Committee on Balance-of-Payments Restrictions

DRAFT REPORT ON CONSULTATIONS WITH ICELAND

1. In accordance with its terms of reference the Committee has conducted a consultation with Iceland under Article XII:4(b). The Committee noted that the previous consultation with Iceland under the same provisions had been held in March 1969 (cf. BOP/R/31 and BOP/83). In conducting the present consultation the Committee had before it a basic document supplied by the Government of Iceland (BOP/102) and a paper containing supplementary background material, dated 26 February 1970, supplied by the International Monetary Fund.

2. The Committee generally followed the plan for such consultations recommended by the CONTRACTING PARTIES (BISD, Seventh Supplement, pages 97-98). The consultation took place on 16 March 1970. 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 International Monetary Fund had been invited to consult with the CONTRACTING PARTIES in connexion with this consultation with Iceland. In accordance with the agreed procedures the representative of the Fund was invited to make a statement concerning the position of Iceland. The statement made was as follows:

"The Fund invites the attention of the CONTRACTING PARTIES to the supplementary background material dated February 26, 1970 which has been transmitted to the CONTRACTING PARTIES.

"The Fund believes that at the present time the general level of restrictions of Iceland which are under reference does not go beyond the extent necessary to achieve a reasonable rate of increase in its reserves."
Opening statement by the representative of Iceland

4. In his opening statement, the full text of which is reproduced in Annex I, the representative of Iceland outlined the vicissitudes in his country's economic position and balance of payments in recent years, their prospects for the near future as well as the economic and commercial policies being pursued. The sustained boom of 1962-66 had been followed in 1967-68 by a serious decline in the volume of exports, aggravated by a decline in prices. The steep decline in exports and in per capita national income entailed two drastic devaluations of the currency in 1967 and 1968. It was gratifying that in the circumstances the policy of trade liberalization had been maintained. As had been forecast, a recovery in the fisheries production, together with an improvement in the terms of trade, had brought about a rise in GNP by some 2 per cent in 1969. While there had been a setback in agricultural production, the increase in the volume of fisheries production had been substantial and production in manufacturing industries, other than fish processing, had also markedly increased. The devaluations of 1967 and 1968 had helped eliminate the substantial deficit on the balance of payments which had occurred in both these years, and in 1969 there had been a surplus of about $4 million on current account while the foreign exchange reserves had risen by $19 million.

5. Present indications were that fisheries production would continue to expand which, together with improvements in prices, might lead to an increase in the value of these exports by 10 per cent this year. Exports of manufactures were expected to rise briskly as a result of the industrial diversification, supplemented by the effects of the devaluations and the better conditions of access to the EFTA markets following Iceland's accession to that grouping. A rise in GNP by 4 per cent was expected for 1970.

6. Thanks to the vigorous fiscal and monetary policies being pursued, the Government had been able to continue trade liberalization. As a consequence of Iceland's accession to EFTA, import liberalization measures had been undertaken vis-à-vis all countries: the remaining quantitative restrictions on industrial products (except petroleum) would be removed totally by the end of 1974; a number
of products had been added to the free list as from 1 March 1970; and global quotas had been enlarged for a number of products this year. As regards the customs tariff, duties on industrial raw materials had generally been reduced by 50 per cent and those on industrial machinery had been scaled down by a substantial margin to 7 per cent. These reductions on raw materials and machinery applied to imports from all sources, as did the reductions of certain other duties. Apart from these, there were also reductions of protective duties on imports from EFTA countries.

7. In conclusion, the representative of Iceland stressed the importance attached by his Government to the diversification of production and exports. The collapse of herring fishing in 1967/69 had clearly demonstrated the inherent vulnerability of the country's traditional economic structure. It was hoped that Iceland's accession to EFTA would contribute to a quickened pace of the country's industrialization and diversification, and to strengthening her economic basis, thus placing her on a sounder basis as a member of the international trading community.

Balance-of-payments position and prospects and alternative measures to restore equilibrium

8. Members of the Committee expressed special appreciation for the measures which had been taken by the Icelandic Government to meet the difficulties and the serious crisis it had confronted in 1967 and 1968. They were pleased to note the recent substantial improvements in current account and in the overall balance of payments. They commended the Government of Iceland for the steadfast manner in which it had dealt with these difficulties and in pursuing a policy of liberalization. They also expressed the hope that the generally more favourable situation would continue to improve and that the process of liberalization could thus be resumed and accelerated.

9. In reply to questions on the prospects for further improvements in Iceland's balance-of-payments position and internal equilibrium, the representative of Iceland said that while no official forecasts were as yet available, some general indications could be given with regard to the long-run prospects of the fishing industry. Marine biologists were of the opinion that the fish stocks accessible
to Iceland would certainly not yield any sustained increases in catches. Owing to the growing population and labour force, accelerated industrial diversification must be taken as of primordial importance. The foundations for such a policy had been laid in the Búrfell/Straumsvík power project and related aluminium smelter; and had been supported by the economic measures taken in 1967 and 1968, the devaluations and related fiscal measures. Iceland's accession to EFTA had been motivated by the same objectives.

10. As regards the short run, the representative of Iceland thought that some factors in the external situation had also been promising: the fall in fish prices had been reversed; access to the United Kingdom and other EFTA markets had been obtained on a non-discriminatory basis for frozen fish and other products of interest to the fish industry. Among recent governmental measures the reduction in import duties on raw materials and machinery should aid export industries, and membership in EFTA, which opened up possibilities of industrial co-ordination and rationalization and of closer economic co-operation in general, should have the effect of facilitating and hastening industrial development in Iceland. All these would undoubtedly contribute to strengthening the balance-of-payments position of the country. It should also be said that for the immediate future, a successful development would seem to depend closely on Iceland's ability to maintain internal cost-price stability.

11. With respect to industrial diversification, it was asked whether concrete plans existed for the establishment of any new industries other than the aluminium smelting already mentioned. The representative of Iceland described the structure of the country and said that certain industrial development projects were under study and the following lines could be mentioned: the production of magnesium, salt, perlite, seaweed and heavy water. Aluminium production was of course capable of substantial expansion. However, no concrete projects had as yet been decided upon. Diversification could also be pursued through the expansion of facilities for the processing or further processing of fish, wool and skins, which were traditionally exported in unprocessed form. Useful information on these industrial opportunities was being disseminated by the Ministry of Industry, whose efforts were supplemented by those of the Federation of Icelandic Industries, which had set up a small promotional office to that end.
12. Noting the importance of wage and price stability to the maintenance of external equilibrium of Iceland, members of the Committee pointed out that while the necessary adjustments over the past years had not caused serious industrial stoppages a great deal would seem to be at stake with respect to the forthcoming wage negotiations. Some concern was expressed over the inflationary impact of automatic wage adjustments and it was asked whether Iceland authorities would seek a greater degree of flexibility in the wage-price relationship in the course of the labour negotiations in May. The representative of Iceland recalled that the automatic link between wages and prices had been restored only last September. In the course of 1969, wages levels had risen by 12 per cent while prices had risen by 22 per cent over those of the previous year. While labour unions would undoubtedly present wage claims which would compensate as much as possible the rise in prices, the Government would do its utmost to ensure that the wage increases would be of manageable proportions.

13. In reply to a question on when the Fish Price Equalization Fund would start to function, the representative of Iceland said that the scheme was already in operation although detailed arrangements were still to be evolved.

14. A member of the Committee, enquired as to the significance of the statement in the IMF background paper to the effect that business firms had been made subject to licensing and restricted to Icelandic nationals. The Committee was informed that subsequent to the preparation of the IMF paper in question, the legislation had been amended so that such licences could be granted irrespective of the nationality of the applicant.

System and methods of restriction

15. In the course of discussion under this heading, members of the Committee recalled the various favourable developments which would seem to afford the Icelandic authorities greater scope for progressive action. In view of the persistent efforts made by the Icelandic authorities to maintain a liberal trade
policy even in severely adverse circumstances, the recent improvements seemed to
give hope for further significant progress in trade liberalization. In this
context a member of the Committee expressed gratification over the abolition of
the tax on motor vehicles in Iceland on 1 March 1970 which should help to reverse
the drastic decline in such imports during the 1967-1969 recession and following
the large devaluations of 1967 and 1968. Members of the Committee enquired
whether the Icelandic Government had adopted or was formulating any concrete
plans for the further liberalization of imports in the near future.

16. In reply, the representative of Iceland called attention to the fact that
the Icelandic economy had only very recently emerged from a severe difficulty
which could very well have led to the adoption of policies severely restrictive
of foreign trade. That the Government was anxious to resume and accelerate the
process of liberalization at the earliest opportunity had been borne out by the
various measures taken on 1 March as described in the basic document before the
Committee: apart from the reduction of duties on industrial imports from EFTA
countries, duties on raw materials and semi-manufactures for domestic industries
had been reduced by 50 per cent and duties on industrial machinery had been
reduced substantially, both on a most-favoured-nation basis. Import restrictions
had been removed for over twenty tariff items (see Annex III to the basic document)
and import quotas had been substantially increased (cf. Annex II, ibid.). While
the present circumstances could hardly justify any steps beyond what had already
been taken, it remained the Government's firm policy to remove the remaining
restrictions as rapidly as possible; at any rate all restrictions on industrial
products, other than petroleum and petroleum products, would be removed within
the next five years, i.e. not later than the end of 1974.

17. In response to a specific question, the representative of Iceland stated
that chocolate and sweets remained subject to import restrictions for the time
being and that these restrictions were being maintained both on balance-of-payments
considerations and for the purpose of assisting small domestic producers in a
somewhat depressed industry which had enjoyed protection from foreign competition for many years. Imports of these products were, however, expected to be gradually liberalized during 1972-1974: global quotas would be provided as from 1972 and liberalization should be completed not later than the end of 1974. The representative of Iceland also undertook to convey to the attention of his Government certain comments made by a member of the Committee on the restrictions on coffee, a product of exclusive export interest to developing countries.

18. One member of the Committee enquired about the nature of any special undertakings Iceland might have accepted towards other EFTA countries with respect to quantitative restrictions and how would these affect Iceland's programme of trade liberalization. The representative of Iceland confirmed that trade liberalization in Iceland had proceeded and would continue to proceed on a non-discriminatory basis. The removal of restrictions on 1 March, although taken in consequence with Iceland's accession to EFTA, applied to imports from all sources; the same would apply to all future action to be taken between now and the completion of the process by 1 January 1975; all import quotas were also of a global nature and were available to all exporting countries.

19. Recalling the comments they had made during the last consultation with Iceland on the country's reliance on bilateral payments and trade agreements - in particular the then newly revised agreement with Brazil - members of the Committee observed that there still remained several such agreements all providing for bilateral clearing; that Iceland seemed to have continued to rely on this device for the maintenance of its markets for certain traditional fish exports; and that these arrangements seemed to account for over 10 per cent of Iceland's total imports (1968 basis). Invited to comment on this tendency and the prospects of a reduction in the trade coverage of such agreements, the representative of Iceland pointed out that there had been in the past ten years a consistent trend in Iceland to move away from the use of bilateral agreements; whereas as late as 1960 Iceland had had bilateral trading relations with ten countries, at present no more than five such agreements remained in force (the agreements with Finland, Israel, Spain, Czechoslovakia and Poland having been discontinued during this period). Among the existing agreements, the one with
Hungary was likely to be discontinued this year. The current agreement with the USSR, covering the three-year period of 1969-71, contains indicative quotas for the exchange of Icelandic frozen fish, salted herring, woollen goods, canned fish products for Soviet petroleum products, iron and steel, automobiles and lumber. Iceland was unable to find sufficient alternative outlets for the export products mentioned and discontinuation of this arrangement would certainly accentuate her difficulties in present circumstances. Iceland was, therefore, desirous of continuing the present bilateral trading arrangement with the Soviet Union.

20. In amplification and clarification of the information given in the basic document, the representative of Iceland stated that, following the indication given by his delegation at the last consultation, the Government had abolished the State monopolies on perfumes and essences in 1969. The monopoly on matches had not been changed as had been intimated, the authorities having found it impractical to discontinue it at this juncture. As regards the other monopoly arrangements, fertilizers, wine, liqueur and tobacco were subject to State trading for fiscal, health and other legitimate reasons; in the view of the Icelandic authorities, these State-trading arrangements were in full conformity with the rules and criteria of GATT.

Conclusions

21. Members of the Committee commended the Government of Iceland for the policies it had pursued and the progress made in coping with the balance-of-payments difficulties. The Committee expressed the hope that continued improvements in the balance-of-payments would enable Iceland to undertake further liberalization measures in the near future.

22. The representative of Iceland stated he had taken note of all the views and comments put forward at this consultation, which he would convey to his authorities for attention.