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AN INVESTMENT PROGRAM FOR ICELAND

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The Problem

The terms of reference of the technical assistance mission to Iceland were broad: to survey the present and proposed investment program of the country and to make recommendations on the need for, and eventual form of, a central investment institution. The mission was specifically concerned with: a) a brief survey of the economic position of the country and its resources; b) the prospects for development, c) the major lines of future investment and d) the establishment of institutions to carry out such investment.

The problem of the Icelandic economy hardly resemble those of any other country. The economy is a mixture, in large part highly developed, and in a smaller degree very underdeveloped. In no sense is it a backward country. Iceland has one of the highest standards of education in the world, a per capita national income which ranks her among the top countries of Europe, and a western system of banking and commerce, but the economy is insufficiently diversified and rather precariously dependent on a single export. The existing resources are — if compared, for example, with those of Denmark and Norway — fully adequate to support a high standard of living for the present population and for probable future increases.

The problem of investment in Iceland is greatly complicated by the smallness of the population and its relatively limited financial resources. A single hydroelectric plant (such as the Sog Project now under construction) will cost the equivalent of over one-third of Iceland's exports in 1950.

The four major development projects planned for 1951 and 1952 bulk so large in the economy that all other investment has had to be curtailed sharply, no matter how urgent the need for better roads, more housing or a broader agricultural program. Iceland has a priorities problem of exceptional magnitude. This problem is further complicated by the fact that foreign exchange earnings, which account for as much as half the national income are highly variable, and make the planning of investment that much more difficult.

In the past five years, the country has spent over $300 million on investments. In spite of this very large expenditure, which amounts to over $2,300 a person, Iceland has not yet achieved either full economic viability or reasonable economic stability. While the volume of investment over the next five years will necessarily be much smaller, its prudent direction can assure a more adequate diversification of the economy in the future and perhaps be even more productive than the larger investments undertaken since the end of the war.
Conversion Rates

$1.00 = 16.3 \text{ Kr.}$

$1 \text{ Kr.} = 6.1 \text{ U. S. \$}$

100 m.\text{Kr.} = $6.1 \text{ m.}$

PART I - THE ECONOMY
A. The Population

Iceland's small population occupies an island as large as the combined areas of the Netherlands, Belgium and Denmark. Many of Iceland's problems arise from the size of the population in relation to the large land area. The overhead of Government, administration, transportation and communications is heavy and burdensome.

The total population of Iceland, which experienced the very large average increase of 1.75% per annum in the past decade, is now 142,000. During the same period, the rural population, attracted by the high wages of the urban areas during and after the war, declined abruptly from 30.6% of the total population in 1940 to 19.5% in 1950. Reykjavik, the capital city, in turn has grown by 70%, and other urban areas have increased almost as rapidly. Nearly half the population is now concentrated in a relatively small area of southwest Iceland. This growth of the urban areas, particularly that of Reykjavik, has meant a severe strain on their transportation, school, housing and power facilities. It has been a major contributing factor to the enormous post-war investment requirements of Iceland, and the future investment program must take into account an expected continuance of this urban expansion.

B. The National Income

The war and immediate post-war period created exceptionally favorable conditions for Iceland. By 1948, Iceland's real national income was up 80% over the pre-war income, and probably ranked, on a per capita basis, among the two or three highest in Europe. Although as exports have fallen off during the past two years, real national income has declined somewhat (a further decline was prevented by ECA aid), it is still on a high level. In 1950 it amounted to around $700 per capita.

The following is a rough estimate of Iceland's national income for 1950.

National Income of Iceland
(million kromur)

<table>
<thead>
<tr>
<th>Category</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private Consumption</td>
<td>1180</td>
</tr>
<tr>
<td>Public Consumption</td>
<td>130</td>
</tr>
<tr>
<td>Total Consumption</td>
<td>1310</td>
</tr>
<tr>
<td>Net Investment</td>
<td>330</td>
</tr>
<tr>
<td>Net National Product</td>
<td>1540</td>
</tr>
<tr>
<td>Maintenance and Repair</td>
<td>170</td>
</tr>
<tr>
<td>National Expenditure</td>
<td>1810</td>
</tr>
<tr>
<td>Minus Balance of Payments Deficit</td>
<td>160</td>
</tr>
<tr>
<td>Gross National Product,</td>
<td></td>
</tr>
<tr>
<td>Domestically Produced</td>
<td>1650</td>
</tr>
</tbody>
</table>
Gross investment, which at one point in the post-war period reached 45% of the national income, was down in 1950 to the still high level of 30%. The balance of payments deficit was the equivalent of half the net investment for the year.

The national income is heavily dependent on exports and other foreign earnings. Receipts in foreign exchange are normally equal to as much as half the national income. Fluctuations in fish prices or catches have an immediate and direct influence on the national income, as does foreign aid in the form of grants or loans, and expenditures in the country.

C. Savings

Although the per capita national income ranks among the highest in Europe the volume of voluntary institutional and personal savings, particularly in liquid form, is low. The effect of years of currency depreciation has been noticeable in diverting savings into consumer goods, durable or otherwise, and particularly into housing, including repairs, additions, and furniture.

There are no complete data on the volume of savings in Iceland. In 1950 it is estimated that voluntary savings in institutional form were as follows:

<table>
<thead>
<tr>
<th>Institution</th>
<th>Amount (Kr.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Life Insurance</td>
<td>3 m.</td>
</tr>
<tr>
<td>Savings Accounts, Commercial Banks</td>
<td>16 m.</td>
</tr>
<tr>
<td>Savings Accounts, Savings Bank</td>
<td>8 m.</td>
</tr>
<tr>
<td>Savings Accounts, Cooperatives</td>
<td>-1 m.</td>
</tr>
<tr>
<td></td>
<td>26 m.</td>
</tr>
</tbody>
</table>

In addition to these voluntary personal savings which came to less than 2% of estimated personal incomes in 1950, social security contributions were about 45–50 m. Kr.

Corporate savings in the form of reinvested profits were substantial from 1945 through 1948, but the shortage of raw materials, which restricted production, reduced such profits in 1949 and 1950. Net profits after taxes, the bulk of which was reinvested, was reported as 29 m. Kr. in 1949. In 1950 net investment in industry, commerce and fishing (other than new trawlers and vessels) was not much in excess of 20 m. Kr. The bulk of this investment was financed through current profits or through drawing down cash reserves accumulated from previous years.

Sales of securities (particularly bonds) have had highly variable degrees of success. In the immediate post-war years, sales of such securities of the Government and municipalities were common, and a Government loan with lottery features in 1949 was quite successful. Stringent credit restrictions sin
1948, have, however, diverted surplus liquid funds very heavily into mortgages or to other "private" loans where returns may range from 8 to 20% and there have been few bond issues since 1949.

The 1951 bond issues of Sog and Laxa have been only moderately successful, with around 5 m. Kr. sold during the first two months of the year. These issues were calculated to yield somewhat over 6% and have therefore been relatively attractive in comparison with savings deposits which pay 3 - 4 1/2% interest. In addition, they are bearer bonds and have some attraction as a method of concealing income.

The market for shares and stocks of private enterprises in Iceland is very nearly non-existent and little effort has been made to encourage it, but the country should be ready for such a development, since savings are attracted to adequate returns and there is a certain degree of speculative instinct in people who live by fishing. It is noteworthy that the most successful bond issue in recent years involved a lottery feature.

Stabilization of the currency should be an important factor in promoting additional savings, and the development of more effective financial institutions should enable the growth of a full-fledged securities market.

D. The Internal Financial Position

Beginning with the early war years and continuing thereafter until 1950, Iceland had a chronic inflation. The post-war inflation was brought about by the large investment program and an inflationary mechanism which automatically adjusted basic wage rates proportionally to prices. With the inflation came serious dislocations in the country's economic, social and financial status, and a continued impairment of her export position because of production costs.

From September 1949 when the krone was first devalued, and particularly after March 1950, when the second devaluation took place, the Government undertook vigorous measures to restore monetary equilibrium. During 1950 the investment program was reduced in real terms to a level about 45% below that of 1948. The Government budget, in spite of a loss in revenue from the sharp decline in imports, ended the year with a surplus of 34 m. Kr. on current account, which approximately balanced the deficit on capital account. If the foreign loans and payments incurred by the Government for the purchase of trawlers to be resold internally are deducted, the over-all budget had a surplus of 10 m. Kr. for the year. Bank credit has been strictly controlled; the increase of a little over 10% during the year reflected mainly higher import prices following devaluation. The link between wages and prices was broken by the Government in January of this year. By the end of 1950, Iceland had moved very rapidly towards monetary equilibrium.

It is doubtful whether complete stability will be attained in 1951. While it is anticipated that the budget will balance or may even have a surplus, there are three factors that may bring a continuance of inflation in 1951: a) there has been heavy trade union pressure for higher wages because of a
continued rise in the cost of living index, b) in spite of the fact that the Economic Board had recommended an investment program only 3 to 5% larger than that of 1950, the Government has raised the investment level 13% above that recommended by the Board, c) there is increasing pressure on domestic prices from rising prices abroad.

The increase of $3 million in drawing rights in the EPU announced in March and an expected additional ECA grant should enable a substantial increase in imports of raw materials and consumers goods to take place this year, and in consequence it is estimated that counterpart deposits should increase by about 200 m. kr. during the year. It is doubtful, however, whether these deposits, together with an anticipated budget surplus, will be sufficient to offset the inflationary pressure arising from the investment program and an expected higher level of wages.

E. The Post-War Investment Program

Iceland's post-war investment program has been of extraordinary dimensions. During the five year period from 1946 through 1950, gross investment came to well over $300 million, with $200 to $225 million of this sum in the form of imported investment goods and equipment. This last figure alone is over ten times the 1951 Government budget. The per capita investment for the five years was around $2300 - a rate which may have exceeded the U. S. per capita gross investment in equipment and durable goods for the same period. It also represented a real rate of capital formation around six times the pre-war Icelandic rate.

The investments, carried out with great speed and energy but with little planning or coordination, concentrated on a) a modern fishing fleet, b) fish-processing plants, quick freezing plants and canneries, c) a modern and greatly expanded merchant marine, d) a large-scale housing program, and e) public works, power, transportation and communications. The major part of these activities were carried out by the Government but there was substantial private investment not only in housing but in small industries and agriculture.

While the achievements of the program were large, they were carried out at the expense of serious dislocations in the social structure of the country, a severe monetary inflation, the exhaustion of Iceland's exchange reserves and, in recent years, a chronic shortage of consumers goods as well as raw materials for the industrial and other productive equipment. A surprisingly small percentage of the country's foreign exchange availabilities have gone for imports of consumption or luxury goods - perhaps no more than 30% of the total for the period.

The program, while a courageous effort, has not yielded results commensurate with its size. There was never a well conceived and coordinated program designed to achieve diversification. The program was based on the assumption that exceptional fish markets abroad and the herring runs would both continue.
On the positive side the program carried out much of the basic social overhead investment required for the economy. Iceland is now able to carry most of its foreign trade in its own vessels, the formerly primitive fishing industry has been substantially modernized, and living conditions have greatly improved. The economy has achieved a firmer basis on which to build for the future.

F. Foreign Trade

Iceland's exports in 1948 reached a post-war peak of $60 million, a per capita export of $431, far higher than that of New Zealand, her nearest competitor. This resulted from a successful winter herring season and unusually large sales of iced fish both commercially and through offshore purchases by ECA.

In 1949, exports fell to $40 million and in 1950 to $29 million, the lowest point since 1942. The sharp drop in the past two years has arisen from internal and external causes: a) the competition of synthetic vitamin production in the U. S. reduced by three-quarters the cod-liver oil exports to the U. S., long a staple item, b) the post-war expansion of the European fishing fleet sharply hit Iceland's export markets for iced fish, c) for a long period the krone was overvalued which priced many of Iceland's exports out of some of the main world markets, and they have been slow to recover after devaluation, d) the herring season failed for several years, e) a prolonged trawler strike in 1950 which probably cut Iceland's exports by as much as 10% for the year.

The country was slow at first to realize the difficult problems of adjustment required, but it has adapted its production and marketing methods to changing overseas markets with increasing speed. After devaluation it pushed with vigor the market for frozen fillets in the U. S. to a point where they have now nearly replaced in value the old cod-liver oil exports, while a successful investment in 1950 in fish-drying equipment has already made possible increased sales in the Latin American and Mediterranean markets. This increased flexibility should be of importance to the economy in overcoming some of the unfavorable effects of rapid changes in export markets.

G. The Balance of Payments

Iceland's balance of payments deficit from 1946 through 1950 came to approximately $93 million. This the country financed mainly by drawing down her exchange reserves by $74 million, obtaining the remainder from ECA grants and loans, including a grant through EBU, and small loans raised in the U. K. and Denmark. Since imports of investment goods exceeded $200 million for the period, Iceland itself financed from its own resources as much as 90% of the external costs of the post-war investment program. External grants and loans, while relatively small over the whole period, were of considerable significance during the period of declining exports in 1949 and 1950.
Iceland's 1950 deficit on a transactions basis came to $6.2 million. However, pre-payments on ship purchases and machinery for the current power projects brought the total cash deficit to around $10.2 million. For the current year, the transaction deficit may be as high as $15 m., but because of large pre-payments the cash deficit may be substantially lower.

The question of when or by what means Iceland can, will or should achieve balance in its current accounts is not easy to answer for a country whose exports can drop, as they did between 1948 and 1950, by 50%. It would be possible for Iceland to achieve balance on current account in 1953 by reducing the expected 1952 level of investment by one-third and by raising the 1950 level of exports by 15 to 20%; this would theoretically eliminate the need for foreign aid thereafter. However, it is assumed that some foreign aid — whether in the form of loans or grants including NATO expenditures will continue from 1953 on — and that it will not be necessary to cut investments to this extent. Such a reduction would curtail Iceland's ability to achieve final balance at a higher level of productivity and national income.

H. Foreign Exchange Reserves

Foreign exchange reserves reached a peak of 582 million Kr. ($89.7 m.) in November of 1944, an amount equivalent to around $700 a person. These reserves included around $65 million in dollars, with most of the remainder in sterling.

Heavy imports, largely in consequence of the great post-war investment program, brought about a rapid exhaustion of the reserves. At the end of 1949, net reserves were 19.9 million Kr. ($1.9 million), and during several months of 1950, Iceland's net exchange reserves were in a deficit position. With the conversion, however, of a part of the initial position of EPU into reserves, Iceland ended the year 1950 with net reserves of 42 million Kr. ($2.6 million). They are still exceptionally small to meet any crisis, but ECA and EPU assistance should help avoid any serious exchange problem this year and next, while the dollar position may improve substantially as a result of the temporary re-establishment of foreign military forces in the country.

I. Foreign Debt

Iceland's foreign debt is now relatively low in relation to the country's foreign exchange receipts. In 1939, the foreign debt amounted to 49.2 million Kr. ($10.8 million) equal, at that time, to about one-third of the national income and to about two-thirds of a year's exports. During the war Iceland paid off most of its external debt which was reduced at the end of 1945 to 6.2 m. Kr. ($961,000).
Since 1945, Iceland has acquired ECA loans aggregating $4.4 million, and $4.1 million sterling and Danish krone loans for new trawlers and ships. Although the total long-term external debt of the Government is up to around $10.5 million, the burden is not large compared with pre-war—and comes to a little over 10% of the national income for 1950 and to a little over a third of 1950 exports. Service payments after 1952 on the present debt are less than two percent of gross receipts for 1950 on the balance of payments. Iceland can, therefore, provided there is a suitable investment program for the future, justifiably contemplate further development of the economy through external loans. However such borrowing should be held within reasonable limits and for projects which show evidence of strengthening the economy and improving its balance of payments position.
PART II - A DEVELOPMENT PROGRAM
A. The Basis for Development

1. Resources

Iceland is usually described as lacking resources. There are few known mineral deposits or forested areas, and much of the country is uninhabitable. But Iceland has sufficient resources for both a growing population and a higher standard of living, including: a) one of the great fisheries of the world, which is still far from its full development, b) an undeveloped natural grassland environment as a basis for considerable agricultural expansion, c) abundant potential hydroelectric power together with natural steam and hot water, d) sufficient raw materials for many small industrial plants e) a unique scenery and history for a tourist industry, f) a strategic location which makes the country an important air base and weather reporting station.

Iceland also has a stable and effective democratic government, a highly literate and intelligent population, and a western system of commerce and banking.

The heavy war and post-war movement of population to the areas in and around Reykjavik and Akureyri (which now have three-fifths of Iceland's total population), while not an unmixed blessing for the country, should make it easier than in the past to plan and carry out concentrated social overhead investments within these areas as a basis for productive investment.

Iceland's economy should be able to achieve viability and independence within the next few years, provided the existing resources are efficiently and intelligently developed. The reduction of imports of coal, feedstuffs, cement, salt, and foods which can be grown domestically, may save the economy $5-7 million a year and this together with an expansion of the low 1930 level of exports by 10% could bring balance of payments equilibrium. Stability will be much harder to achieve; this will involve diversification both of the domestic economy and of exports. It will be a much longer range task to reduce significantly the present high percentage of fish exports in total exports.

2. Psychological Framework

Though the post-war investment program was far from fully effective, it showed a willingness on the part of the country to make sacrifices for the future. More important have been the major achievements in the last two years in the area of monetary stability. Beginning in 1947, and continuing into 1949 and 1950, the Government has made strenuous efforts to bring the investment program into line with the country's resources, to balance the budget and to restore monetary equilibrium. The Government has successfully overcome the financial and political difficulties of the two successive devaluations. The Government has shown awareness of the problems facing the country in the future, a willingness to have outside technicians where necessary to aid in meeting these problems, and a determination that investment policy in the future will be carried out on a more rational basis than in the past.

3. Civil Service

The civil service of Iceland, in the seven years since full independence was achieved, has shown a considerable growth in the quality of its
personnel, and the spirit and conscientiousness of the staff. The technical staff is generally excellent, though notably overworked and too often heavily burdened with administrative and operative details. The relatively large number of Icelanders receiving training within the country and abroad in engineering, law, economics and the social sciences, gives great promise for the development of a high level of technical staff to plan and carry out the future development of the country.

Economic Data

The Icelandic data, on which investment decisions will rest, range from excellent to fragmentary. During the last five years, economic research in national accounting has greatly improved, the data available on the structure of investments are very good and there are reasonably good data on commerce, banking, trade and industry. There are still many gaps in statistics on prices, savings, labor and manpower, the distribution of the national income, and productivity. There will undoubtedly be continued improvement in statistical and economic analyses, particularly with the expansion of the research in the proposed Central Bank.

B. Investment by Sectors

1. Fisheries

According to the "Cooley" report by a group of U. S. fisheries experts who visited Iceland in 1950, the Icelandic fisheries are potentially able to capture a "major position of the world markets" since Icelandic waters have the "highest quality fish available in the world." There are more species available than in any competing area and they are near to the shore and processing plants which assures maintenance of their quality. Iceland's position in world markets depends very largely on the extent to which costs of production can be made competitive.

The Icelandic catch in 1949 amounted to 337,000 metric tons and in 1950 to 323,000 tons. A brief reference has already been made in the section on foreign trade to the rapid changes in world markets and to the continuous changes needed in the mode of preparations. Whereas over 40% of the 1949 catch was in the form of iced fish, in 1950 it was only 10%, while salted fish rose from 12 to 30% of the total.

In the Icelandic economy fish and fish products are around 95% of all exports and the fluctuations in catches, in the herring runs, and in world markets affect immediately the entire economy. It is obvious that an investment program should give first consideration to the sector which bears the whole economy on its back; nevertheless the impact of such investments on the economy as a whole must also be weighed carefully.
Post-war investments in the fishing industry were made with a lavish hand. The total amount invested over the past five years may have reached $100 million and a very heavy share of this was in foreign exchange. In addition, for several years the Government has had a heavy budgetary burden in covering the operating losses of the herring fleets and factories, and has recently had to institute special exchange measures in order to enable fishing boats to operate profitably. In spite of all the measures taken, Icelandic exports in 1950 were down to the 1942 level in value.

The most important measures required for the fishing industry appear to be:

a) the rationalization of the quick-freezing industry along the lines of the Cooley report, to reduce costs and improve the marketing, particularly of fillets,

b) increased research and experiments with small by-product industries (fish chemicals and extracts),

c) some additional fish-drying facilities for the Latin American and Mediterranean markets, the most important outlets for dried fish, and

d) possibly the conversion of idle coal-burning trawlers to oil, to improve catches of rosefish (ocean perch) and haddock.

The Government of Iceland is taking energetic steps along the lines recommended in the Cooley report. Fortunately, the investment required is not large and, in relation to the $17 million going into the three current construction projects noted below, it would be very small. The rationalization measures in particular will not require either very heavy internal costs or any very large expenditures in foreign exchange. Activity along these lines deserves continued support as one of the most important measures which can reduce costs of production, add new products and bring increased exports, particularly to the dollar area.

2. Hydroelectric Power and Thermal Resources

Iceland's per capita installed power capacity is now around fifth in Europe. Although power consumption is now eight times the pre-war rate, there is still a critical shortage of power, and this factor, together with its importance to future development, gives power development a high priority in Iceland's investment program.

The Sog project, in particular, is a most desirable addition to the economy and in the long run will greatly strengthen it, since it will affect industrial and domestic power consumption in an area containing nearly half the population of the country. The Laxa project is also of importance, inasmuch as it will cut coal imports considerably in that area, though the project serves a relatively small population in comparison with Sog.
Thermal springs already heat around three-quarters of the houses of Reykjavik and, with further investment, should be able to heat the entire city. It is also planned to heat other towns in this manner. This type of investment is estimated to save 300 Kr. or more ($20) per person per year in coal imports.

Interesting experiments have been made with drilling for natural steam. This may be an important future source of power and heat, although investigations have not yet proceeded far enough to determine whether this will be as cheap a source of power as water. Future development of natural steam may give rise to a small chemical and pharmaceutical industry in the country and provide a further diversification of the economy.

The most important immediate investments, aside from the two power projects under construction, appear to be additional hot water heating facilities to reduce coal imports and increased electrification of rural areas as essential to agricultural development.

3. Agriculture

Next in importance to its fishing grounds, are Iceland's natural grasslands. The area of land suitable for agriculture is almost unlimited in relation to the size of the population. At present less than 2% of the potential agricultural land area is cultivated and improved. There is opportunity for restocking sheep to a level above that existing before their decimation by disease, for the expansion of the dairy and poultry industry, for a substantial increase in the domestic production of feedstuffs and for the introduction of oats, barley, legumes and beef cattle. A limiting factor in agricultural development will be manpower, but improved techniques, additional machinery and fertilizers, and transfers of farmers to reclaimed and improved land should largely overcome this particular handicap.

The post-war development program did not entirely neglect agriculture but other investment was given substantial priority. In spite of this and the drain of farm labor to the cities, agricultural production has increased about 10% (milk, hay, butter, potatoes) since the end of the war. The large-scale program undertaken by the Government for the slaughtering of diseased sheep has been largely completed, and the rebuilding of stocks has already begun in the now disease-free areas. Although wool production was down in recent years, its value has risen considerably along with world prices, and exports of wool and sheepskins were 6% of Iceland's exports in 1950.

In the investment planning for 1950 and 1951, agriculture has continued to have a relatively low priority. The Government should now consider giving agricultural investment a high future priority since 1) a high level of agricultural production can be an excellent stabilizing influence in so unstable an economy as Iceland's, 2) investment in agriculture can greatly reduce and possibly eventually eliminate the largest single dollar import, that of feedstuffs, 3) there are other agricultural products such as dairy products, potatoes and vegetables whose import can be eliminated, 4) the rising population, concentrated as it is in urban areas, will require increased...
food production, 5) there is every prospect of increasing exports of wool, mutton and dairy products, and perhaps in the longer run eggs and beef.

Agriculture is undoubtedly now the most underdeveloped sector of the economy. To improve the level of agriculture in the country, and particularly to develop exports is a long-range task. The nucleus of a ten-year program for agricultural development has already been formulated with an estimated cost of approximately one billion Icelandic Kronur. Such a proposal may be excessive in amount, but it provides a basis on which to develop a program. The most impressive feature of the program lies in the fact that the Icelandic farmers are themselves expected to bear at least half the costs, with the rest to be financed through loans or grants.

The most important lines of future agricultural development appear to be:

1) the rebuilding of sheep stocks. Present plans call for an increase to 700,000 head in ten years, but agricultural experts in Iceland believe this can be done in a shorter period with proper management and that there can be a further expansion to a million head in ten to fifteen years. Such a program would provide exports of wool and mutton, additional meat for home consumption and the basis for an expanded domestic textile industry;

2) the building of hay silos and barns, hay-drying equipment and hay meal factories to preserve the nutrient qualities of domestically grown hay;

3) introduction of small grains, clover and legumes;

4) continued land drainage as a basis for improved grass production, which would substitute for imported feedstuffs;

5) the increase of dairy cattle, as a result of more and higher quality feed, and the introduction of beef cattle;

6) increased production of fish meal extracts for poultry and cattle feed;

Other requirements of Icelandic agriculture include improved housing, more and better use of fertilizers, additional dairy barns, extensive research and instruction, improved communications, rural electrification, and the acquisition of additional machinery including especially spare parts. The development of agriculture will be relatively slow and it will not be spectacular but it offers one of the best prospects for the increased diversification and stability of the economy.
The most urgent immediate requirements appear to be:

a) the construction of hay silos (including drying equipment). There has been a direct connection between the wet weather, the poor existing silage, the spoilage of grass, and the relatively large importations of feedstuffs from the dollar area.

b) cow barns and stables, and other farm buildings,

c) additional machinery and spare parts,

d) equipment for land drainage.

4. Industries

There has been substantial post-war industrial expansion in Iceland, but much of the investment has taken place behind the protective shelter of the scarcity of consumption goods and has not always been investment most needed for the economy. Industrial development on a sound and economic basis is particularly important. With adequate power facilities now under construction, and certain raw materials available, there should be a number of small industries suitable for introduction to the country, or for expansion: fish glue, fish chemicals and extracts, chinaware, salt, ship drydocking and repairs, dairy products, possibly lanolin, etc. The production of salt through evaporation by natural steam or hot water, for example, would save 10 million Kr. a year in imports ($600,000).

There are two major industrial plants now under consideration:

a) Cement Plant

Iceland has long needed a cement plant. The country itself produces no building materials while the climate requires solidly constructed buildings. The heavy post-war investment program necessitated imports of approximately 280,000 tons of cement. Imports in 1950 of around 37,000 tons were the lowest of the post-war years, but should be substantially higher this year and next.

Cement production did not, earlier, appear practicable in the apparent absence of local raw materials, but the post-war discovery of local deposits of shell sand in Faxa Bay and of basalt sand and siliceous rock appear to have made the project feasible. If the raw material can be delivered to the plant site cheaply enough, the project should have a high priority for several reasons: a) it can supply a major deficiency in the economy in the form of building materials, b) it is basic to the future investment needs of agriculture (hay silos and other farm buildings) communications.
housing and industrial buildings, and c) it is technologically a simple process.

The foreign exchange savings will be substantial. Cement imports have varied from a post-war high of 73,000 tons annually to the 1950 low of 37,000 tons. A "normal" year's imports will, of course, be closely related to the level of investment, but would hardly be below 40,000 tons and in the next five years may range from 40 to 60,000 tons.

Present plans call for the construction of a plant of 75,000 tons capacity, to cost around $2.8 million, of which $2 million would be in foreign currency. Equipment is available in Denmark, for delivery around the end of 1952, and construction would therefore start in late 1952 and continue in 1953 and not overlap with the three major projects now under way. The cost is relatively small in comparison with those of the current investment program (hydroelectric power $12.4 million and the fertilizer plant $4.8 million) and the foreign exchange costs of the plant would be saved in approximately two years through domestic production of cement. The presently planned capacity is undoubtedly too large for Iceland's current needs which raises a problem similar to that of the fertilizer plant noted below.

At present, the plant is planned as a Government enterprise as have been most of the large industrial investments in Iceland. The plant, however, appears especially suitable for the attraction of private capital, possibly capital now going into speculative investments which are not necessarily to the advantage of the country, or into private loans for housing and other purposes at high interest rates.

b) Fertilizer Plant

A nitrogenous fertilizer plant has been under consideration in Iceland since before the war. Such a proposal has merits in that a plant of this type requires few imported raw materials and meets an essential import requirement for agriculture and future agricultural development. Its construction, however, presents problems unique to Iceland.

The plans that have been drawn up for the project provide for a plant very much greater than needed for present Icelandic consumption, with an initial outlay sufficiently large to divert substantial resources from other urgent investment requirements of the economy. The project will require an initial investment of around 80 million Kr. ($4.8 million) with costs in foreign currency
of $3.6 million. The plant, which is to be completed in 1952, is planned to produce around 6,000 tons of nitrogenous fertilizer as compared with planned imports in 1951 of around 2,450 tons. The cost of this project is equal to nearly 20% of the total value of Icelandic exports in 1950, and to an equal percentage of the value of net investment in 1951. The plant represents a very large investment in a single industry, an investment which can hardly be justified in its present high priority and present size on purely economic grounds.

However, in view of 1) the importance of nitrogenous fertilizer to the economy, 2) the fact that fertilizer import costs now exceed a half a million dollars a year in foreign exchange, and 3) the possibility of larger import requirements as investment in agriculture expands, the construction of a plant on a smaller scale (3,000 - 4,000 tons) may be justified, though costs of production were to be as high or higher than those of corresponding European plants. Final judgment on this question can be made only after the completion of engineering studies of costs of construction and production of plants of varying productive capacities. The Government has, however, indicated its intention to carry out the construction as originally planned.

C. The Present Investment Program

The investment program for the current year calls for gross investment of 595 million Kr. ($36 million) and net investment of 405 million Kr. ($25 m.) out of an expected gross national product of around 1,800 million Kr. Even with direct foreign assistance to the investment projects of approximately 100 m. Kr. ($6 m.) and indirect assistance through EPU and ECA to cover most of the local currency expenditures resulting in imports of consumption goods, the program appears somewhat excessive in relationship to available resources.

Around 142 million Kr. ($8.6 m.) of proposed net investments are for social investments (largely housing) which do not contribute directly to the strengthening of the economy and its balance of payments. The "productive" investment for the current year is very heavily concentrated on four major projects, the Sog and Laxa power developments, a nitrogenous fertilizer plant, and on the import of new trawlers now on order in the U. K. Total investment in these four projects will amount to over 280 million Kr. ($17 million) during the next two years, with around 183 million Kr. ($11 m.) to be spent in 1951. The hydroelectric plants alone will take about one-third of the total net investment in Iceland for 1951.

The hydroelectric plans are desirable additions to the economy although from a purely economic point of view -- the construction of Laxa might preferably have been postponed till 1952, to minimize the impact of the projects on the economy in 1951, and to provide a larger scope for other more urgent investment requirements during 1951, such as agriculture. The fertilizer plant, to cost nearly $5 million, will also divert substantial resources away from other desirable investments.
A major share of the net investment in fisheries will go for new trawlers now on order in Britain. It is not possible to assess accurately the extent to which they will strengthen the economy. If the trawlers can produce additional fish for export, particularly haddock and rosefish for filleting, they may be a very desirable addition. The rather precarious state of the iced fish market, however, would indicate that the present fishing capacity is more than sufficient for this aspect of the export trade. Only a small amount of the total investment allocation for fisheries has been made for the rationalization of the quick freezing plants.

It was originally planned that agriculture receive a small increase in net investment over 1950 (from about 31 million Kr. to about 36 million Kr.) but this figure has now been raised. Its execution, however, will depend upon the availability of external aid. Very little goes to other urgent requirements particularly to small industries.

On the whole, the present investment program of Iceland is not the best that could be devised. The investment in power is sound though perhaps too heavily concentrated in one year. Too little goes to agriculture, to small industries, to roads, etc. and probably too much to new trawlers and to the fertilizer plant.

D. A Framework of Future Investment

It is a risky business to project, in monetary terms, the possible scale of investment over the next five years. The average Icelandic technician expresses a preference for predicting Iceland's balance of payments for 1961 to that of 1951/53. This caution originates in the volatile nature of the economy, its exports and national income. It would be possible, for example, for a single good herring catch to increase exports in one year by as much as ten million dollars and the national income by twenty million dollars (20%). Not only is the level of national income indeterminate from one year to the next, but the level of foreign aid beyond 1952 cannot be estimated with any precision, nor can the willingness of the Icelander to continue to accept a shortage of goods or to make other sacrifices in the interests of future productivity, be assessed.

It is even difficult to assess precisely an acceptable level of investment in the present year. The Economic Board, which controls the level of imports and of private investment, is in the difficult position of having to recommend, at the beginning of a calendar year, a level of investment feared to Iceland's foreign exchange and internal financial resources. The Board must determine whether an increase in investment from 510 m. to 525 m. Kr. would be too great, when neither the level of exports or of the national income or the extent of foreign assistance can be known fully. This must be done, further, by a Board having no real control over Government investments.
In projecting here a possible future rate of investment for Iceland there are two major factors to consider: a) the level of exports (excluding invisible earnings and foreign aid) normally comes to around half the national income and is the major determinant of the size of this income, and b) around half of all expenditures in Iceland normally are spent on imported goods. The proportion may run to 75% in the case of investment which therefore strongly affects the quantity of consumption goods available. One assumption must be made - that the level of foreign exchange earnings of 1950 represents not only the low point of the post-war period but will go no lower in the next few years and may rise slowly (in the absence of sudden windfall gains or losses) as effective investment is carried out. In addition, a normal rate of gross investment to national income of 20% is predicated after 1953. In 1950 the rate was around 31%, with foreign aid of $10 million. The percentage will be slightly higher in 1951.

The following table projects a possible future model of the national income and investments.

TABLE I

Possible Model of National Accounts
1950 - 1955
(In Million Dollars equivalent of Icelandic Kronur)

<table>
<thead>
<tr>
<th>Year</th>
<th>External Earnings (Exports &amp; Invisibles)</th>
<th>Foreign Assistance (Grants, Loans or NATO expenditures)</th>
<th>Imports (Including invisibles)</th>
<th>National Income</th>
<th>Gross Investment</th>
<th>Gross Inv. as % of National Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>40</td>
<td>10</td>
<td>50</td>
<td>96</td>
<td>30</td>
<td>31</td>
</tr>
<tr>
<td>1951</td>
<td>40</td>
<td>15</td>
<td>55</td>
<td>110</td>
<td>35</td>
<td>32</td>
</tr>
<tr>
<td>1952</td>
<td>45</td>
<td>10</td>
<td>55</td>
<td>110</td>
<td>25</td>
<td>23</td>
</tr>
<tr>
<td>1953</td>
<td>50</td>
<td>5</td>
<td>55</td>
<td>110</td>
<td>25</td>
<td>20</td>
</tr>
<tr>
<td>1954</td>
<td>50-55</td>
<td>5</td>
<td>55-60</td>
<td>110-120</td>
<td>22-24</td>
<td>20</td>
</tr>
<tr>
<td>1955</td>
<td>50-55</td>
<td>5</td>
<td>55-60</td>
<td>110-120</td>
<td>22-24</td>
<td>20</td>
</tr>
</tbody>
</table>

\[1/\] NATO expenditures will be made in 1951, though the major effects will not appear until 1952.

The model projected above assumes: a) a stable national income from 1951 to 1953 with a modest rise thereafter, b) a moderate increase in exports from 1952 to 1955, c) continued availability of foreign aid after 1952 though on a reduced scale. It also takes for granted that the level of consumption goods imports will continue to be a residual in the economy, and
adjusted to the level of national income and investments, and to the need for rebuilding exchange reserves. Equipment, including raw materials for investment, have made up as much as two-thirds of all imports from 1945 to 1950 while consumers goods imports (including raw material, fuel, etc. for the production of consumption goods) probably have not exceeded 30% of imports in any post-war year.

The model further assumes that investment will reach its peak in 1951 and will decline in 1952 and 1953 to around $25 million. This represents a fairly sharp decline. It may be possible to carry out a larger program if foreign aid (including NATO expenditures) is greater than the $10 million estimated here, or if exports rise rapidly. It is assumed that from 1953 on, gross investment may be from 350 million to 400 million Kr. ($22 - 25 million) depending upon a number of variables, including the level of domestic savings, consumption and foreign earnings. It will also depend on how quickly the proposed investment program can reduce imports of feedstuffs, food, cement, fertilizers, coal, etc. As imports of these items decline, there will be a larger margin of resources available for consumption or investment.

The following table is a tentative projection of future investments on the basis of the national income projection in Table I. The data for 1951 and 1952 are based on the current investment program of the Icelandic Government.

**TABLE II**

**Possible Model of Future Icelandic Investment Program**

(Gross investment in million dollars equivalent of Icelandic Kronur)

<table>
<thead>
<tr>
<th>Year</th>
<th>Power</th>
<th>Fertilizer</th>
<th>Cement</th>
<th>Agriculture</th>
<th>Fisheries</th>
<th>Industry and Commerce</th>
<th>Social Investments</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>4.0</td>
<td>-</td>
<td>-</td>
<td>2.5</td>
<td>6.7</td>
<td>2.0</td>
<td>14.7</td>
<td>29.9</td>
</tr>
<tr>
<td>1951</td>
<td>8.8</td>
<td>2.0</td>
<td>-</td>
<td>3.6</td>
<td>4.6</td>
<td>1.7</td>
<td>15.0</td>
<td>36.3</td>
</tr>
<tr>
<td>1952</td>
<td>4.5</td>
<td>2.8</td>
<td>-</td>
<td>3.6</td>
<td>3.6</td>
<td>2.5</td>
<td>(8.5)</td>
<td>25.5</td>
</tr>
<tr>
<td>1953</td>
<td>1.0</td>
<td>-</td>
<td>2.5</td>
<td>5.0</td>
<td>3.0</td>
<td>3.0</td>
<td>(10.5)</td>
<td>25.0</td>
</tr>
<tr>
<td>1954</td>
<td>1.0</td>
<td>-</td>
<td>-</td>
<td>5.0</td>
<td>3.0</td>
<td>3.0</td>
<td>(10-12)</td>
<td>22-24</td>
</tr>
<tr>
<td>1955</td>
<td>1.0</td>
<td>-</td>
<td>-</td>
<td>6.0</td>
<td>3.0</td>
<td>3.0</td>
<td>(9-11)</td>
<td>22-24</td>
</tr>
</tbody>
</table>

1951-55; 16.3  4.8  2.5  23.2  17.2  13.2

1/ Housing, Transport (except fishing vessels), Communications, Public Works.
The carrying out of a rational investment program within such limits as these after 1951 will require some exceptionally tight budgeting. Between 1945 and 1948 little consideration was given to the question of priorities. Not until the exchange reserves ran out did the problem become acute, and the Government was forced to limit investment increasingly from year to year, until by 1950 the real volume of investment was down by about 45% from the 1948 level. The very high level of investment planned for 1951, which is up by 20% over 1950, arises from the expected termination of ECA assistance after 1952 for which reason the Government decided to carry out three major projects simultaneously. This program should have required a sharp contraction in all other investments, including housing, communications, public works and agriculture. Although such a contraction was recommended by the Economic Board, it was not approved by the Government. There will be a similar investment problem in 1952.

The priority problem from 1953 on should be much more manageable. With the single exception of the cement plant, there does not appear to be any major construction project required, and the economy can concentrate on:

a) the construction of power transmission lines, especially to rural areas,

b) increased agricultural development,

c) development of small industries,

d) continued moderate but urgent investments in the fishing industry, and

e) necessary social investments (primarily roads and housing).
PART III - THE INVESTMENT INSTITUTIONS
1. Current Investment Programming

During the first five post-war years Iceland undertook an extraordinary investment program which failed to yield results commensurate with the size of the investment. The investment program planned for 1951 and 1952, is still not the best program that could be devised for the country, indicating that there is urgent need for a single, quasi-independent investment institution having major responsibilities for the programming and the financing of future investments within the country.

At present, the Economic Board (which is reported shortly to be abolished) regulates the physical volume of private investment, primarily through its power to license imports of investment goods. There is no single Government agency below the Cabinet level which regulates the total physical volume of investment, including that of the Government, nor is there any body or board in either the Government or the banking system responsible for either long-range planning or for the coordination, integration, or control of the financing of long-term investment within the country. In fact, the Government's investments take priority over all other investments, whether they deserve it or not.

Long-term investments in Iceland are now financed through:

a) The Treasury budget:

1) on current account: - roads, harbors, communications, and other transport facilities and such enterprises as the state monopolies, state printing office and barrel factory.

2) on capital account - in the form of direct grants, or foreign and domestic loans to State enterprises, State public works and private enterprises.

b) Autonomous agencies

The Sog Power Authority, for example, which apparently has no surplus or reserves of its own, finances its capital expenditure with grants from the city of Reykjavik, advances from the Treasury out of counterpart funds, foreign loans by way of the Treasury and its own internal bond issues.

c) State funds:

1) Agriculture. In the Agricultural Bank there are six separate funds for agricultural development, although only two of these are of importance. There are also four other agricultural funds outside the Bank.

2) Fisheries. Two separate fisheries funds are functioning, as well as the Fisheries Loan Department of the National Bank.

3) Workmen's building fund, and other miscellaneous state funds.
d) The Banking System:

1) through the two principal commercial banks, particularly the Landsbanki which holds at the present time 164 m. Kr. in long-term securities, the majority for development purposes.

2) through the small savings banks which may make direct municipal loans, hold securities, etc.

e) Other Sources

1) through the profits of enterprises such as the Iceland Steamship Company which has financed an almost complete new post-war merchant marine in this manner,

2) through the savings deposits in the Cooperatives which form a substantial part of their investment capital, etc.

2. Proposed Investment Bank

Neither the Treasury nor the Landsbanki is in a position to coordinate or supervise these various investment activities and to bring them into line with the investment requirements and the financial resources of the country. It is therefore recommended that an investment organization be set up for this purpose. Such an organization has been under active consideration by the Government and can be an important asset in Iceland's future development. Its principal functions would be:

a) To conduct economic and technical research on the investment requirements of the economy, to make recommendations to the Government on such requirements in accordance with the financial resources of the country and to be the major organization responsible for the financing of the medium and long-term investments.

b) To supply capital to public, private or mixed enterprises, including such existing financial institutions as the Agricultural Bank and the Fisheries Bank.

c) To make, guarantee, or participate in loans to any industrial, agricultural or commercial enterprise.

d) To purchase, hold and sell bonds, stocks or shares in such enterprises.

e) To promote and encourage savings and to assist in the development of a broader securities market.

f) To establish, sponsor or conduct industrial, agricultural or fisheries research and experimental services.

g) To provide technical and financial advice to the Government and to private enterprises.

h) To act as a financial agent of the Government in securing long-term foreign investment loans.
In Iceland, it is most urgent to keep down overhead costs by making full use of existing or proposed financial organizations and their research and technical staffs. Under these circumstances, the Investment Bank should be closely associated with the proposed new Central Bank,1 to the extent, wherever possible, of maintaining common research, technical, accounting and administrative facilities. Safeguards will be necessary to ensure that this association will not be allowed to impair the independence of the new Central Bank and, of course, the two organizations should be separate legal entities each with its own assets and liabilities.

It is recommended:

1) That an Investment Bank be organized, with a managing Director who would be chairman of the Board of Directors of the Bank. It would be particularly desirable, in view of the need for close coordination of the two institutions, that the President of the Central Bank or his nominee be a member of the Board of the Investment Bank.

2) That the Bank begin operations with a capital of 150 m. Kr. to be obtained in part by the release of counterpart funds now on deposit with the Landsbanki, and in part by the transfer of securities now held by the Landsbanki.

3) That all counterpart fund releases in 1951 and 1952 for the Sog and Laxa projects and the fertilizer plant (estimated at 110 m. Kr. for 1951 and 1952) be made from the capital of the Investment Bank. The Bank would release such funds to the enterprises, on appropriate terms of repayment in interest and amortization.

4) That the Bank be authorized to issue its own obligations under Treasury guarantee.

5) That the Landsbanki transfer to the Investment Bank part or all of its present long-term bonds and debentures of the following categories:

- a) Herring factories  18.3 m. Kr.
- b) State Shipping Dept.  7.2 m. Kr.
- c) Municipal Power Development  38.9 m. Kr.
- d) Municipal Harbors  5.3 m. Kr.
- e) Securities and Debentures of Private Industries  7.4 m. Kr.
- f) Reykjavik Hot Water System  86.9 m. Kr.

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1/ The organization of a Central Bank has been recommended by Mr. Henry C. Murphy, International Monetary Fund, in a memorandum of April 30, 1951 to the Icelandic Government.
6) That the Treasury provide that future repayments, if any, to the following funds be made directly to the Investment Bank:
   a) Fisheries Loan Department
   b) Loans to State Herring Factories
   c) Fishing Ship Funds
   d) Herring Fisheries Assistance Funds.

7) That the existing Power Development Fund be transferred to the Bank.

8) That the Treasury consider an annual contribution to the Bank for development purposes.

9) That, from time to time, other additions to its capital be made from the Central Bank's earned surplus.

10) That the Investment Bank normally be the channel for future foreign development loans.

3. Other Investment Institutions

   a) The Economic Board

   The present role of the Economic Board is somewhat anomalous since it does not, in effect, control or plan state investments and suggestions have been made for the abolition of the Board. It is recommended that the Economic Board be replaced by a small permanent, non-political body responsible directly to the Cabinet for:

   a) the coordination of all Government and municipal investments in public works, transportation, ports, roads and housing, and in close cooperation with the Investment Bank, for final policy recommendations to the Cabinet on investments by major sectors of the economy.

   b) general supervision of revenue-producing state enterprises (herring and fertilizer factories, state monopolies, telecommunications, hydroelectric plants, etc.) with particular reference to:

      1) assuring that their rate structure or pricing policy is sufficient not only to cover their costs of operation but to earn a revenue for the state and

      2) advising the Government as to whether existing or future revenue producing enterprises of the Government should take the form of mixed or private corporations.
c) Administrative control of the various state development funds for housing and social investments (other than power, agriculture and fisheries) such as:

- Workmen’s Building Loan Fund
- Harbor Fund
- State Institution Building Funds
- Bridges Construction Fund

b) Agricultural Bank

The Icelandic system of fiscal administration has grown over the years into a system of some complexity. There are a large number of state funds (around thirty for various development purposes, though some are of minor importance or are largely dormant). A few of the funds are dependent on annual grants but the great majority have their own cash assets earmarked for specific purposes. This system has drawbacks: a) it is administratively cumbersome, b) it requires a larger technical staff to operate than is necessary, c) the system particularly lacks flexibility and one fund may be short of cash for an urgent project while another fund has a surplus.

In agriculture there are six major and three minor funds for agriculture, and one fund for agricultural relief.

Separate State Funds

- a) Farm Purchase Fund
- b) Farm Machinery Fund
- c) Land Breaking Fund
- d) Agricultural Relief Fund

Funds in Agricultural Bank

- e) Agricultural Equipment Fund
- f) Agricultural Building Loan Fund
- g) Agricultural Mortgage Fund
- h) Small Buildings Fund
- i) New Buildings Fund
- j) Reserve Fund

(The last three funds are of minor importance)

Although the Government’s Land Breaking Fund held cash deposits with the Agricultural Bank at the end of 1950 in the amount of 6 m. kr., these funds were earmarked for the specific purpose of land drainage and could not be used directly for any other agricultural project, while the two principal funds in the Agricultural Bank were short of capital.
The existing Agricultural Bank appears to be efficiently operated and to have a reasonably good technical agricultural staff and it is recommended:

a) that the Agricultural Bank be the major instrument for financing agricultural development. To this end, it should work in close cooperation with the Investment Bank, the principal channel for foreign development loans;

b) that the assets of the ten existing funds be merged into a single fund as a part of the capital of the Agricultural Bank. This single fund would be used for general agricultural development, without regard to the original purpose, except as specifically directed by the Althing.

c) that 10 m. Kr. from the counterpart funds be made available to the Bank during the current year in order to maintain at least the current rate of agricultural development.

Consideration should also be given to the proposal that as repayments on existing loans to commerce and industry in the commercial section of the Bank are made, they be merged with the existing agricultural funds and be used thereafter for agricultural development.
PART IV - OTHER MEASURES
1. The Tax Structure

The fiscal policies of the Government will play an important role in future development. Between 1945 and 1949, government fiscal operations were responsible, directly or indirectly, for most of the large credit expansion and overinvestment. At the present time the budget is fully in balance, but a substantial portion of the local currency costs of the three major projects now under way, together with other projects such as agriculture and housing, will require extra-budgetary Government assistance, mainly through the release of counterpart funds. Future projects will require such assistance either directly from the Government or through the Investment Bank.

Iceland's fiscal system is unusual, inasmuch as the national system of taxation is highly regressive, while the municipalities have a more progressive system of direct taxation. For the current fiscal year, sales taxes and custom duties are estimated to yield 56% of the national Government's revenue, the wine and tobacco monopolies a further 23%, while direct income taxes will provide only 13% of current revenue.

It is therefore recommended that the Government institute a special study of the fiscal system of Iceland (possibly with the aid of an outside expert) with a view to determining:

1) the distribution of the national income, on which data are still lacking,

2) the effects of the present tax structure on investments, consumption and the distribution of the national income,

3) whether the present tax structure can be improved as a means to increase savings, promote investment, and to provide a sounder revenue system for the Government,

4) whether a single national income tax should be instituted and the receipts divided between the national and municipal Governments on an equitable basis.

5) whether existing institutions which are tax-exempt should be made subject to taxes,

6) the extent of tax evasion.

2. Savings

Private savings are at a low ebb in Iceland. This has been one of the most serious aspects of the depreciation of the currency. Personal savings in liquid assets during 1950 probably amounted to no more than 25 m. Kr. Life insurance sales are exceptionally small, with only 3 m. Kr. paid in as premiums in 1950. Corporate savings in the form of profits
reinvested may not have been more than another 20 m. Kr. One of the most urgent
tasks of the Government in its future development program is the establishment of
measures to increase voluntary savings and to channel them in the most economic-
ally desirable directions. With the high income level existing in Iceland, sav-
ings should be capable of expansion to a greater volume than in the past, provided
there are prospects of a reasonably stable price level over the longer run and a
satisfactory level of business activity. This will be very largely determined by
the over-all monetary, economic and investment policy of the country.

The existing institutions for channeling savings are not fully adequate to
the task. Their improvement should enable an expansion of both equity and bond
holdings by individuals and institutions. To this end it is recommended:

1) That the proposed Investment Bank encourage the formation of
share capital in private enterprises through the underwriting
of their issue. In particular, it is recommended that the
cement plant be financed, insofar as possible, through the
public sale of shares, particularly to individuals rather
than institutions, as a means to encourage savings and relieve
the Government of the heavy burden of investment. If the
Government considers it desirable to place a ceiling on divi-
dends, this should not be less than 10%.

2) That a system of postal savings deposits be instituted. This
is a particularly simple system and well suited to Iceland
where many areas of the country are not served by branch banks.

3) That efforts be made by the Treasury and the new Central Bank
to widen the market for both Government and corporate bonds
through such measures as daily price quotations, and redis-
counting facilities for short-term Government paper, and that
the Investment Bank make full use of its suggested powers to
buy and sell corporate bonds.

4) That, since long-term Government or Government-guaranteed
issues have had only very moderate success, the Government
consider the issuance of bonds of medium-term maturities
(serial bonds, for example, of three to seven years) at rates
from 1 to 3% above existing time deposit rates.

5) That savings departments of commercial banks and cooperatives,
savings banks, and life insurance companies, be encouraged to
hold a greater proportion of Government and Government-
guaranteed bonds, including those of the Investment Bank and
a smaller proportion of real estate securities.

3. Freight Rate Structure

Freight rate receipts from the Icelandic merchant marine represent a very
large item in the current balance of payments and in the national income. Gross
receipts in 1950 probably exceeded 90 m. Kr., an amount equivalent to over 20%
of the year's exports, and to nearly 6% of the national income.
The Icelandic merchant marine is unquestionably a national asset and a major saver and earner of foreign exchange. Because it is such an important factor in the national economy it is suggested that the Government, as an essential part of the future investment plans of the country, undertake studies of:

a) The Icelandic freight rate structure in its relationship to the world freight price level, and the extent to which adjustments in the Icelandic rate structure could improve Iceland's export position and

b) the extent to which the earnings of the merchant marine can be used for general economic development.

4. Foreign Exchange Reserves

Iceland has, for the past two or three years, existed on a dangerously low minimum of exchange reserves. The importance of such reserves to an economy dependent upon highly fluctuating exports and export prices can hardly be overstressed.

The rebuilding of Iceland's exchange reserves can be an important element in the future stability of the economy and its currency. It is recommended therefore that Iceland build up its exchange reserves over the next five years to a point where they amount to at least one year's essential imports, or about the equivalent of $20 m. (300 m. Kr.). This should be one of the most important tasks for the new Central Bank and will mean some sacrifice in either investment or consumption over the next five years, but such a program should not be unmanageable. The Investment Bank will necessarily have to take into account the exchange reserve requirements of the country in determining the amount of long-term financing it will undertake. It would be quite possible for the country to be borrowing abroad for long-range development while building up its reserves.

While no specific provision is recommended, since future fluctuations in the economy will be the final governing factor, it is suggested that in any year in which exports are expected to exceed $35 m., Government policy (to be determined in close consultation with the new Central Bank) should be geared through budget surpluses or other suitable financial measures, to the rebuilding of the Central Bank's exchange reserves. In particular it is recommended that at least a part of any extraordinary receipts arising from NATO expenditures in Iceland be devoted to this purpose.