EXHIBIT I-5

BALANCE OF PAYMENTS: ICELAND (1967-74)
(In millions of U.S. $)

	1967	1968	1969	1970	1971	1972	1973	1974
1. Merchandise Exports (F.O.B.)	98.7	82.8	107.1	146.0	150.4	191.7	267/0	373.9
2. Merchandise Imports (F.O.B.)	150.8	129.4	105.6	141.6	200.0	215.5	299.2	501.5
a. Of which special imports 1/	25.0	26.0	14.8	23.3	44.6	32.2	71.5	113.9
3. Trade Balance	- 52.1	- 46.6	1.5	4.4	- 49.6	- 23.8	- 32.2	-127.9
4. Services, Net	- 0.1	0.5	3.0	3.0	5.5	3.8	5.4	- 7.6
5. Balance of Goods and Services	- 52.2	- 46.1	4.5	7.4	- 44.1	- 20.0	- 26.8	-135.5
6. Transfer of Payments, Net	- 1.4	- 1.0	- 0.8	- 0.4	- 0.1	0.2	14.9 2/	1.1
7. Current Balance	- 53.6	- 47.1	3.7	7.0	- 44.2	- 19.8	- 11.9	-134.4
8. Balance on Capital Account	27.5	31.0	16.3	3.1	59.4	26.6	22.2	82.8
9. Errors and Admissions, Net	1.4	1.1	- 0.8	1.0	- 0.7	- 1.6	-	-
10. Special Drawing Rights	-	-	-	2.5	2.5	2.4	-	-
11. Change in Foreign Exchange Reserves	- 24.7	- 15.0	19.2	13.6	17.0	7.6	10.3	- 51.3
12. Foreign Exchange Holdings (End of year)	24.2	5.3	22.6	37.1	54.3	70.9	81.2	30.1
13. Foreign Exchange Holdings (In months of imports purchasing power)	1.9 mo	0.5 mo	2.6 mo	3.1 mo	3.3 mo	3.9 mo	3.3 mo	0.7 mo

1/ Special imports include ships and aircraft, imports for power projects and aluminum smelter.

2/ Reflects large influx of housing/materials for the Vestmannaeyar population.

Source: OECD Economic Surveys, National Economic Institute.

EXHIBIT I-6

TOURIST RECEIPTS COMPARED TO POPULATION AND
EXPORTS OF GOODS AND SERVICES IN OECD EUROPEAN COUNTRIES: 1972

	1972 Internat'l Tourist Receipts	1972 Exports of Goods and Services	Tourism Receipts as a Percentage of Exports	Population (Mid-1972)	Receipts Per Person (Host Country)	1970-72 Change in Receipts Per Person	
	(millions of US $)	(millions of US $)	Percent	(Thousands)		Amount	Percent
Austria	$ 1,600	$ 6,137	26.1	7,489	$214	$79	58.5
BLEU	436	20,015	2.2	10,054	43	7	19.4
Denmark	485	6,185	7.8	4,998	97	33	51.6
Finland	240	3,749	6.4	4,636	52	25	92.6
France	1,917	34,708	5.5	51,714	37	13	54.2
Germany	1,853	57,030	3.2	61,626	30	14	87.5
Greece	393	1,871	21.0	8,871	44	22	100.0
Iceland	*9*	*322*	*2,8*	*209*	*43*	*18*	*72.0*
Ireland	183	2,241	8.2	3,011	61	- 3	- 4.7
Italy	2,176	25,696	8.5	54,394	40	9	29.0
Netherlands	762	20,658	3.7	13,316	57	24	72.7
Norway	203	6,110	3.3	3,933	52	11	26.8
Portugal	415	2,294	18.1	8,717	48	23	92.0
Spain	2,511	7,589	33.1	34,367	73	22	43.1
Sweden	179	10,521	1.7	8,122	22	4	22.2
Switzerland	1,296	11,031	11.7	6,378	203	58	40.0
Turkey	105	1,868	5.6	37,045	3	2	200.0
United Kingdom	1,369	37,247	3.7	55,847	25	6	31.6
Total OECD European Countries	16,132	255,272	6.3	374,727	43	14	48.3
U.S.	2,706	73,461	3.7	208,727	13	-	-
Yugoslavia	460	4,079	11.3	20,755	22	-	-

Source: OECD "International Tourism and Tourism Policy in OECD Member Countries," 1974, and OECD Economic Surveys

receipts per person have grown faster than the OECD average over the last few years. *As was shown by Exhibit I-5 however, tourism has made little positive contribution in the balance of payments due to its small relative size and the large outflow of tourist expenditures by Icelanders going abroad.* Exhibit I-7 shows that tourism expenditures by traveling Icelanders amount to 1.7 percent of total imports, with a per capita expenditure rate well exceeding the OECD average. The terms of trade for the tourism account are shown in Exhibit I-8, which bears out this relatively rapid growth of outgoing tourism. This further indicates that only by exacting or encouraging greater per capita receipts (self-defeating if it is in the form of price increases) has Iceland been able to avoid a serious deterioration in the overall terms of tourism trade. *Nevertheless, the tourist industry has a significant positive role to play in the overall economy, particularly as it is a growth industry and one that has shown remarkable stability over the last ten years.* Exhibit I-9 compares this growth of tourist volumes and expenditures with that of the major export industry, marine products, over the 1965-74 period. *Although tourism currently contributes much less in the way of total earnings, its earnings have risen fifteen-fold over the ten years while marine product earnings have increased by 4-1/2 times (in current prices).* Also shown are the changes in <u>volumes</u> of "output" (tourists or fish catch), which underscore the unusually wide variation in the marine products industry. Fortunately, per unit price increases in the marine industry have been sufficiently large to offset the effects of this fluctuation.

EXHIBIT I-7

TOURIST EXPENDITURES COMPARED TO POPULATION AND IMPORTS OF GOODS AND SERVICES: OECD EUROPEAN COUNTRIES: 1972

	1972 Intnl. Tourism Expenditures (Millions of U.S. $)	1972 Imports of Goods and Services (Millions of U.S. $)	Tourism Expenditures as a Percentage of Imports	Population (Mid 1972) (Thousands)	Expenditures per Person
Austria	$ 526	$ 6,360	8.3%	7,489	$70
Belgium	712	18,466	3.9	10,054	71
Denmark	370	6,167	6.0	4,998	74
Finland	159	3,877	4.1	4,636	34
France	1,570	32,809	4.8	51,714	30
Germany	4,513	52,493	8.6	61,626	73
Greece	96	2,844	3.4	8,871	11
Iceland	*13*	*352*	*3.7*	*209*	*62*
Ireland	122	2,494	5.0	3,011	41
Italy	1,051	24,672	4.3	54,394	19
Netherlands	888	19,489	4.6	13,316	67
Norway	221	6,204	3.6	3,933	56
Portugal	153	2,675	5.7	8,717	18
Spain	266	7,792	3.4	34,367	8
Sweden	679	10,023	6.8	8,122	84
Switzerland	628	10,301	6.1	6,378	98
Turkey	59	1,960	3.0	37,045	2
United Kingdom	1,315	36,367	3.6	55,847	24
Total OED European Countries:	**$13,341**	**$245,345**	**5.4%**	**374,727**	**$36**
U.S.	**$4,856**	**$78,072**	**6.2%**	**208,727**	**$23**
Yugoslavia	**200**	**3,948**	**5.1**	**20,755**	**10**

Sources: OECD "International Tourism and Tourism Policy in OECD Member Countries," 1974, and OECD Economic Surveys

EXHIBIT I-8

TERMS OF TOURISM TRADE*

(1970 = 100)

	Tourism Receipts			Tourism Expenditures			Terms of Tourism Trade		
	Volume	Price	Total	Volume	Price	Total	Volume	Price	Total
1971	115	110	126	120	115	138	96	96	91
1972	129	127	163	141	132	186	91	96	88
1973	140	182	255	177	157	277	79	116	92

* Compares the relationship of volume and per capita receipts/expenditures of Iceland tourists ("price" of tourism product) with those of Icelanders traveling abroad. The ratios of inflow to outgo are analogous to the general concept of "terms of trade."

Source: Checchi and Company

EXHIBIT I-9

A COMPARISON OF FLUCTUATIONS IN OUTPUT AND EARNINGS
IN TOURIST AND MARINE PRODUCTS INDUSTRIES
IN ICELAND: 1965-1974

(in millions of kronur at current prices)

	Tourist Receipts		Marine Products (F.O.B.)	
	Receipts	Index (1965=100)	Earnings	Index (1965=100)
1965	104	100.0	5,789.4	100.0
1966	116	111.5	5,812.4	100.4
1967	125	120.2	4,116.1	71.1
1968	174	167.3	4,089.7	70.6
1969	320	307.7	7,757.9	134.0
1970	441	424.0	9,968.9	172.2
1971	555	533.7	11,746.3	202.9
1972	710	682.7	12,225.3	211.2
1973	1,133	1,089.4	19,400.0 *	335.1
1974	1,613	1,551.0	26,580.0 *	459.1

	Tourists (Annual Visitors)		Fish Volume (Thousands of tons)	
	Number	Index (1965=100)	Quantity	Index (1965=100)
1965	28,879	100.0	1,199.0	100.0
1966	34,733	120.3	1,240.3	103.4
1967	37,728	130.6	896.4	74.8
1968	40,477	140.2	599.4	50.0
1969	44,099	152.7	685.9	57.2
1970	52,908	183.2	729.9	60.9
1971	60,719	210.3	680.7	56.8
1972	68,026	235.6	722.6	60.3
1973	74,019	256.3	901.3	75.2
1974	68,476	237.1	925.0 *	77.1

* Preliminary estimates

Source: National Economic Institute, Iceland Statistical Bulletin, Central Bank of Iceland

Nevertheless, a well-planned investment program in the tourist industry is justifiable as part of an overall diversification plan which would include other growth industries, e.g., manufacturing. This latter sector has shown the greatest vitality and export potential of late, primarily due to the (deliberate) selection of relatively high energy manufacturing industries and the comparative advantage that Iceland enjoys in this resource.

An independent worldwide review of the stability of tourism earnings was conducted to test the hypothesis that tourism is generally a more stable earner of foreign exchange than agricultural/primary commodities, the latter being particularly important sectors for the non-industrialized world as well as many so-called developed nations. Agricultural commodity and tourism earnings indices were calculated for forty-six nations over the 1966-69 time period. The results are shown in Exhibit I-10. For the entire forty-six nations agricultural earnings declined slightly over the four-year period while tourism earnings increased by 26 percent. The experience was generally repeated on a country-by-country basis, some of which are also shown in Exhibit I-10. In spite of the huge recent increases in the cost of food, agricultural, and other raw materials (including oil) in the 1970's--often spurred by shortages and speculation in commodity markets--the subsequent world-wide recession has so reduced demand for some of these products that many of the nonindustrialized Third World nations have suffered large reductions in earnings, once again raising the specter of instability (with the initial result being a call for world price stabilization

EXHIBIT I-10

STABILITY OF EARNINGS: AGRICULTURAL EXPORTS VS. TOURISM EARNINGS FOR REPRESENTATIVE COUNTRIES: 1966-1969

(1966 = 100)	1967	1968	1969
Nordic/N. Europe OECD			
Belgium-Luxembourg			
Agricultural Commodity Index[1]	99	105	107
Tourist Earnings Index	105	119	137
Denmark			
ACI	98	88	90
TEI	109	109	127
Finland			
ACI	68	92	104
TEI	109	143	189
Ireland			
ACI	117	111	115
TEI	105	100	103
Norway			
ACI	96	99	109
TEI	107	108	125
Sweden			
ACI	100	104	114
TEI	110	110	128
Developing Countries: OECD			
Greece			
ACI	115	96	108
TEI	88	84	105
Portugal			
ACI	108	113	111
TEI	100	79	67
Spain			
ACI	100	99	97
TEI	94	94	101
Turkey			
ACI	120	107	117
TEI	108	200	208
Yugoslavia			
ACI	97	81	91
TEI	129	162	208
Africa			
Kenya			
ACI	81	79	94
TEI	102	114	116
Uganda			
ACI	100	102	105
TEI	147	175	243

(continued)

EXHIBIT I-10 (continued)

(1966 = 100)	1967	1968	1969
Asia			
Ceylon			
ACI	96	88	81
TEI	107	120	193
India			
ACI	110	108	96
TEI	133	200	1100
Pakistan			
ACI	85	70	88
TEI	173	133	329
Philippines			
ACI	101	103	103
TEI	154	92	94
Thailand			
ACI	103	97	97
TEI	145	145	158
Americas			
Brazil			
ACI	94	103	121
TEI	125	142	233
Columbia			
ACI	99	107	104
TEI	130	136	158
Mexico			
ACI	74	91	104
TEI	110	131	147
Peru			
ACI	81	89	78
TEI	112	65	118
Total 46-Nation Sample*			
ACI	96	97	99
TEI	108	113	126

1 These are foreign exchange earnings for the particular country's two major food or agricultural exports.

* Only 22 are shown in detail. These represent developing nations in various regions of the world, as well as many developed nations substantially reliant upon the export of agricultural/food products.

Sources: International Union of Official Travel Organizations, Food and Agricultural Organization of the United Nations, Checchi and Company

agreements).

3. Inflation

Inflation is one of the striking and most persistent characteristics of the Icelandic economy. In fact, the average rate of inflation has consistently exceeded the European or OECD average by a multiplicative factor of three. In 1974, the cost of living increased by a staggering 43 percent over 1973. Exhibit I-11 details the rise, over the 1967-74 period, of both wages and the cost of living index in Iceland. As can be seen, nominal wages have increased four-fold as a result of continuing domestic demand/consumption and a national unemployment rate hovering around the 0.5 percent level. Real wages, however, have risen only 27.5 percent over the entire seven-year period. Earnings, which include the effects of increased labor participation rates and overtime pay, have risen somewhat higher. These increases in labor remuneration can largely be attributed to the favorable terms of trade which have been obtained in the export sector. The increase in export earnings from the fisheries sector has been passed through to the employees of this sector (many of whom have incomes tied to the size/value of the fish catch) and then--by institutional arrangements and indexing of wages--to the other sectors. Thus the inflationary impact of wage agreements rapidly diffuses throughout the economy. Expansion of the money supply and bank credit has been excessive throughout recent years, a situation partly due to the absence of mechanisms like open-market operations to regulate supply of money. *The heavy reliance upon imports whose costs are also fast-rising adds additional fuel to the*

EXHIBIT I-11

WAGES AND PRICE LEVELS: 1967-1974

	Wage and Salary Rates For All Employees		Real Wage and Salary Rates For All Employees		Cost of Living	
	Index 1967=100	Change From Previous Yr	Index 1967=100	Change From Previous Yr	Index 1967=100	Change From Previous Yr
1967	100.0	-	100.0	-	100.0	-
1968	106.2	6.2%	94.0	- 6.0%	113.0	13.0%
1969	119.8	12.8	87.1	- 7.3	137.5	21.7
1970	149.0	24.4	95.7	9.9	155.7	13.2
1971	176.6	18.5	106.2	11.0	166.3	6.8
1972	225.2	27.5	122.7	15.5	183.6	10.4
1973	278.1	23.5	124.0	1.1	224.2	22.1
1974	408.8	47.0	127.5	2.8	320.6	43.0

Sources: National Economic Institute, OECD Economic Survey of Iceland (1974)

inflationary inferno. Import substitution to escape this reliance, in light of resource and/or market limitations, is not a practical alternative. Although real wages and earnings have still increased over this period, complete circumvention of the undesirable effects of inflation has not been achieved.

The distortions are particularly apparent in the credit markets where inflation--coincident with interest rates ceiling--has made the real rate of return on most forms of savings negative. Domestic credit has been shunted into more speculative channels, like real estate. This has led to a heavy reliance upon foreign borrowing and, subsequently, demands for foreign exchange to amortize such loans. In addition, the effects of inflation upon income and wealth distribution have not been isolated and offset, so there may exist an undesirable income shift away from the relatively low and fixed-income groups. Finally, and most relevant to the tourism industry, *Iceland has been pricing itself out of the mass market, certainly in North America and even in inflation-prone Europe.* This is evidenced by the decrease in tourist visitations in 1974, the first such drop since 1957, and the decreased length of stay of those that did come in 1974. *Discussions with many tourists reveal that their plans to return or lengthen their stays in Iceland will be altered if the trend of rising local costs is not stemmed.*

4. Financial Markets

Iceland does not have an organized market for money and credit. This naturally has many implications for the financing of tourism development. The purpose of this subsection is to set the

stage by outlining the constraints imposed on putative projects by Iceland's financial system.

The absence of credit markets is reflected in the relatively small portion (compared to other European economies) of credit allocation decided upon by financial intermediaries. While gross domestic savings in 1971 and 1972 were 25 percent of gross domestic product, some 40 percent of savings was allocated directly by savers themselves; only 60 percent, in other words, was channeled through the financial system.

Lack of an organized market refers to two specific factors:

1. The total investible funds demanded by Icelanders has not of late been supplied by Icelandic sources at prevailing interest rates. Part of the reason is the very high rate of inflation coincident with interest rate ceilings, which makes the real rate of return on savings accounts negative. As mentioned, foreign borrowing is a significant portion of the total credit supply.

2. Much of the credit in Iceland is not freely available to all borrowers. Credit is often earmarked for specific uses, either by law (in the case of government agencies) or by choice (for private financial intermediaries).

In short, new investments in tourism or any other field must compete for funds in a very tight and artificially constrained credit market.

There are effectively ten classes of suppliers of funds, each of which can be considered potential sources of financing for tourism projects. These are summarized below.

1. The Central Bank (Sedlebanki Islands) is the hub of economic activity in Iceland. Not only does it create money (by printing it or by manipulating the supply of credit through required reserve ratios and interest rate ceilings) but the Central Bank is involved in financing projects requiring foreign capital. It assists

developers by first guaranteeing them the right to purchase a predetermined amount of foreign exchange at a set price; and second, in many cases by guaranteeing the loan itself. The former is crucial to any project and is not so difficult to obtain as the latter.

While the Central Bank does not provide credits directly to private or public sector borrowers, it does provide money to the Investment Credit Fund for relending to various sectors of the economy. We will discuss these further below.

2. Commercial Banks provide short- and medium-term credit, but almost no long-term credit. There are seven such banks, some of which are partly or wholly state-owned. Each is identified with a particular interest: fisheries, agriculture, industry, and so forth. In general, commercial banks are not very interested in risk capital or equity arrangements, and would only be marginal sources for large-scale private sector schemes. But they do lend to the Investment Credit Fund, as mentioned below.

3. There are over fifty Savings Banks with over 125 branches. These accept deposits and make loans, but normally only for residential construction. They are thus akin to savings and loan associations in the United States.

4. There are also about fifty Cooperative Savings Departments, but these exist solely to finance the operations of the cooperatives themselves.

5. The Investment Credit Funds are a very important source of long-term credit in Iceland. There are three major funds--for fisheries, agriculture and industry--and they are usually administered by commercial banks. The financial support for these comes from the Development Fund of Iceland (Framkvaemdasjodur Islands) which channels funds to all three Investment Credit Funds. The monies are collected from specially earmarked taxes, grants from general revenues, and outside borrowing. The Development Fund of Iceland also makes loans directly for other public investments.

More important are several minor Credit Funds also financed by the Development Fund of Iceland, including a Regional Development and a

Tourism Fund. Typically these make many small loans supplementary to provision of other money from private industry or the municipality most affected by the investment in question. Repayment terms depend on those obtained by the Development Fund from the primary source. If the funds come from a commerical bank, repayment to the Development Fund will be at this same rate. For foreign loans, the same rate as paid by the Development Fund is charged, but stipulation may be made that the repayment be in foreign exchange, thus tying the effective interest rate to the exchange rate. Finally, the Development Fund may charge six to seven percent interest, but these rates are indexed to cover inflation.

6. Private Insurance Companies are comparatively small sources of finance, and in general do not make very large loans. Loans are more easily accorded enterprises or municipalities for whom the company underwrites.

7. Pension Funds, of which there are now almost one hundred, have grown rapidly to become an important source of finance in Iceland, to a large extent because contributions from employers and employees are mandatory. Most lending is to members and is earmarked for residential construction.

8. The Social Insurance System, including the Unemployment Insurance Fund, is also the beneficiary of mandatory contributions. Particularly because of the almost complete lack of unemployment, the system has built up considerable assets which are loaned to private and public borrowers.

9. Foreign Borrowing has traditionally been a major source of long-term capital for Iceland, particularly for large investments. As mentioned earlier, the Central Bank will guarantee the Icelandic borrower the right to purchase foreign exchange at a set price for repayment of the loan, and may guarantee the loan itself. The latter is dependent, not just on a showing of project feasibility, but the role of the project in the Bank's overall plan for Icelandic development. The guarantee, of course, makes foreign borrowing easier and cheaper. In the United States, Iceland has been able to attract capital

for municipal improvements in Reykjavik and other uses, and is considered to have good credit standing.

10. Private Investors of any magnitude in Iceland are few; only Flugleidir and Sammband could be considered possible sources of large amounts of private capital. The large amount of saving not passing through the banking system means that much private capital is being lent, but doubtless in very small amounts.

Exhibit I-12 on the next page summarizes the credit market operations of 1971 and 1972. It is important to note, however, that no information is available to distinguish credit for new investment as opposed to that for operation of existing concerns. The Annual Report of the Central Bank for 1972 notes:

> Generally it may be assumed, however, that the banking system supplies mostly the operational credit in the country whereas the non-banking financial institutions, the investment credit funds, the pension funds and long-term foreign lenders, supply credit mostly for investment. Short-term borrowing abroad constitutes mainly credit for current operations.

As always when shortages of capital at current interest rates arise, a major difficulty exists in assuring an efficient allocation of what credit and capital do exist. This is made all the more problematic by the fact that some investment is channeled by non-bank financial institutions in accordance with specific regional or industrial plans, while the rest is left to market determination. For example, the OECD reports that the Investment Credit Funds' lending in 1974 amounted to nearly one-half that of the banking sector. *This means that the Government of Iceland has direct control over a significant portion of total credit in Iceland. It should be noted, however, that it is the*

EXHIBIT I-12

THE SUPPLY OF CREDIT: 1971 AND 1972[1]

(Net movements in millions of kronur)

Lenders:		Borrowers: Central government (1)	Municipalities (2)	Enterprises[6] (3)	Homeowners (4)	Other private (5)	Total (6)
I. Domestic credit, total	1972	47	20	4,515	2,646	106	7,334
	1971	82	250	3,549	1,948	174	6,003
1. Central Bank[2]	1972	283	18	509	---	--	810
	1971	11	21	74	---	--	64
2. Commercial banks[2]	1972	116	42	3,155	201	95	3,525
	1971	63	62	2,193	345	157	2,820
3. Savings banks	1972	3	60	1	441	11	388
	1971	13	37	281	155	17	503
4. Savings departments of cooperatives	1972	--	--	43	---	--	43
	1971	--	--	28	---	--	28
5. Total banking system (1-4)	1972	170	120	2,688	642	106	3,146
	1971	65	120	2,428	500	174	3,287
6. Investment credit funds[3]	1972	158	122	1,712	1,069	--	3,061
	1971	21	106	1,050	834	--	1,969
7. Pension funds[3]	1972	28	3	61	834	--	1,026
	1971	25	2	44	615	--	686
8. Unemployment Insurance Fund[3]	1972	31	15	54	1	--	101
	1971	13	22	27	1	--	61
II. Foreign credit, total	1972	1,356	292	213	---	--	1,435
	1971	1,093	25	2,060	---	--	3,178
1. Long-term borrowing[4]	1972	1,506	292	92	---	--	1,890
	1971	935	25	1,527	---	--	2,487
2. Short-term borrowing[5]	1972	150	--	305	---	--	455
	1971	158	--	533	---	--	691
III. Domestic and foreign credit, total	1972	1,403	312	4,302	2,646	106	8,769
	1971	1,175	275	5,609	1,948	174	8,181

1 Credit transactions between lenders have been eliminated.
2 Foreign funds relent by banks and investment credit funds are included, but book value changes due to the devaluation of the Icelandic kronur in 1972 are excluded.
3 Partially estimated.
4 Excluding borrowing by financial institutions.
5 Excludes direct investment from abroad (1,726 m. kr. in 1971 and 240 m. kr. in 1972.)
6 Including state enterprises.

private sources of capital that have grown most vigorously in recent years. Exhibit I-13 traces the distribution of loan sources from 1968 to 1973. It shows that the non-controlled pension and investment funds are the only sources that have grown in relative importance over that period, together accounting for over 45 percent of loans outstanding in 1973.

The preceding has concentrated on the supply and demand sides of the credit market in Iceland. *A potentially important alternative or complement to loan capital is equity funding. However, for a number of reasons, the current situation in Iceland may discourage foreign participation in tourism development projects.* Not just the uncertain economic picture, but several more specific points bear investigation.

Iceland has no formal program of industrial incentives. Special legislation is required for all foreign participation in domestic enterprises, and so each case is treated differently. Questions on the taxes to be paid and the repatriation of profits are decided on a case-by-case basis, so little can be said a priori about the terms a foreign investor is likely to obtain. As a matter of law, however, no more than 49 percent of the enterprise in question may be foreign-owned; in other words, outright foreign ownership of an enterprise operating in Iceland is not allowed as a rule.

Taxation laws are not particularly favorable. Corporate income is taxed at a flat rate of 53 percent, although up to 25 percent of taxable income may be used for re-investment without being taxed. The level of employers' payroll taxes is higher than in many other countries,

EXHIBIT I-13

TOTAL LOANS OUTSTANDING OF FINANCIAL INSTITUTIONS
(in millions of kronur)

	1968	1969	1970	1971	1972	1973
Commercial Banks	10,596 (44.0%)*	11,455	13,479	16,505	19,861	26,767 (42.2%)*
Saving Banks	1,353 (5.6)	1,626	2,044	2,044	2,883	3,522 (5 6)
Saving Depts. of Cooperatives	515 (2.1)	531	601	629	704	822 (1.3)
Insurance Companies	412 (1.7)	441	511	707	825	1,090 (1.7)
Private Pension Funds	1,989 (8.3)	2,326	2,793	3,559	4,770	6,675 (10.5)
National Insurance System	1,078 (4.5)	1,196	1,402	1,645	1,940	2,450 (3.9)
Investment Credit Funds	8,140 (33.8)	9,656	10,816	12,975	16,205	22,100 (34.8)

* Percent of total.

Source: Central Bank of Iceland in Republic of Iceland Prospectus 10% Bond Due 1979-1994.

and contributions to pension funds and unemployment funds are mandatory. Wages are relatively high in Iceland, of course.

On the positive side, land is not particularly expensive and energy is cheap. Rents are high only in downtown Reykjavik.

It is thus not surprising that those industries that have been established with foreign equity are capital-intensive and very energy-intensive (e.g. the Johns-Manville dyatomaceous earth plant at Myvatn). *On the whole, the special nature of the Icelandic economy and the restrictions imposed on foreign participation make broad-based outside equity unlikely in most sectors.*

5. Public Debt

Public debt comparisons--due to differences in national wealth output, and foreign obligations--are tenuous at best. However, for further insights into the degree of indebtedness of the Icelandic economy, Exhibit I-14, which compares national debt levels for both Iceland and the U.S., is presented. It is interesting to note that, although U.S. debt in per capita terms and as a percent of GNP substantially exceeds that of Iceland, per capita debt in Iceland has tripled over the 1966-73 time period (while in the U.S. per capita debt grew by one-third) and debt has been growing much faster than GNP (the reverse of U.S. experience). *When external debt is considered, the rapid growth of debt in Iceland is even more pronounced.* In fact, per capita external debt has quadrupled over the given period. Due to the large size of the local cerdit market in the U.S., external debt is not significant. Furthermore, *it is estimated that Iceland's external debt service (for*