hope was expressed that Israel would avoid any discrimination in the administration of the present licensing system. The representative of Israel stated that, after an initial period in which industries had been established with insufficient consideration of their ultimate capacity to compete without protection, Israel now realized that in its own interest all industries must be forced to compete. This was of course much more easily said than done, particularly at a time like the year 1966 when the Government's policy was widely blamed for unemployment. It was against this background that progress toward liberalization in 1966 had been made and in this context that the action to admit some imports never before permitted had to be evaluated. So also for the tariff reductions begun this year. In any case, the basic test for permission to establish a new industry was now the question whether export competitiveness could be achieved with no more than, normally, three to five years' quantitative restrictions. As previously noted,
it was in this context that some transfers of goods from free to licensable lists had taken place. In all such cases, the prospective investors had presented a persuasive case to show that they could export and dispense with quantitative restrictions within the kind of time period indicated.

System and methods of the restrictions

16. Members of the Committee referred to the figures concerning the proportions of trade subject to various import régimes, shown in the background documentation for last year's and this year's consultations. They inquired how these figures had been drawn up; others noted that without consolidated up-to-date lists of products subject to the various import procedures, it was difficult to understand how such data could be prepared or how comparisons from one year to another could be made or verified. Some instances had been noted in which a product believed to have been liberalized had turned up on new liberalization lists, and the percentage breakdown as given did not appear to reflect changes in the system, on which detailed reports were received from time to time. It was also recalled that at one time it had been predicted that a negative list would be available by now, as this was to be drawn up early in 1986 in the process of reviewing items still subject to restrictive licensing. In reply the representative of Israel acknowledged that change had been so rapid, in the process of liberalization, that the administrative services had not been able to keep pace in developing an adequate tabulation of the net results. There was no difficulty in determining the status of individual products so that traders were less handicapped than were those interested in analysis of the overall position, since each foreign exporter or Israeli importer was interested in only a limited range of goods. As to the fact that there had been no change in the percentages despite changes in the make-up of the various lists, one should avoid hasty conclusions. Quantities of imports in a given year reflect not only the liberality or restrictiveness of regulations but also market demand and supply. Without a detailed analysis of the composition of
the figures, including knowledge of the year used as a basis for the breakdowns in the various compilations, one should not attempt to evaluate the figures in detail. He asked the Committee's indulgence and patience and assured them that his own officials were most anxious to put an end to the somewhat confused condition of the lists. While he would not promise to deliver a list at a date which might later prove to be impractical, he would do his best to see that priority was given to drawing up and keeping current consolidated lists showing which products were admitted without licence, which were subject to automatic licensing and which were still subject to discretionary licensing. This would be preferable to an effort to explain the figures on proportions subject to various régimes appearing in the documents, which undoubtedly reflected correctly enough the approximate shares of trade subject to the various methods but which would certainly be reviewed and revised once the new lists were available.

17. Members of the Committee referred again to Israel's bilateral payments agreements in which no change appeared to have occurred since the last consultation, and inquired whether there were any prospects for the termination of any of the existing agreements. They also asked what kind of commodity coverage was included in these agreements and whether the agreements might be described as of the "balancing" variety, that is with lists on both sides; they also wished to know whether the agreements contained any element of discrimination among the countries involved. In reply the representative of Israel first emphasized that only 4.3 per cent of Israel's trade was involved in all of the agreements which might be called bilateral payments agreements, though some were not strictly intergovernmental agreements. Imports from these countries had either fallen or done no better than keep pace with the growth of total import trade. Israel had regularly let bilateral payments agreements lapse when the trade partner had itself gone over to a system of free multilateral trade. More than that Israel could hardly do, however, for it was not possible to sell to the State-trading countries unless agreements
had been concluded. A small country has to adopt itself to the trade problems and methods used by its trading partners, and Israel could certainly not afford to forego any export markets while her need to increase exports remained so great. These would be export markets which Israel would especially regret losing since, unlike the general situation in trade with other countries, exports to these countries did cover fully the imports which Israel bought from them. Furthermore, Israel was always very careful to buy from the State-trading countries only at prices competitive with world prices. The products which Israel bought there were largely bulk raw materials, and whenever imports were licensed from bilateral countries imports were also licensed from elsewhere to help ensure that prices would be competitive. Israel had, however, no intention of extending the sector of its trade which is subject to bilateral payments agreements. He knew, he said, of no discriminatory import facilities or of any premium prices involved in operation of the agreements.

18. Members of the Committee expressed satisfaction on learning that Israel did not intend to extend the area covered by bilateral agreements, but urged that Israel reconsider its continued resort to these agreements, as the IMF Executive Board had done. They expressed great sympathy with Israel in its efforts to expand exports notwithstanding the rather narrow range of products which it could sell, but nevertheless urged that in the long run a continued reduction in the use of bilateral payments agreements would be in the country's best interests. In particular, the question was asked how the Government of Israel could "encourage" imports from bilateral countries, and in what such encouragement might consist. In reply the representative of Israel pointed out that products purchased from these countries were not generally products which had been placed on the free list. The encouragement really consists in a willingness to licence the imports, and in selecting the products to be licensed the Government had naturally followed the traditional pattern of trade with those countries. He emphasized, however, that whenever goods were
licensed from bilateral countries, licences were also accorded for imports from multilateral countries (usually under the automatic licensing procedure) in order, as he had stated, to make sure that the relative costs were kept in line. This had been fairly easy to do when imports were rising but was more difficult when imports were falling, since Israel did of course feel an obligation to fulfil the commitments made under the bilateral agreements.

For a small country like Israel transportation considerations also entered into this calculation to some extent, especially in trade with distant countries, for if bulk goods had been exported the shipment could only be made economic by purchase of goods from the country of destination in order to fill the ships on the return voyage. From this standpoint some directing of import trade helped to move the exports.

19. Members of the Committee referred to a statement in the background paper that the purpose of the required licence under the automatic approval system is to check the prices of competitive imports. This raised the question what happens after the check has been made, or in other words was this check being used as something like an anti-dumping control. The representative of Israel acknowledged that some surveillance over prices was maintained, both to see that no dumping was being practised and to see that no purchases were being made from high-cost sources. He added that this should not be thought of as a complete system of control however, as there was a recognition that much interference with trade posed risks of error possibly greater than the risks of letting trade take care of itself. Nevertheless, though this method was regarded as less than ideal, it appeared that a control of this kind fulfilled a necessary function with a minimum of disadvantage.

Conclusions

The Committee thanked the representative of Israel for the full and frank way in which he had responded to their questions and welcomed the steps taken to pursue domestic policies designed to restore equilibrium and to intensify and diversify production for export. They hoped that Israel would bear in mind
the contribution which improved access for imports to the Israel market could make in bringing about more effective use of resources and that Israel would continue to move toward liberalization through removal of quantitative restrictions and continued reduction of tariff protection. They also concurred with the Fund in regretting the lack of progress in terminating bilateral payments agreements. The representative of Israel assured the Committee that he would convey the views which had been expressed to his Government and he wished to state, as he had done during the consultation, that Israel was well aware of the need to make its industry as competitive as possible, in its own interests, and would continue to move toward liberalization and non-discrimination as rapidly as conditions permitted.