



18

ECONOMIC SURVEYS



ICELAND

I . 2 . B . 3 .

ORGANISATION FOR ECONOMIC
CO-OPERATION AND DEVELOPMENT

PARIS NOVEMBER 1964

BASIC STATISTICS OF ICELAND

THE LAND

Area (1,000 sq.km.)	103	Unproductive area (1,000 sq.km.)	78
Productive area	25	<i>Of which:</i>	
<i>Of which:</i>		Glaciers	12
Cultivated area	1	Other area devoid of vegetation	66
Rough grazings	24		

THE PEOPLE

Population, Dec. 1963	187,000	Number of inhabitants per sq.km.	1.6
Net increase 1959-1963, annual average (per cent)	1.9	Occupational distribution 1960, per cent:	
<i>Of which:</i>		Dairy and sheep farming	17
Net national increase	2.0	Fisheries	8
Net migration	- 0.1	Fish processing	10
		Other manufacturing	16
		Construction	12
		Commerce and communications	20
		Other services	16

GOVERNMENT AND PARLIAMENT

Government, from 1960, number of Ministers:		Parliament, from 1963, number of seats:	
Independence Party	4	Independence Party (Lib. Cons.)	24
Social Democrats	3	Progressive Party (Agrarian)	19
		Labour Alliance (Socialists, Communists)	9
		Social Democrats	8
			60
Last general election: 1963		Next general election: 1967	

LIVING STANDARDS

Calories per head, per day	3,240	Per 1,000 inhabitants 1963:	
Minimum hourly daytime wages for male unskilled labour in July 1964 (Ic. kr.)	36,18	Number of:	
Average yearly wage income of married workers, skilled and unskilled, and seamen in 1963 (Ikr)	125,000	Passenger cars	120
		Radio sets	460
		Telephones	254
		Energy consumption per head in 1963:	
		Coal equivalent (metric tons)	4.4

PRODUCTION AND CAPITAL FORMATION

Averages for the years 1959-63

Gross National Product in 1961 prices:		Gross Fixed Capital Formation in 1961 prices:	
Millions of Ic. kr.	11,000	Millions of Ic.kr.	3,000
Per head, US \$	1,460	Percent of GNP	27

FOREIGN TRADE

Exports of goods and services in 1963 as percentage of GNP	44	Imports of goods and services in 1963 as percentage of GNP	46
Main exports 1963 as percentage of exports of goods:		Main imports 1963 as percentage of imports of goods:	
Fish and fish products	92	Equipment	33
Agricultural products	6	Other manufactures	38
		Fuels	11

THE CURRENCY

Monetary unit: Króna.

Currency unit per U.S. dollar. 43,00

ECONOMIC SURVEYS BY THE OECD

ICELAND

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 OECD 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 OECD, which came into being on 30th September 1961.

The Members of OECD are: Austria, Belgium, Canada, Denmark, France, the Federal Republic of Germany, Greece, Iceland, Ireland, Italy, Japan, 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
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ECONOMIC SURVEYS BY THE OECD
ICELAND

Production has expanded fast in recent years. With the introduction of better methods and equipment, the fish catch has increased sharply, and output in most other sectors has also increased strongly. But the expansion has been accompanied by continued inflation, with strong pressure on the labour market, and sharp upward movements in wages and prices. The current account of the balance of payments changed to show a deficit in 1963; but the deficit was not higher than envisaged in the Economic Programme for 1963-1966. The foreign exchange reserves continued to grow as borrowing abroad, connected with the rise in investment, increased.

More stable conditions have been restored in 1964. Demand pressure has eased somewhat, mainly as a result of tighter monetary conditions. The current external account has improved considerably, and the foreign exchange reserves have continued to rise. Prices have been stable since May, although partly as a result of higher subsidies. A frame agreement between the Government and the central labour and employers organisations concluded in June — the first of its kind in Iceland — should ensure stability in basic wage rates for a year, although some cost of living adjustment of wages cannot be excluded. But the better stability thus achieved is precarious; the labour market is still very tight and the budgetary position has deteriorated, partly because of higher subsidies to avoid an increase in prices following the adjustment of farmers' incomes in September. Consolidation of the more stable conditions will require considerable efforts to prevent excessive increases in domestic demand and costs.

I. CURRENT TRENDS

Output and Demand

The real gross national product, following a modest increase of 1.5 per cent in 1961, rose by 8 per cent in 1962 and 7 per cent in 1963. With an improvement in the terms of trade, the gross national income has risen even faster — by 5.1 per cent in 1961, 8.4 per cent in 1962, and 7.6 per cent in 1963. In 1964, the gross national product is likely to rise at about

the same rate as in 1963, and the indications are that the terms of trade continue to improve.

The strong increase in the fish catch has been an important element in the expansion. In terms of quantity, the total catch increased by 17 per cent in 1962, but fell by 7 per cent in 1963. But as a result of changes in the composition of the catch, a higher degree of processing, and higher export prices, the value of the catch rose in both years, by 12 per cent in 1962 and 8 per cent in 1963, with the increase falling exclusively on herring. In 1964, the value of the fish catch is likely to increase considerably thanks to an exceptionally good winter cod fishing season, a record summer herring catch, and some further rise in export prices.

Output in most other sectors has also expanded fast. Production in manufacturing, excluding fish processing, rose by 6 to 8 per cent both in 1962 and 1963, despite sharp increases in domestic costs and stronger competition from abroad resulting from tariff reductions, and the removal of import controls. Output in the building and construction sector, relatively low in 1961, rose by 15 per cent in 1962 and 19 per cent in 1963. In 1964 the expansion in both manufacturing and construction has slowed down because of the weaker trend in home demand. Agricultural output rose little in 1962 and 1963, mainly because of bad weather, but should rise significantly in 1964.

TABLE 1. SUPPLY AND USE OF RESOURCES

	1963 ACTUAL KR. M. CURRENT PRICES	PERCENTAGE CHANGE FROM PREVIOUS YEAR — IN VOLUME			
		1961	1962 ¹	1963 ¹	1964 ²
Gross national product	13,660	1.5	8.0	7.0	6.4
National expenditure.....	13,890	- 2.4	7.3	13.7	9.2
Private consumption	9,008	1.6	9.7	8.1	6.1
Public consumption.....	1,210	1.2	8.2	3.2	3.7
Gross fixed asset formation	3,803	- 22.6	16.6	29.8	10.1
Change in livestock.....	35	..	..	..	..
Balance of goods and services	- 230	..	..	..	..
Exports.....	6,070	1.5	22.0	5.4	7.4
Imports	6,300	- 6.4	20.1	18.1	12.2

1. Preliminary figures.

2. Estimates.

Source: Economic Institute, Reykjavik.

Higher incomes as a result of large fish catches and sharp increases in wages and salaries have led to a steep increase in aggregate demand, with strong pressure on resources. Real domestic expenditure on consumption and investment rose by more than 11 per cent between 1962 and 1963. There was a particularly sharp increase in fixed investment, about 30 per

cent. This was partly due to large imports of ships and aeroplanes. But there was also a steep increase in investment in construction (25 per cent), notably in the private sector. Such indicators as exist, particularly the more moderate rise in imports, suggest that the increase in domestic demand has slowed down in 1964. Private consumption may still be rising relatively fast, but there are indications that the increase in inventory accumulation and building activity is levelling off; the volume under construction is still very high, but building starts are falling, influenced by tighter credit conditions.

Prices and Wages

The more stable development of prices and wages achieved by the Stabilisation Programme adopted in 1960 was broken by large increases in wages in June, 1961, and the subsequent devaluation in August. Strong demand pressures developed again in 1962, and became worse in 1963. From the middle of 1962 the rise in prices continued almost unabated until the spring of 1964, when the cost of living index was about 40 per cent higher than two years earlier. This increase in prices, as the inflationary trend in much of the earlier post-war period, can to a great extent be ascribed to excessive increases in wages, salaries and agricultural incomes in conditions of very strong pressure on resources. In 1962, wage rates and farmers' incomes¹ rose by an average of 12 per cent. In the course of 1963, wages were increased by some 30 per cent, about half of which was granted in December. Farmers' incomes were adjusted accordingly. Other factors have also contributed to the rise in prices, notably the increase in import prices, especially of coffee and sugar, in 1963 and the first few months of 1964, and the increase in the general sales tax from 3 to 5 ½ per cent in January, 1964. At a further remove, however, the persistent inflation can be ascribed to more deep-rooted factors, of which the following have been of particular importance:

- a) the one-sided structure of the economy;
- b) distortions in the structure of wages and prices;
- c) institutional factors;
- d) agricultural policies.

Heavy dependence on fluctuating fish catches and exports is an important source of instability. The fishing sector (including fish processing) accounts for one-fifth of the gross national product and more than 90 per cent of merchandise exports. By coincidence, export prices have tended to rise in periods of good fish catches, and vice versa, thereby accentuating the impact of unstable fishing conditions on the economy. The one-sided structure has rendered the operation of efficient incomes and demand

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

management policies rather more difficult in Iceland than in many other countries. Good fish catches and export prices produce an immediate increase in incomes for fishermen and — more indirectly, but nevertheless rather automatically — higher incomes among workers in the fish-processing industry. This normally leads to strong pressures for similar income increases in other sectors of the economy, irrespective of the movement of productivity in individual sectors or the economy as a whole. Strong and sudden increases in incomes clearly complicate the task of demand management policy, and have tended to lead to similar increases in domestic demand, resulting in considerable strain on the labour market, with further repercussions on wage developments.

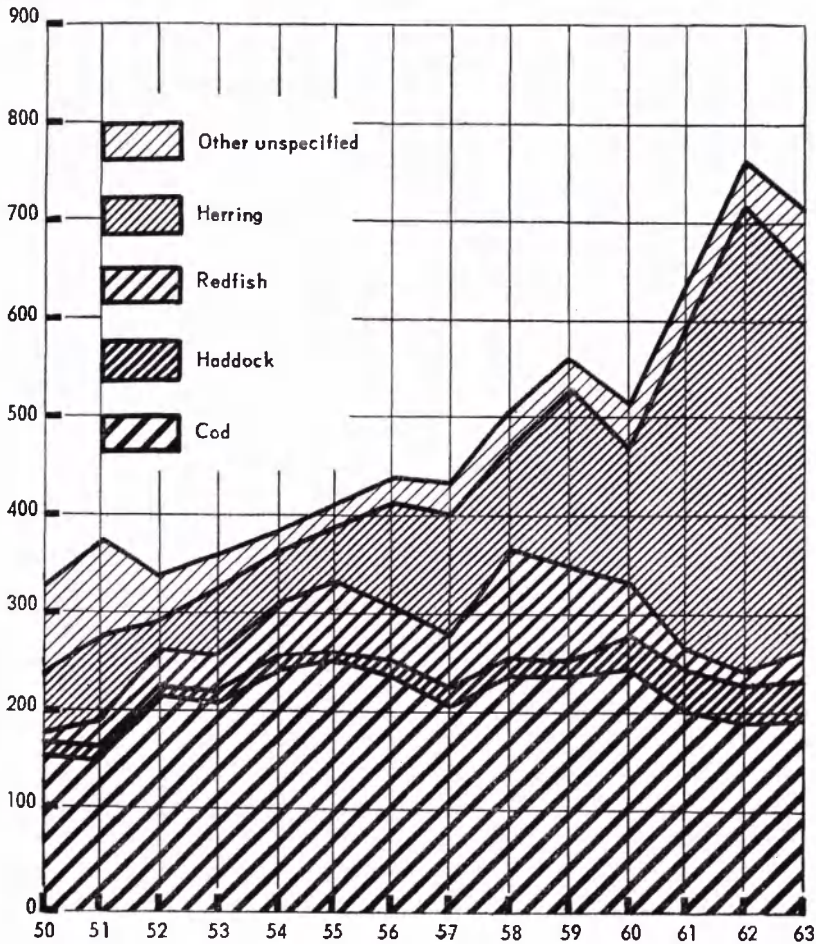
Over much of the post-war period the structure of prices has been distorted by an inappropriate customs tariff and by the widespread use of import levies, export subsidies, consumer subsidies, and price controls. To a large extent these distortions resulted from inflation and an inappropriate rate of exchange dating back to the Second World War and its aftermath. A decline in per capita income in real terms between 1947 and 1952 was an important reason why these anomalies were retained in Iceland at a time when they were being removed in most other Member countries. Their continued existence has been an important factor underlying subsequent inflation. Decisions to remove them have led to price increases which the trade unions have wanted to compensate by wage increases. But decisions to maintain or, at times, increase the distortions have imposed serious constraints on the operation of anti-inflationary fiscal policy; subsidies have typically amounted to one-fifth of budget expenditure. The Stabilisation Programme of 1960, correcting the exchange rate and abolishing the system of export subsidies and import levies, involved the most radical removal of price distortions undertaken up to that time. Since then, further steps in this direction have been taken through tariff reductions while at the same time the general sales tax has been increased. Moreover, in 1963 price control on ocean freight rates was abolished as well as subsidies on imported goods (coffee, fodder and fertilizer). Dissatisfaction of the trade unions with the price increases resulting from these corrections has been an important element in the labour unrest of recent years. This was recognized in the frame agreement concluded in June 1964 which has led to a renewed increase in consumer subsidies and thereby to a heavy increase in the burdens of the Treasury.

Anomalies in the structure of wages and salaries — to a large extent arising during the last World War — have also created considerable difficulties. Dissatisfaction with the existing pattern of wages has led to competition between individual branches to regain or maintain their relative positions. Efforts to change the wage structure have therefore normally resulted in general and excessive wage increases.

Certain institutional factors have also constituted an obstacle to the achievement of economic stability, notably the lack of centralisation

Diagram 1. FISH CATCHES 1950-63

Thousand tons



Source: Icelandic submission to the OECD.

within the organisations of both workers and employers. Generally, local unions are organised according to craft, and cover only individual towns or villages. They are not, except in one or two cases, combined in national craft or industrial federations, but only in one Federation of Labour which has but a limited influence on the policies of individual unions. The formulation and execution of trade union policy is also impeded by political factors which have made responsible leadership in, and co-operation between, individual unions difficult. On the employers' side, the Federation of Employers conducts wage negotiations for its members. But important branches remain outside the Federation, and the position of the Federation vis-à-vis its own members is traditionnally weak. This

organisational structure has prevented co-ordination of wage settlements in individual sectors, thus rendering the application of a government incomes policy virtually impossible.

There can be little doubt that agricultural policy has contributed importantly to the inflationary trend. As in most other countries, an important objective of the authorities' agricultural policy has been to ensure the farmer an income comparable to that prevailing in certain other sectors. But in Iceland this objective has been observed in an inflexible manner which has accentuated the inflationary spiral. Farmers' incomes are regulated not once a year, as in many other countries, but every quarter. Moreover, according to existing rules and regulations, the Government has no influence on either the total adjustment of agricultural incomes or the way in which it is to be achieved. Both matters are determined by a group of six members, with three representatives of the farmers and three representatives of the consumers, the latter appointed by the trade unions. If no agreement is reached, the dispute is settled by an official mediator. It seems clear that this system leaves little scope for government influence to minimise the price effects of agricultural income settlements. Apart from its inflationary effects, the existing system means that the Government is almost excluded from influencing important areas of agricultural policy, such as farmers' prices which clearly constitute a major determinant of the volume and composition of agricultural production.

Agricultural policy has also involved the payment of large amounts of consumer subsidies and, increasingly, export subsidies based on the prices guaranteed in the home market. The subsidies have represented a heavy burden on the government budget, rendering more difficult the adoption of an anti-inflationary fiscal policy.

Prospects for establishing more stable conditions have improved considerably in 1964. By May the rise in costs in 1963 had very largely been absorbed, and the rise in prices levelled out. In June, the Government, the Federation of Labour and the Employers' Association as well as other employer organisations reached a frame agreement, on the basis of which new wage settlements of one year's duration were to be concluded in individual industries. According to the frame agreement, there was not to be any general increase in wages during the agreement period. On the other hand, workers were to receive benefits in the form of slightly reduced working hours at unchanged pay, lengthened vacation and the inclusion of payment for official holidays, other than Sundays, in weekly and monthly pay. These benefits were on the whole to be limited to unskilled workers, as they had already been obtained by most other groups. In addition, the Government undertook to carry out several measures to improve financing of residential construction with the aim of ensuring sufficient housing and helping low income families to acquire apartments. The linking of wages to the cost-of-living index, which had been prohibited by law since 1960, was to be resumed. A new wage compensation index, excluding the increase in agricultural prices resulting from an

increase in wages will be computed. Full wage compensation will be paid according to changes in this index of one point or more. The increase in labour costs per hour resulting from the agreement, if observed, would amount to 6 to 7 per cent for unskilled workers receiving weekly or monthly pay; for other groups the increase would be smaller. Settlements have by now been reached in most industries, and stability in wages, apart from possible cost-of-living adjustments, should therefore be ensured for a year. The settlements are in line with the frame agreement as far as the unions of unskilled workers are concerned but provide for larger increases than anticipated in the frame agreement as far as the unions of skilled workers are concerned, especially the printers.

In September, the review of agricultural incomes led to an agreement providing for an increase in farmers' prices of 11.7 per cent, the equivalent of an increase of 3.5 per cent in the cost-of-living index. For the time being, the effect on the cost-of-living index will be offset by an increase in consumer subsidies in order to avoid a renewed wage/price spiral. The adjustment of farmers' incomes can be ascribed to higher prices on fodder and fertilizers, the rise in workers' and fishermen's incomes over the last year exceeding the increase in wage rates (for which adjustments in agricultural incomes have already been made) and the benefits received by the workers according to the June settlement. The agreement also provides for an increase in government grants and increased bank credits to agriculture. The agricultural agreement represented a continuation of the policy of achieving wage and price stability by negotiations between the authorities and the major interest groups in the country, and has led to no immediate increase in prices. But it has made it more difficult to adopt and maintain non-inflationary monetary and fiscal policies.

The Balance of Payments

Good fish catches and favourable marketing conditions abroad, with an increase in export prices, have led to a sharp increase in merchandise exports, by 12 per cent from 1962 to 1963 and by 23 per cent in the first ten months of 1964 compared with a year earlier. But in 1963 merchandise imports rose by as much as 23 per cent, and even if ships and aircraft are excluded, the rise was 19 per cent. And with some decline in military receipts, the current account changed from a surplus of \$ 7.5 million in 1962 to a deficit of \$ 5.3 million in 1963. This development was clearly associated with the strong increase in investment, and the change in the current external account was no bigger than envisaged in the Economic Programme for 1963-1966, adopted last year. In 1964, with the strong increase in exports, the current balance has improved. Imports rose fast in the first ten months of the year, but the rise was mainly due to large deliveries of ships and aircraft; excluding these, imports showed an increase of only 4 per cent and the trade balance improved.

The capital inflow has been more than sufficient to cover the current

deficit, so that the foreign exchange reserves have continued to rise. In 1963, public borrowing abroad was particularly high, very much in line with the Economic Programme for 1963-1966. Private borrowing abroad also rose, notably because of foreign credits related to the deliveries of ships and aeroplanes. These credits are likely to show a further increase in 1964, but public borrowing will be much lower than in 1963. At the end of 1963 the external debt, private and public, totalled \$ 74 million. At the end of July, the gross official reserves amounted to \$ 35 million, the equivalent of 4 months' merchandise imports (f.o.b.).

The expansion of Iceland's exports in recent years has been facilitated by the fact that the increase in production has to a large extent consisted of herring oil and meal, which are readily marketable, while Eastern Europe has remained an important market for frozen and salted herring. The future expansion of exports will increasingly depend on market conditions for more processed fish products (frozen fish fillets, for example). But these products encounter protective tariffs in Western Europe and also, to some extent, in the United States. With the entering into force of the common external tariff of the European Economic Community, this protection is being increased, except for frozen fillets in France. Tariff reductions by the European Free Trade Association are placing Iceland at an increasingly disadvantageous competitive position in that area. Iceland has recently adhered to the General Agreement on Tariffs and Trade, on a provisional basis, and is participating in the Kennedy round of tariff negotiations. The authorities hope that the negotiations will give serious attention to the problems of trade in fish products and lead to a reduction of tariffs and other barriers to trade for fish products as well as other goods.

II. ECONOMIC POLICY

The Stabilisation Programme adopted in 1960, following strong inflation in much of the 1950's, represented a serious effort to restore internal and external stability, and remove import restrictions and other barriers to trade which had tended to isolate Iceland from the world economy. Its main features included devaluation of the Krona, the removal of export subsidies and import taxes, strict limitation of the expansion of bank credit, a balanced government budget, and a gradual liberalisation of imports. The programme did not succeed in arresting inflation for very long, but it has had significant and durable effects in other areas. The change in policy established more effective government control of monetary and financial conditions, which has since been maintained. The balance of payments position, very difficult during most of the 1950's, was greatly improved, with a strong increase in the foreign exchange position; the reserves have continued to rise to date. Moreover, the introduction of a realistic exchange rate, the removal of price distortions resulting from an

TABLE 2. BALANCE OF PAYMENTS

\$ million.

	1960	1961	1962	1963	JAN.-JUNE	
					1963	1964
1. Merchandise imports (f.o.b.)	83.9	71.7	83.3	102.2	47.7	59.2
<i>of which</i> : ships and aircraft	15.7	4.7	4.5	8.8	3.1	13.5
2. Merchandise exports (f.o.b.)	66.9	71.7	84.4	94.2	42.2	50.2
3. Balance on goods	- 17.0	—	1.1	- 8.0	- 5.5	- 9.0
4. Military receipts	10.4	11.4	10.4	8.8		
5. Interest on foreign debt, net	- 2.7	- 3.0	- 2.3	- 2.3		
6. Other services, net	- 2.0	- 3.2	- 1.7	- 3.8		
7. Balance on goods and services ...	- 11.3	5.2	7.5	- 5.3		
8. Amortisation of foreign debt	- 7.5	- 8.8	- 10.4	- 9.1		
9. Public borrowing	7.6	5.8	5.5	10.8		
10. Private borrowing	8.5	2.7	3.1	7.4		
11. Other capital movements, net	9.8	4.4	8.7	0.1		
12. Change in official foreign exchange	7.1	9.3	14.4	3.7	2.5	- 0.6
<i>i)</i> convertible currencies	3.3	13.2	12.6	2.6	1.0	- 1.6
<i>ii)</i> clearing currencies	3.8	- 3.9	1.8	1.1	1.5	1.0
13. Net foreign exchange position (end of period)	3.0	12.3	26.7	30.5	29.2	29.9

Source: Icelandic submission to the OECD.

artificial system of export subsidies and import taxes, the extensive liberalisation of trade and reduction of tariffs, and the abolition of investment controls have led to a better composition of investment, with favourable effects on production, notably in the fishing sector.

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. In the 1960-1963 period, investment in the fisheries, both in boats and equipment, was higher than in the preceding years. The increase in the size of fishing boats and the investment in new and better equipment — notably detection equipment, nets of artificial fibres, and a new type of hauling equipment — are the main reasons for the strong increase in fish catches in recent years.

Last year the authorities adopted an Economic Programme for 1963-1966, the first of its kind that has been prepared in Iceland¹. 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 is based on an increase in the real gross national product

1. The Programme and problems related to its implementation were discussed in some detail in last year's annual review of Iceland; see Economic Survey by the O.E.C.D., Iceland, Paris, December 1963.

of 4 per cent a year, and on the maintenance of a relatively high rate of investment to some extent financed by long-term borrowing abroad. The programme aims at a high level of investment in the fisheries, and the fish processing industry, the backbone of the economy. The significant expansion of hydro electric capacity envisaged by the programme 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. Investment in agriculture and residential construction, which were high in the 1950's, are planned to level off in the programme period.

Over the past year, however, with strong increases in prices and wages, the attention of the authorities has had to be concentrated on stabilisation rather than growth problems. As a result of continued efforts to arrest the inflation, the situation has clearly improved in 1964, with respect to the movement of wages as well as demand. But it would not be safe to assume that the more moderate developments of 1964 to date represent a clear change of trend. The achievement of better stability will require energetic action impinging upon both the development of incomes and the course of demand.

Incomes Policy

The June agreement is the first of its kind in Iceland, and represents a significant improvement in several respects. In the first place, it is a co-ordinated settlement covering practically all wages and salaries. Second, it covers a fixed period as long as a year; in recent years contracts have generally not covered a fixed period and were therefore open to re-negotiation at any time. Moreover, the rise in costs resulting from the agreement, although still rather considerable, is much lower than in earlier settlements. Although it is still uncertain whether price stability can be achieved after the recent increases in costs, the possibility for doing so seems better than for some time. The June agreement reflects an improvement in labour relations, and is the result of efforts by all parties concerned to limit the rise in wages to a rate compatible with economic stability. It is to be hoped that similar considerations will prevail also next summer when wages fall due for re-negotiation; given the strong increase in costs in the last couple of years, the scope for wage increases next year will clearly be limited, even with a continuation of the favourable trend in production and exports. Guidelines indicating the real scope for income increases might facilitate the achievement of non-inflationary settlements.

According to existing legislation, the Government is debarred from influencing either the magnitude of the adjustment of farmers' incomes or the manner in which it is achieved. This would seem anomalous, because it renders the operation of an incomes policy in Iceland virtually impossible, and it excludes government influence from important areas of agricultural policy. The authorities will have to consider whether the existing system

TABLE 3. MONETARY SURVEY
A. COMMERCIAL AND SAVINGS BANKS
Changes in Major Items

Millions of kronur.

	1961	1962	1963	1963 JAN.-MAY	1964 JAN.-MAY
Lending	351	585	762	472	416
Financed by:					
Deposits	776	979	658	516	552
— Demand	233	209	— 63	210	324
— Savings	543	770	721	306	228
Borrowing from Central Bank	— 101	— 156	63	49	75
Borrowing abroad	36	234	19	— 66	22
Decline in foreign assets	25	— 41	— 16	37	— 17
Decline in reserves	— 285	— 356	— 19	— 108	— 203
of which blocked reserves ¹	251	273	206	158	97
Decline in restricted reserves	— 155	— 47	19	— 15	2
Other (increase in other liabilities)	56	— 29	37	61	— 13
Total	352	584	761	474	418

1. Time deposits and blocked deposits under existing reserve requirements.

B. CENTRAL BANK
Changes in Major Items

Millions of kronur.

	1961	1962	1963	1963 JAN.-JULY	1964 JAN.-JULY
Claims on Government	— 30	— 81	— 21	— 13	308
Claims on private	385	202	6	— 28	— 38
Claims on banks	— 110	— 155	72	138	87
Foreign assets (net)	488	875	163	57	— 8
Total	733	841	220	154	349
Reserve money ¹	420	533	141	13	400
Restricted deposits	155	47	— 19	12	— 2
Government deposits	56	55	147	136	— 45
Counterpart funds	— 27	186	— 61	— 56	— 28
Other	129	20	12	49	24
Total	733	841	220	154	349

1. Currency plus deposits of commercial banks with Central Bank.

Source: International Financial Statistics.

for determining agricultural incomes is compatible with their efforts to establish a general incomes policy.

Monetary Policy

The strong rise in foreign exchange reserves in 1962 and the first half of 1963 was accompanied by a large increase in savings deposits and in

the liquidity of banks and enterprises. It was a major aim of monetary policy to neutralize this increase in liquidity by requiring the banks to pay a substantial proportion of the increase in deposits into blocked accounts with the Central Bank. Whereas this policy played a major role in building up the foreign exchange reserves it did not prove sufficiently restrictive to prevent a strong increase in bank credit and liquidity in 1962 and the first half of 1963, which again contributed to the strong expansion of imports and investment. In June, 1963, this trend began to reverse itself. A fall in reserves coupled with a continued policy of restraint on behalf of the Central Bank and a seasonally strong fiscal position caused the liquidity of the banking system to fall substantially. At the same time the strong increase in investment in 1963 together with higher prices and wages led to a much tighter liquidity situation in industry. These developments were further strengthened by an agreement made between the Central Bank and the commercial banks to restrict the credit expansion, and interest rates applicable to the commercial banks' business with the Central Bank were raised. Measures were also taken to restrict the use of foreign credits to finance imports. All this led to a slowing down in the increase in bank deposits and bank credit and a general tightening of monetary conditions. From October, 1963, this began to show in a slackening in the growth of demand, and both imports and investment levelled off. In 1964 this tightening of monetary conditions has to some extent been counteracted by a weakening of the budgetary positions, entailing a sharp increase in Central Bank credit to the Government. This can partly be ascribed to a seasonal deficit in the Government budget, but is also reflects a deterioration of the underlying position.

The frame agreement concluded in June between the authorities and the labour market organisations included a decision to tie loans from the Housing Administration to a price index. This measure was strongly influenced by equity considerations. But it should also serve to restrict demand, because it should discourage speculative investment in housing. It is difficult to assess what the longer-term implications of the introduction of purchasing power guarantees in financial contracts would be; experience from other countries is very limited. Given the extent to which attitudes are influenced by inflationary expectations, the introduction of such a guarantee would seem a reasonable measure to adopt. But such measures should form part of a comprehensive anti-inflationary programme; in particular, a disinflationary budgetary policy needs to be maintained.

Fiscal Policy

In 1962 and 1963 the budget showed surpluses on current and investment account equivalent to about 2 per cent of G.N.P. The surplus on the overall budget, including lending transactions, was smaller, amounting to about 1 per cent of G.N.P. in 1963. The 1964 budget, as adopted by

Parliament, showed a much smaller surplus on current and investment account, and the out-turn of the budget may even show a poorer result. Tax receipts may rise faster than envisaged earlier, but this may well be more than offset by additional expenditure. In January, following the large wage increases granted in December, measures were taken to maintain the competitiveness of the export industries; the export levy on frozen fish and certain other products was reduced from 6 to 4.2 per cent of the f.o.b. value, and various forms of subsidies to the fishing industry were introduced; these subsidies, however, were to be financed by the proceeds from the increase in the general turnover tax from 3 to 5½ per cent. Consumer subsidies have also been increased during the year, and agricultural export subsidies are likely to be higher than estimated in the budget, partly because of increased domestic prices of agricultural products.

The weakening of the budget clearly runs counter to the needs of the present situation. A reasonable minimum objective for fiscal policy would have been to maintain the 1963 surplus, so that the movement of the budget did not act as a stimulus to private demand. Action to strengthen

TABLE 4. GOVERNMENT FINANCES

Millions of kronur.

	ACTUAL 1961	ACTUAL 1962	ACTUAL 1963	APPROVED BUDGET 1964
Current revenue:				
Direct taxes	106	119	183	255
Indirect taxes	1,232	1,561	1,904	1,945
Revenue of government monopolies	271	306	361	426
Other	56	66	69	64
Total	1,665	2,052	2,517	2,690
Current and investment expenditure:				
Subsidies	327	378	429	393
Social security and pensions	410	463	563	742
Transportation and communication	174	201	246	254
Economic development	138	149	202	227
"Capital" investment expenditure ¹	62	63	75	98
Other	461	565	738	893
Total	1,572	1,819	2,253	2,607
Surplus on current and investment account	93	232	265	83
Other transactions²:				
Amortisation of debt	- 17	- 14	- 16	- 15
Contribution to the State Guarantee Fund	- 3	- 59	- 38	- 46
New lending	- 30	- 16	- 84	- 1
Miscellaneous transactions	29	18	- 3	6
Total	- 21	- 70	- 141	- 56
Net change in floating debt, bank deposits and cash holdings	72	162	124	27

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

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

Source: Economic Institute, Reykjavik.

the budget has been complicated by the fact that public opinion is pressing strongly for increased Government expenditures and a reduction of direct taxes; with the inflation of recent years, and despite some adjustment of tax rates in the spring of 1964, most taxpayers are now subject to the higher rates of the progressive tax structure. Nevertheless, it is difficult to see how measures to tighten the budget can be avoided if a better balance between supply and demand is to be achieved.

Private investment in housing, fisheries, agriculture and manufacturing is to some extent financed by credit from extra-budgetary public funds. All the funds have their own sources of income, and most of them receive some appropriations from the budget. In addition, the Government usually has to provide them with substantial funds each year, which traditionally are not channelled through the budget. The financing of especially large public investment projects is also traditionally excluded from the budget. In recent years the authorities have considered it essential that the problems of this extra-budgetary financing should be considered in relation to the general economic situation and, more specifically, in relation to the fiscal and monetary situation. In 1963 a special programme for this financing was prepared and published as part of the Economic Programme 1963-1966. A similar programme was prepared for 1964, according to which total extra-budgetary financing of this kind, excluding the funds' own revenues, will decline from Kr. 529 million in 1963 to Kr. 319 million in 1964, reflecting largely the Government's decision not to raise any major loans abroad in 1964; in 1963, such loans had accounted for almost half the total programme of financing. As a result, and in view of the prevailing economic situation with strong demand pressures, a substantial reduction in investment programmes and contributions to investment funds has been effected. At the same time, the Government has attempted to tap domestic financial resources to a larger extent than in 1963. The forced savings of young people have been increased. A new agreement has been made with the commercial and the largest savings banks about their participation in the financing programme; this, however, reduced the banks' contribution from 15 to 10 per cent of the increase in their total deposits. The proceeds of the Government bond issue which may be floated in the near future will be used to finance the investment funds. It is important that the investment funds should be financed in a non-inflationary manner also in 1965.

III. CONCLUSIONS

In recent years, economic trends have been favourable in several respects. The rate of growth has been very high, much higher than in the 1950's and higher than in most other Member countries. The rise in

exports has been remarkable, especially in view of the sharp increase in wages; large fish catches and rising export prices have to some extent offset the rise in costs; the government subsidies introduced in January have also helped. Moreover, a strong balance of payments position has been maintained. The current account changed to show a deficit in 1963, but this development was closely related to the sharp increase in investment, and in line with the Economic Programme for 1963-1966. The current account has improved in the present year. The foreign exchange reserves continued to rise in 1963, and have remained at the higher level in 1964 to date.

The trends in domestic activity and foreign payments have to an important extent resulted from the introduction of new techniques in the fisheries and strong foreign demand for Icelandic exports. But they are also to a large extent the result of better policies. The Stabilisation Programme adopted in 1960 represented an important and durable improvement in economic policies. The progressive removal of price distortions and the liberalisation of foreign trade have led to a better composition of investment and higher efficiency. Greater firmness in monetary and fiscal policies has helped to strengthen the foreign balance. The Economic Programme for 1963-1966, the first of its kind, adopted last year to promote growth and more rational policies also represents an important step forward, although it has not yet had time to show any considerable effect upon economic developments.

But economic policy has not yet been able to arrest the inflation, which continued at a high rate in 1962 and 1963. Conditions have, however, improved considerably in 1964; prices have been stable since May, and the increase in domestic demand as well as in wages has slowed down considerably. The authorities have the opportunity to take advantage of the fact that, for the first time in very many years, wage contracts have been achieved which represent only a moderate rise in costs, cover the greater part of the trade unions and are applicable for a period as long as a year. Nevertheless, the resulting rise in wage costs, the re-introduction of the automatic wage-price link, and the increase in farmers' incomes in September will make it difficult to achieve reasonably stable conditions in the near future. But it is clear that the possibility for doing so is better than for a very long time. The most immediate task of the authorities must be to maintain the better labour relations of which the recent agreement is a reflection, and it is to be hoped that all parties concerned recognize the importance of reaching a non-inflationary wage settlement in 1965.

It is unlikely, however, that durable stability will be achieved unless excess demand is removed. The budget is a key factor in the authorities' policies to ease the pressure on resources, notably the labour market. Budget expenditure is rising fast, and the increase in subsidies and other transfer payments have led to an increase in private disposable incomes, strengthening demand pressures. As a result the budgetary position has

deteriorated sharply. It is essential that this trend in government finances should be reversed. This will be difficult in existing circumstances, with public opinion pressing for higher government expenditures and a reduction of taxes. But it is unrealistic to believe that stability can be restored in the absence of a considerable tightening of fiscal policy.

Maintenance of credit restraint is also essential, and the introduction of purchasing power guarantees in certain financial contracts should encourage healthy rather than speculative investment.

In the somewhat longer run, the efforts made in recent years to remove distortions in the economy should be continued, with a favourable effect on the allocation of resources. And the Government has an important role to play in establishing a better system of wage and income determination but the success of these efforts will of course depend on the co-operation and responsibility shown by labour and management. The co-ordinated agreement concluded in June represents a significant step in the right direction. Moreover, an agricultural policy which gives reasonable satisfaction to the farmers without jeopardizing other important objectives of economic policy needs to be evolved. Progress in these directions would greatly ease the task of maintaining economic stability, and it would have a favourable impact on economic growth.

STATISTICAL ANNEX

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TABLE I. NATIONAL ACCOUNTS 1950-1963

Kr. million.

	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961	PRELIMINARY FIGURES	
													1962	1963
<i>Current prices:</i>														
1. Private consumption	1,514	1,921	2,039	2,394	2,619	2,944	3,485	3,540	4,113	4,758	5,376	6,036	7,435	9,008
2. Public consumption	192	237	275	296	325	379	461	517	582	631	721	780	959	1,210
3. Gross domestic fixed and asset formation	389	513	610	730	835	1,091	1,368	1,543	1,665	1,942	2,499	2,207	2,838	3,803
4. Changes in stocks	57	1	20	60	33	129	- 24	- 16	95	104	- 93	163	- 112	- 130
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	5,612	6,070
6. Less: 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	5,257	6,300
7. Gross national product at market prices	2,069	2,535	2,821	3,376	3,789	4,401	5,128	5,418	6,364	7,214	8,089	9,417	11,476	13,660
<i>Percentage of GNP at current prices:</i>														
1. Private consumption	73.2	75.8	72.3	70.9	69.1	66.9	68.0	65.3	64.6	66.0	66.5	64.1	64.8	65.9
2. Public consumption	9.3	9.4	9.7	8.8	8.6	8.6	9.0	9.5	9.1	8.7	8.9	8.3	8.4	8.9
3. Gross domestic fixed asset formation	18.8	20.2	21.6	21.6	22.0	24.8	26.7	28.5	26.2	26.9	30.9	23.4	24.7	27.8
4. Exports of goods and services..	27.8	35.2	31.8	34.3	34.4	30.7	29.3	25.6	24.1	21.6	46.9	45.8	48.9	44.4
5. Imports of goods and services..	31.8	40.6	36.2	37.4	35.0	33.9	32.5	28.6	25.6	24.6	52.0	43.4	45.8	46.1
<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	142.0	155.8	168.4
2. Public consumption	117.6	115.6	118.0	122.5	133.2	143.0	155.3	167.8	174.3	178.3	196.3	198.7	215.0	221.9
3. Gross domestic fixed asset formation	106.4	110.8	115.5	135.0	147.5	182.0	198.7	204.9	201.6	217.3	236.2	182.8	213.1	276.6
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	268.8	283.3
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	197.9	233.7
6. Gross national product	109.6	106.3	104.6	121.0	131.3	144.6	146.8	147.4	161.6	163.5	168.9	171.4	185.1	198.1

Source: Icelandic submission to the OECD.

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

1960 PRICES	I. KR. MILLION						PERCENTAGE DISTRIBUTION					
	1958	1959	1960	1961	1962	PRE-LIMI-NARY 1963	1958	1959	1960	1961	1962	PRE-LIMI-NARY 1963
Gross fixed asset formation, total	2,133	2,300	2,499	1,934	2,256	2,929	100.0	100.0	100.0	100.0	100.0	100.0
I. <i>Industrial asset formation</i>	988	1,078	1,337	950	1,132	1,558	46.3	46.9	53.5	49.1	50.2	53.2
1. Agriculture	245	249	208	216	246	289	11.4	10.8	8.3	11.2	10.9	9.9
2. Fisheries	151	204	478	103	151	287	7.1	8.9	19.1	5.3	6.7	9.8
3. Fish processing	153	108	108	93	179	187	7.2	4.7	4.3	4.8	7.9	6.4
4. Manufacturing other than fish processing	194	134	138	127	154	229	9.1	5.8	5.5	6.6	6.8	7.8
5. Transport equipment	145	230	247	234	223	283	6.8	10.0	9.9	12.1	9.9	9.7
6. Commercial buildings	47	57	97	111	110	151	2.2	2.5	3.9	5.7	4.9	5.1
7. Various machinery and equipment	53	96	61	66	69	132	2.5	4.2	2.5	3.4	3.1	4.5
II. <i>Residential construction</i>	595	663	578	442	498	638	27.9	28.8	23.1	22.9	22.1	21.8
III. <i>Public works and buildings</i>	550	559	584	542	626	733	25.8	24.3	23.4	28.0	27.7	25.0
1. Electric power, generation and distribution	221	188	140	99	106	141	10.4	8.2	5.6	5.1	4.7	4.8
2. Geothermal heating and water supply	49	55	58	39	63	88	2.3	2.4	2.3	2.0	2.8	3.0
3. Communications	171	200	254	238	283	332	8.0	8.7	10.2	12.3	12.5	11.3
4. Public buildings	109	116	132	166	174	172	5.1	5.0	5.3	8.6	7.7	5.9

Source: Icelandic submission to the OECD.

TABLE III. FISHERIES AND AGRICULTURE

	UNITS	AVERAGE 1950-53	AVERAGE 1954-57	1958	1959	1960	1961	1962	1963	1964
FISHERIES:										
<i>Value of production:</i>	Index 1958 = 100									
1. Current prices, in U.S. \$	—		(86.7)	100.0	100.6	88.9	103.2	115.8	125.5	..
2. 1960 prices	—		(86.3)	100.0	95.2	95.1	104.2	110.5	117.1	..
TONNAGE OF FISHING FLEET:	—									
3. Trawlers (end of year)	—	107.9	99.3	100.0	97.7	115.3	115.3	113.1	103.5	(96.2)
4. Motor boats (end of year)	—	86.2	93.3	100.0	111.5	116.9	138.5	145.4	156.9	(181.8)
5. Total (end of year)	—	97.1	96.3	100.0	104.6	122.8	126.9	129.2	130.1	(138.8)
AGRICULTURE:										
<i>Value of production¹:</i>	—									
6. Current prices, in I.kr.	—		(75.0)	100.0	104.2	117.3	147.9	171.5	210.0	..
7. 1960 prices	—		(86.3)	100.0	100.4	103.0	111.1	114.2	116.9	..
CULTIVATION AND LIVESTOCK²:										
8. Cultivated grassland	1,000 hectares		58.3	66.3	70.2	74.7	78.4	82.5	86.6	91.0
9. Sheep	1,000 heads		635.5	769.8	774.8	794.9	833.8	829.8	777.3	(727.3)
10. Cattle	—		46.4	49.0	48.0	49.9	53.4	55.7	55.9	(56.9)

1. Excluding change in livestock.

2. Beginning of year.

Source: Icelandic submission to the OECD.

TABLE IV. PRICES

Indices, March 1959 = 100.

	1961				1962				1963				1964			
	MARCH	JUNE	SEPT.	DEC.	MARCH	JUNE	SEPT.	DEC.	MARCH	JUNE	SEPT.	DEC.	MARCH	JUNE	SEPT.	DEC.
1. Goods and services	117	118	123	131	132	133	138	143	147	149	154	166	180	187	185	
2. of which: Food	110	111	117	129	129	131	138	146	150	153	160	180	198	206	199	
3. Rent	101	101	101	101	103	103	104	104	105	107	108	108	109	113	115	
4. Consumer Prices Total (1 + 3).....	114	115	120	126	127	128	132	136	140	142	146	156	168	174	173	
5. Direct taxes less transfers	21	21	36	26	28	24	45	45	47	47	72	72	80	80	92	
6. Cost of living index (1 + 3 + 5)	104	104	110	115	116	116	122	126	129	131	138	146	158	163	163	

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Index of Building Costs, February 1959 = 100

	1961			1962			1963			1964		
	FEBRUARY	JUNE	OCTOBER	FEBRUARY	JUNE	OCTOBER	FEBRUARY	JUNE	OCTOBER	FEBRUARY	JUNE	OCTOBER
1. Index of building costs.....	114	115	126	130	132	135	137	138	148	159	165	

Source: Hagtidindi.

TABLE V. CREDIT SURVEY
END OF PERIOD

I. Kr. million.

	1958 YEAR	1959 YEAR	1960 YEAR	1961 YEAR	1962				1963				1964	
					I	II	III	IV	I	II	III	IV	I	II
CENTRAL BANK POSITION:														
A. With commercial and savings banks:														
1. Bills rediscounted	645	858	737	795	594	575	822	682	581	708	928	747	621	753
2. Loans on bonds ¹	66	65	141	41	11	6	0	0	1	46	34	—	45	—
3. Advances ¹	69	70	74	6	6	0	0	4	14	28	10	2	4	15
4. Deposits	61	52	138	591	716	743	909	1,062	1,104	1,084	1,094	1,101	1,272	1,352
a) Reserve requirements	—	—	47	289	325	415	486	577	648	749	743	770	860	920
b) Other blocked ¹	—	—	—	155	181	180	187	215	235	243	221	208	189	190
5. Net credit (1 + 2 + 3 - 4)	719	941	813	251	- 105	- 161	- 87	- 376	- 508	- 302	- 122	- 352	- 602	- 584
B. With investment credit institutions:														
6. Advances ¹	71	69	58	348	362	346	352	407	424	385	382	401	384	348
7. Deposits	32	30	29	51	50	31	44	75	88	43	33	82	30	42
8. Net credit ¹ (6 - 7)	39	38	29	298	312	315	308	332	336	342	349	319	354	306
C. With monetary institutions (A + B):														
9. Net credit (5 + 8)	758	979	842	549	207	154	221	- 44	- 172	40	227	- 33	- 248	- 278
D. With treasury and general governments:														
10. Advances	148	139	204	161	196	200	228	136	129	114	119	77	196	288
11. Securities	52	96	112	202	218	230	239	294	325	307	290	354	368	374
12. Deposits	93	147	183	312	306	317	294	370	414	527	497	517	508	476
13. Net credit	107	88	133	50	108	113	173	60	40	- 106	- 88	- 86	56	186
COMMERCIAL AND SAVINGS BANKS:														
14. Bank credits ¹	3,279	3,899	4,197	4,548	4,549	4,823	5,196	5,126	5,316	5,738	6,135	5,895	5,949	6,324
a) Commercial banks ¹	2,871	3,397	3,651	3,886	3,861	4,077	4,400	4,270	4,457	4,829	5,330	5,085	5,134	5,463
b) Savings banks	408	562	546	662	688	746	796	856	858	909	805	810	815	861
15. Total deposits	2,354	2,673	3,012	4,053	4,072	4,334	4,570	4,761	4,970	5,158	5,299	5,389	5,647	5,927
a) Commercial banks	1,896	2,122	2,388	3,253	3,253	3,440	3,610	3,721	3,943	4,077	4,343	..	..	..
i) Sight deposits	611	639	602	947	947	960	1,012	902	1,213	1,186	1,267	..	..	..
ii) Time deposits	1,285	1,483	1,786	2,306	2,306	2,480	2,598	2,819	2,730	2,891	3,076	3,299	3,389	3,498
b) Savings banks	458	551	624	800	819	894	960	1,040	1,027	1,081	956	1,007	995	1,077
i) Sight deposits	26	41	38	53	45	65	90	85	74	87	76	67	56	66
ii) Time deposits	432	510	586	747	774	829	870	955	953	994	880	940	939	1,011
16. Credits in excess of deposits ¹	925	1,226	1,185	495	477	489	625	365	346	580	836	506	302	397

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 OECD and Hagtidindi.

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

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

	1958	1959	1960	1961	1962	1963		1964
						JUNE	DEC.	JUNE
CREDITS BY INDUSTRY (percentage distribution):								
17. Agriculture and food processing	13	12	11	11	11	11	12	11
18. Fish and fish processing	32	35	35	30	28	27	25	27
19. Commerce	18	18	19	20	22	23	23	23
20. Manufacturing	12	11	12	13	13	13	14	13
21. Dwellings	11	11	10	11	11	11	11	10
22. Transportation and communication	2	1	1	2	2	2	2	2
23. Electricity	6	6	3	3	3	2	2	2
24. General Government			2	2	2	3	3	4
25. Other	6	6	7	8	8	8	8	8
26. Total	100	100	100	100	100	100	100	100

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