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ECONOMIC SURVEYS BY THE OECD

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RETOUR BUREAU 712

ICELAND

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JANUARY 1963

ORGANISATION FOR ECONOMIC
CO-OPERATION AND DEVELOPMENT

PARIS

ICELAND

BASIC STATISTICS

THE LAND AND POPULATION

Area (1,000 sq. km.)	103	Urban population Reykjavik, December 1961	73,388
of which:		Other, December 1961	47,736
Cultivated area, January 1961	0.8	Population by occupation 1950:	
Rough grazings, average 1953-57.	19.8	Agriculture	20 %
Glaciers	14.0	Fishing	11 %
Population 1962	184,000	Fish processing	5 %
No. of inhabitants per sq.km.	1.7	Manufacturing	16 %
Population increase, average 1950-60.	2.1 %		

PRODUCTION

Total fish catch, average 1953-60 (1,000 metric tons)	453	Sheep population, January 1961 (1,000 heads).	836
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GOVERNMENT AND PARLIAMENT

Government (number of ministers):		Parliament (No. of seats):	
Independent Party (Conservatives)	4	Independent Party (Conservatives)	24
Social Democrats	3	Progressive Party (Liberals)	17
		Communists	10
		Social Democrats	9
		Last general election 1959	60
		Next general election 1963	

LIVING STANDARDS

Calories per head, per day 1958.	3,240	Number of passenger cars in use per 1,000 inhabitants, 1960	85
Energy consumption per head, 1957 (O.E.E.C. average = 100)	163	No. of radio sets per 1,000 inhabitants 1958.	278
Paper consumption per head, 1957 (O.E.E.C. average = 100)	80	Average hourly wages of unskilled labour in Reykjavik, July 1962 (Kronur).	26.29

FOREIGN TRADE

Exports:		Imports:	
Main exports 1961 (percentage of total exports):		Main imports 1961 (percentage of total imports):	
Fish and sea products	91	Equipment	28
Agricultural products	6	Other manufactures	35
		Fuels	14

THE CURRENCY

Monetary unit: Krona	Currency unit per U.S. dollar.	43.00
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ICELAND

1963

ORGANISATION FOR ECONOMIC
CO-OPERATION AND DEVELOPMENT

The Organisation for Economic Co-operation and Development was set up under a Convention signed in Paris on 14th December 1960 by the Member countries of the Organisation for European Economic Co-operation and by Canada and the United States. This Convention provides that the O.E.C.D. shall promote policies designed :

- to achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy;*
- to contribute to sound economic expansion in Member as well as non-member countries in the process of economic development;*
- to contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.*

The legal personality possessed by the Organisation for European Economic Co-operation continues in the O.E.C.D., which came into being on 30th September 1961.

The Members of O.E.C.D. are: Austria, Belgium, Canada, Denmark, France, the Federal Republic of Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States.

This document was approved
by the Economic and Development Review Committee
in December 1962

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ICELAND

1. Considerable progress in the development of the Icelandic economy has been achieved since the end of the war. But the rate of advance has been irregular, reflecting in particular Iceland's heavy dependence on the fish catch, which fluctuates considerably, and on exports of fish. Moreover, both the course of the economic development and the balance of payments have been adversely affected by the inflation which marked much of the period. The Stabilization Programme which the Icelandic authorities adopted in February 1960 with the support of the International Monetary Fund and the O.E.E.C., succeeded in restoring a better balance between supply and demand. External equilibrium was established, with a significant strengthening of the foreign reserves, and once the effects of the 1960 devaluation had been absorbed, prices became more stable. But large increases in wages and agricultural prices in the summer of 1961 once again forced up prices and necessitated a further devaluation of the krona. And the task of maintaining economic stability has again been made more difficult by a new large round of wage and farm income increases which took place in the summer of 1962.

I. POST-WAR DEVELOPMENTS

2. In the 1950's the real gross national product rose by about 4 per cent a year, not much below the rate achieved by European O.E.C.D. countries combined. But with a strong increase in the population, output per capita rose by only 1.8 per cent a year, well below the advance in most other member countries, despite a much higher level of investment in Iceland. In this period Iceland devoted about 25 per cent of the gross national product to fixed asset formation, with the ratio rising from about 20 per cent in 1950 to some 30 per cent in 1960; the average rate of European Member countries combined was less than 20 per cent. The lower return on investment, in terms of output, than in other countries can largely be ascribed to three main factors.

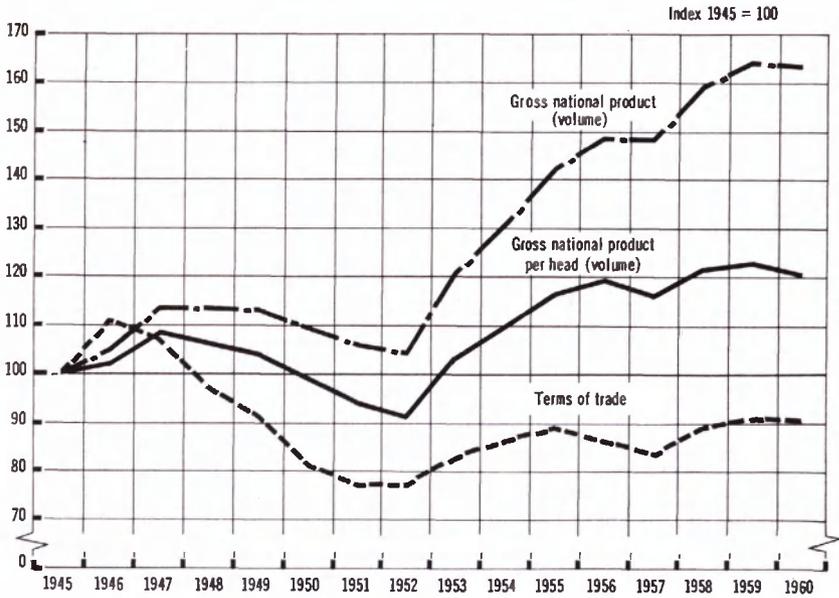
3. In the first place, the scarcity of natural resources, the harshness of the climate, and the large size of the country with

a small and dispersed population have rendered investment more expensive than in many other countries, notably in infrastructure agriculture and residential construction. The small domestic market has made it difficult to develop internationally competitive industries.

4. Second, heavy dependence on foreign trade and the narrow range of exports have rendered the economy highly sensitive to changes in external conditions. With imports accounting for about 40 per cent of the total supply of goods and services, the rate of expansion necessarily has to be kept in line with the increase in foreign exchange earnings. And since foreign exchange earnings have to a large extent been determined by unstable fish catches and terms of trade, the expansion has shown rather marked fluctuations.

Diagram 1 -

SOME INDICATORS OF LONG-TERM DEVELOPMENT



Source : Icelandic submission to the O.E.C.D.

5. Following rapid expansion in the early post-war period, when foreign demand for fish was strong and when Iceland had large foreign exchange reserves accumulated during the war, activity stagnated or declined from 1948 to 1952; the terms of trade deteriorated by 30 per cent and fish catches were relatively low. Output rose strongly in the following years up to 1956; the fish catches were better, the terms of trade improved, and military receipts added greatly to the foreign exchange

earnings. But the expansion was interrupted in 1957, and again in 1960, because of unfavourable external conditions.

6. A third factor which, from time to time, has served to hamper economic growth, has been inadequate economic policies. Every growth period has ended in a burst of inflation. Between 1950 and 1960, the consumer price index rose by 115 per cent, much more than in most other Member countries. In the early 1950's a sharp increase in import prices was an important causal factor, and excessive negotiated wage increases have exerted an important independent influence. But in the second half of the decade, government action to keep domestic demand in line with available resources was generally inadequate; in particular, the excessive expansion of bank credit and lending by public investment funds was an important source of inflation.

Table 1. GROSS FIXED INVESTMENT
IN THE 1950's AND IN 1960 AND 1961

	1950-1954	1955-1959	1960	1961
Total fixed investment in percent of G.N.P.	21	26	27	(23)
Percentage distribution of fixed investment :				
Agriculture	10	10	8	11
Fisheries	5	5	16	5
Manufacturing	14	12	10	13
(of which, fish-processing) ..	(5)	(5)	(4)	(5)
Electricity and power works ..	14	10	9	8
Transportation and communications	17	17	16	21
Construction equipment	2	2	1	2
Dwellings	31	36	28	24
Public administration and other services	7	8	12	16
Total	100	100	100	100

Source : Icelandic submission to the O.E.C.D.

7. Inflation and an overvalued currency, coupled with a discriminatory system of de facto multiple exchange rates, led to an uneconomic allocation of resources, discouraging the development of export industries and favouring investment in protected home-market industries, agriculture and residential construction. In the second half of the 1950's, investment in agriculture and residential construction together accounted for nearly half the total of fixed asset formation. And the conditions prevailing in the post-war period have not been conducive to foreign investment in Iceland, without which important new export industries can hardly be developed.

8. Inflationary conditions and the high level of domestic investment led to a difficult balance of payments position. Throughout the 1950's the current account of the balance of payments was in deficit, with a significant increase in Iceland's foreign indebtedness. By 1960, the cost of servicing the foreign debt represented about 10 per cent of exports of goods and services. Since 1960, however, the current account has been in surplus.

9. After 1949, when Iceland and most other countries devalued their currencies in relation to the U.S. dollar, the exchange value of the krona had progressively to be reduced from 9.31 to the dollar in early 1950 to the present rate of 43. During much of the 1950's, the official exchange rate remained unchanged at an artificially high level, and a cumbersome multiple rate system, consisting of import levies and export subsidies, was developed. This system was abolished in 1960, when a uniform and realistic exchange rate was established as part of the Stabilization Programme.

II. RECENT DEVELOPMENTS

10. The Stabilization Programme represented a radical change in economic policy. Apart from the devaluation of the krona, its main features included strict limitation of the expansion of bank credits, a balanced budget and a gradual liberalisation of imports.* Subsequent developments have shown that, by and large, the Programme was a realistic one, leading to better stability without any important adverse effects on production or employment. But relatively poor fish catches and falling prices on some export products up to the middle of 1961, although helping to remove inflationary expectations, had adverse effects on production and the foreign balance. Since then, however, with good fish catches and better export prices, production has expanded fast and the foreign balance has improved. But the rise in incomes resulting from larger fish catches and higher exports has also served to strengthen the demands on domestic resources, rendering more difficult the stabilization of costs and prices, and requiring continued fiscal and monetary restraint.

Monetary Policy

11. Monetary policy has been the main weapon used to restrain the expansion of home demand. The Stabilization Programme imposed ceilings on the expansion of credit both from the Central Bank and the commercial banks, and interest rates were substantially increased.

* For a detailed description of the Programme, see Economic Conditions in Member and Associated Countries of the O.E.E.C. - Iceland, O.E.E.C., Paris 1960.

Table 2. POSITION OF MONETARY INSTITUTIONS WITH THE CENTRAL BANK

I. Kr. millions

	STATUS AT END OF PERIOD				CHANGE 1)				SEPT. 1961- SEPT. 1962
	1960	1961		1962	1960	1961		1962	
	YEAR	YEAR	SEPT.	SEPT.	YEAR	YEAR	TO SEPT.	TO SEPT.	
1. Central Bank loans to the banks ..	951	842	993	822	- 42	- 109	42	- 20	- 171
2. Bank deposits at the Central Bank.	138	591	423	909	86	453	285	318	486
of which :									
(a) Free deposits	71	117	133	236	19	46	62	119	103
(b) Reserve requirements	47	289	199	486	67	252	156	167	263
(c) Other blocked deposits ...	-	155	67	187	-	155	67	32	120
3. Net position of the banks with the Central Bank	- 813	- 251	- 570	87	128	562	243	338	657
4. Net position of investment credit funds with the Central Bank	29	298	115	308	9	- 269	- 86	- 10	- 193
5. Securities bought	n.a.	n.a.	n.a.	10	n.a.	n.a.	n.a.	10	10
6. Net position of monetary institu- tions with the Central Bank (3+4+5)	- 842	- 549	- 685	- 231	137	293	157	318	454

1) Positive figures means improvement of monetary institutions with the Central Bank.

Source : Icelandic submission to the O.E.C.D.

12. The 1961 central bank credit to the banking sector and the investment funds was subject to a ceiling of I.Kr. 875 million, plus a seasonal margin of 150 million. In August this ceiling was reduced to I.Kr. 750 million to prevent an excessive expansion of credit after the latest devaluation of the krona. In fact, these credits remained well below this ceiling throughout the year, largely because of the increase in foreign exchange reserves which led to an increase in commercial bank deposits with the Central Bank; at the end of the year net central bank credit to the banking and investment fund sectors stood at I.Kr. 550 million. Net central bank credit to the Treasury was also kept within the prescribed ceiling.

13. But commercial and savings bank credit rose by I.Kr. 650 million, *greatly in excess of the target set for 1961 (I. Kr. 200 million). This was partly related to a strong build-up of inventories resulting from large fish catches, but in part also to the rise in prices that followed the increase in wages and the devaluation. The increase in bank credit was financed by an expansion of deposits; in fact, savings deposits rose by I. Kr. 608 million and demand deposits by 220 million.

Table 3. BANK DEPOSITS AND CREDITS
MONEY SUPPLY

I. Kr. millions

	1960	1961	JANUARY- AUGUST 1961	JANUARY- AUGUST 1962	PERCENTAGE INCREASE AUGUST 1961 AUGUST 1962
Change in :					
Savings deposits	358	608	289	431	28.4
Current account deposits ¹⁾	- 41	220	397	216	3.8
Total deposits ..	317	828	686	647	21.8
Bank credits ...	298	648 ²⁾	525 ²⁾	409	11.2 ²⁾
Bank deposits less credits ..	19	180	161	238	
Money supply ³⁾ ..	- 30	351	449	278	11.5

1) Excluding savings deposits with cheque account facilities.

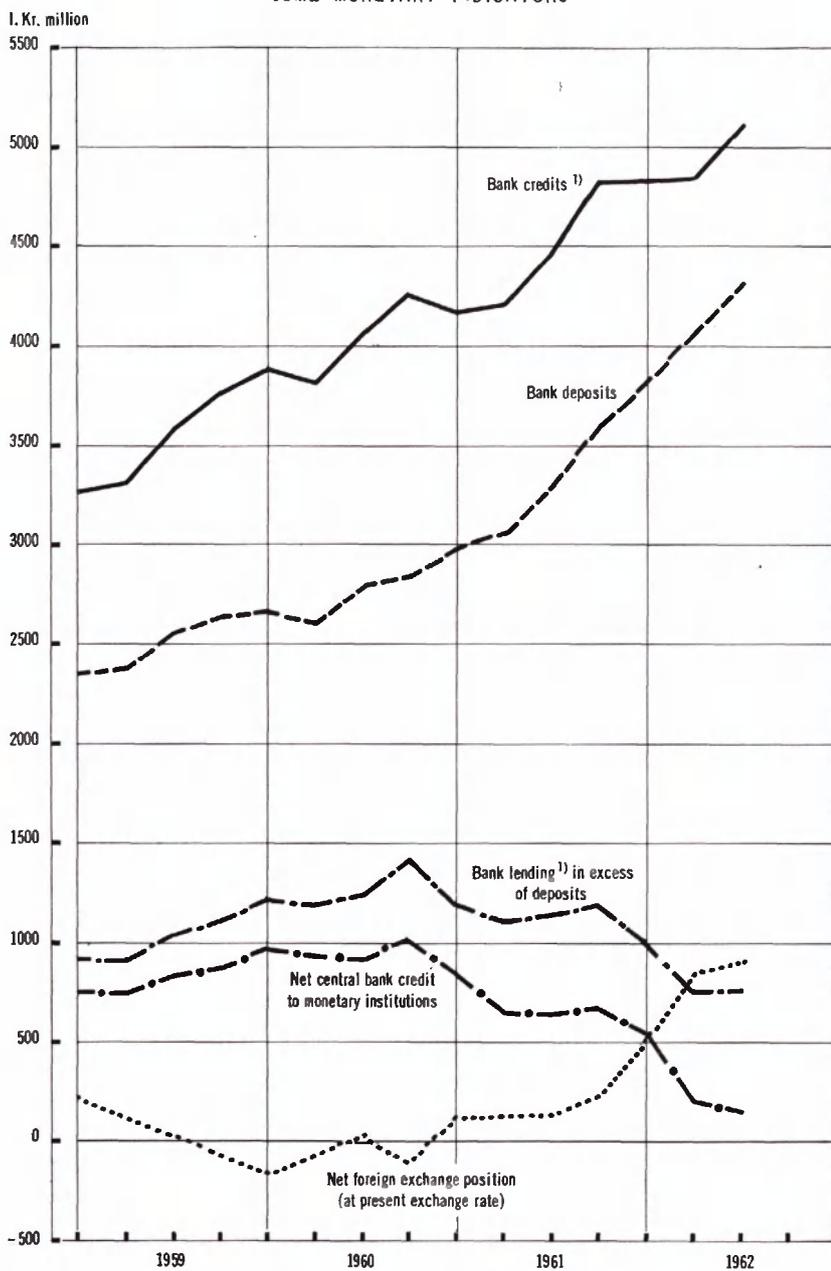
2) Including loans taken over by the Fisheries Mortgage Department.

3) Notes and current account deposits.

Source : Icelandic submission to the O.E.C.D.

* Including loans taken over by the Fisheries Mortgage Department.

Diagram 2
SOME MONETARY INDICATORS



1) Including I. Kr. 295 million taken over by the Fisheries Mortgage Department in the second half of 1961.

Source: Icelandic submission to the O.E.C.D.

14. Monetary developments in 1962 have largely followed the pattern set in 1961. Net central bank credit to the banking sector and investment funds has been further reduced to I. Kr. 161 million in August. The expansion of commercial and savings bank credit in the first eight months of 1962, although still rather substantial because of the rise in costs and prices, has been lower than in 1961, and it has been financed by a further strong increase in deposits.

15. The money supply has risen considerably over the last year, (11.5 per cent from August 1961) partly because of the surplus on external account. This expansion can hardly be said to be excessive given the growth of output (4 to 5 per cent) and the sharp increase in prices (15 per cent) which resulted from the rise in wages and other incomes. And the existing reserve requirements have considerably restrained the expansion of the lending base of the commercial and savings banks; during the first half of 1962 their free deposits with the Central Bank rose from I. Kr. 118 to 148 million.

The Budget

16. The government budget has remained in surplus, and has therefore exerted a restraining influence on the expansion of demand. In 1961 the net reduction in the Government's floating debt together with the net increase in bank deposits and cash holdings amounted to I. Kr. 72 million. The increase in revenue resulting from the devaluation offset the higher expenditures caused by the increase in wages and the devaluation itself. Moreover, the devaluation gain on existing export stocks (I. Kr. 94 million) was used to establish a special fund for the servicing of government guaranteed loans in default. This reduced budget expenditure in 1961 by I. Kr. 71 million.

17. The Icelandic authorities also expect a cash surplus in 1962. As a result of higher production and incomes, revenues are expected to rise sufficiently to cover the increase of expenditure. The 1963 budget, submitted to the Althing in October, envisages considerable increases in expenditure as a result of normal increase in government services, the rise in wages and salaries, and the increase in consumer subsidy payments caused by growing consumption. The Government aims, however, at keeping the budget in balance.

Output and Demand

18. From early 1960, when the Stabilization Programme was introduced, until the middle of 1961 there was little increase in production. This was no doubt partly due to the restraints on domestic demand. But it was also influenced by relatively poor fish catches and a decline in export prices which reinforced the weaker trend in home demand.

Table 4. GOVERNEMENT BUDGET ACCOUNTS

I. Kr. millions

	1959 YEAR	1960 YEAR	1961 YEAR	1961 JANUARY- OCTOBER	1962 JANUARY- OCTOBER
Direct taxes	164	99	106	..	..
Indirect taxes and miscellaneous revenue...	896	1,389	1,559	..	..
Current receipts	1,060	1,488	1,665	1,215	1,524
Current and fixed investment expenditures..	1,009	1,401	1,572	1,240	1,478
Balance on current and fixed investment account.....	51	87	93	- 25	46
Consolidated debt and credit transactions ..	- 37	- 51	- 20	..	..
Receipts	84	72	34	..	..
Expenditures	121	123	54	..	..
Net changes in floating debt, bank deposits and cash holdings	13	35	72		

Source : Icelandic submission to the O.E.C.D.

19. The situation changed in the second half of 1961. A large summer herring catch was followed by an exceptionally good herring season in the autumn. Preliminary estimates suggest that, between 1960 and 1961, the real gross national product rose by 4 per cent, because of the strong expansion in the second half of the year. Output has continued to rise in 1962, with a further increase in the fish catches. Although catches are likely to fluctuate in the future, as they have done in the past, the authorities feel there are reasons to believe that good catches can be expected for some time to come. There are indications that the age-classes of the most important species - especially cod, haddock and herring now entering the fishing banks - are relatively large. Moreover, the increase in catches, particularly of herring in recent years, has to a great extent been the result of new devices for detection and new types of fishing gear, and the full effect of these technical innovations have not yet been seen.

Table 5. FISH CATCH

Thousand metric tons

MODE OF PROCESSING	1954-58 ANNUAL AVERAGE	1959 YEAR	1960 YEAR	1961		1962
				YEAR	JANUARY-AUGUST	JANUARY-AUGUST
A. White fish						
On ice	13.5	13.3	27.8	33.1	15.5	14.6
Frozen	190.5	236.2	200.0	144.8	118.0	108.6
Stock-fish	47.4	45.0	56.1	47.6	42.5	31.9
Salted	89.8	69.4	74.9	68.8	63.5	67.3
For factories .	6.2	10.7	6.6	3.7	3.0	1.7
Other	3.6	6.9	8.6	8.4	7.1	7.3
Total	351.0	381.5	374.0	306.4	249.6	231.4
B. Herring						
Salted	37.5	36.3	21.8	68.1	54.5	54.8
Frozen	12.0	15.1	11.1	32.0	14.3	25.8
For factories .	35.8	131.5	103.5	225.8	179.8	301.6
Total	85.3	182.9	136.4	325.9	248.6	382.2
TOTAL CATCH	436.3	564.4	510.4	632.3	498.2	613.6
caught by:						
Trawlers	174.0	156.4	113.7	72.4	53.2	22.5
Other vessels .	262.3	408.0	396.7	559.9	445.0	591.1

Source : Icelandic submission to the O.E.C.D., Aegir.

20. There is little information about the movement of demand in 1962, but such indications as exist, notably the development of imports, suggest that the pressure on resources is increasing.

Balance of Payments

21. The improvement of the balance of payments in 1960 continued in 1961, when the current account showed a surplus for the first time in the post-war period. The value of merchandise exports, helped by the good fish catch, rose by 7 per cent (in dollars), and merchandise imports (excluding ships and aircraft) showed some further decline, reflecting weaker home demand. Imports of ships and aircraft, exceptionally high in 1960, fell back to a more normal level in 1961. Although military receipts declined, and interest and other current expenditure rose, the current account showed a surplus of 6 million in 1961.

22. Net foreign borrowing, largely short-term, and transfers in 1961 amounted to \$ 3.3 million, so that the net foreign exchange reserves rose by \$ 9.3 million; reserves of convertible currencies rose even more sharply than the total. In the first eight months of 1962, with a sharp increase in exports, the net foreign exchange position improved \$ 8.2 million. Although imports are also rising strongly again, present trends suggest that a fairly high current surplus will be achieved also in 1962.

23. The rise in reserves in 1960 and 1961 enabled Iceland to repay fully before February, 1962, the \$ 7 million credit received from the European Fund; instead, in place of this credit and to meet unforeseeable fluctuations in exchange earnings, Iceland obtained a \$ 5 million line of credit for two years and the standby credit from the IMF (\$ 1.6 million) has been prolonged. In June and September repayments totalling \$ 4 million were made to the IMF, leaving only a drawing equivalent to Iceland's gold tranche.

24. The liberalisation of imports initiated by the Stabilization Programme has been continued. As a result of measures taken in 1961 and the first half of 1962, 88 per cent of private imports (on a 1958 basis) can now be freely imported from European O.E.C.D. countries. It is the intention of the authorities to continue the policy of liberalising imports.

25. As a result of the more liberal trading policy, the proportion of imports taken from O.E.C.D. countries rose from 60 per cent in 1959 to more than 70 per cent in the first half of 1962, with a decline in the shares of the Soviet Union and other Eastern European countries. The changes on the export side have been even more marked, with O.E.C.D. countries increasing their share from 55 per cent in 1959 to 70 per cent in the first half of 1962.

Table 6. BALANCE OF PAYMENTS

Millions of dollars

	1957	1958	1959	1960	1961 YEAR 1)	1961 JANUARY- AUGUST	1962 JANUARY- AUGUST
1. Merchandise imports (f.o.b.)	71.4	76.8	83.5	83.9	71.8	44.2	51.5
of which : ships and aircraft	2.5	5.3	7.3	15.7	4.7	1.0 ³⁾	0.0 ³⁾
2. Merchandise exports (f.o.b.)	60.5	65.6	65.0	66.9	71.6	40.5	52.4
3. Trade balance	-10.9	-11.2	-18.5	-17.0	- 0.2	- 3.7	- 0.9
4. Military receipts	8.2	12.5	12.3	10.4	11.1	"	"
5. Interest on foreign debt, net	- 1.3	- 1.3	- 1.9	- 2.7	- 2.9	"	"
6. Other services, net	- 6.2	- 4.5	- 4.4	- 2.0	- 2.0	"	"
7. Balance on goods and services	-10.2	- 4.6	-12.5	-11.3	6.0	"	"
8. Amortization of foreign debt	- 2.8	- 3.8	- 6.5	- 7.5	- 8.8	"	"
9. Other capital expenditure	- 2.6	- 3.3	- 3.5	- 0.7	- 0.9	"	"
10. Public borrowing	9.1	12.6	9.3	7.6	5.8	"	"
11. Private borrowing	3.0	2.1	4.2	8.5	2.7	"	"
12. Other capital receipts ²⁾	0.9	- 0.2	2.7	10.5	4.5	"	"
13. Change in official foreign exchange reserves..	- 2.6	2.8	- 6.3	7.1	9.3	2.4	8.2
(i) convertible currencies	- 3.1	3.1	- 7.3	3.3	13.2	6.9	7.4
(ii) clearing currencies	0.5	- 0.3	1.0	3.8	- 3.9	- 4.5	0.8
14. Net foreign exchange position (end of period)..	0.9	5.1	- 3.3	3.0	12.2	5.4	20.4

1) Preliminary figures.

2) Excluding aircraft.

Source : Icelandic submission to the O.E.C.D.

Table 7. IMPORTS AND EXPORTS BY AREAS

	1958	1959	1960	1961	1960		1961		1962	
	YEAR	YEAR	YEAR	YEAR	1st HALF	2nd HALF	1st HALF	2nd HALF	1st HALF	JULY- AUGUST
I. IMPORTS										
A. Total value, \$ million ..	86.1	94.7	88.7	74.7	44.3	44.4	31.9	42.8	40.7	13.0
B. Percentage distribution :										
O.E.C.D. countries ..	57.9	60.2	69.0	67.9	70.0	67.8	66.7	68.5	71.4	71.3
European	44.0	44.3	54.9	51.5	54.9	54.9	49.4	53.1	55.9	59.3
North America	13.9	15.9	14.1	16.4	15.1	12.9	17.3	15.4	15.5	12.0
Soviet Union	17.4	16.0	13.9	14.7	10.6	16.9	13.5	15.5	10.7	11.4
Eastern Europe	14.8	14.5	8.9	8.3	9.6	8.3	9.6	7.2	7.1	8.5
Other	9.9	9.3	8.2	9.1	9.8	7.0	10.2	8.8	11.0	8.8
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
II. EXPORTS										
A. Total value, \$ million ..	65.5	64.9	66.4	71.5	31.8	34.6	30.2	41.3	39.9	12.5
B. Percentage distribution :										
O.E.C.D. countries ..	53.4	55.5	66.1	75.3	60.3	71.1	78.7	72.5	69.8	82.6
European	41.0	38.5	51.9	60.8	48.8	54.6	60.1	61.4	55.7	62.8
North America ...	12.4	16.9	14.2	14.5	11.5	16.5	18.6	11.1	14.1	19.8
Soviet Union	16.5	18.3	15.0	7.2	22.4	8.1	0.5	12.6	15.7	5.1
Eastern Europe	18.4	15.4	8.2	7.0	9.4	7.0	10.5	3.8	4.9	6.2
Other	11.7	10.9	10.7	10.5	7.9	13.8	10.3	11.1	9.6	6.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source : O.E.C.D. Statistical Bulletins, Icelandic submission to the O.E.C.D.

Table 8. IMPORTS BY MAJOR CATEGORIES

In millions of dollars

	1958	1959	1960	1961			1962			
	YEAR	YEAR	YEAR	YEAR	1st HALF	1st QTR	2nd QTR	1st HALF	1st QTR	2nd QTR
Food	8.5	9.2	8.5	8.2	3.9	1.9	2.0	4.2	1.9	2.3
Beverages and tobacco	1.6	1.6	1.6	1.4	0.4	0.3	0.1	0.8	0.4	0.4
Crude materials	5.4	5.3	5.1	4.2	1.6	0.6	1.0	1.9	0.6	1.3
Fuels	12.5	14.2	11.6	10.5	4.1	1.5	2.6	4.9	2.3	2.6
Oils and fats	0.9	0.7	0.8	0.7	0.3	0.1	0.2	0.3	0.1	0.2
Chemicals	4.3	5.4	4.7	4.3	2.3	0.9	1.4	3.1	0.8	2.3
Manufactures	31.8	32.9	27.2	25.8	10.8	5.8	5.0	14.6	5.9	8.7
Machinery and equipment ..	12.3	13.2	19.9	10.8	4.5	2.1	2.4	5.9	2.4	3.5
Transport equipment (excluding ships)	3.5	5.4	4.1	5.9	3.0	0.9	2.1	5.0	1.0	4.0
Ships	5.3	6.8	15.2	2.9	1.0	0.0	1.0	0.0	0.0	0.0
Total	86.1	94.7	88.7	74.7	31.9	14.1	17.8	40.7	15.4	25.3

Source : Hagtidindi.

Table 9. EXPORTS BY MAJOR CATEGORIES

Millions of dollars

	1958 YEAR	1959 YEAR	1960 YEAR	1961		1962
				YEAR	1st HALF	1st HALF
Salted fish	8.3	7.1	7.6	9.8	5.8	5.8
Stock-fish	3.1	4.6	4.4	6.5	3.1	2.9
Frozen-fish	23.4	25.5	23.5	17.2	7.7	11.5
Fish on ice	1.1	1.6	3.3	4.8	2.0	1.8
Cured herring ..	6.8	6.0	4.1	8.0	1.5	3.5
Frozen herring ..	1.4	0.9	0.9	1.8	1.2	1.8
Herring and fish meal	8.4	7.3	5.7	8.4	3.5	5.6
Herring and fish oil	3.0	1.4	5.8	3.3	0.6	2.0
Cod liver oil	2.0	2.0	1.8	1.1	0.4	0.5
Other fish or sea products	3.2	2.9	3.8	4.0	2.0	2.2
Total of the above	60.7	59.3	60.4	64.9	27.8	37.6
Agricultural pro- ducts	3.8	4.8	4.0	4.0	1.7	1.9
Other	1.0	0.8	1.5	2.6	0.7	0.4
Grand total	65.5	64.9	66.4	71.5	30.2	39.9

Source : Statistical Bulletin.

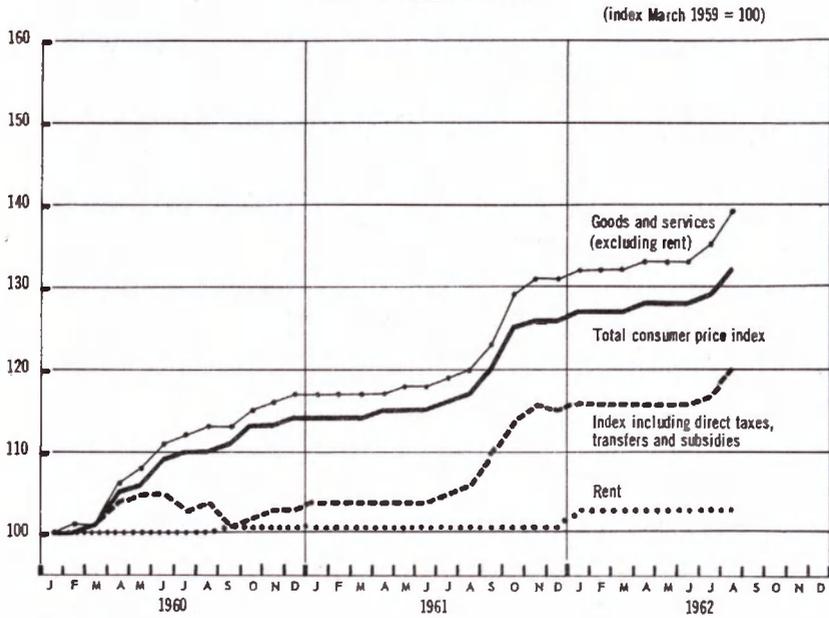
Prices and Wages

26. The stabilization policy has been less successful in the field of prices and wages. By early 1961, the effects of the 1960 devaluation on prices had worked themselves out, and the consumer price index showed only a moderate increase in the first half of the year. But the index rose sharply again in the second half, because of the rise in wages, agricultural prices and the devaluation in August. And after a period of stability in the first six months of 1962, the index began to rise rapidly again, because of a further sharp increase in wages and agricultural prices. The wage increases coupled with the rise in incomes resulting from large fish catches have led to higher demand and strong pressure on the labour market.

27. Early in 1961, in discussions with representatives of both employers and trade unions, the Government stated the view that, with favourable external conditions, the economy could support an increase in wage rates of about 3 per cent a year; and although export prices were relatively low and the 1960

fish catches had been poor, the Government would support such an increase provided that three year contracts were concluded. No agreement was reached along these lines, and prolonged strikes in May and June led to settlements which entailed immediate increases of between 13 and 19 per cent, and a further 4 per cent increase in June 1962. These were followed by similar settlements for employees in trade and other services as well as for civil servants and, according to law, by a corresponding increase in agricultural prices. Since wage increases of this magnitude were bound to endanger the profitable operation of the fishing industry and weaken the foreign balance, the exchange rate was adjusted in August to 1. Kr. 43 to the U.S. dollar.

Diagram 3
PRICE DEVELOPMENTS



Source: Hagtidindi.

28. The wage agreements concluded in 1961 has contained a renegotiation clause with a month's notice in case of a devaluation or of a given price increase (5 per cent in one year or 7 per cent in two years). The agreements were not, in fact, terminated immediately after the 1961 devaluation. But at the beginning of 1962 the trade unions presented the Government with a number of requests, including a reduction of import duties and freight rates on necessities, and a cut in interest rates which would enable the employers to increase wages without raising prices. Such changes in economic policy would

clearly have run counter to the immediate needs of the situation, and the Government pointed out that since the 4 per cent increase in wages due in June was in excess of the normal rise in productivity, no further increase in wages was justifiable, except some adjustments for lower-paid workers.

29. In April the trade unions broke off the discussions with the Government and announced their wage claims. Subsequent negotiations between the unions and the employers led to agreements providing for increases averaging about 8 per cent in addition to the 4 per cent included in the 1961 contracts. In September, an agreement on agricultural prices was reached between farmers and consumers, entailing an average increase in farmers' prices of about 12 per cent. The authorities expect the combined result of the latest wage increases, the agricultural agreement, increased freight rates, and the remaining effects of the 1961 wage increases and the devaluation, to push up the cost of living index by 9 per cent, most of it in September and October.

III. CONCLUSIONS

30. The Stabilization Programme of February 1960 was well conceived and administered. The confidence that other governments, acting through the IMF and the O.E.E.C., expressed in the combination of measures adopted by the Icelandic authorities was justified by the elimination of excessive demand pressures; the balance that emerged was a far better one than the economy had achieved during any other period since the war. The Icelandic authorities now have more effective control of financial and monetary conditions. The balance of payments has greatly improved, with a significant increase in foreign exchange reserves. The system of export subsidies and import taxes has been replaced by a uniform exchange rate. And a large proportion of foreign trade has been liberalised.

31. But this better stability has been seriously endangered by excessive wage increases, despite considerable efforts by the Government to maintain a reasonable relationship between the movements of money incomes and production. In both 1961 and 1962 the Government formulated a wages policy which, if observed, would have led to an increase in real wages without upsetting economic stability. But the recent excessive increases in negotiated wages have shown the limited extent to which government stabilization policies can be effective in a free economy if there is inadequate cooperation on the part of management and labour.

32. While the increase in wages of 1962 is clearly out of line with any normal advance in productivity, the Icelandic authorities fell that the economy is in a better position to absorb it than in 1961. With continued good fish catches, the operation of

the fishing industry has not been endangered ; and the external position is much better than earlier, although imports are rising fast and some decline in the current surplus is expected in 1963. The authorities believe that it should be possible, with the maintenance of fiscal and monetary restraints, to stabilize prices at the present level, provided that no further general increase in wages takes place for at least a year. Whether this will be possible will, very largely, depend on the attitude of the trade unions and the employers ; practically all wage agreements concluded in 1962 could already be terminated as a result of the recent rise in prices. If financial stability is to be achieved and maintained - and this is essential for the longer-term development of the economy - labour and management must show a greater degree of cooperation and responsibility than in the past.

33. Post-war developments have shown that a fast rate of growth cannot easily be achieved in Iceland. The scarcity of natural resources, the inherent instability of the fishing industry, the smallness of the economy, and the size, nature and climate of the country are all important obstacles to rapid growth. On the other hand, the high level of general education, the rapid expansion of the population, and large hydro-electric and geo-thermal energy resources constitute important assets for further expansion.

34. Past experience suggests that a greater diversification of output and exports is an important prerequisite for faster and more steady growth, and this will require a high level of investment. The maintenance of financial stability is essential, both to promote an economic allocation of resources and to attract foreign capital which will help accelerate the expansion of the economy. Faster expansion can also be furthered by a better planning of public investment and of public assistance to private development projects. To these ends a development programme is being prepared, and will probably be completed early in 1963. The O.E.C.D. will be ready to study this programme and the forms under which it could help forward its implementation.

STATISTICAL ANNEX

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Table 1. NATIONAL ACCOUNTS - 1945-1960

	Indices 1945 = 100												
	1948	1948	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960
A. TOTAL VOLUME INDICES													
1. Private consumption	102.5	104.2	97.0	93.3	87.5	103.2	111.0	118.7	125.6	121.4	131.0	139.1	139.8
2. Public consumption	112.3	115.2	117.6	115.6	118.0	122.5	133.2	143.0	155.3	168.0	174.6	178.7	191.6
3. Gross domestic fixed capital formation ...	171.2	147.7	106.4	110.8	115.5	135.0	147.5	179.1	200.2	203.7	201.4	214.7	221.9
4. Exports of goods and services	95.2	115.2	93.8	118.6	116.0	151.4	170.8	173.3	192.1	175.8	195.0	193.6	219.6
5. Imports of goods and services	130.5	103.2	73.4	88.9	86.2	116.0	126.8	143.5	155.1	139.0	154.7	168.7	184.4
6. Gross national product	105.0	113.8	109.6	106.3	104.6	121.0	131.3	142.4	148.9	148.7	159.5	162.4	163.8
B. VOLUME PER CAPITA													
7. Private consumption	100.5	97.8	87.4	82.5	76.5	88.5	92.9	97.3	100.5	95.1	100.0	104.4	102.7
8. Gross national product	102.7	106.7	99.1	94.2	91.1	103.6	109.8	116.5	119.2	116.1	121.8	123.2	120.1
C. TERMS OF TRADE													
9. Terms of trade	111.3	97.8	81.5	77.5	77.9	83.7	87.0	89.3	86.8	84.1	89.3	91.0	90.2
10. The volume of exports multiplied with the index for terms of trade	105.8	112.5	76.3	91.7	90.2	126.6	148.3	154.4	166.6	147.6	173.8	175.8	197.7
D. PERCENTAGES OF G.N.P. AT CURRENT PRICES													
11. Private consumption	75.2	74.1	73.2	75.8	72.0	70.7	69.1	66.1	67.9	65.6	64.9	66.5	65.9
12. Public consumption	9.1	8.8	9.3	9.4	9.7	8.8	8.6	8.6	9.0	9.6	9.2	8.8	8.6
13. Gross domestic fixed capital formation ...	27.0	22.7	18.8	20.2	21.9	21.8	22.0	24.8	26.7	28.1	26.1	26.4	29.5
14. Exports of goods and services	25.2	29.2	27.8	35.2	31.7	34.2	34.4	30.7	29.3	25.7	24.2	21.7	46.5
15. Imports of goods and services	36.9	31.9	31.8	40.6	36.0	37.3	35.0	33.9	32.5	28.8	25.7	24.8	51.6

SOURCE : Icelandic submission to the O.E.C.D.

Table II. GROSS FIXED ASSET FORMATION BY INDUSTRY
OF USE IN THE 1950's

1954 prices

	KRONERS MILLION			% DISTRIBUTION			ANNUAL % CHANGE		
	1950	1955	1959	1950	1955	1959	1950-1955	1955-1959	1950-1959
1. Agriculture	51.6	114.3	120.6	8.6	11.2	9.9	17.2	1.4	9.9
2. Fisheries	22.4	30.3	83.2	3.7	3.0	6.9	6.2	28.6	15.7
3. Manufacturing	76.5	100.6	128.0	12.7	9.9	10.5	5.6	6.2	5.9
4. Construction	8.1	18.8	22.3	1.3	1.8	1.8	18.4	4.4	11.9
5. Electricity and waterworks ..	59.6	58.1	152.1	9.9	5.7	12.5	-0.5	27.2	11.0
6. Transportation and commu- nication	115.0	219.3	186.0	19.1	21.5	15.3	13.8	-3.6	5.5
7. Dwellings	218.4	399.1	407.6	36.3	39.1	33.6	12.8	0.5	7.2
8. Public administration and other services	50.6	80.0	115.6	8.4	7.8	9.5	9.6	9.6	9.6
9. TOTAL	602.2	1,020.5	1,215.4	100.0	100.0	100.0	11.2	4.5	8.1

SOURCE : Icelandic submission to the O.E.C.D.

Table III. FISHERIES AND AGRICULTURE

	UNITS	AVERAGE 1952-1955	1956	1957	1958	1959	1960	1961	1962
FISHERIES									
Value of production	Index								
1. Current prices	1956 = 100	83.0	100.0	94.2	114.4	119.8	102.3	123.2	..
2. 1954 prices		84.4	100.0	93.4	111.8	116.6	106.2	121.0	..
Tonnage of fishing fleet	"								
3. Trawlers (end of year)		114.5	100.0	100.5	106.0	103.6	122.2	122.2	(122)
4. Motor boats (end of year)		91.8	100.0	101.8	104.4	116.4	136.1	144.6	(152)
5. Total (end of year)		103.1	100.0	101.2	105.2	110.0	129.2	133.4	(137)
AGRICULTURE									
Value of production ¹⁾	"								
6. Current prices		71.5	100.0	112.7	124.2	133.4	150.6	185.1	..
7. 1954 prices		84.1	100.0	107.1	112.7	113.1	116.9	125.2	..
Cultivation and livestock ²⁾									
8. Cultivated grassland ...	1,000 hectares	52.7	59.4	62.8	66.3	70.2	74.7	78.4	82.5
9. Sheep	1,000 heads	508.1	657.3	706.3	769.8	774.8	794.9	832.8	(832.8)
10. Cattle	"	44.8	45.5	47.5	49.0	48.0	49.9	53.4	(54.4)

1) Excluding change in livestock.

2) Beginning of year.

SOURCE : Icelandic submission to the O.E.C.D.

Table IV. PRICES

Indices March 1959 = 100

	1960				1961				1962			
	I	II	III	IV	I	II	III	IV	I	II	III	October
1. Goods and services	101	108	113	116	117	118	121	130	132	133	137	141
2. of which : Food.....	99	102	106	110	110	111	114	129	130	130	137	143
3. Rent	100	100	101	101	101	101	101	101	103	103	103	104
4. CONSUMER PRICES TOTAL	100	107	110	113	114	115	118	126	127	128	131	135
5. Net of direct taxes and transfers	100	87	42	21	21	21	27	33	28	27	45	45
6. Total (4) including direct taxes and transfers (5).....	100	105	103	103	104	104	107	115	116	116	120	125
7. Index of building costs	99	99	111	112	113	114	115	123	128	130	132	"

Table V. CREDIT SURVEY

End of period

I. Kr. million

	1958 YEAR	1960 YEAR	1960				1961				1962		
			I	II	III	IV	I	II	III	IV	I	II	III
CENTRAL BANK POSITION													
A. With commercial and savings banks													
1. Bills rediscounted	645	858	796	876	931	737	610	715	885	795	594	575	822
2. Loans on bonds ¹⁾	66	65	111	72	122	141	140	167	54	41	11	6	0
3. Advances ¹⁾	69	70	47	47	77	74	81	43	53	6	6	0	0
4. Deposits	61	52	58	99	170	138	191	276	423	591	716	743	909
a) Reserve requirements	-	-	-	-	-	47	-	84	135	198	289	325	415
b) Other blocked ¹⁾	-	-	-	-	-	-	-	-	67	155	181	180	-
5. Net credit (1 + 2 + 3 - 4)	719	941	895	896	960	813	640	649	570	251	-105	-161	-87
B. With investment credit institutions													
6. Advances ¹⁾	71	69	62	61	61	58	52	55	168	348	362	346	352
7. Deposits	32	30	15	24	10	29	15	50	53	51	50	31	44
8. Net credit ¹⁾ (6 - 7)	39	38	46	37	50	29	37	5	115	298	312	315	308
C. With monetary institutions (A + B)													
9. Net credit (5 + 8)	758	979	941	933	1,010	842	677	653	685	549	217	164	231
D. With treasury and general government													
10. Advances	148	139	97	170	223	204	227	310	265	161	196	200	228
11. Securities	52	96	107	105	111	112	119	132	170	202	208	220	229
12. Deposits	93	147	166	198	167	183	191	195	252	312	306	317	294
13. Net credit	107	88	38	77	167	133	155	247	183	50	98	103	163
COMMERCIAL AND SAVINGS BANKS													
14. Bank credits ¹⁾	3,279	3,899	3,826	4,075	4,282	4,191	4,213	4,475	4,713	4,544	4,549	4,823	5,196
a) Commercial banks ¹⁾	2,871	3,397	3,347	3,581	3,763	3,651	3,662	3,896	4,093	3,886	3,861	4,077	4,400
b) Savings banks	408	562	479	494	519	540	551	579	620	658	688	746	796
15. Total deposits	2,354	2,673	2,622	2,807	2,857	2,990	3,089	3,312	3,622	3,818	4,072	4,334	..
a) Commercial banks	1,896	2,122	2,111	2,263	2,285	2,388	2,475	2,657	2,907	3,025	3,253	3,440	3,610
i) Sight deposits	611	639	629	672	633	602	648	719	865	805	947	960	1,012
ii) Time deposits	1,285	1,483	1,482	1,591	1,652	1,786	1,827	1,938	2,042	2,220	2,306	2,480	2,598
b) Savings banks	458	551	511	544	572	602	614	655	715	793	819	894	..
i) Sight deposits	26	41	21	30	42	37	33	41	58	54	45	65	..
ii) Time deposits	432	510	490	514	530	565	581	614	657	739	774	829	870
16. Credits in excess of deposits ¹⁾	925	1,226	1,204	1,268	1,425	1,201	1,124	1,163	1,091	726	477	489	..

¹⁾ Items affected by the refinancing of the fisheries: In the second half of 1961, the Fisheries Mortgage Department took over loans from the banks amounting to 1, Kr. 295 million.

SOURCE: Icelandic submission to the O.E.C.D.

Table V. CREDIT SURVEY (cont' d)

End of period

	1958	1959	1960	1961		1962
				SEPTEMBER	DECEMBER	SEPTEMBER
				CREDITS BY INDUSTRY (percentage distribution)		
17. Agriculture and food processing	13	12	11	10	11	10
18. Fish and fish processing	32	35	35	35	30	31
19. Commerce	18	18	19	20	20	22
20. Manufacturing	12	11	12	11	13	12
21. Dwellings	11	11	10	10	11	10
22. Transportation and communication	2	1	1	2	2	2
23. Electricity	6	6	3	3	3	3
24. General Government			2	2	2	3
25. Other	6	6	7	7	8	7
26. Total	100	100	100	100	100	100

SOURCE : Icelandic submission to the O.E.C.D.

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ECONOMIC SURVEYS BY THE OECD

ICELAND

DECEMBER 1963

ORGANISATION FOR ECONOMIC
CO-OPERATION AND DEVELOPMENT

PARIS

ICELAND

BASIC STATISTICS

THE LAND

Area (1,000 sq. km)	103	Urban population Reykjavik, December 1962	74,97
Of which:		Other, December 1962	48,97
Cultivated area, January 1962	0.8	Population by occupation, 1960:	
Rough grazings, 1962	23.8	Agriculture	17 0
Glaciers	12.0	Fishing	8 0
Population 1963	187,000	Fish processing	10 0
No. of inhabitants per sq.km.	1.8	Manufacturing	16 0
Population increase, average 1950-60	2.1 %	Construction	12 0

PRODUCTION

Total fish catch, average 1959-62 (1000 metric tons)	618	Sheep population, January 1963, (1000 heads)	77
--	-----	--	----

GOVERNMENT AND PARLIAMENT

Government (number of ministers):	Parliament (No. of seats):
Independent Party (Conservatives) 4	Independent Party (Conservatives) 2
Social Democrats 3	Progressive Party (Liberals) 1
	Communists
	Social Democrats
	6
	Last general election 1963
	Next general election 1967

LIVING STANDARDS

Calories per head, per day 1958 3,240	Number of passenger cars in use per 1000 inhabitants, 1962 10
Average hourly wages of unskilled labour in Reykjavik, June 1963 (Kronur) 29.68	No. of radio sets per 1000 inhabitants 1963 44
	No. of telephones per 1000 inhabitants (end of 1962) 24

FOREIGN TRADE

Exports:	Imports:
Main exports 1962 (percentage of total exports):	Main imports 1962 (percentage of total imports):
Fish and sea products 92	Equipment 2
Agricultural products 7	Other manufactures 3
	Fuels 1

THE CURRENCY

Monetary unit: Krona	Currency unit per U.S. dollar 43,0
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ECONOMIC SURVEYS BY THE OECD

ICELAND

This document was approved
by the Economic and Development Review Committee
in December 1967

The Organisation for Economic Co-operation and Development was set up under a Convention signed in Paris on 14th December 1960 by the Member countries of the Organisation for European Economic Co-operation and by Canada and the United States. This Convention provides that the O.E.C.D. shall promote policies designed:

- to achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy;*
- to contribute to sound economic expansion in Member as well as non-member countries in the process of economic development;*
- to contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.*

The legal personality possessed by the Organisation for European Economic Co-operation continues in the O.E.C.D., which came into being on 30th September 1961.

The Members of O.E.C.D. are: Austria, Belgium, Canada, Denmark, France, the Federal Republic of Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States.

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by the Economic and Development Review Committee
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ICELAND

1. Following the inflationary conditions that had marked much of the post-war period, the Stabilisation Programme adopted in 1960 led to a better economic balance, with a strong increase in the foreign exchange reserves. The programme included measures establishing more effective government control of monetary and financial conditions, it introduced a uniform and more realistic exchange rate, removed price distortions and liberalised an important part of foreign trade. Stabilisation policy has been less successful in the field of wages and prices. Apart from two periods of stability in the first halves of 1961 and 1962, prices have risen sharply, influenced by pressure on resources and excessive increases in wages both in 1962 and 1963. Nevertheless, the progress made towards establishing more stable financial conditions has facilitated a discussion of longer-term trends and policies and, in April 1963, the Government adopted a long term economic programme for the four years 1963-1966. The present report discusses the long-term programme and considers the main conditions for its implementation.

I. THE ECONOMIC PROGRAMME FOR 1963-1966

2. The long-term programme is the first of its kind that has been prepared in Iceland. As in most other Member countries that are making use of long-term planning, economic programming in Iceland is taking place in a predominantly free market economy, with little direct government intervention with the activities of the private sector; to influence these activities the Icelandic authorities rely mainly on general monetary and fiscal measures. The estimates for the private sector are therefore merely indicative, showing the developments which the authorities feel are feasible and desirable, while the estimates for the public sector represent more definite programmes.

3. The essence of the long-term plan is not to expand faster, but more rationally. To this end, the maintenance of economic stability is important. And it is a central feature of the plan to continue the policies adopted in 1960 to remove price distortions resulting from inflation, protection and controls; the programme aims at further reductions in tariffs, subsidies and restrictions on foreign trade and payments. The plan includes:

- a) a general programme indicating the rates of growth of output and major demand components towards which economic policy will be directed;
- b) a more detailed programme for investment and its financing in 1963. Similar programmes for the rest of the planning period are under preparation.

a) THE GENERAL PROGRAMME

4. The targets for the next few years have been drawn up in the light of earlier trends and achievements. Since the first decade after the second world war represented a difficult adjustment period for Iceland, the programme has mainly been drawn up in the light of the 1955-1962 experience.

Production

5. The programme, summarised in Table 1, is based on an increase in the real gross national product of 4 per cent a year, about the same rate as that achieved in the 1955-1962 period. Since the growth of the population will decline somewhat, output per caput is expected to rise by 2.2 per cent a year, slightly faster than the 2.0 per cent rate experienced in the 1955-1962 period. On the assumption of unchanged terms of trade, the gross national income should rise at the same rate as output.

TABLE 1. SUPPLY AND USE OF RESOURCES

End of 1962 - prices.

	1962 ACTUAL	1966 ESTIMATE	PERCENT- AGE DIS- TRIBUTION 1966	ANNUAL PERCENTAGE INCREASE	
	<i>I. Kr. million</i>			1955-1962	1962-1966
Gross national product	11,585	13,550	100.0	4.1	4.0
National expenditure	11,320	13,650	100.7	4.1	4.8
Private consumption	7,674	8,910	65.8	4.3	3.8
Public consumption	994	1,240	9.2	6.0	5.7
Gross fixed asset formation	2,711	3,440	25.4	4.2	6.1
Change in livestock	22	20	0.1	..	..
Balance of goods and services....	265	- 100	0.7	..	..
Exports	5,250	6,155	45.4	4.8	4.1
Imports	4,985	6,255	46.1	4.9	5.8

Source: Iceland, Economic Programme 1963-1966, Reykjavik 1963.

6. The expected increase in output is very much in line with the 50 per cent growth target that O.E.C.D. countries have set for themselves for the 1960's (4.2 per cent a year)¹. But with a strong increase in popu-

1. See the O.E.C.D. report "Policies for Economic Growth", Paris, November 1962.

lation, output per caput is expected to rise more slowly than in most other Member countries, despite a higher rate of investment in Iceland. In the 1955-1962 period Iceland devoted about 28 per cent¹ of the gross national product to fixed asset formation; the average rate of European Member countries combined was less than 20 per cent². The development programme envisages an average rate of investment of 26 per cent, which is still much higher than in most Member countries.

7. The lower return on investment, in terms of output, than in other countries can be ascribed to several factors. The scarcity of natural resources, the harshness of the climate, and the large size of the country with a small and dispersed population render investment expensive; the small domestic market has made it difficult to develop internationally competitive industries; the instability resulting from heavy dependence on fluctuating fish catches and terms of trade may also have had an adverse effect on growth.

8. But the Icelandic authorities feel that the slow rate of growth in relation to labour and capital inputs can mainly be ascribed to inadequate economic policies. The inflationary conditions prevailing over much of the post-war period, and the price distortions resulting from high import duties, export premiums, and consumer subsidies have led to an uneconomic allocation of resources, with an adverse effect on growth. And the conditions prevailing in the post-war period have not been conducive to foreign investment in Iceland, without which important new export industries can hardly be developed.

9. The progress that has been made towards removing price distortions and restoring financial stability should have a favourable impact on future expansion, but it is not expected that recent and prospective changes in economic policy to promote economic stability and faster growth will yield very considerable results in the immediate future. And since exports will be somewhat handicapped by Iceland's position outside both the E.E.C. and the E.F.T.A., the authorities feel it would not be prudent to base future plans on a higher growth rate than the 4 per cent achieved in the 1955-1962 period; this estimate implies only a slightly faster increase in output in relation to inputs of labour and capital than in previous years.

10. The programme does not provide production estimates for individual sectors, since very few production statistics exist in Iceland. But it is clear that the G.N.P. estimate is based on the assumption of relatively favourable fish catches. The catch has increased considerably in recent years, rising by more than 50 per cent by volume between 1958 and 1962; but the increase affected mainly herring which attracts lower prices than most other types of fish, so that the value of the catch in constant prices rose by 20 per cent. Since the improvement can to

1. Based on figures in 1960 prices.

2. Based on figures in current prices for the 1955-1961 period.

a large extent be ascribed to better fishing techniques and the employment of a greater number of boats, the authorities feel that it is reasonable to expect good catches to continue in the next few years. The use of asdic, for instance, has permitted the location of shoals of fish in deep water which would never have been found without the use of this instrument. As a result, instead of being a highly seasonal activity, herring fishing has become a year round occupation. Other new equipment introduced includes synthetic fibre nets and the power block. There are also indications that the conservation measures introduced in the early 1950's are showing good results, especially in the case of haddock and flatfish.

TABLE 2. FISH CATCH

Thousands of metric tons.

	1958	1959	1960	1961	1962	1963
Herring	107	183	136	326	478	
White fish	398	381	374	306	287	
Total	505	564	510	632	765	

Source: Icelandic Submission to the O.E.C.D.

11. On balance, the estimate of the gross national product on which the programme has been based would seem to be a reasonable one. With relatively favourable external conditions, and with economic policies conducive to growth, leading to better stability and a more appropriate allocation of available resources output may well grow faster than assumed. But experience has shown that, given the size, nature and climate of the country, a fast rate of growth cannot easily be achieved in Iceland. And it would clearly be imprudent to gear the programme to a much higher rate of expansion than that achieved in the past.

Consumption and Investment

12. Domestic expenditure on consumption and investment is expected to rise by 4.6 per cent a year, rather faster than production. Private consumption is intended to grow more slowly than the real gross national product. But the programme aims at strong increases in both public consumption and capital formation. The rate of increase in public consumption is influenced by large needs for public services, notably in the field of education, health and transportation. The investment rate¹ of about 26 per cent for the period as a whole has been chosen despite the fact that it is a little higher than the rate the economy has

1. Gross fixed asset formation as per cent of the gross national product.

been able to digest without inflation in the recent past; in 1954, a year of reasonable balance, the investment rate amounted to 24.8 per cent; and in 1961 and 1962, when the current account of the balance of payments showed large surpluses, the rate amounted to only 22-24 per cent. But since the composition of investment in the 1963-1966 period is likely to change so as to entail an increase in the import content, it is felt by the authorities that the 26 per cent rate adopted in the economic programme should not entail undue pressure on domestic resources.

13. The investment programme, shown in Table 3, aims at a particularly large increase in public fixed capital formation, with a large hydro-electric power plant as the main project in this sector. This plant would be designed to cover the rising needs of the economy as well as providing the basis for establishing power-intensive industries in Iceland.

14. In the industrial sector the most spectacular increase is expected to take place in the fish processing industry, with continued expansion of the herring factories, modernisation of the freezing plants, and an increase in the capacity of the canning industry. Investment in the fisheries, although remaining high, will be somewhat lower than in the preceding four years period, but with large investment in the fishing boats in 1963. Investment in manufacturing (excluding fish processing), which has increased strongly in recent years, is likely to remain high, influenced *inter alia* by the need for modernisation and rationalisation resulting from more liberal import policies; tariffs were somewhat reduced in 1963 and the authorities intend to take further steps in this direction. The sharp increase in expenditure on "miscellaneous machinery and equipment" mainly reflects heavy investment in office equipment and building and construction machinery. Investment in agriculture and residential construction is expected to remain at about the level of the 1957-1961 period.

15. The change in the pattern of capital formation which the investment programme represents seems, clearly, a step in the right direction. The expansion of hydro-electric capacity is an important pre-requisite for the development of new and existing industries which are needed to provide the basis for some diversification of the structure of exports (fish and fish products represent more than 90 per cent of existing commodity exports). But the fisheries will remain the backbone of the economy, and high investment in this sector is still desirable; in the 1950's investment in fishing boats and equipment, and in the fish processing industry, was relatively low, hampered by financial difficulties which resulted from inflation and an inappropriate exchange rate.

16. The levelling off of investment in agriculture would also seem to be a desirable development; indeed, it might well be appropriate to aim at some reduction of investment in this sector. Stimulated by import tariffs and controls, government grants and subsidies, and

TABLE 3. INVESTMENT PROGRAMME

End 1962 prices.

	ANNUAL FIGURES OR AVERAGES <i>Millions of kronur</i>					PERCENTAGE INCREASE	
	1957-61 ACTUAL	1963-66 ESTIMATES	1962	1963	1964-66 ESTIMATES	1957-61/ 1963-66	1962-63
Public works and buildings	709	1,150	786	980	1,210	62	25
Electric power, generation and distribution.....	202	370	127	185	430	83	46
Geothermal heating and water supply	57	75	93	80	75	32	-14
Communications	290	435	346	425	440	50	23
Public buildings, including schools and hospitals....	160	270	220	290	265	69	32
Industrial asset formation	1,259	1,420	1,307	1,565	1,370	13	20
Agriculture.....	278	285	270	270	290	3	0
Fisheries	241	230	135	405	170	-5	200
Fish processing	128	180	220	220	170	41	0
Other manufacturing	194	215	178	200	220	11	12
Transport equipment	240	260	259	230	270	8	-11
Commercial buildings	100	110	137	120	105	10	-12
Miscellaneous machinery and equipment	78	140	108	120	145	79	11
Residential construction	758	770	618	675	800	2	9
Total gross fixed asset formation	2,726	3,340	2,711	3,220	3,380	23	19

Source: Iceland, Economic Programme 1963-1966, Reykjavik 1963.

special credit facilities, investment in agriculture has been very high throughout the post-war period, relatively much higher than in other Northern countries. There is already a surplus of dairy products which can only be exported with the aid of subsidies, at a great loss for the economy as a whole. A minimum objective of agricultural policy must be to keep output within the limits of domestic demand. Policy must aim at further rationalisation, and the transfer of manpower to other sectors must be encouraged. While it is unrealistic to expect agricultural policy to be based on pure economic considerations, the present level of fixed investment in agriculture seems excessive.

TABLE 4. INVESTMENT IN AGRICULTURE
IN ICELAND AND OTHER COUNTRIES

	1957	1960	1962	1963 - 66
<i>Agricultural investment per cent of G.N.P.:</i>				
Iceland	3.3	2.5	2.5	2.2
Denmark	1.7	2.1	2.1	..
Sweden	1.5	1.4	1.4	..
Norway	2.1	1.9	1.9	..

Source: O.E.C.D. Statistical Bulletin and national sources.

17. The estimate for residential construction, with practically no increase from the 1957-1961 period to 1963-1966, would also seem to be a reasonable policy target. Because of a prospective sharp increase in the number of married couples, however, the programme envisages a fairly strong increase of housebuildings in the course of the period, to a level in 1966 which is high in relation to G.N.P. Residential construction was high throughout the 1950's, stimulated by inflation; it was brought down to a more appropriate level by measures taken under the stabilisation programme. Since Iceland's housing standards are already high and since other investment needs are pressing, it should be a matter for consideration, whether the requirements for housing could not be met by a smaller increase in residential construction than envisaged during the programme period. The resources thus released might be more profitably employed in other sectors.

The Foreign Balance

18. With domestic expenditure on goods and services rising faster than production, and with no improvement of the terms of trade envisaged, the current account of the balance of payments is expected to change back into deficit. Commodity exports are expected to rise by about 5 per cent a year, but commodity imports are thought likely to increase by about 6 per cent; moreover, imports of services are expected

to increase somewhat more rapidly than exports of services, thus reducing the export surplus of services. To cover the deficit on current account, contractual repayments on existing and prospective foreign loans, and to enable some increase to be made in the foreign exchange reserves, the authorities estimate that new foreign borrowing at a rate of \$ 14 million a year will be required.

TABLE 5. BALANCE OF PAYMENTS

Constant 1962 prices. \$ million.

	1962	1963	1964	1965	1966
Merchandise exports	84.2	86.5	90.9	95.5	100.3
Merchandise imports	82.2	95.3	98.8	101.5	104.4
Trade balance	2.0	-8.8	-7.9	-6.0	-4.1
Military receipts, net.....	8.4	7.4	7.4	7.4	7.4
Services, net	-4.2	-4.4	-4.8	-5.2	-5.7
Balance of goods and services.....	6.2	-5.8	-5.3	-3.8	-2.4
Capital imports	18.9	17.2	14.0	14.0	14.0
Amortisation	-10.6	-8.4	-8.5	-8.7	-7.7
Increase in foreign exchange reserves.....	14.5	3.1	0.2	1.5	3.9

Source: Iceland, Economic Programme 1963-1966, Reykjavik 1963.

19. It would certainly seem appropriate for Iceland to try to accelerate the development of the economy by some import of foreign capital. Although the Icelandic economy is in many respects well advanced, with a relatively high per caput national income, it faces many problems similar to those of the under-developed countries. This applies in particular to the need to diversify the present one-sided structure of exports, which requires a volume of investment which is large in relation to the domestic economy.

20. This estimate of foreign borrowing needs is, of course, uncertain; but judged by past trends and present tendencies, it does not seem unrealistic. Table 6 shows that the volume of exports is expected to rise rather less fast than in the 1955-1962 period, while the volume of imports is thought likely to grow more rapidly than previously, in line with the assumption that the import content of domestic expenditure will increase. The terms of trade have tended to improve over recent years, but it would probably be imprudent to assume a further improvement in the next few years since Icelandic exports to E.E.C. and E.F.T.A. countries may be adversely affected by increasing tariff differentials. Receipts from the defence forces are expected to decline somewhat from the 1962 level. The repayment obligations on the external debt

are of course already known. On balance, and with reasonable stability in the economy, there is little reason to expect the foreign account to develop less favourably than assumed in the programme. But it seems appropriate, as provided for in the programme, to aim at raising the foreign exchange reserves somewhat during the period.

TABLE 6. FOREIGN TRADE

Annual growth rates at constant prices.

	1955-1962 ACTUAL	1963-1966 PROGRAMME ESTIMATES
	<i>Per cent</i>	
Imports of goods	4.1	6.2
Imports of goods and services	4.9	5.8
Exports of goods	5.3	4.5
Exports of goods and services	4.8	4.1
	<i>1953 = 100</i>	
Terms of trade	105 ¹	(105)

1. 1955-1961.

Source: Iceland, Economic Programme 1963-1966, and O.E.C.D. Statistical Bulletin.

b) INVESTMENT AND ITS FINANCING IN 1963

21. Gross fixed asset formation is expected to show a particularly sharp increase in 1963, with the external deficit swinging from surplus to deficit. The programme envisages new borrowing and other capital inflows totalling \$ 17.2 million, sufficient to finance the current deficit (\$ 5.8 million), contractual repayments on the external debt (\$ 8.4 million), and to ensure some increase in the foreign exchange reserves (\$ 3.0 million). Most of this amount has already been secured, including a \$ 5.6 million government loan raised in London, a \$ 1.3 million P.L. 480 loan from the U.S. authorities, and large shipping credits. But since the current deficit is likely to be higher than expected, the reserves may decline somewhat rather than increase.

22. The financial programme for 1963 is concerned not only with securing an adequate total of internal and external finance, but also with its distribution to the various sectors of the economy. The authorities have estimated that, in addition to the funds provided by the government budget, the implementation of the 1963 investment programme will require the Government to provide Kr. 472 million¹,

1. Including kr. 77 million needed to consolidate preliminary financing of investment in earlier years.

partly for its own projects and partly to feed the public investment funds which supply credit to private enterprise. About two-thirds of this, or Kr. 285 million, will be covered by the two foreign loans referred to earlier. The authorities intend to provide the remainder by channeling private savings to the projects in need of finance. The commercial banks, the largest savings banks, and the Unemployment Insurance Fund have agreed to participate in the financing of these projects; according to the agreement, 15 per cent of the increase in the commercial and savings banks' deposits in 1963 will be used for this purpose. The Government also hopes to enlist the participation of the pension funds and the insurance companies in the financing of the investment programme.

23. Both investment and consumption rose faster in 1963 than foreseen in the economic programme. Private consumption probably showed an increase of about 6 per cent in real terms (instead of 4 per cent), and private fixed investment rose sharply; the large number of projects started will affect investment also in 1964. Public investment increased in line with the programme. Since total output expanded as envisaged, the strong increase in domestic demand led to a larger current external deficit than earlier expected, and the foreign exchange reserves have declined somewhat rather than increased.

II. THE IMPLEMENTATION OF THE ECONOMIC PROGRAMME

24. The programme is necessarily based on a number of assumptions about conditions external to the Icelandic economy — e.g., marketing conditions abroad and fishing conditions at home. The estimates for the private sector are by nature uncertain. And it may, as the programme develops, prove appropriate for some of the targets for the public sector to be adjusted up or down. Hence, the importance of revising the programme from time to time in order that any necessary adjustments may be made. With reasonably favourable fish catches and marketing conditions abroad, the implementation of the development programme will very largely depend on:

- a) an adequate volume of external loans at reasonable terms;
- b) the maintenance of economic stability at home;
- c) an improvement in the policy-making and administrative machinery of the Government.

a) EXTERNAL FINANCE

25. The volume of capital imports envisaged in the programme does not seem excessive. It is, of course, true that foreign borrowing of \$ 14 million a year would represent some 5 per cent of the gross national product, or 10 per cent of exports of goods and services. But

since contractual repayment during the period will average more than \$ 8 million a year, and some further strengthening of the foreign exchange position is envisaged, the net increase in foreign indebtedness will be much less, about \$ 4.5 million a year. This corresponds only to about 5 per cent of gross investment; domestic capital formation will very largely be financed by domestic savings.

26. Domestic savings are in fact relatively high in Iceland. In the 1955-1962 period, private and public savings combined amounted to 24.3 per cent¹ of the gross national product. In the programme period the savings rate is expected to rise slightly to 24.7 per cent. These rates are much higher than those achieved by most other Member countries; in the 1955-1961 period only Norway and Germany showed higher rates than Iceland.

TABLE 7. SAVINGS RATE IN SELECTED COUNTRIES
AVERAGE 1955-1961 AT 1954 PRICES

Per cent of G.N.P.

Iceland	25.0
Norway	25.4
Sweden	20.2
Germany	25.1
France	18.4
Italy	21.7
United Kingdom	15.5

Source: O.E.C.D. General Statistics.

27. The present foreign debt is not unduly high, amounting to 25 per cent of the gross national product. And its expected growth over the next few years should not significantly increase this ratio. According to the economic programme, the balance of payments would not be burdened by an increase in the servicing of the foreign debt (amortisation and interest). Since the average maturity of the existing external debt is relatively short, and the authorities hope to be able to raise long-term loans, payments in respect of amortisation and interest are expected to rise only moderately, and to fall in relation to growing exports.

28. Moreover, the improvement of the balance of payments in recent years has strengthened the economy's ability to take on new debt commitments, and should ease the problem of raising capital abroad. The current foreign balance, in large deficit during most of the 1950's, showed important surpluses in 1961 and 1962, influenced by the stabilisation programme of 1960. The net foreign exchange

1. Based on figures in 1960 prices.

TABLE 8. SERVICING OF FOREIGN DEBT INCURRED UP
TO END OF 1966

Million Kronur.

	1962	1963	1966	1970
Amortisation	455	361	333	327
Interest	130	133	188	141
Total	585	494	521	468
Total, as per cent of exports of goods and services ¹	11.0	9.2	8.5	6.3

1. Assuming that exports grow at the same rate after 1966 as in the 1963-1966 period.

Source: Iceland, Economic Programme 1963-1966, Reykjavik 1963.

position of the Central and commercial banks combined has improved considerably, changing from an excess of liabilities in 1960 to net reserves of about \$ 29 million in the middle of 1963, the equivalent of about 4 months' commodity imports.

29. But success in obtaining the external loans required for the implementation of the development plan will, as the programme recognises, depend to an important extent on the maintenance of economic stability at home. While progress has been made in this direction since the adoption of the stabilisation programme in 1960, excess demand conditions and a wage-price spiral have again developed.

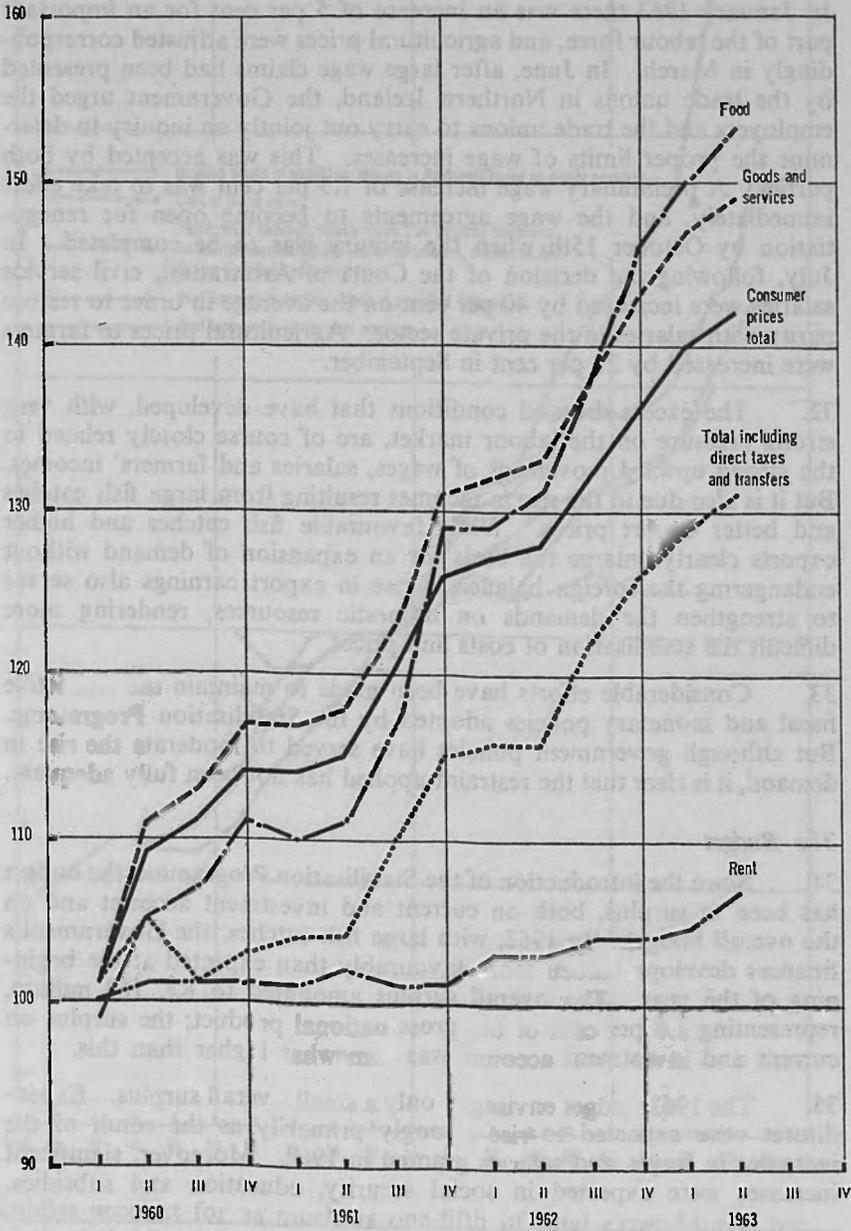
b) ECONOMIC STABILITY

30. Following the better economic balance achieved in 1960 and 1961, inflationary pressures developed again in 1962 and have become more serious in 1963. The cost of living index, virtually stable in the first half of 1962, rose by 12.5 per cent over the twelve months up to mid-1963; in August the index was 25 per cent higher than in August 1961 when the Icelandic krona was devalued. The trade balance deteriorated sharply in the first half of 1963, with imports rising by as much as 28 per cent from a year earlier; exports rose by 5 to 6 per cent. While it was to be expected that the current account surplus would decline or be replaced by a deficit in a year with sharp increases in domestic investment and imports of fishing boats, the rise in imports in the first half of the year was far in excess of the rate envisaged in the development programme. The current deficit has largely been financed by imports of capital, but the foreign exchange reserves have declined somewhat in recent months.

31. The inflationary trend can be ascribed to two factors: large increases in nominal incomes and excess demand conditions. Wage

Diagram 1. PRICES

MARCH 1959 = 100



Source: Hagtidindi.

rates and farmers' incomes¹ rose by about 15 per cent in 1961, after which the Krona was devalued. In 1962 they rose by an average of 12 per cent, while the average income of workers and fishermen, because of large fish catches and wage drift, increased by as much as 21 per cent. In January 1963 there was an increase of 5 per cent for an important part of the labour force, and agricultural prices were adjusted correspondingly in March. In June, after large wage claims had been presented by the trade unions in Northern Iceland, the Government urged the employers and the trade unions to carry out jointly an inquiry to determine the proper limits of wage increases. This was accepted by both parties. A preliminary wage increase of 7.5 per cent was to take effect immediately, and the wage agreements to become open for renegotiation by October 15th when the inquiry was to be completed. In July, following the decision of the Court of Arbitration, civil service salaries were increased by 40 per cent on the average in order to restore parity with salaries in the private sector. Agricultural prices to farmers were increased by 21 per cent in September.

32. The excess demand conditions that have developed, with very strong pressure on the labour market, are of course closely related to the strong upward movement of wages, salaries and farmers' incomes. But it is also due to the rise in incomes resulting from large fish catches and better export prices. While favourable fish catches and higher exports clearly enlarge the basis for an expansion of demand without endangering the foreign balance, a rise in export earnings also serves to strengthen the demands on domestic resources, rendering more difficult the stabilisation of costs and prices.

33. Considerable efforts have been made to maintain the restrictive fiscal and monetary policies adopted by the Stabilisation Programme. But although government policies have served to moderate the rise in demand, it is clear that the restraint applied has not been fully adequate.

The Budget

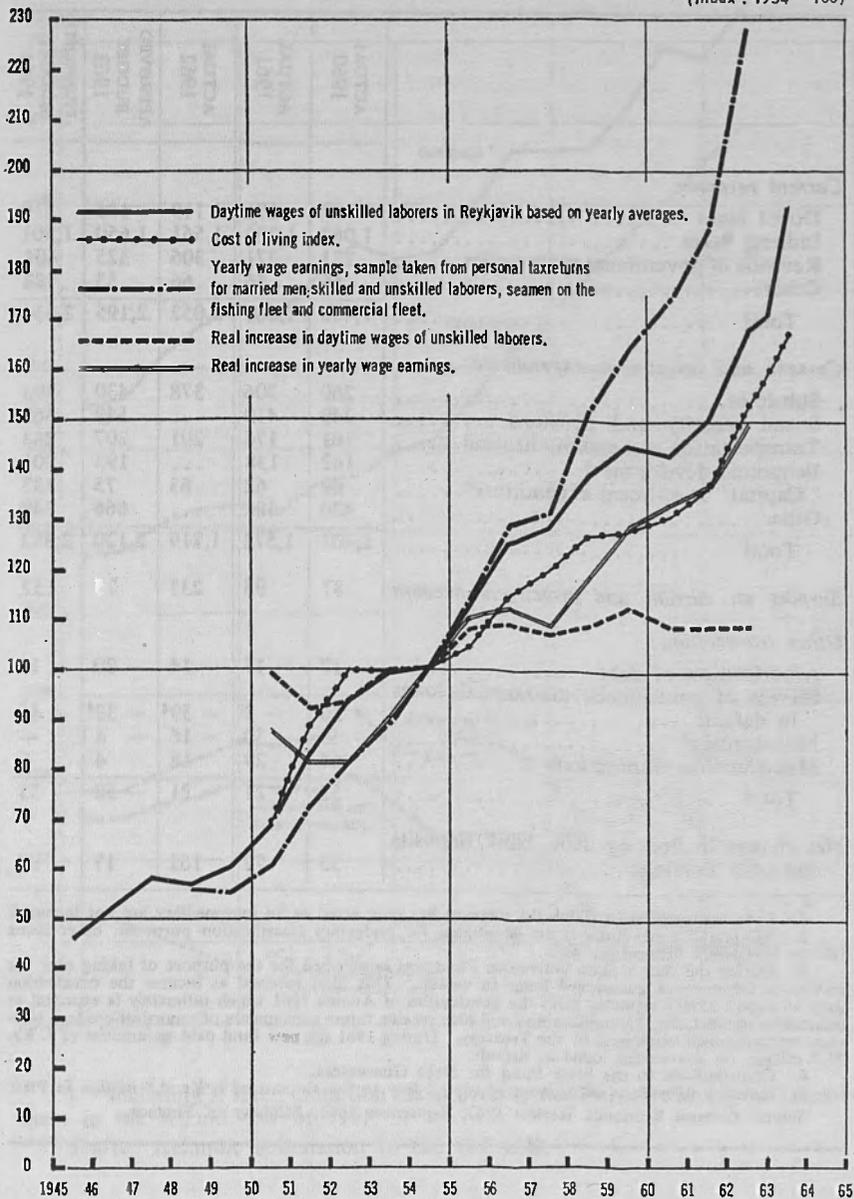
34. Since the introduction of the Stabilisation Programme, the budget has been in surplus, both on current and investment account and on the overall budget. In 1962, with large fish catches, the Government's finances developed much more favourably than expected at the beginning of the year. The overall surplus amounted to Kr. 162 million, representing 1.4 per cent of the gross national product; the surplus on current and investment account was somewhat higher than this.

35. The 1963 budget envisaged only a small overall surplus. Expenditures were expected to rise strongly primarily as the result of the increases in wages and salaries granted in 1962. Moreover, significant increases were expected in social security, education and subsidies.

1. According to existing legislation, agricultural incomes are adjusted in accordance with changes in wages and salaries.

Diagram 2. WAGES, PRICES AND INCREASES IN REAL WAGES

(Index : 1954 = 100)



Subsidies account for as much as one-fifth of total expenditures, but recently subsidies were discontinued on all imported commodities, which reduced these payments by about 10 per cent. Considerable

TABLE 9. GOVERNMENT FINANCES¹

Millions of Kronur.

	ACTUAL 1960	ACTUAL 1961	ACTUAL 1962	APPROVED BUDGET 1963	PROPOSED BUDGET 1964
<i>Current revenue:</i>					
Direct taxes	99	106	119	165	210
Indirect taxes	1,062	1,232	1,561	1,650	1,901
Revenue of government monopolies.....	271	271	306	325	401
Other.....	56	56	66	55	22
Total	1,488	1,665	2,052	2,195	2,534
<i>Current and investment expenditure:</i>					
Subsidies.....	260	306	378	430	393
Social security and pensions.....	349	410	...	549	663
Transportation and communication.....	161	174	201	207	243
Economic development	142	138	...	193	201
"Capital" investment expenditure ²	69	62	63	75	133
Other.....	420	482	...	666	749
Total	1,401	1,572	1,819	2,120	2,382
<i>Surplus on current and investment account</i>	87	93	233	75	152
<i>Other transactions:</i>					
Amortisation of debt	- 17	- 17	- 14	- 20	- 15
Service of government guaranteed loans in default	- 50	- 3 ³	- 59 ⁴	- 38 ⁴	- 46
New lending ⁵	- 49	- 30	- 16	- 4	-
Miscellaneous transactions	64	29	18	4	6
Total	- 52	- 21	- 71	- 58	- 55
Net change in floating debt, bank deposits and cash holdings	35	72	162	17	97

1. Loan transactions in which the treasury has only acted as an intermediary are not included.

2. "Capital" expenditure is so designated for budgetary classification purposes: other items include investment expenditure also.

3. During the year a State Guarantee Fund was established for the purpose of taking over the service of Government guaranteed loans in default. This fund received as income the devaluation gain on export stocks resulting from the devaluation of August 1961 which ultimately is expected to amount to about I. Kr. 127 million and will also receive future repayments of amortisations and interests on guaranteed loans paid by the Treasury. During 1961 the new fund paid an amount of I. Kr. 71.3 million on guaranteed loans in default.

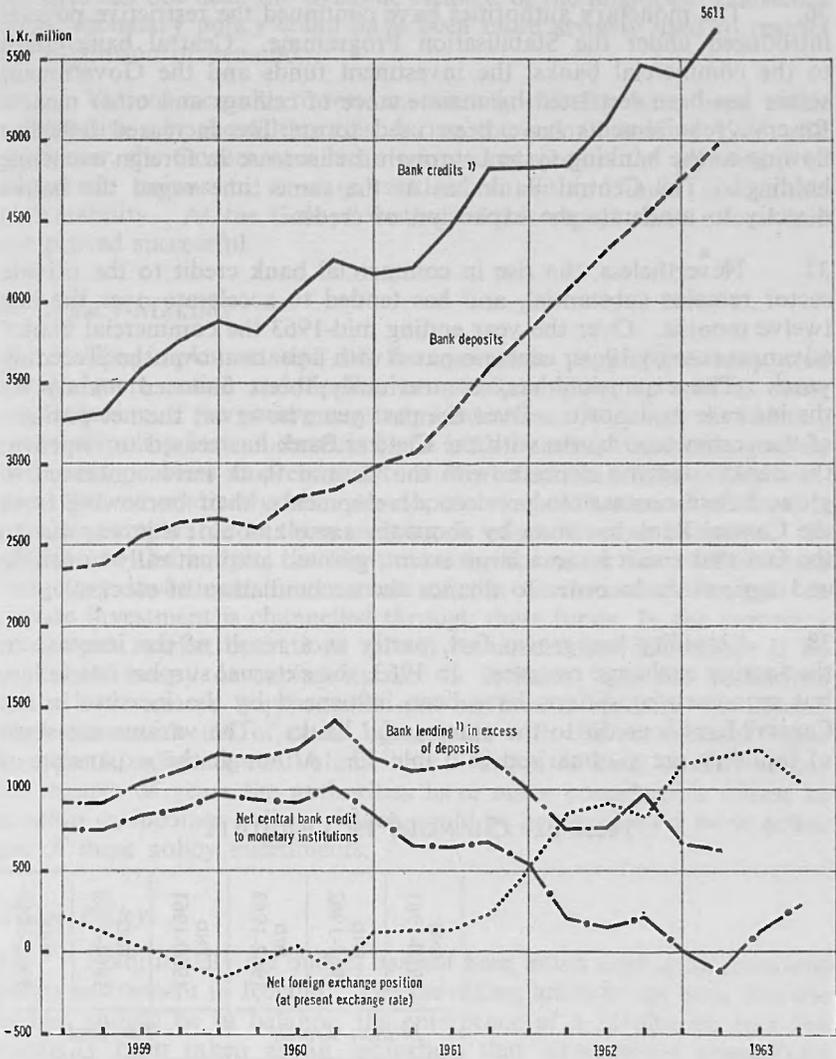
4. Contributions to the State Fund for Debt Guarantees.

5. Includes obligations on account of capital levy to the amount of I. Kr. 4.5 million in 1960.

Source: General Economic Review 1962, September 1963, Ministry of Finance.

increases were also expected in revenue although lower than the increases in expenditures. Indications are, however, that revenue will increase much more than expected, and that in spite of the increase in salaries of Government employees a surplus will be realized of about the same

Diagram 3. SOME MONETARY INDICATORS



1. Including I. Kr. 295 million taken over by the Fisheries Mortgage Department in the second half of 1961.

Source: Icelandic submission to the O.E.C.D.

size as in 1962. In view of the existing inflationary conditions an even larger surplus would, however, have been desirable. The budget for 1964, as proposed by the Government, shows an overall surplus of only Kr. 11 million.

Credit Policy

36. The monetary authorities have continued the restrictive policies introduced under the Stabilisation Programme. Central bank credit to the commercial banks, the investment funds and the Government sector has been restricted by maintenance of ceilings and other means. Reserve requirements have been used to sterilize increased liquidity flowing to the banking system through the increase in foreign exchange holdings. The Central Bank has at the same time urged the banks directly to moderate the expansion of credit.

37. Nevertheless, the rise in commercial bank credit to the private sector remains substantial, and has tended to accelerate over the last twelve months. Over the year ending mid-1963 the commercial banks' advances rose by 19 per cent compared with 8 per cent over the preceding year¹. The expansion has, as previously, been financed mainly by the increase in deposits. Over the past year, however, the net position of the commercial banks with the Central Bank has ceased to improve; the banks' demand deposits with the Central Bank have continued to grow, but in contrast to previous developments, their borrowing from the Central Bank has risen by about the same amount; this was due to the fact that credit is, to a large extent, granted automatically to fishing and agriculture in order to finance the accumulation of stocks.

38. Liquidity has grown fast, partly as a result of the increase in the foreign exchange reserves. In 1963, the external surplus has fallen, but monetary conditions have been influenced by the increase in the Central Bank's credit to the commercial banks. The various measures of liquidity are summarised in Table 10. Although the expansion of

TABLE 10. CHANGES IN LIQUIDITY

	END 1960-1961	END 1961-1962	MID 1962-1963	END 1960-1961	END 1961-1962	MID 1962-1963
	<i>Million Kronur</i>			<i>Per cent</i>		
Money supply.....	+ 329	+ 324	+ 164	29	22	10
Near-money.....	+ 552	+ 779	+ 826	25	28	27
Commercial banks' free reserves..	+ 26	+ 153	- 56	29	131	- 38

Source: International Financial Statistics, and Icelandic submissions to the O.E.C.D.

1. Total bank credit to private sector, including that of the Fisheries Mortgage Department, rose by 18 per cent over the twelve months up to June 1963, compared with 14 per cent over the preceding year.

the economy may require an increase in the money supply, and this increase has not been the dynamic element of the inflationary development, monetary policy could have been more actively used to restrict the expansion of demand.

39. Various measures to restore economic stability have been under consideration by the Authorities during the second half of 1963. In particular, the Government has attempted to obtain the agreement of the trade unions to a wage settlement within limits compatible with stability. At the time of writing of this report these efforts had not proved successful.

c) POLICY-MAKING

40. The implementation of the economic programme may well require more active and flexible economic policies, as well as some strengthening of the government administration. Although the existing range of policy instruments could be both improved and enlarged, an important problem at present is to make better use of the policy weapons that have already been developed. Iceland's arsenal of these is roughly comparable to those existing in other Member countries. In addition to the budget, the Government also makes use of four extra budgetary investment funds; most of the Government's support to private investment is channelled through these funds. In the monetary field, open market operations cannot be undertaken since there is no organised money or capital market in Iceland. But the authorities apply both reserve requirements and bank rate; recently the Central Bank also made use of credit agreements with the commercial banks in order to influence the volume and direction of bank credit. In the last couple of years the authorities have made considerable efforts to develop an incomes policy. Much could be achieved by a more active use of these policy instruments.

Fiscal Policy

41. Traditionally the budget has not been much used as an economic policy instrument in Iceland. The prevailing attitude has been that the budget should be in balance; the emergence of a surplus *ex post* has normally been taken as an indication that government expenditure could be increased or receipts reduced, or vice versa in the case of a deficit. In 1962, however, when the budget showed a surplus, the Minister of Finance decided that, in view of the economic conditions then prevailing, the surplus should not be used to increase government expenditure, but should be deposited in the State Equalisation Fund; this Fund was established by law more than 30 years ago, but this was the first time it was used.

42. It is essential that economic considerations should play a greater role in determining budget policy. What is important is not whether

the budget is in balance, but whether there is a reasonable balance between aggregate demand and supply in the economy. The maintenance of economic balance is the responsibility of the authorities, and the budget is one of the most important instruments that can be used for this purpose; normally the budget should be in deficit when the economy is under-employed because aggregate demand is not high enough; if aggregate demand is excessive the budget should be in surplus.

43. In Iceland, as in other countries, there are many practical difficulties involved in the flexible use of the budget as an economic policy instrument. A large proportion of budgetary expenditure is determined by legal commitments; the level and structure of taxation are influenced by a number of considerations other than those related to short-term demand management; and the speed with which variations in expenditure and taxation can be made is conditioned by the principles and procedures of parliamentary government. But these problems would not seem to be more difficult in Iceland than elsewhere, and considerable progress has been made in some countries towards making the budget a more flexible policy instrument.

Monetary Policy

44. Monetary policy has been used fairly actively in the last three years. But adequate flexibility is still hampered by the system whereby credits are granted automatically to agriculture (up to a certain limit) and fishing according to certain established rules related to stock accumulation and production. While it is clear that monetary policy must facilitate production and trade by providing credit, there is no reason why such credit should be granted automatically; automatism prevents flexibility and encourages abuse. If the system of automatic credits has to be maintained for the time being, it is important to ensure that monetary expansion is not excessive. To this end, new legislation has been proposed which would limit the increase in automatic credits to the reserves which the banks are required to keep with the Central Bank. The Bill now before the Althing would also authorise the authorities to float a bond issue with a relatively low rate of interest, but carrying a devaluation guarantee.

Incomes Policy

45. The steps taken in recent years to obtain a reasonable relationship between the movements of nominal incomes and productivity represent an important advance; in both 1961 and 1962 the Government set guiding lights for wage settlements and made considerable efforts to get them observed. But it is doubtful whether an effective incomes policy can be established in Iceland without greater centralisation and co-ordination of wage and income settlements. Better co-ordination

would seem to be particularly important in present circumstances when the pressure on wages to a large extent reflects competition between individual branches to regain or maintain their relative positions. Co-ordination on a nation-wide basis, providing for full confrontation of claims and views of all parties concerned, should help to produce better understanding of the real scope for income increases as well as of the pattern of income adjustments which the existing situation requires. The Government has an important role to play in bringing about a better system of wage and income determination. But the Government's efforts will only succeed if labour and management show co-operation and responsibility.

Administrative Machinery

46. The preparation of a long-term plan, albeit in itself a useful exercise, is clearly only the first step towards a consistent longer-term policy. Experience from other countries suggests that at least two conditions must be fulfilled if the plan is to serve any useful purpose beyond the benefits that flow from its preparation. First, if it is not to be overtaken by events, the plan must be revised as events develop and prospects change. This so-called "rolling planning" can best be done by a permanent administrative body that specialises in this exercise. Second, arrangements are required within each ministry to ensure that government policy in individual sectors conforms with the long-term plan. In Iceland, the Economic Institute recently established under the Prime Minister is responsible for the preparation of long-term programmes and the supervision of their implementation. But the administrative machinery in the individual ministries has not yet been adapted to the conditions under which government activities are to be guided by a longer-term plan. If long-term planning is to have any real meaning, in the sense of influencing the pattern of economic developments, a certain minimum of administrative machinery occupied on problems of long-term planning is required in all important ministries.

III. CONCLUSIONS

47. The main conclusions of this survey may be summarised as follows:

- i) The development plan prepared by the Icelandic authorities appears a well-conceived and realistic guide for economic policy. Eschewing any dramatic increase in the growth rate, it concentrates on maintaining a large investment effort and at re-orientating capital expenditure towards more directly productive projects. In particular, the faster development of energy resources and the fish processing industry

would seem desirable; an expanded energy base is essential for further industrialisation and diversification of production and exports; and greater rationalisation and expansion of the fisheries and the fish processing industry, in which Iceland has proved herself notably efficient, is clearly appropriate.

- ii) The volume of foreign borrowing assumed in the programme does not seem excessive; the net capital imports envisaged are small in relation to domestic savings and should not lead to undue increases in the foreign debt or its servicing.
- iii) But the implementation of the programme will, to a very large extent, depend upon the success of the authorities in restoring, and then maintaining, economic stability. The budget needs to be stricter; in the excess demand conditions prevailing in 1962 and 1963, a budget surplus representing less than 1.5 per cent of G.N.P. is inadequate. And credit expansion needs to be restricted; this can hardly be done without the modification, if not elimination, of the present automatic credit arrangements.
- iv) The problem of stabilising prices is seriously complicated by the fact that attitudes and conditions created by long-standing inflation are not easily removed. Inflation generates its own momentum. In particular, the problems arising from the efforts of individual sectors to restore or improve their relative position are not easily amenable to economic policy treatment. But an essential element of measures to deal with these problems must consist of better co-ordination of wage and income settlements. And co-operation and sense of responsibility on the part of labour and management is an essential condition for success.
- v) Achievement of both the growth and stability objectives will require an improvement in the making of policies. Instability resulting from fluctuating fish catches and other factors call for more active demand management policies. And some adaptation and strengthening of the government administration is essential if the long-term programme is properly to be implemented.

TABLE I. NATIONAL ACCOUNTS 1950-1962

I. Kr. Million.

	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960 ¹	1961 ¹	1962 ¹
<i>Current Prices:</i>													
1. Private consumption	1,514	1,921	2,039	2,394	2,619	2,947	3,481	3,540	4,113	4,758	5,376	6,129	7,254
2. Public consumption	192	237	275	296	325	379	461	517	582	631	699	765	948
3. Gross domestic fixed and asset formation	389	513	610	730	835	1,091	1,368	1,516	1,658	1,904	2,459	2,148	2,825
4. Change in stocks	57	1	20	60	33	128	- 18	- 11	81	99	- 81	170	- 59
5. Exports of goods and services..	575	893	898	1,159	1,305	1,349	1,503	1,386	1,536	1,556	3,790	4,315	5,270
6. <i>Less:</i> Imports of goods and services	658	1,030	1,021	1,263	1,328	1,491	1,665	1,552	1,627	1,777	4,204	4,084	4,980
7. Gross national product at market prices	2,069	2,535	2,821	3,376	3,789	4,403	5,130	5,396	6,343	7,171	8,039	9,443	11,258
<i>Percentage of G.N.P. at current prices:</i>													
1. Private consumption	73.2	75.8	72.3	70.9	69.1	66.9	67.9	65.6	64.8	66.4	66.9	64.9	64.4
2. Public consumption	9.3	9.4	9.7	8.8	8.6	8.6	9.0	9.6	9.2	8.8	8.7	8.1	8.4
3. Gross domestic fixed asset formation	18.8	20.2	21.6	21.6	22.0	24.8	26.7	28.1	26.1	26.6	30.6	22.7	25.2
4. Exports of goods and services..	27.8	35.2	31.8	34.3	34.4	30.6	29.3	25.7	24.2	21.7	47.1	45.7	46.8
5. Imports of goods and services..	31.8	40.6	36.2	37.4	35.0	33.9	32.5	28.8	25.7	24.8	52.3	43.2	44.2
<i>Total volume indices (1945 = 100):</i>													
1. Private consumption	97.0	93.3	87.5	103.2	111.0	118.7	125.6	121.4	130.9	139.1	139.8	144.2	156.0
2. Public consumption	117.6	115.6	118.0	122.5	133.2	143.0	155.3	167.8	174.3	178.4	190.4	195.0	212.5
3. Gross domestic fixed asset formation	106.4	110.8	115.5	135.0	147.5	182.0	198.7	203.2	198.5	218.6	232.5	179.7	216.8
4. Exports of goods and services..	93.8	118.6	116.0	151.4	170.8	174.6	193.5	177.0	196.6	196.8	216.9	220.3	247.7
5. Imports of goods and services..	73.4	88.9	86.2	116.0	126.8	143.2	156.0	141.3	156.9	170.8	176.1	164.9	185.4
6. Gross national product	109.6	106.3	104.6	121.0	131.3	143.9	147.8	146.8	159.8	162.7	167.5	172.6	184.7

1. Preliminary figures.

Source: Icelandic submission to the O.E.C.D.

TABLE II. GROSS FIXED ASSET FORMATION, BY INDUSTRY OF USE

PRICES AT END OF YEAR 1962	I. Kr. Millions						PERCENTAGE DISTRIBUTION					
	1957	1958	1959	1960	1961	1962	1957	1958	1959	1960	1961	1962
Gross fixed asset formation, total	2,702	2,614	2,877	3,050	2,385	2,895	100.0	100.0	100.0	100.0	100.0	100.0
I. Industrial asset formation	1,153	1,150	1,289	1,577	1,128	1,422	42.7	44.0	44.8	51.7	47.3	49.1
1. Agriculture	286	297	302	253	252	317	10.6	11.4	10.5	8.3	10.6	10.9
2. Fisheries	146	165	229	547	120	194	5.4	6.3	8.0	17.9	5.0	6.7
3. Fish processing	120	162	118	121	119	218	4.5	6.2	4.1	4.0	5.0	7.5
4. Manufacturing other than 3	201	234	177	187	171	210	7.4	8.9	6.1	6.1	7.2	7.3
5. Transport equipment	261	157	261	273	249	252	9.7	6.0	9.1	9.0	10.4	8.7
6. Commercial buildings	62	75	97	125	140	142	2.3	2.9	3.4	4.1	5.9	4.9
7. Various machinery and equipment	77	60	105	71	77	89	2.8	2.3	3.6	2.3	3.2	3.1
II. Residential construction	877	759	847	737	570	625	32.5	29.0	29.4	24.2	23.9	21.6
III. Public works and buildings	672	705	741	736	687	809	24.8	27.0	25.8	24.1	28.8	27.9
1. Electric power generation and distribution	177	290	256	172	115	133	6.5	11.1	8.9	5.6	4.8	4.6
2. Geothermal heating and water supply	45	60	68	68	42	81	1.7	2.3	2.4	2.2	1.8	2.8
3. Communications	320	216	269	328	315	377	11.8	8.3	9.4	10.8	13.2	13.0
4. Public buildings	130	139	148	168	215	218	4.8	5.3	5.1	5.5	9.0	7.5

Source: Icelandic submission to the O.E.C.D.

TABLE III. FISHERIES AND AGRICULTURE

	UNITS	AVERAGE 1952-1955	1956	1957	1958	1959	1960	1961	1962	1963
FISHERIES:										
<i>Value of production:</i>										
	Index									
1. Current prices	1956 = 100	83.0	100.0	94.2	114.4	119.8	102.3	123.2	139.7	..
2. 1954 prices	—	84.4	100.0	93.4	111.8	116.6	106.2	121.0	137.0	..
<i>Tonnage of fishing fleet:</i>										
3. Trawlers (end of year)	—	114.5	100.0	100.5	106.0	103.6	122.2	122.2	119.8	(111)
4. Motor boats (end of year)	—	91.8	100.0	101.8	104.4	116.4	136.1	144.6	151.7	(168)
5. Total (end of year)	—	103.1	100.0	101.2	105.2	110.0	129.2	133.4	135.8	(139)
AGRICULTURE:										
<i>Value of production¹:</i>										
6. Current prices	—	72.2	100.0	112.3	126.9	133.8	150.1	185.1	214.6	..
7. 1954 prices	—	84.3	100.0	107.0	112.8	113.2	116.2	125.2	128.8	..
<i>Cultivation and livestock²:</i>										
8. Cultivated grassland	1,000 hectares	52.7	59.4	62.8	66.3	70.2	74.7	78.4	82.5	86.4
9. Sheep	1,000 heads	508.1	657.3	706.3	769.8	774.8	794.9	833.8	829.8	(796.8)
10. Cattle	—	44.8	45.5	47.5	49.0	48.0	49.9	53.4	55.7	(57.7)

1. Excluding change in livestock.

2. Beginning of year.

Source: Icelandic submission to the O.E.C.D.

TABLE IV. PRICES

Indices, March 1959 = 100.

	1960				1961				1962				1963		
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III
1. Goods and services.	101	111	113	117	117	118	123	131	132	133	138	143	147	149	154
2. of which: food ...	99	105	107	111	110	111	117	129	129	131	138	146	150	153	160
3. Rent	100	100	101	101	101	102	101	101	103	103	104	104	105	107	108
4. CONSUMERS PRICES TOTAL	101	109	111	114	114	115	120	126	127	128	132	136	140	142	146
5. Net of direct taxes and transfers	99	70	21	21	21	21	36	26	28	24	45	45	47	47	72
6. Total 4 including direct taxes and transfers 5	101	105	101	103	104	104	110	115	116	116	122	126	129	131	138
	1 Mar.	1 July	1 Nov.		1 Mar.	1 July	1 Nov.		1 Mar.	1 July	1 Nov.		1 Mar.	1 July	1 Nov.
7. Index of building costs	99	111	113	—	114	115	126	—	130	132	135	—	137	138	—

Source: Hagtidindi.

TABLE RE
ENDRIO

	1958 YEAR	1959 YEAR	1960 YEAR
CENTRAL BANK POSITION			
A. With commercial and savings banks:			
1. Bills rediscounted	645	858	731
2. Loans on bonds ¹	66	65	141
3. Advances ¹	69	70	70
4. Deposits	61	52	131
a) Reserve requirements	—	—	41
b) Other blocked ¹	—	—	—
5. Net credit (1 + 2 + 3 - 4)	719	941	811
B. With investment credit institutions:			
6. Advances ¹	71	69	51
7. Deposits	32	30	21
8. Net credit ¹ (6 - 7)	39	38	21
C. With monetary institutions (A + B):			
9. Net credit (5 + 8)	758	979	841
D. With treasury and general government:			
10. Advances	148	139	201
11. Securities	52	96	111
12. Deposits	93	147	181
13. Net credit	107	88	131
COMMERCIAL AND SAVINGS BANKS			
14. Bank credits ¹	3,279	3,899	4,191
a) Commercial banks ¹	2,871	3,397	3,651
b) Savings banks	408	562	541
15. Total deposits	2,354	2,673	3,011
a) Commercial banks	1,896	2,122	2,331
i) Sight deposits	611	639	601
ii) Time deposits	1,285	1,483	1,731
b) Savings banks	458	551	621
i) Sight deposits	26	41	31
ii) Time deposits	432	510	591
16. Credits in excess of deposits ¹	925	1,226	1,181

1. Items affected by the refinancing of the fisheries: in the second half of 1961, the Fisheries Mortgage Department took over loans from the banks amounting to I. Kr. 295 million.

Source: Icelandic submission to the O.E.C.D.

N.B. No corrections have been made for the overtaking of savings banks by commercial banks.

RREDIT SURVEY

RIOD

I. Kr. Million.

1961				1962				1963		
I	II	III	IV	I	II	III	IV	I	II	III
610	715	885	795	594	575	822	682	581	708	929
140	167	54	41	11	6	0	0	1	46	34
81	43	53	6	6	0	0	4	14	28	10
191	276	423	591	716	743	909	1,062	1,104	1,084	1,094
84	135	199	289	325	415	486	577	648	749	743
—	—	67	155	181	180	187	215	235	243	221
640	649	570	251	-105	-161	-87	-376	-508	-302	-122
52	55	168	348	362	346	352	407	424	385	382
15	50	53	51	50	31	44	75	88	43	33
37	5	115	298	312	315	308	332	336	342	349
677	653	685	549	207	154	221	- 44	-172	40	227
227	310	265	161	196	200	228	136	129	114	119
119	132	170	202	218	230	239	294	325	307	290
191	195	252	312	306	317	294	370	414	527	497
155	247	183	50	108	113	173	60	40	-106	- 88
4,213	4,475	4,713	4,548	4,549	4,823	5,196	5,126	5,316	5,738	6,135
3,662	3,896	4,093	3,886	3,861	4,077	4,400	4,270	4,457	4,829	5,330
551	579	620	662	688	746	796	856	858	909	805
3,089	3,312	3,622	4,053	4,072	4,334	4,570	4,761	4,970	5,158	5,299
2,475	2,657	2,907	3,253	3,253	3,440	3,610	3,721	3,943	4,077	4,343
648	719	865	947	947	960	1,012	902	1,213	1,186	1,267
827	1,938	2,042	2,306	2,306	2,480	2,598	2,819	2,730	2,891	3,076
614	655	715	800	819	894	960	1,040	1,027	1,081	956
33	41	58	53	45	65	90	85	74	87	76
581	614	657	747	774	829	870	955	953	994	880
1,124	1,163	1,091	495	477	489	625	365	346	580	836

TABLE V. CREDIT SURVEY (Cont'd)
END OF PERIOD

	1958	1959	1960	1961	1962		1963
					SEPT.	DEC.	SEPT.
CREDITS BY INDUSTRY (percentage distribution):							
17. Agriculture and food processing	13	12	11	11	10	11	11
18. Fish and fish processing	32	35	35	30	31	28	29
19. Commerce	18	18	19	20	22	22	23
20. Manufacturing	12	11	12	13	12	13	13
21. Dwellings	11	11	10	11	10	11	10
22. Transportation and communication	2	1	1	2	2	2	1
23. Electricity	6	6	3	3	3	3	2
24. General Government			2	2	3	2	3
25. Other	6	6	7	8	7	8	8
26. Total	100	100	100	100	100	100	100

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O. E. C. D. PUBLICATIONS
2, rue André-Pascal, Paris-XVI^e
No. 16,819. January 1964.

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PRINTED IN FRANCE