At its meeting on 22-23 January 1970 the Council of Representatives was informed by the delegation of Israel that Israel had introduced further measures affecting imports, in the form of an import deposit requirement, for the purposes of safeguarding the foreign exchange reserves and restoring internal equilibrium. The Council, on the basis of the information available, agreed that the measure should be examined in relation to the relevant provisions of the General Agreement, and the Committee on Balance-of-Payments Restrictions was instructed to undertake this examination at an early date, taking into account the discussions at the last consultation with Israel on its import restrictions.

Inasmuch as the new measure was stated to have been resorted to for balance-of-payments reasons, the Committee's discussions, which took place on 17 March 1970, covered all the aspects normally covered in a consultation on balance-of-payments restrictions. The Committee considered, therefore, that this may be deemed to constitute Israel's consultation for 1970. Accordingly the Committee generally followed the plan for such consultations recommended by the CONTRACTING PARTIES (BISD, Seventh Supplement, pages 97-98). The present report follows the usual pattern of a report on such a consultation. The Committee's special recommendations on the import deposit scheme are set forth in the concluding section of the report.

The Committee had before it: (a) the report on the last consultation with Israel (BOP/R/40); (b) a new basic document supplied by the Israeli authorities which contains, inter alia, a description and explanation of the import deposit.
scheme and to which were attached the relevant administrative regulations (BOP/R/103); and (c) supplementary background material supplied by the International Monetary Fund, dated 26 February 1970.

Consultation with the IMF

4. 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 these Israeli measures. In accordance with the agreed procedures the representative of the Fund was invited to make a statement concerning the position of Israel. The statement made was as follows:

"The Fund invites the attention of the CONTRACTING PARTIES to the statement made by the Fund representative on the occasion of the CONTRACTING PARTIES 1969 balance of payments consultation with Israel, and to the supplementary background material dated 26 February 1970, which has been transmitted to the CONTRACTING PARTIES.

"The import deposit scheme introduced by Israel on 11 January 1970 was one of a series of measures designed to slow down the decline in foreign exchange reserves. Other measures taken by the Government include increases in income tax and some indirect taxes, higher social security contributions and a compulsory defense loan.

"Israel's balance of payments is characterized by large annual deficits on goods and services which are financed by a surplus on capital account and by a substantial inflow of funds from unilateral transfers. In most of the years during the 1960's, up to 1968, capital inflows and receipts from unilateral transfers exceeded the deficits on goods and services, with the result that Israel was able to increase her holdings of foreign exchange reserves."
The situation changed rapidly, however, during 1968 and 1969, when rising government expenditure, mainly for defense, and an expansion in domestic activity, particularly a rapid acceleration of investment, led to a sharp rise in imports. In 1968 the deficit on goods and services rose by $165 million, to $696 million. The rapid expansion in domestic activity continued throughout 1969, as Government and private consumption rose by nearly 12 per cent and investment increased by 24 per cent. Imports grew during the year by about 20 per cent, with imports of consumer goods rising by nearly 30 per cent and investment goods by 40 per cent. Commodity exports continued to grow, increasing by 14 per cent. Although exports of citrus fruit did not come up to expectations, increasing by only 5 per cent, exports of other agricultural products rose by 13 per cent and industrial exports were 14 per cent higher. Exports of services rose by less than 2 per cent in 1969 compared with an increase of 29 per cent in 1968: the main reasons for the slowdown in 1969 were a decline of 12 per cent in tourism (following an 84 per cent increase in 1967) and a decline of 16 per cent in investment income.

The deficit on goods and services grew in 1969 by $208 million, or 29 per cent, to $930 million. Unilateral transfers were $37 million higher and the inflow of medium and long-term capital, at $240 million, was $10 million higher than that of 1968. As a result almost the entire increase in the goods and services deficit had to be financed by a running down of gold and foreign exchange reserves. The Bank of Israel's holdings of gold and foreign exchange declined in 1969 by $250 million to $412 million; this amount was equivalent to two and one half months of imports; a year earlier reserves were equivalent to four and one half months of imports.

In 1969 Israel purchased the equivalent of $45 million from the International Monetary Fund; this purchase comprised the gold tranche and the first credit tranche. Further on 22 January 1970, Israel used the full amount of her allocation of SDR's ($15.1 million).
"The import deposit scheme introduced on 11 January 1970, is limited in its impact as it applies only to approximately 16 per cent of total commodity imports. The Fund believes that the effect of the import deposit scheme does not go beyond the extent necessary, in conjunction with other measures, to stop a serious decline in Israel's monetary reserves. The Fund hopes that, when the balance of payments situation permits some relaxation of policy, the Israel authorities will accord priority to phasing out the deposit scheme."

Opening statement by the representative of Israel

5. In his opening statement, the text of which is annexed to the present report, the representative of Israel recalled the discussions on the country's balance-of-payments position at the last consultation with Israel in November 1969, and supplied information on more recent developments. Attention was drawn to the mounting deficit on current account, and the resulting drastic decline in foreign exchange reserves in 1969 and in the early months of 1970. The measure taken in January 1970 formed part of a series of policy measures which had been foreshadowed during the November consultation, and was accompanied by a number of internal measures aimed at stabilizing wages and prices and at containing the inflationary pressures in general. In this context the representative of Israel described the main features of a tripartite agreement recently concluded between the Government, the employers and the trade unions, which provided for very limited wage increases, to be paid in the form of Government bonds, which would be matched by equivalent bond purchases by the employers. Parallel to this agreement a number of fiscal measures were taken by the Government, including an increase in the defence levy, higher social security contributions, placing the defence loan on a compulsory basis, a rise in indirect taxes, and a reduction in foreign exchange travel allowances. Other measures, such as the abolition of the legal interest rate ceiling, changes in taxation procedures, and limitations on housing and building projects, were also to be shortly implemented.
6. The import deposit scheme had been introduced in the context of a series of diverse measures designed to stem the drain on the foreign exchange reserves. It was, however, not aimed at lowering the level of imports in absolute terms, but merely at achieving a lower rate of growth of imports which was currently running at an excessively high level. It covered only a small proportion — some 16 per cent — of total imports and affected mainly consumer goods. The bulk of imports, including plant and equipment, raw materials and Government imports were not affected. The measure was regarded as being of a purely temporary nature, and the Government's basic policy remained one of liberalization of the foreign trade régime. Israel's long-term policy was to solve her balance-of-payments problems through the expansion of exports and foreign exchange receipts rather than through the paring down of imports.

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

7. In discussing the balance-of-payments position of Israel, the Committee generally referred to the relevant material contained in the basic document, the supplementary paper supplied by the IMF and the statement by the Fund representative quoted in paragraph 4 above. Members of the Committee expressed their understanding and concern for Israel's balance-of-payments difficulty. It was noted that the recent aggravation of these difficulties would seem to stem in some measure from increased defence expenditures abroad. The increase in imports, especially defence imports, had substantially overtaken the growth in exports and had upset the traditional pattern of Israel's balance of payments, which has historically been characterized by a considerable current account deficit more than adequately covered by capital inflows, preponderantly comprising unilateral transfers from abroad. Defence imports, which had represented some 25 per cent of the deficit on goods and services account in 1964-1966, accounted during the last three years for about 50 per cent of the deficit, on the average. During 1969, nearly 40 per cent of the budget and 25 per cent of the gross national product were devoted to defence expenditures, and no alleviation
of this burden would seem to be in sight. Added to this, important elements of the Israeli progress toward balance-of-payments equilibrium are precarious, especially in the case of receipts from tourism and the closely-related transportation services, which could be adversely affected by military and political events. In the face of this conglomeration of extremely difficult problems it was probably inevitable that Government officials in Israel should advocate various, often widely divergent, policies. The representative of Israel was invited to comment on the prospects of the various policy lines being followed, on how the Government envisaged dealing with the immediate critical situation, on how it planned to correct its balance-of-payments deficit, particularly the increased deficit in the current account, and on how it viewed the prospects for Israel's balance of payments in 1970. Specifically, he was asked whether his Government expected capital inflow to increase in 1970.

8. The representative of Israel, in reply to these questions, reiterated the principal points in his opening statement relating to his Government's basic policies and long-term objectives. As regards the balance-of-payments prospects for 1970, the Israel representative gave the Committee some tentative estimates for comparison with the 1968 and 1969 figures given in the basic document (cf. BOP/103, page 7). In discussing these projections the Israeli representative stressed their provisional nature and the likelihood of their being adjusted and revised in the coming months. Apart from the uncertainty of future events, Government policies directly bearing on the flow of foreign currency receipts and expenditures were themselves subject to frequent review and modification. As the main objective of Government policy at present was to stop the boom and to restore a more steady rate of economic growth, without bringing about a recession, the various policy measures had to be applied with extreme delicacy and reviewed constantly in the light of their effects and ramifications. Consequently, there could be no question of setting fixed courses to be inflexibly followed over prolonged periods or of giving exact economic forecasts for the coming years.
9. A member of the Committee observed that, even though capital inflow and unilateral transfers to Israel in 1969 had, as had been forecast by the Israeli authorities, both significantly exceeded their 1968 levels (by $37 million and $10 million respectively), these had been insufficient to close the rapidly rising current account payments gap, and this had to be met by running down foreign exchange reserves. As regards 1970, it had been forecast that capital inflow and unilateral transfers would again rise, although in the latter case by a smaller margin than in 1969. On the other hand, the increased inflow of these capital funds would seem to be increasingly devoted to current, notably defence, expenditure rather than, as previously, to productive investment. The Israeli representative was invited to comment on the long-term implications of this change in the country's debt structure.

10. It was noted in the discussion that the current difficulties met by Israel in its balance of payments and the fall in foreign exchange reserves must be viewed against the background of a booming economy and a remarkably high rate of growth in the gross national product and in industrial production. Remedies to redress the external disequilibrium, as the Israeli authorities were obviously aware, had to be sought through appropriate domestic and monetary policies. The measures that had been taken in the past year to combat excess demand e.g. the bank credit restriction introduced last November bearing directly on import financing, the rise in the Bank rate with the ancillary aim of raising commercial lending rates, the wage stabilization agreement mentioned above, etc. would all appear to be appropriate in the circumstances. Invited to comment on the effects of these various internal financial measures, the representative of Israel expressed the view that as the measures had mostly been introduced only recently, it was too early to assess their effects. The credit restrictions and high cost of borrowing should dampen demand, although this had not as yet been reflected in a decline in imports. The boom spell had not yet been broken, and disposable personal income had not yet been reduced to any significant extent; a certain
time would have to lapse before the effects of the disinflationary measures were generally felt. In general, public expectation had remained buoyant and the various fiscal measures adopted had had so far only a limited effect on spending. It was to be hoped that when the effects of all these measures became generally felt, their impact would not be so strong as to bring on a full fledged recession.

System and methods of the restrictions

11. Members of the Committee recalled an indication given by the Israeli representative at the consultation last November concerning the pending adoption of a five-year plan providing for tariff reductions on industrial products in 1971-1975, and referred to the growing need for fiscal revenue on the part of the Government. They wished to know the general outline of Israel's tariff policy during the next years and whether it remained Israel's intention to pursue the previously announced goal of reducing average tariffs to a range of 30 to 60 per cent by 1974, and an eventual goal of 25 to 35 per cent, as described in paragraph 20 of the report on last November's consultation with Israel (BOP/R/40). The representative of Israel replied that there had been no changes in the five-year tariff reduction plan. By 1975, import duties on all products which were also locally produced would be at such a level as to afford the locally produced product effective protection of not more than 35 per cent (i.e. 35 per cent on the value added in domestic production). Despite the difficult balance-of-payments situation tariff reductions scheduled for 1 January 1970 had been effected on that date.
12. Asked whether the five-year plan for tariff reduction had been published, the representative of Israel stated that the policy had been announced and discussed with industry, but that a detailed schedule of proposed tariff reductions for individual items had not been published. As had been explained at the last consultation the value-added element differed not only from industry to industry, but between different producers in a given sector. The calculation of the rate of tariff reduction necessary to bring the protection down to a uniform level would also be different in practically every case. This was a laborious and time-consuming process. In order to avoid complications and unnecessary polemics, the authorities had decided not to publish the reduction rates until the appropriate time. In response to questions on the way the protective duties based on the value-added content of local products were to be calculated, the representative of Israel explained that the protective duties would be applied naturally only to products which were also produced in Israel. Import duties and excise taxes on other products, in fact the vast majority of imports, would be of a fiscal nature and their calculations would not be related to any such criteria. 

13. In response to questions concerning the administration of the import controls, the representative of Israel informed the Committee that there had been further removals of administrative controls since last November, for example, certain products mentioned in list "f" as well as in certain other lists had since been taken off the controlled list. A schedule had been worked out for the liberalization of the products mentioned in list "a-2". The process of liberalization had been greatly accelerated in 1969; in the coming years it would be continued at a somewhat slower pace. The accelerated liberalization had met with considerable criticism in Israel, and a special Public Committee had had to be set up to investigate appeals by manufacturers. However, the policy had been to require concrete evidence of disruption and damages before protective tariffs could be raised for a particular industry. In other words the established policy of trade liberalization would be continued.
14. Questions were raised concerning Israel's bilateral agreements. The representative of Israel confirmed that of the five bilateral payments agreements which his Government had had in lieu of the last consultation in November 1969, only those with Hungary, Bulgaria, Brazil and Portugal remained in force. The bilateral agreement with Yugoslavia had lapsed in March 1970. He stated that his Government's policy in the past three years had been directed towards the gradual termination of bilateral payments agreements. He recalled that while three years ago there had been ten such agreements, representing some 3 to 4 per cent of Israeli trade, there were now only four such agreements, covering no more than 1 per cent of Israel's total trade.

15. Recalling earlier discussions, some members noted that the purchase tax levied in Israel on certain items, imported into or produced in Israel, was set at rates generally ranging from 2 to 60 per cent of the wholesale value, in some cases exceeding 100 per cent, and that an unexpected increase of up to 16 per cent in this tax had taken effect with respect to a wide range of consumer goods in May 1969. Since then further increases on passenger cars, imported cigarettes, liquor and food delicacies had been announced in early February 1970. As a result the tax on full-size imported cars had been over $6,000 per unit, while the same type of cars manufactured in Israel carried a tax of only about $1,000. This situation had arisen because the present purchase tax on cars assembled in Israel was based on value while motor size and weight were the criteria for taxing most imported cars. In this context, it was asked whether any further rate changes in the Israel purchase tax system were contemplated in the near future. It was also asked what the aim was of the increase in purchase taxes effective 9 February 1970, and when the Government of Israel expected to adopt a uniform basis for levying the purchase tax to eliminate the higher effective rate falling on certain foreign goods, as compared to similar domestic goods.

16. The representative of Israel replied that the system of taxation was maintained under legislation which existed before Israel joined the GATT and hence was permitted under the terms of its accession. With respect to large cars, it was the Government's policy to encourage for economic and social
reasons the use of small cars in Israel and for the same reasons the local production of large cars, above 1800 cc, had been halted. The recent changes in the rate of the purchase tax on local cars had narrowed the gap between the tax imposed on imported cars and that imposed on local cars. This had caused some outcry by Israeli producers who claimed that they had insufficient protection.

The import deposit scheme

17. At the outset of the discussions the representative of Israel pointed out that the new import measure under examination should be described as an import deposit scheme rather than a "prior" deposit scheme since the deposit was not required prior to the issue of an import licence, which might be several months before the goods were actually imported, but only when the goods were cleared through the customs.1

18. Some members of the Committee expressed concern that the scheme, which required importers of all goods bearing a customs duty of 30 per cent or more to deposit one half of the c.i.f. value of imports with the Bank of Israel for a six-month period, would certainly have a restrictive effect on imports, particularly since the Central Bank had publicly urged banks not to grant credit to finance these deposits. It was appreciated that the immediate objective of the imposition of this requirement was to take liquidity out of the economy and to reduce the scope for speculative purchases. However, since most basic food commodities, raw materials and machinery for agricultural or industrial use were exempt, the impact of the deposit requirement was concentrated on such products as non-essential foodstuffs, luxury consumer items and manufactured goods of a type produced in Israel. Countries mainly exporting such products would be particularly bearing the burden. The Government of Israel was therefore urged to phase out the scheme in a non-discriminatory fashion as soon

1Consequently, the words "Prior Deposit" in the title of document BOP/103 should be changed to "Import Deposit".
as possible. The representative of Israel stated that the current intention of his authorities was to terminate the scheme by the end of 1970.

19. In reply to a question on what alternative measures had been considered to replace the import deposit scheme, the representative of Israel said that so far no alternative measures had been considered. He also stated that no changes were planned with respect to the present scheme, either in the deposit rate or in the product coverage. Asked if there were any procedures for providing relief where all or part of the goods on which a deposit was required was re-exported, the representative of Israel said that to the best of his knowledge none of the goods subject to the deposit requirement was intended for re-export. Goods in bond which had not passed through the customs were not subject to the deposit requirement. On the question of how the deposit was determined in those cases where specific duty rates were applied, the representative of Israel assumed that as the import prices were known to the customs authorities, there would be no difficulty in determining the amount of the deposit even though the import duty was specific. Asked what was the trade value of the manufactures covered by the scheme, he replied that this had amounted to $220 million in 1969. It was queried why a trade restrictive measure had been chosen to assist the balance-of-payments adjustment in lieu of internal measures, and in reply the representative of Israel pointed out that it had not been chosen in lieu of, but in addition to, internal measures.

20. While it was appreciated that the import deposit scheme was a temporary measure to be eliminated at the end of 1970, some members of the Committee felt that general fiscal and monetary measures, which, unlike the import deposits, would not have the effect of protecting or discriminating in favour of similar domestic products, were preferable alternatives for the purpose of redressing a balance-of-payments situation. Further, the import deposit scheme could also have the effect of diverting productive resources from export industries and thus adversely affect development of Israel's export capabilities. The representative of Israel stressed that the import deposit scheme was introduced in addition to a wide range of internal measures. While monetary
and fiscal measures were evidently more important tools to curtail consumption. The measure with an immediate psychological impact had been found necessary. The importance of the scheme resided in the fact that it had an immediate effect on the traders' import planning, particularly with regard to consumer goods. Any adverse effects on the export industries would be negligible.

21. A member of the Committee, noting that the deposit scheme had been accompanied by certain measures of credit restriction, supplemented by the removal of the ceiling on interest rates, asked what was the strength of the request made by the Central Bank for commercial banks not to extend credit to finance import deposits. The representative of Israel replied that the request had been indeed a stern one. In general the Bank of Israel had already done a great deal to limit loans and restrict credit. The Bank held sufficient authority to do this and no further legislative action was needed.

22. In reply to a query on whether the import deposit scheme would be removed in a selective or in a uniform manner, the representative of Israel said that it would be removed for all countries simultaneously in a nondiscriminatory manner.

Conclusions

23. Members of the Committee recalled the comments and views put forward at the last consultation with Israel in November 1969 and expressed the hope that the various fiscal and monetary measures that had been taken would be effective in stemming excess demand, and in lessening the pressure on the balance of payments, so as to enable Israel to resume, in the near future, the import liberalization programme.

24. As regards the import deposit scheme, the Committee noted the view of the IMF that "the effect of the scheme does not go beyond the extent necessary, in conjunction with other measures, to stop a serious decline in Israel's monetary reserves". The Committee shared the hope of the Fund that when the balance-of-payments situation permitted some relaxation of policy, the Israeli
authorities would accord priority to phasing out the deposit scheme (cf. paragraph 4 above). It was also understood that phasing out of the scheme would be undertaken in a non-discriminatory manner.

25. The representative of Israel stated that his delegation had taken note of all the views and comments put forward at this meeting and would convey them to the attention of the appropriate authorities in Israel.