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 June 1971 (BOP/R/55). In conducting the present consultation the Committee had before it: (a) a basic document supplied by the Government of Iceland (BOP/128); (b) a decision taken by the IMF Executive Board on 4 October 1972 concerning Iceland (Spec(72)113), and (c) papers containing background material, dated 7 August and 29 September 1972 supplied by the Fund.

2. The Committee generally followed the plan for such consultations recommended by the CONTRACTING PARTIES (see BISD, 18th supplement pages 52-53). The consultation took place on 27 October 1972. 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 made a statement concerning the position of Iceland, as follows:

"The Fund invites the attention of the CONTRACTING PARTIES to the Executive Board decision of 4 October 1972, taken at the conclusion of its most recent Article XIV consultation with Iceland, and particularly to paragraphs 2 to 4 which read as follows:

'2. Real gross national product showed a rapid increase, for the second consecutive year, rising by 9.5 per cent in 1971. The expansion was sustained largely by domestic demand factors which showed a sharp upturn in the second half of 1970. Imports in 1971 rose at about the same rapid pace as in 1970. The value of exports hardly expanded in 1971; a decline in volume was offset by another sharp rise in export prices of fish products. Official reserves continued to rise in 1971.'

'3. The incomes policy measures adopted in November 1970 to halt the price-wage spiral moderated the increase in nominal wage rates in 1971, but, since they also slowed down the rise in consumer prices, they helped sustain a rapid increase in real personal disposable income. These measures
contributed to a significant worsening of the budget position compared with 1970. The weakness in general demand management policies also helped to bring to an end the contractionary influence of the Fish Price Equalization Fund in the second half of 1971.¹

¹. The continued sharp increase in domestic demand and the renewal of the price-wage spiral in the first half of 1972 has been threatening Iceland's international competitiveness. To stem this threat and also to gain time for reassessment of economic policy, the authorities introduced in July 1972 a temporary price freeze, and higher consumer subsidies and family allowances. The Fund notes this action and also the Government's intention to finance the additional government expenditure by curtailment of other budget expenditure. In the light of developments so far in 1972, the central government budget accounts are likely to show a continued deficit even though there is already heavy pressure on resources. These pressures, together with the deterioration in the terms of trade, are likely to result in a balance of payments deficit on current account that may not be sustainable in the medium-term.²

"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 stop a serious decline in its monetary reserves."  

Opening statement by the representative of Iceland

4. In his opening statement, the full text of which is reproduced in the Annex, the representative of Iceland briefly recalled the serious economic difficulties his country had faced in 1967 and 1968 and outlined the gradual recovery, which had started in 1969. Iceland's economic development in 1971 had been characterized by a continuous expansion of demand and production: real GNP had risen, the terms of trade had improved and export prices for fishery products had increased by an average 25 per cent. Domestic expenditure had also risen by some 28 per cent in 1971, accompanied by increased imports. As a result, the balance of payment for 1971 had deteriorated and shown a deficit on current account of some $45 million. However, inflow of foreign capital had offset this imbalance and exchange reserves had increased in 1971. Prospects for the final results of 1972 were somewhat less favourable: real GNP was expected to show a smaller increase, the fisheries sector was expected to suffer a production fall of some 5 per cent, while domestic demand (with full employment restored) was rising, as were imports. The expected result on the balance of payments was a deficit on current account of nearly $50 million and a decline of foreign exchange reserves of some $3 million. The representative of Iceland explained how the rapid rise in prices during the first half of 1972 and the pressures of domestic demand had prompted the Government to re-introduce a strict price freeze in July. Budgetary results for 1972 were uncertain, although a deficit was expected. The rate of monetary expansion had
slowed down somewhat, but remained higher in 1972 than had been planned for by the Central Bank. Efforts were being made to contain domestic liquidity by reducing the use of foreign suppliers’ credit for imports. This was not done to restrict trade however, but to help achieve a healthier balance-of-payments situation. He concluded by recalling that, under the circumstances, Iceland had achieved a great degree of trade liberalization - 93 per cent of total commodity imports - and that remaining import restrictions on industrialized products, with the exception of petroleum products, would be removed before 1975. Liberalization measures were carried out on an most-favoured-nation basis and thus were of benefit to all GATT contracting parties.

5. Members of the Committee expressed appreciation for the detailed information supplied by the representative of Iceland, and welcomed the renewed assurance that Iceland would pursue a continued liberal trade policy which would culminate in the removal of restrictions on industrial products by 1 January 1975. It was noted that, with regard to the balance of payments, a deficit on current account of some $50 million was expected by the end of 1972 and that the level of foreign exchange reserves would decline by some $3 million. Asked whether the Icelandic authorities had any quantitative estimates for the 1973 balance of payments, the representative of Iceland replied these did not exist and that it was very difficult to arrive at accurate estimates for the future in view of the special nature of the Icelandic economy which relied on a limited range of products for export earnings which were subject to sharp fluctuations in supply and prices. He said that fish prices were now high and appeared firm in the immediate future.

6. Recalling discussions at previous consultations with Iceland on the question of diversification of production, particularly for the export sector, a member of the Committee asked what progress had been achieved in this field, and whether the heavy expenditure being incurred to increase the Icelandic fishing fleet - some 11 per cent of total real fixed investment in 1972 - did not run counter to the general policy of diversification. He also enquired whether this could not lead to overfishing and therefore poor prospects for returns on such heavy investment. The representative of Iceland explained this investment was aimed at modernizing a very out-dated trawler fleet. Because of overfishing, Iceland had taken measures to extend the fishing limits, and as this extension would also make for a greater share of Iceland in the total catch the projected investment in forty new vessels by 1974, was considered a viable investment. He stressed that Iceland was still predominantly dependent on fish as a source of export earnings and as such fisheries should be expanded. This did not detract from the need to diversify the economy, particularly in the export sector. An aluminium smelter, with a total capacity of 77,000 tons per year, had been built although, owing to the depressed world market, stocks of aluminium had been accumulated last year. Various feasibility studies had been undertaken for other projects, e.g. a sea-chemicals plant, heavy water production, sea-weed utilization
and oil refining. While most of these projects appeared to be sound, no production decisions had yet been made. On the other hand, there were a number of existing domestic industries which were showing good export potential, such as woollen goods, furs, canned fish products and diatomous earth, etc. While this export sector was small, it was showing good growth - some $14 million were expected from it in 1972, compared to $2.8 million in 1968.

The representative of Iceland added that all projections of composition of exports in the future showed that the fishing sector could not absorb the growing labour force and that, in order to attain full employment, other fields would have to be developed, among which tourism and transportation showed growth potential.

7. Members of the Committee noted that the central Government budget was in deficit and was likely to continue to show a deficit. Referring to the increased expenditure resulting from higher consumer subsidies and family allowances, introduced in July 1972 together with a new price freeze, they asked whether Government budgetary policy would not have an unduly expansionary effect, and whether apart from the intended reductions in other budgetary items, any other measures were envisaged. The representative of Iceland reiterated his earlier statement that higher subsidies and family allowances were to be moderated through a reduction in other items on the expenditure side of the budget and said that there was some concern over the expansionary effects of this year's budget. However, he was not in a position at this stage to say what new measures could result from the current Parliamentary budget debate. He recalled, however, that the price-freeze reintroduced in July, was intended as a temporary measure and that fiscal reforms introduced at the same time were expected to have a stabilizing effect. The representative of Iceland drew attention to that part of paragraph 5 of the IMF Executive Board Decision of 4 October 1972, in which the Fund expressed satisfaction with the intention of the Icelandic authorities to adopt a set of stabilization measures.

8. In reply to questions concerning the operation of the Price Equalization Fund, discussed in previous consultations, the representative of Iceland stated that the Fund was considered a useful instrument for demand management and it had worked well.

9. In the monetary field, members of the Committee referred to the 1971 credit expansion which had turned out to be greater than expected, and asked whether measures were envisaged to restrain further expansion in 1973. It was also noted that while the rate of savings had declined in 1972, inflation, which was of the wage-push situation type, had continued. Asked to comment on what measures were envisaged to contain this trend in the future, the representative of Iceland explained that in his view monetary policy, and in particular the use of the bank rate to control credit, could not be relied upon mainly because the range of interest rate change called for would have excessively unfavourable cost effects. The re-discount rate as such was not used to control internal demand, mainly because of the absence of an organized capital market. However, the rate of
monetary expansion had been slower so far during this current year as compared to 1971. The control of money supply expansion was considered as a more effective weapon, giving the monetary institutions of the country, and therefore could be relied upon as an efficient monetary instrument. While no direct measures had been taken to stimulate private savings, changes in the fiscal system such as higher real estate taxes might contribute to a change in the composition of investments in the right direction.

Methods of restrictions

10. In reply to questions concerning the trade effects of the agreement with the Soviet Union and Eastern Germany the representative of Iceland said that the non-official agreement with Eastern Germany covered a small amount of trade and was patterned on similar agreements between Nordic countries and Eastern Germany. The future form of this agreement was at present under study. The agreement with the Soviet Union constituted an important and necessary feature of Iceland's trade. The USSR bought certain fish products for which it was difficult to find alternative markets. In return, Iceland reserved its petroleum market for the USSR. The importance of this agreement to Iceland's economy had been fully recognized by its EFTA partners and also by the EEC in the context of the July 1972 trade agreement. In reply to a query, the representative of Iceland confirmed that petroleum - a major product included in the bilateral agreement with the Soviet Union - would not be liberalized in January 1975. The Committee was informed that the two bilateral payments agreements mentioned above were the only ones now in existence, the agreement with Brazil represented a reciprocal arrangement and should be deleted from the enumeration in the basic document BOP/128.

11. A member of the Committee, commenting on the Icelandic present practice of allowing special suppliers' credit for up to three months for imports from bilateral trading partners while denying this facility to imports from convertible currency countries, questioned the consistency of this with the provisions of Article I of the General Agreement. The representative of Iceland took note of this statement, recalling that at the last consultation he had stated that the length of the credit has been reduced from six to three months.

12. In reply to a question regarding the possible duration of the import levy of 25 per cent on automobiles introduced by the Ministry of Finance in April 1972, the representative of Iceland said that there was no provision regarding the termination date of this measure.

13. In reply to questions as to which products would remain restricted after 1 January 1975, the representative of Iceland stated that all the products listed on page 1 of Annex I in the basic document BOP/128, plus tariff items 27.09.00, 27.10.29, 27.10.40, 27.10.50, petrol and petroleum products, and 96.01.00, brooms and brushes would remain restricted. The remaining negative list would therefore be very short, and consist mainly of agricultural items.
14. Asked whether any acceleration of the programme for liberalization could be expected, the representative of Iceland stated that some products under restrictions were progressively being liberalized, as could be seen from the growing size of global quotas, but that because Iceland's economy was sensitive, any acceleration of the programme, concerning industrial goods, which in any case was due for completion by 1 January 1975, was not to be expected. The timing and completion of the programme was a contractual obligation under Iceland's agreement with EFTA, and would be met. Liberalization was effected on a most-favoured-nation basis.

15. Asked what the prospects were for private importers to enter trade in products reserved to State trading, the representative of Iceland said that his Government had no such intentions.

Conclusion

16. The Committee took note of Iceland's progress in trade liberalization, as shown by the steady increase in the number of liberalized items and the growing size of global quotas. It welcomed the Government's decision, as mentioned in the IMF decision of 4 October 1972, to pursue a continued liberal trade policy. While appreciating the assurance concerning the completion of the trade liberalization programme for industrial products by 1 January 1975, the Committee urged the Icelandic Government to explore the possibility of accelerating the process. The Committee also expressed concern over the expansionary effects of the present budgetary policies and expressed the hope that adequate measures would be taken to contain this trend so as to ensure progress towards greater price and cost stability and a sustainable external balance.