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 November 1972 (BOP/R/64). In conducting the consultation the Committee had before it: a basic document supplied by the Government of Iceland (BOP/140) and a paper containing supplementary background material dated 13 November 1973 supplied by the International Monetary Fund.

2. The Committee generally followed the plan for such consultations recommended by the CONTRACTING PARTIES (see BISD, Eighteenth Supplement, pages 52-53). The Committee met on 29 November 1973. 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. The representative of the Fund made a statement concerning the position of Iceland, as follows:


The deficit in the trade account of US$12.9 million (including "special" trade, i.e., exports of aluminum and imports of ships, aircraft, and for the
aluminum smelter complex) during January-August of 1973 represented an improvement of US$4 million compared with that in the corresponding period in 1972. Gross official reserves increased by US$16.4 million to US$100 million (SDR 83 million) during the year ended September 1973. This level of reserves is equivalent to 43 per cent of the value of imports in 1972 and to about one half of the value of imports during January-August 1973. However, the balance of payments position of Iceland is subject to a number of weaknesses and uncertainties, particularly its high dependence on fish catch and unpredictable developments in prices of their main export products on foreign markets. The decline in the deficit in the trade account (with imports on a c.i.f. basis) during the first eight months of this year must be appraised against the background of large deficits in 1971 and 1972 which amounted to US$70.2 million and US$42.3 million, respectively.

The par value of the Icelandic krona was changed from IKr 95.5429 to IKr 107.008 per unit of SDR on December 19, 1972, which represented a devaluation of 10.7 per cent. On February 15, 1973 a new central rate of IKr 118.898 per unit of SDR was established which represented a further devaluation of 10 per cent and left the exchange rate in terms of the U.S. dollar unchanged. Since then the current account has shown an improvement. Since early 1973 there had been a marked improvement in the profit situation in the fishing industry largely due to exceptionally favorable export prices, and export receipts had increased rapidly. On the other hand, as a result of the weakening of domestic demand and the increase in import prices there had been only a moderate increase in the volume of imports. Faced with the serious problem of upward price and cost pressures, induced not only by the very rapid rise in export prices but also by
the effect on the wage regulating index of the accelerated increase in import prices and of the termination of the price freeze on January 1, 1973 the Icelandic authorities adopted several stabilization measures in April including a change in the central rate of the krona from IXr 115.898 to IXr 112.168 per unit of SDR on April 30, 1973 which represented a revaluation of 6 per cent.

The revaluation of the currency was, in part, aimed at reducing the export receipts of the fish processing industry in terms of krona, thereby limiting the scope for an increase in the raw fish prices, and in part at easing the upward pressure on domestic prices and costs through its moderating effect on krona import prices. As the U.S. dollar depreciated vis-à-vis European currencies and Iceland maintained the central rate in relation to the U.S. dollar, the krona was effectively depreciated vis-à-vis the currencies of Iceland's main trading partners. Since these developments cancelled most of the intended stabilizing effects on domestic prices and costs of the earlier revaluation, the authorities decided to pursue a policy of "controlled" floating as from June 15, 1973. The intention of the authorities was to utilize this greater exchange flexibility to set new buying and selling rates for the U.S. dollar which imply a small initial appreciation of the Icelandic krona in terms of the U.S. dollar. Until September the krona in terms of the U.S. dollar floated upward by about 6 per cent; the rate has remained unchanged since.

Thus far in 1973, the balance of payments and reserves position of Iceland has shown considerable strength. However, there is some uncertainty with respect to the continuation of favorable export prices of fish, which have been mainly
responsible for the increase in export receipts during recent months. Moreover, during the third quarter of 1973 imports again appear to have risen faster than exports. The Fund annual Article XIV consultation discussions with Iceland are scheduled to be held in early December 1973. Taking into account Iceland's present exchange rate policy, the consultation should place the Fund in a better position to judge whether the continued maintenance of import restrictions is warranted on balance of payments grounds."

Opening statement of the representative of Iceland

4. In his opening statement, the full text of which is reproduced in the Annex, the representative of Iceland outlined the main developments in the Icelandic economy and in the balance of payments during 1972-73. In the light of the slower growth rate achieved in 1972 and the deteriorating balance-of-payments situation which had been forecast for 1973, the krona had been devalued on 17 December 1972 by 10.7 per cent.

5. However, economic developments in 1973 had in many ways been quite unexpected. The volcanic eruption in Vestmannaeyjar, which had temporarily paralyzed the country's most important fishing centre had reduced the economy's growth potential for 1973 by about 1 to 1½ per cent. Following the devaluation of the United States dollar in mid-February 1973, and in view of the importance of this currency for Iceland's export earnings it was decided to let the krona follow the dollar and this policy continued until the end of April 1973. On 27 April, following considerable increases in the export prices of fish production and to counter inflation, the krona was revalued by 6 per cent, and as from 14 June the
Government permitted a controlled upward float of the krona against the dollar while keeping its value stable in terms of the currencies important to Iceland's export trade. On 13 September, in the light of the favourable trend in export prices and rising import prices, it was decided to increase the market rate of the krona with respect to all other currencies by 3.6 per cent. In comparison with the situation prior to the devaluation of December 1972, the krona was by mid-November 4 per cent higher than the dollar, but 3 per cent lower than all currencies (including the dollar) weighted by their relative shares in Iceland's foreign trade and payments. In conjunction with the revaluations in April and September 1973 various auxiliary measures were taken to stimulate savings and decelerate monetary expansion.

6. It now appeared that the GNP for 1973 would increase by 4½-5 per cent over the previous year. In the fisheries sector, the decline of the white fish catch was continuing but this was compensated to a great extent by the increased capelin catch. Due to the rapidly increasing export prices the profitability of the fisheries industry was much improved over the previous year despite large cost increases. Private consumption was expected to increase in real terms by 6 per cent. Fixed investment was expected to rise by 16 per cent in volume compared to the previous year. Due mainly to the very substantial increases in export prices of fish products, total commodity exports would show an increase in value of about 50 per cent. The balance of goods and services was expected to show a deficit of about 1Kr 4,000 million, or some US$44 million, but this would be more than offset by a heavy inflow of long-term capital. Consequently, the overall balance of payments for 1973 would be expected to show a surplus of 1Kr 1,500 million or roughly US$17 to US$18 million.
7. Inflation continued to be the major economic problem facing the country. Although the basic balance-of-payments situation was fairly satisfactory the rapid domestic inflation could endanger the balance of payments in the long run. Iceland's terms of trade were expected to weaken considerably in 1974 with a negative effect on the balance-of-payments position.

8. In conclusion the representative of Iceland drew the Committee's attention to the tariff reductions on a most-favoured-nation basis which would shortly come into effect in the context of tariff reductions related to Iceland's membership of EFTA and the new free-trade agreement with the EEC. In regard to quantitative restrictions, he pointed out that commodity liberalization on the basis of 1972 imports amounted to nearly 93 per cent and he reiterated Iceland's undertaking that all restrictions on industrial products (other than those affecting petroleum products) would be removed before 1975 on a most-favoured-nation basis.

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

9. Members of the Committee expressed appreciation for the detailed information supplied by the representative of Iceland. One member observed that Iceland's reserves were at a very high level and still growing steadily, and furthermore Iceland's balance-of-payments performance had in the past always turned out better than predicted. Commenting on these observations, the representative of Iceland said that it was extremely difficult for a small country with such a turbulent economy and so heavily dependent on foreign trade to determine the optimum level of reserves. He added that the present increase in reserves should be seen as a cyclical phenomenon. In regard to the second
observation, he stated that it was only in the last two years that actual balance-of-payments results had been better than those predicted, but this was mainly due to the influence of extraneous factors.

10. A member of the Committee observed that during the period under review there appeared to be a close link between exchange rate adjustments and changes in the balance-of-payments situation, and asked how long the authorities of Iceland intended to pursue this policy. In reply, the representative of Iceland said that the aim of Iceland's exchange rate policy was to secure a healthy export development of the economy. He emphasized that in recent years Iceland's economy had been moving away from almost total dependence on a single crop (fish) towards a more diversified export pattern. In this situation it was important to give adequate incentives to new exports.

11. In reply to a question in regard to the principal currencies involved in Iceland's foreign trade, the representative of Iceland stated that the most important currency was the United States dollar, which was followed by the pound sterling. The US dollar alone had accounted for about 57 per cent of total foreign exchange receipts in the twelve months ending September 1973, which was some 6 percentage points lower than the preceding twelve months. On the payments' side the dollar in contrast accounted for a little over 23 per cent.

12. Noting that Iceland's present production capacity was fully employed, a member of the Committee asked what measures were envisaged to promote new investments in order to ensure a stable growth of the economy. In reply, the representative of Iceland explained that in the present phase of the business cycle Iceland's problem was to restrain investment, rather than to promote it. In these circumstances, measures taken by Iceland's authorities were concerned with
the composition of investments rather than with their absolute size. Thus, for example, they were trying to make relatively more resources available for investment in the industrial sector.

13. While noting the satisfactory rate of increase in industrial productivity, a member of the Committee wondered whether the positive effects of this trend had not been outweighed by the rise in wage rates. In reply, the representative of Iceland stated that, while the past five years had seen an unprecedented growth in industrial productivity, this had not unfortunately been sufficient to outweigh inflationary trends in the economy. In addition to the problems posed by domestically generated inflation, Iceland had now to face the problem of an accelerating trend of rising import prices, and this latter question was causing Iceland's authorities considerable concern because of its future implications for the balance of payments.

**Methods of Restrictions and effect of restrictions**

14. A member of the Committee recalled the conclusions of the previous consultation which urged the Icelandic Government to explore the possibilities of accelerating the process of the trade liberalization programme for industrial products which was to be completed by 1 January 1975, and asked whether this recommendation had been acted on. The representative of Iceland pointed out that the commodities which remained restricted belonged to sectors of the Icelandic domestic industry which were very sensitive to foreign competition. He recalled that as a result of Iceland's membership in EFTA and its free-trade agreement with the European Economic Community his country was under contractual obligation to remove quantitative restrictions on all industrial products except oil by 1 January 1975. This liberalization was a significant undertaking and his...
authorities had to proceed with care in the dismantling of quantitative restrictions. Global quotas had been gradually increased and would be further increased in 1974. The representative of Iceland reiterated his Government's determination to pursue its policy of trade liberalization. In this context the two agreements with EFTA and the EEC had occasioned important most-favoured-nation reductions in quantitative restrictions.

15. The representative of Iceland drew the Committee members' attention to that part of his opening statement in which he referred to forthcoming tariff reductions. He pointed out that when examining Iceland's trade liberalization it should be borne in mind that the country's trade policy was undergoing fundamental structural change in its trade policy: from a very high tariff structure it was moving toward a low tariff one. Iceland's ability to further lower tariffs would depend to a considerable degree on other countries' tariff reductions for Iceland's exports. In this context his authorities looked forward to an early start of the multilateral trade negotiations.

16. In reply to a question concerning the future of Iceland's trade and payments agreement with the USSR, the representative of Iceland said that this agreement was valid until the end of 1975, and that negotiations for renewal would start at an appropriate time. Questions were also raised concerning the status of Iceland's bilateral trade agreement with the German Democratic Republic. The representative of Iceland explained that prior to the present agreement trade between the two countries had been on a private barter basis. In February 1973 an official bilateral trade agreement on a convertible payments basis was concluded. Aside from general provisions it contained indicative commodity lists of export products for both countries.
Asked what percentage share these agreements represented in Iceland's total imports, the representative of Iceland said that trade with the German Democratic Republic made up 0.2 per cent of Iceland's imports in 1972, and that trade with the USSR accounted for 5-6 per cent of Iceland's total imports for the same year.

17. A member of the Committee asked whether the Icelandic Government was contemplating measures that would allow private importers to deal in products reserved to State trading. The representative of Iceland replied that there was no change in policy in this respect. The commodities reserved for State trading were generally liberalized and could be imported from all sources. State trading for certain products did not influence the choice of source of supply.

18. In reply to a question concerning a termination date for the import levy of 25 per cent on automobiles, introduced by the Ministry of Finance in April 1972, the representative of Iceland said that his authorities had no intention to alter this measure for the time being.

19. One representative asked whether the global quota for coffee had been increased in 1973. The representative of Iceland pointed out that the 1972 quota for coffee had amounted to IKr 5 million and that the global quota for 1973 had been raised to IKr 6 million. He explained that this quota applied only to roasted coffee in small retail packings whereas other coffee imports were unrestricted and duty free.

Conclusions

20. The Committee took note of Iceland's progress in trade liberalization as shown by the gradual removal of quantitative restrictions and increases in global quotas, which would lead to complete liberalization of industrial products (except petroleum products) by 1 January 1975. It welcomed the favourable
developments in Iceland's balance of payments and reserve position in 1973, but noted the uncertainties referred to with respect to some elements of the terms of trade for 1974. The Committee noted that the IMF would be in a better position to provide a determination, in accordance with the provisions of Article XV:2, after the Fund's forthcoming mission to Iceland. The Committee therefore deferred reaching conclusions, pending the Fund's determination and completion of the consultation with Iceland in March 1974.