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To: Members of the Executive Board

From: The Secretary

Subject: Report on the Meetings of the GATT Committee on Balance of Payments Restrictions

Attached for the information of Executive Directors is a report by the Fund representative on meetings of the GATT Committee on Balance of Payments Restrictions, held in Geneva during October 30-November 2, 1984.

Att: (1)

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Department Heads

INTERNATIONAL MONETARY FUND

Meetings of the GATT Committee
on Balance of Payments Restrictions

Report by the Fund Representative

November 23, 1984

The GATT Committee on Balance of Payments Restrictions met in Geneva during October 30-November 2, 1984, under the chairmanship of Mr. J.N. Feij (the Netherlands). Full consultations were held with Korea and Portugal, and consultations under simplified procedures were held with Bangladesh and the Philippines. In preparation for the consultations, the Fund had transmitted for use by the CONTRACTING PARTIES its latest Recent Economic Developments reports on the four countries. 1/ In addition, pursuant to the arrangements for Fund-GATT cooperation, statements of the Fund's findings on Korea and Portugal had been prepared for the CONCTRACTING PARTIES and approved by the Executive Board. 2/ The Fund representative was Mr. S.J. Anjaria.

1. Korea

For this consultation, the Korean authorities had submitted the basic document, and a study on the effects of protectionism on the Korean economy. 3/ The Committee also had before it a GATT secretariat background paper. 4/ In his opening statement, 5/ the representative of Korea reviewed recent developments in the Korean economy, focusing on the external sector and the major policy adjustments pursued by the authorities since the previous full GATT balance of payments consultations in 1979. He stressed that his authorities considered Korea's liberalization policies in the trade, investment, monetary, and financial fields to be essential to Korea's export-led growth strategy. As regards trade policies, the authorities had raised the import liberalization ratio (i.e., the ratio of import items on the automatically approved list to all import items) from 68 percent in 1979 to 85 percent in 1984; by 1986, this ratio was expected to reach the level prevailing in the industrial countries, and all restrictive measures on manufactured goods were scheduled to be removed by 1988. In 1983, the authorities had also revised the tariff system, which had lowered the average (unweighted) tariff rate for manufactured goods from 22.6 percent in 1983 to 20.6 percent in 1984; the average was to be further lowered to 16.9 percent by 1988. In addition, steps were being taken to simplify trade procedures, for example, by abolishing the systems for end-user recognition and the export-import link.

1/ Bangladesh, SM/84/160 (7/6/84); Korea, SM/84/121 (5/25/84); the Philippines, SM/84/132 (6/13/84); and Portugal, SM/84/170 (7/16/84).

2/ EB/CGATT/84/4 (10/15/84), and Corr. 1 (10/17/84).

3/ BOP/246 (10/10/84) and Corr. 1 (10/19/84) and Add. 1 (10/17/84).

4/ BOP/W/83 (10/16/84).

5/ Appendix I.

The Korean representative also outlined the steps being taken to liberalize inward foreign direct investment, exchange controls, and the financial system. The authorities had responded to the second oil shock and the economic setback suffered in 1980 by adopting a comprehensive program of adjustment policies, including strict financial discipline, monetary restraint, and flexible exchange rate management, which had brought about substantial improvements in the performance and prospects for growth and the balance of payments. The rapid growth of Korea's trade over the years had benefited both Korea and its trading partners, but uncertainties about intensified protectionism abroad, high levels of international interest rates, and a fragile and uneven world economic recovery cast a shadow over Korea's prospects for realizing its growth potential. The representative of Korea noted that Korea's trade liberalization policies had been designed to promote trade in accordance with GATT principles and to discourage protectionist measures against Korea's exports. Nevertheless, continued access to export markets was crucial to developing countries like Korea in their efforts to achieve sustainable balance of payments positions and to attain growth targets. He stressed the critical role of the GATT, and affirmed his authorities' intention to work closely with the GATT in strengthening international cooperation to keep an open world trading environment.

The Fund representative made a statement on Korea, which is reproduced in Appendix II. The subsequent Committee discussion was grouped under three headings: Korea's balance of payments position and prospects; the system, methods, and effects of import restrictions; and external factors.

Under the first heading, many Committee members (including Australia, Canada, the European Community, Japan, the Philippines, Sweden, and the United States) praised the recent successes in Korea's economic performance, including the restoration of the growth momentum, reduction of inflation, and the improvement in the trade balance and the narrowing of the current account deficit. Several members applauded Korea's trade liberalization efforts. The representative of Sweden welcomed the transparency of recent trade policy actions, and urged the Korean authorities to accelerate the liberalization process. The representative of Canada expressed appreciation for the authorities' declared intention to assume greater responsibilities under the GATT, and urged them to adhere to the GATT codes on nontariff measures where they had not done so.

The representatives of the European Community, Japan, the Philippines, and the United States raised questions concerning prospects for the invisibles account of Korea's balance of payments. The representative of Korea said that the medium-term prospects for the invisibles account were not very favorable, given high international interest rates and a fall in receipts from overseas construction due to the retrenchment of investment in the Middle East; however, construction companies were endeavoring to improve their financial structures and to concentrate on more sophisticated projects.

In the context of a discussion on the medium-term growth and external sector prospects, the representative of Korea noted that the original five-year development plan for 1982-86, prepared in 1979, had assumed a 10 percent annual increase in petroleum prices and projected an increase in external debt to US$64 billion at the end of the plan period. The more recent revised five-year plan projected a growth in the external debt to US$47 billion in 1986, mainly because of a downward revision in the petroleum price assumptions. In response to a query, he noted that Korea was reducing reliance on short-term debt; its proportion in total external debt had declined from 34 percent in 1980 to 28 percent in September 1984, and was expected to fall further. In response to a question on prospects for increasing domestic savings, the representative of Korea stated that his authorities attached high priority to increasing domestic savings, and the stabilization of the economy should contribute to this end. The expected increase in household incomes was anticipated to be conducive to fostering private savings. Under the revised five-year plan, the authorities hoped Korea would close the current account gap by 1986 and move to a moderate surplus in subsequent years. However, realization of these projections depended crucially on continued access to export markets and stable international interest rates.

The representative of Sweden requested clarification of the reasons why, although Korea expected to achieve current account balance by 1986, the current import liberalization plan did not foresee complete removal of restrictive measures on manufactures until 1988. The representative of Korea replied that the trade liberalization target had been set more recently, while the current account projection was included in the development plan. The two were broadly consistent. He emphasized the need to proceed with caution on trade liberalization, but noted that, even by 1986, import liberalization would be raised to over 90 percent.

Under the second heading (the restrictive system), the Committee had a lengthy discussion on specific features of Korea's import policy, practices, and plans. Several Committee members (including Australia, Canada, the European Community, and the United States) suggested that the effectiveness and coverage of the import liberalization process in Korea could be enhanced. In addition, several members raised questions concerning the present and prospective use of additional tariffs, and asked to what extent the availability of this instrument could be viewed as offsetting the liberalization of nontariff measures. Comments were also made on the certainty of access to the Korean market.

In response, the Korean representative emphasized that Korea was still at the beginning of the trade liberalization process. The Korean market was being opened steadily; considerable liberalization had already taken place in sectors such as clothing and footwear, and further opening measures were planned. Import liberalization now covered nearly 80 percent of the value of imports, as against 85 percent of tariff lines. The targeted reduction of the average tariff rate on manufactured goods to 17 percent by 1988 would still leave Korea with a relatively high tariff in relation to the industrial countries; however, the authorities would consider further reductions if these were feasible.

The flexible emergency tariff system and the adjustment tariff system were akin to safeguard actions under GATT Article XIX, in that they were intended to protect domestic industry from unexpected import surges; as such, they enabled the authorities to introduce greater liberalization of nontariff restrictions than would otherwise be possible. Emergency and adjustment tariffs were not imposed on the 214 items whose tariffs were bound under GATT rules. Adjustment tariffs could be imposed only on liberalized imports, and for six-month periods up to a maximum of three years from the date of liberalization.

The representative of Korea provided information on a number of other points raised by Committee members. He noted, inter alia, that Korea's Foreign Exchange Demand and Supply plan was not used as a foreign exchange allocation system, or to restrict imports.

Under the final heading (external factors), the Committee considered the study on the effects of protection on the Korean economy. The Chairman noted that this discussion would serve only to introduce greater symmetry in the Committee's report, rather than to produce recommendations for action, since Korea had not explicitly invoked paragraph 12 of the 1979 Declaration on Trade measures. 1/ During the discussion, Committee members generally welcomed the Korean document for the quality of the information and analysis included. The representative of the United States expressed regret that the document had been made available too late to provide an opportunity for studied comments on the analysis undertaken. Several Committee members emphasized that the main objective of the Committee was to focus on import restrictions maintained by the consulting country, rather than on the restrictions applied by trading partners.

The representative of the European Community stated that he shared many of the concerns on protectionism expressed by the Korean authorities in their submission. He also had several reservations concerning the methodology utilized and the conclusions drawn. The document rightly emphasized the importance of structural adjustment; however, industrial countries also faced the problem of adjusting in a socially and politically acceptable manner. The Korean authorities' document suggested that:

> the increase in protectionist measures seems to be due, in part, to the reluctance of advanced nations to relinquish their declining industries. Advanced nations should concentrate on highly technological industries, rather than holding on to those industries which have lost their competitive edge in international markets. 2/

1/ Under paragraph 12 of the 1979 Declaration on Trade Measures, the Committee could be requested to consider the actions that could be taken by other contracting parties to improve the export prospects of a developing consulting country, and to make suggestions in this area to the GATT Council.

2/ BOP/246/Add. 1 (10/17/84), page 15.

The representative of the European Community stated that this view was not totally correct; industrial countries could not be expected to abandon whole industrial sectors. Even in the textiles and clothing sector, there had been structural adjustment in the industrial countries, and the entirety of this sector was not necessarily a province of the developing countries.

The representative of the European Community also had difficulties with the second suggestion put forward by the Korean authorities--that "a freeze on all types of new trade barriers, a standstill agreement, should be immediately enacted." 1/ He recalled that the standstill embodied in the November 1982 GATT Ministerial Declaration was being monitored in the GATT Council. However, assessments that concluded that there had been a recent increase in GATT-inconsistent measures were not always justified. While improved market access for developing countries was a shared objective, contracting parties could not be expected to renounce rights under the GATT in the framework of a standstill commitment. The need was rather to ensure that GATT rules were generally respected and that a dynamic process was begun, leading toward a more equitable balance of rights and obligations. The representative of the European Community welcomed the intention of the Korean authorities to participate in a new round of multilateral trade negotiations; the European Community believed that considerable preparations and consultations would be required for a new round to be initiated.

The representative of Argentina made a statement for the record. In it, he drew attention to the Fund statement which, in reviewing Korea's external trade environment, had noted that "Korean exports to developing countries have also been subjected to protectionist measures, particularly counterpurchase agreements." 2/ He noted that, at a recent discussion on countertrade at the GATT Consultative Group of Eighteen, no clear conclusion had emerged as regards the consistency or otherwise of countertrade arrangements and practices with the General Agreement on Tariffs and Trade. Accordingly, he did not agree that there was a basis for the Fund's characterization of counterpurchase agreements as protectionist practices. He also drew the implication from the Fund statement that countertrade was practised only by developing countries, and objected strongly to this. The representative of Brazil placed on record his support for the statement of the representative of Argentina, adding that the Fund statement on this point was not supported by evidence. The Fund representative drew the Committee's attention to the discussion on countertrade that had been carried out in the Fund recently, and provided information relating to it.

The representative of the Philippines considered that the Korean submission was an example of how other consulting countries might approach the subject of external factors affecting their export prospects. Trade liberalization had been recognized as an important element in alleviating balance of payments problems of consulting countries, and the Committee had a role to play in this regard.

1/ BOP/246/Add. 1 (10/17/84), page 15.
2/ See Appendix II, page 2, second full paragraph.

The representative of Japan stated that the macroeconomic model presented in the Korean submission represented an interesting approach, but that he had some reservations about the methodology employed. The impact of trade restrictions on an economy, as estimated by Korea, depended on the specific assumptions used, and in any case was very difficult to estimate. Nevertheless, he welcomed the document, which he characterized as the first by a developing country expressing willingness to participate in a new round of trade negotiations. The agenda of the new round would of course be a matter of discussion among contracting parties; even so, he welcomed the Korean authorities' contribution on this subject. 1/ The representative of Japan added that he had reservations regarding the concept of "administrative obstacles" facing Korea's exports in foreign markets; many of these reflected technical standards applied for legitimate reasons, and not import restrictions.

The representative of Korea, in response to these comments, emphasized that the purpose of the exercise in document BOP/246/Add. 1 was to illustrate the significance of the effect of protectionism on the balance of payments of a country such as Korea by using a simple econometric model. Many other elements affected the balance of payments, but the effect of restrictive measures abroad was found to be greater than might have been expected. The report was to be regarded as supporting documentation that might provide a basis for further examination of external factors in future consultations.

Following the discussion on Korea, the Committee adopted the following conclusions:

> The Committee welcomed the recovery in the Korean economy which had taken place in the last few years as a result of the application of sound domestic policies, in particular the marked reduction of inflation, the relatively high rate of growth and a substantial reduction in the balance of payments deficit. The Committee appreciated Korea's efforts, as part of its overall economic policy, to introduce a progressive liberalization of import licensing, a reform of the tariff structure, a reduction of other nontariff restrictions and a revision of import procedures. The Committee urged Korea to pursue its liberalization program as vigorously and speedily as possible and expressed the hope that the rapid improvement in the balance of payments would soon obviate the need for trade restrictive measures.

1/ In their document BOP/246/Add. 1 (10/17/84), the Korean authorities had stated that:

> "The new round should be a forum for discussing ways to reverse protectionist measures. In this view, the agenda should focus on discouraging the use of orderly marketing agreements, voluntary export restraints, antidumping and countervailing suits, safeguards, and all other invisible administrative trade barriers."

At the same time, the Committee expected that Korea would continue the further simplication of import procedures as well as the reduction in the number of different measures applying simultaneously, thus bringing greater certainty and predictability in Korea's import regime and permitting trade liberalization to have its full effect. It expressed the hope that, in the process of trade liberalization, the introduction of restrictions which would counteract such liberalization would be avoided.

The Committee noted the concerns expressed by Korea regarding protectionism, and welcomed the special study on the effects of protectionism presented by Korea as a useful contribution to the discussion of external factors affecting a consulting country's trade. Although there had not been sufficient time for a full analysis of the study and several members had expressed reservations on some aspects of it, a number of the points contained in the study deserved careful consideration.

2. Portugal

In addition to the Fund documentation, the Committee had before it documents prepared by the Portuguese authorities and the GATT secretariat. 1/ Introducing his authorities' documentation, the representative of Portugal said Portugal's external trade balance had improved considerably in early 1984, enabling the adoption of measures to reduce reliance on import restrictions for balance of payments purposes. In particular, the 30 percent import surcharge had been reduced to 10 percent in March 1984. The representative of Portugal referred to some points raised in the 1983 GATT balance of payments consultation with Portugal. Regarding the timetable for abolishing the remaining 10 percent import surcharge and the 60 percent surcharge on "nonessential" goods, he said that, in the previous week, a "constat d'accord" had been signed in Dublin by the representatives of the European Communities and the Government of Portugal, calling for the accession of Portugal to the EC on January 1, 1986. As no transitional period was foreseen during the accession negotiations, the surcharges must legally be abolished on the date of the accession. In practice, however, the 60 percent surcharge would be replaced by a value-added tax to be introduced from July 1, 1985. As regards the quota for completely-knocked-down (CKD) motor vehicles, the possibility was being discussed of extending the quota system for a few years after the accession to permit the reorganization of the motor vehicle sector in Portugal. Finally, the representative of Portugal noted that the issuance of import licenses had recently been made smoother with the introduction of a computerized system for this purpose in the Lisbon area; the computerization would be fully operational when extended to the Oporto area in early 1985. The authorities continued to pursue policies aimed at improving the balance of payments and restoring sustainable economic growth.

1/ BOP/249 (10/17/84); L/5145/Add. 3 (7/12/84); L/5545/Add. 1 (7/12/84); and BOP/W/82 (10/16/84) and Corr. 1 (10/30/84).

The Fund representative made a statement, reproduced in Appendix III.

The Committee then discussed certain aspects of Portugal's balance of payments situation and prospects. The representative of the United States requested clarification on the supplementary budget for 1984, and the steps envisaged to reduce the budget deficit in 1985. The representative of Portugal responded that the 1984 supplementary budget, under discussion in Parliament, was not expected to lead to a substantial increase in public expenditure. The 1985 budget had yet to be approved by the Council of Ministers. Responding to queries on the prospects for reducing inflation, the representative of Portugal stated that certain measures to contain the budget deficit, such as the freeing of some administered prices, had led to price increases in the short term; by the end of the year, the rate of inflation was expected to be reduced by 5-6 percentage points. In response to a question by the representative of the European Community on exchange rate policy, the representative of Portugal stated that his authorities maintained a flexible crawling peg policy, presently involving a 1 percent effective depreciation per month on average. The authorities continuously reviewed trends in domestic and foreign inflation rates, and Portugal's foreign exchange reserves position, in implementing the exchange rate policy. Responding to a query by the representative of the European Community on recent developments in the competitiveness of Portuguese industry, the representative of Portugal stated that, although data for 1984 were not yet available, exports remained generally competitive, owing to the flexible exchange rate policy and moderate wage settlements. In response to a question by the United States representative on the prospects for restructuring the public enterprise sector with a view to reducing government subsidies, the representative of Portugal confirmed that the process of adapting public monopolies was well under way, with monopolies in the cereals, sugar, and oilseeds sectors reduced or eliminated.

The discussion then turned to some specific aspects of Portugal's restrictive system. In response to questions by the United States representative, the representative for Portugal stated that, while the 10 percent import surcharge would be abolished from January 1, 1986, there were no plans to reduce the surcharge in a phased manner prior to that date. He also reiterated that the import licensing system was not used for restrictive purposes, but as a means for registration of goods for statistical purposes. The representative of the Philippines requested the Portuguese delegation to clarify their intention, as implied in the Fund statement, to maintain a nonrestrictive import licensing system applied to all but "selected products." The representative of Portugal responded that the "selected products" referred to the negative list notified to the GATT in the context of Portugal's GATT accession, and thus constituted "residual restrictions" in GATT terminology. The scope of this negative list had been considerably reduced since the initial notification in 1968.

In reply to a question by the representative of Canada, the Portuguese representative stated that import licenses on industrial products would be abolished three years after Portugal's accession to the European Community, while the question of licensing for agricultural goods was still under discussion with the Community.

At the conclusion of its deliberations, the Committee adopted the following conclusions:

> The Committee noted the improvement that had taken place in Portugal's balance of payments in 1983, as well as the prospects for further improvement in 1984/85 as a result of the policy measures taken in 1983 and 1984. The Committee welcomed the actions taken by Portugal in 1984 to reduce the import surcharge and simplify import licensing procedures, in line with its previous recommendations.
>
> The Committee noted with satisfaction the plan of the Portuguese authorities to replace the present 60 percent import surcharge by a value-added tax system to be introduced by mid-1985. In welcoming Portugal's intention to phase out the 10 percent import surcharge and to eliminate quantitative restrictions on most products by January 1, 1986, coincident with Portugal's accession to the European Communities, the Committee looked forward to these ends being achieved consistently with the expected improvement in Portugal's balance of payments situation.

3. Consultations under simplified procedures 1/

On the basis of the documentation before it, the Committee concluded, without discussion, that full consultations with Bangladesh were not necessary, and decided to recommend to the GATT Council that Bangladesh be deemed to have fulfilled its obligations under Article XVIII:12(b) for 1984.

With respect to the Philippines, the Committee noted that, since the last full consultation with the Philippines in 1980, the balance of payments situation had deteriorated and a number of modifications in the import regime had been introduced. Accordingly, the Committee decided to hold full consultations with the Philippines, probably in 1985, with the exact dates to be decided subsequently.

1/ In addition to the Fund documentation, the Committee had before it documents prepared by the Bangladesh and the Philippine authorities (BOP/247 (10/15/84) and BOP/248 (10/12/84), respectively), and by the GATT secretariat (BOP/W/85 (10/11/84) and Corr. 1 (10/22/84), and BOP/W/84 (10/12/84) and Add. 1 (10/22/84). Other relevant GATT documents were: Bangladesh, L/5622 (3/21/84); the Philippines, L/5691 (10/8/84) and L/5232/Rev. 1 (4/30/84) Corr. 1, and Corr. 2.

4. Other matters

Under other business, the Committee heard statements from the representatives of Argentina, Colombia, Israel, and Hungary, concerning recent developments in their restrictive systems. The Committee also noted a statement by the representative of Brazil on the current status of discussions with trading partners initiated by Brazil in late 1983 with a view to seeking their agreement on measures to improve Brazil's access to their markets.

a. Argentina

The Chairman referred to recent notifications concerning import prohibitions introduced by Argentina to counter serious balance of payments difficulties. 1/ The representative of Argentina informed the Committee that his authorities had not yet determined whether they wished to invoke GATT Article XVIII to justify this measure, but were expected to do so soon. The Committee agreed with the Chairman that, in the circumstances, it would be premature to attempt to schedule balance of payments consultations with Argentina in the Committee.

b. Colombia

The Chairman, referring to recent notifications by Colombia about import restrictions for balance of payments reasons, requested Committee members' views regarding the scheduling of consultations with Colombia during the course of 1985. 2/ At the suggestion of the representatives of the European Community and the United States, the Committee agreed to schedule such consultations, with the dates to be decided subsequently.

c. Israel

The representative of Israel, referring to the relevant documentation, said that Israel had recently been obliged to temporarily prohibit the importation of certain items, and to extend the application of the import deposit scheme for six months for balance of payments reasons. 3/ At his request, and given the temporary nature of the measures, the Committee agreed to review the question of the timing of the 1985 Israel consultations early next year.

d. Hungary

The representative of Hungary drew the Committee's attention to her authorities' notification of the lifting of reference limits on imports. She also informed the Committee that the remaining Hungarian restrictions for balance of payments purposes--i.e., import quotas in six product categories--would be lifted in January 1985. In the circumstances, the Committee agreed to postpone the decision on whether Article XII consultations with Hungary would be required in the course of 1985.

1/ GATT documents L/5643 and L/5687 and Corr. 1.
2/ GATT documents L/5542 and Adds. 1-3.
3/ GATT documents L/5669, L/5697 and Add. 1.

e. Brazil

The representative of Brazil made a statement on Brazil's initiative to obtain autonomous actions by its main trading partners, launched in the Committee during the consultations with Brazil in December 1983. 1/ Subsequently, Brazil had made submissions, listing specific suggestions for action, to the governments of Australia, Austria, Canada, the European Community, Japan, Sweden, Switzerland, and the United States. The representative of Brazil stated that, in this process, Brazil's intention had been to strictly observe the relevant provisions of the GATT. Although the concept that balance of payments adjustment must be based on export expansion and not import contraction had been broadly recognized, there had been no positive reaction to the Brazilian initiative to date. In some cases, trading partners adopted a negative attitude to Brazil's request. In some cases, barriers to Brazilian products had even been strengthened. The representative of Brazil expressed his authorities' disappointment at the lack of results. He added that they would take these facts into account in examining any future request for GATT balance of payments consultations with Brazil.

The Committee took note of this statement.

1/ SM/83/254 (12/20/83).

GATT--Committee on Balance of Payments Restrictions

Consultation with Korea

Statement by the Representative of Korea

October 1984

On behalf of the Korean delegation, I would like to express my appreciation to the GATT secretariat for its work in the preparation for this consultation.

I would also like to take this opportunity to review recent economic developments, focusing on the external sector and the major policy adjustments that the Korean government has been vigorously pursuing since the last consultation in 1979. I shall then elaborate on the present and future direction of the liberalization policies covering tariffs, trade, investment, foreign exchange, and the banking system. I will conclude with an assessment of Korea's medium-term prospects in light of uncertainties about the world trade and financial environment and in the context of the role of the GATT in strengthening international cooperation.

Under the weight of the second oil shock and subsequent worldwide recession and historically high international interest rates, compounded by unfavorable domestic development, the Korean economy suffered a serious setback in 1980, with output declining, inflation soaring, and the balance of payments deteriorating. In response to these developments, the Government adopted strong adjustment policies consisting of strict fiscal discipline, monetary restraint, flexible management of the exchange rate, greater reliance on the market mechanism, and liberalization policies relating to trade, investment, and financial sector reform. The growth momentum was regained in 1982, inflation was substantially reduced, and the current account deficit narrowed. Swiftly responding to the debt crisis in mid-1982, the Government stepped up its adjustment efforts. By 1983, rapid growth reminiscent of the 1970s was achieved, inflation almost eliminated, and the current account deficit further reduced.

The external debt position was also improved, with a substantial slowing of the growth of debt and a lengthening of its maturity. In order to consolidate these gains, the Government continued to implement its adjustment program in 1984. Growth and inflation this year have been broadly in line with program targets, with real GNP growing at over 8 percent in the first half and inflation being held to 3 percent for the first three quarters. The current account deficit has been somewhat larger than anticipated, partly reflecting higher international interest rates. The prospects for 1984 are that growth will be about 8 percent, inflation below 3 percent, and the current account deficit limited to under 2 percent of GNP. Over the medium term, growth averaging 7.5 percent per annum is targeted, inflation is expected to be low and the current account gap eliminated.

Korea's balance of payments position steadily improved during 1980-83, as domestic adjustment policies were complemented by favorable external developments. The Government expects to limit the 1984 current account deficit to about US$1.4-1.5 billion, and plans to close the gap by 1986 and move to a moderate surplus averaging 1 percent of GNP in subsequent years.

Since 1980, in line with an open-door economic policy designed to preserve the external competitiveness of Korean producers and improve domestic resource allocation, the Government has undertaken a series of liberalization measures covering imports, foreign investments, tariffs, foreign exchange, and trade procedures. In addition, financial sector reform has been an integral part of the liberalization move.

The import liberalization ratio has risen from 67.6 percent in 1979 to 84.8 percent in 1984. By 1986, this ratio is expected to be near the level prevailing in the advanced industrial countries, and, by 1988, virtually all restrictive measures on manufactured goods are scheduled to be removed. Moreover, since 1981, the Government has consistently made an effort to simplify trade procedures by abolishing the systems for end-user recognition, export-import link, and advance import deposits.

In 1983, the tariff system was revised. As a result, the simple average tariff rate for manufactured goods was lowered from 22.6 percent in 1983 to 20.6 percent in 1984, and is scheduled to be lowered further to 16.9 percent by 1988. Also in that year, the foreign exchange control system was revised by broadening the foreign currency lending system, extending the maturity on swap transactions, and simplifying procedures for overseas investments.

The adoption of a negative list system early this year for foreign direct investment has meant a drastic simplification of administrative procedures as investment projects not included in the list are automatically approved. In addition, for certain designated investment, up to 100 percent foreign ownership is permitted.

During 1980-84, the Government has taken several measures to liberalize the financial sector. In 1982, direct credit controls for each bank were replaced by indirect means through rediscounts, reserve requirements and open market operations; guidelines and interest rates for preferential lending were also abolished and the central bank's rediscount rates unified. In 1983, the Government completed its divestiture of all nationwide commercial banks, granted them greater managerial autonomy, and in 1984 authorized them to undertake new activities to improve profitability and competitiveness. Restrictions on local branches of foreign banks were eased in 1984, with equal treatment vis-a-vis Korean banks to be fully implemented by 1986. It is the intention of the Government to liberalize interest rates over the medium term; toward this end, long-term deposit rates were raised and a wider band for lending rates was permitted in early 1984.

In the future, the pace and extent of liberalization policies will be determined on a pragmatic basis to meet the development of the external and financial sectors and the challenges imposed by the integration of Korea with the world economy.

The liberalization policies that I just described are essential to Korea's export-led growth strategy. The rapid growth of Korea's trade over the years has significantly benefited Korea and its trading partners. But, Mr. Chairman, great uncertainties in years ahead could determine how well Korea succeeds in reaching its growth potential. Intensified protectionism, high levels of international interest rates, and the fragile and uneven world economic recovery cast a shadow over Korea's prospects for realizing its growth and external objectives. Korea's trade liberalization policies have been designed to promote trade in accordance with GATT free trade principles and to discourage protectionist measures against Korea's exports. The role of GATT can hardly be overemphasized. Korea strongly supports, and will work closely with GATT in strengthening international cooperation to keep an open world trading environment. There is no other choice, for continued access to export markets is so crucial to the developing countries like Korea in their efforts to achieve sustainable balance of payment positions and at the same time attain growth targets.

GATT--Committee on Balance of Payments Restrictions

Consultation with Korea

Statement by the Representative
of the International Monetary Fund

October 1984

After two decades of rapid growth, the Korean economy encountered serious difficulties in the early 1980s. The adverse effects of structural imbalances and excess demand pressures were exacerbated in 1980 by several exogenous shocks, including higher international interest rates and the second oil price increase, and culminated in an acute deterioration in economic conditions. Output declined for the first time in Korea's recent history, inflation soared to 35 percent, and the current account deficit widened to 9 percent of GNP. In response to these developments, the Government implemented an adjustment program which was supported by two one-year stand-by arrangements from the Fund (March 1980-February 1982). By 1982, substantial adjustment had taken place: the economy grew by about 5 percent, inflation slowed to about 5 percent, and the current account deficit narrowed to $2.6 billion, or 4 percent of GNP.

In late 1982, the repercussions of the international debt crisis placed new demands on economic management in Korea. The authorities sought to limit Korea's vulnerability to shifts in market sentiment by reducing reliance on foreign loans--especially short-term borrowing, which had accounted for 40 percent of total borrowing during 1981-82--while placing the economy on a noninflationary growth path. The policies adopted in support of these objectives formed the basis for a stand-by arrangement from the Fund (SDR 576 million) for the period July 1983 through March 1985.

Economic performance in 1983 was outstanding: output growth nearly doubled to over 9 percent, inflation fell to a historically low level of 2 percent, and the current account deficit was halved to about 2 percent of GNP. Increases in private consumption, exports, and domestic investment accounted, in almost equal proportions, for the rise in aggregate demand. The stimulus provided by domestic demand, which was the main expansionary force in 1982 and early 1983, gradually diminished as a result of tight financial policies, while foreign demand increased. Appropriate demand management, together with low imported inflation, plentiful food supplies, and moderate wage increases, contributed to the reduction in domestic inflation.

Financial policies were tightened considerably during 1983. The public sector deficit declined from 4.3 percent of GNP in 1982 to 1.6 percent. While cyclical factors also contributed to the improvement in the fiscal position, the major portion of fiscal adjustment was associated with discretionary measures. Higher indirect taxes were supplemented by a newly imposed 5 percent tariff on imported oil. Central government expenditure growth was slowed, while the deficit of the Grain Management Fund was reduced by freezing purchase prices for grains. Monetary expansion, which had hovered around 27 percent throughout the previous three years, was reduced to 15 percent in 1983, while the rate of increase in domestic credit declined from about 34 percent to 18 percent in 1983.

The policies pursued by the authorities led to a decline in the current account deficit from $2.6 billion in 1982 to $1.6 billion in 1983. The volume of merchandise exports rose by 15 percent in 1983, led by a rapid growth in the exports of ships, electronic products, and footwear. Exports were buoyed by the recovery in industrial countries and a 7 percent depreciation of the currency in real effective terms. Import growth was also very high (13 percent in volume terms), reflecting the rapid expansion of economic activity, particularly exports. The trade balance improved by $1.0 billion in 1983, recording a deficit of $1.6 billion. Service receipts from overseas construction fell sharply, owing to a retrenchment of investment by Middle Eastern countries. However, this loss was offset by increases in other receipts and a large reduction in services payments (particularly interest payments). These developments, combined with a small net capital inflow, resulted in an overall deficit of $1.3 billion. Outstanding external debt rose to $40.2 billion at the end of 1983. Debt service payments, including interest on short-term debt, declined from 23 percent of exports of goods and services in 1982 to 22 percent in 1983. During the year, the authorities improved the maturity structure of Korea's external indebtedness.

Korea's external trade environment has been characterized by protectionism abroad and trade liberalization at home. Intensification of restrictive measures against Korean exports continued in 1983. According to official information, as of December 1983, industrial countries were applying protectionist measures against 165 export items (based on the four-digit classification of the Customs Cooperation Councils Nomenclature), up from 152 items at the end of 1982. These items accounted for 42 percent of exports in 1983, up from 36 percent in 1982. Korean exports to developing countries have also been subjected to protectionist measures, particularly counterpurchase agreements.

As regards Korea's import policy, the trend has been toward liberalization. During 1981-83, 838 items were transferred from the list of restricted imports to the list of automatically approved items, leaving only 20 percent of the items on the restricted list, compared to 31 percent in 1980. Emergency tariffs, which prevent, on a temporary basis, excessive imports of goods that have been liberalized, were imposed on 12 additional items in mid-1983, raising the total of affected items to 104--less than 15 percent of the items liberalized during 1981-83. At the end of 1983, emergency tariffs were imposed on 11 new items, while tariffs on 77 items were eliminated.

Turning to developments in the current year, economic performance has remained strong during the first half of 1984. The economic boom of last year has continued, as output has increased by about 9 percent. Exports and domestic demand, especially private consumption, have contributed about equally to the expansion in aggregate demand. Investment in plant and equipment has picked up, more than offsetting a decline in investment in residential construction and infrastructure investment. Domestic inflation has remained about 2 percent. Financial policies have been tightened further in 1984. The public sector recorded a surplus of 0.5 percent of GNP in the first half of the year, compared to a deficit of 1.2 percent in the same period in 1983. Revenues have been rising in line with the growth in nominal GNP, while expenditures growth has been held to about half that rate (5 percent). Monetary policy has also been restrained. Credit expansion slowed to 15 percent in the 12-month period ending July 1984.

In the first seven months of the year, exports rose by 16 percent (annual rate) as foreign demand continued to be robust. Textiles, machinery, and electronics led the export expansion. Despite the strong export performance, the balance of payments has come under some pressure as imports have also grown rapidly (14 percent), owing to a surge in imports of raw materials and capital goods. As a result, the trade deficit was $1.2 billion, or unchanged from the same period in 1983. The current account deficit also remained unchanged, at $1.3 billion. Smaller net capital inflows, however, resulted in an overall deficit of $1.4 billion in the first seven months of the year, compared to $0.9 billion during the same period in 1983.

Notwithstanding Korea's somewhat more difficult external situation, the authorities remain committed to liberalizing Korea's exchange and trade system. Early in 1984, the Government made public its intention to follow a five-year plan of import liberalization. Under this plan, the import liberalization ratio (i.e., the ratio of items on the automatically approved list to all import items) would be raised to 95 percent by 1988. The Government also announced the list of items currently scheduled for liberalization in 1985 and 1986. The advance announcement of the liberalized items is designed to provide domestic manufacturers with adequate time to adapt to greater competition from imports. To further smooth the adjustment process, tariffs on certain liberalized items have been raised temporarily; the authorities have announced that these tariffs will be reduced over a period of 3-5 years.

The Government undertook a comprehensive tariff reform by amending the Tariff Act (effective January 1, 1984). The amendment aims at eliminating excess protection, reducing the dispersion of tariff rates, and lowering tariffs on raw materials. The authorities have also announced that they will reduce nontariff barriers by ensuring that enforcement of regulations is focused on their original purpose (e.g., protection of public health, safety, and national security).

By adopting an export-led growth strategy, Korea has been successful in utilizing its comparative advantage and circumventing the constraint imposed by the size of its domestic market. The authorities are making serious efforts to elevate living standards in Korea, which are still relatively low. The Fund believes it would be unfortunate if the attainment of Korea's growth and external objectives were to be obstructed by the imposition of trade barriers in its export markets. The Fund welcomes Korea's progress toward relaxation of restrictions and hopes that, with the continued pursuit of appropriate economic policies and the cooperation of its trading partners, the liberalization process can be further accelerated.

GATT--Committee on Balance of Payments Restrictions

Consultation with Portugal

Statement by the Representative
of the International Monetary Fund

October 1984

Portugal's current account balance deteriorated from a situation of near equilibrium in 1979 to deficits equivalent to 11.5 percent of GDP in 1981 and 13.4 percent of GDP in 1982 as a result of adverse external developments and of an accommodating stance of financial policies. In the same period, the rate of inflation remained considerably above the OECD average. During the first few months of 1983, the unsatisfactory economic situation, coupled with prolonged political uncertainties, contributed to significant financing difficulties in the international capital markets, resulting in sizable losses of official reserves.

The new government that took office in June 1983 quickly embarked on a stabilization program supported by a new stand-by arrangement with the Fund. The main objective of the program was the reduction of the current account deficit of the balance of payments to the equivalent of 9 percent of GDP in 1983 and 6 percent of GDP in 1984. The improvement in the external position targeted by the Portuguese authorities was based on a comprehensive policy effort designed to reduce domestic demand and promote foreign exchange earnings. The policy strategy in support of the external adjustment objective included: (a) a 12 percent devaluation of the escudo in June 1983, followed by a continuation of the policy of a "crawling peg" depreciation against a basket of currencies; (b) increases in August 1983 of 2 percentage points in interest rates on time deposits and 2 1/2 percentage points in nominal bank lending ratio; (c) a package of tax measures equivalent to about 1 percent of GDP, sharp increases in administered prices of essential goods and of public services, efforts to contain public consumption and cuts in the public investment program; (d) a monitoring and reduction in the deficit of the public sector enterprises; and (e) a marked deceleration in the growth of total financing to the economy.

Performance under the program, especially in the external sector, was generally satisfactory in 1983. The current account deficit was contained below US$1.7 billion, namely, 8 percent of GDP, or about US$300 million, less than the program target. Total external debt remained well below the program ceiling, and its short-term component in particular recorded a sizable (US$500 million) decline, leading to a significant improvement in the maturity structure of the debt. On the other hand, despite a 7 percent decline in real domestic demand, inflation accelerated to 34 percent by the end of 1983, largely as a result of adjustments in administered prices and a sizable devaluation of the escudo. Moreover, owing to a strong export performance, real GDP showed no change. The combined borrowing requirements of the general government and the public enterprises declined significantly from 22.2 percent of GDP in 1982 to 15.2 percent of GDP in 1983.

Preliminary indications through the first half of 1984 point to a continuing recession in domestic demand, which, in conjunction with a continued rapid growth of exports, is very likely to contribute to an improvement in the balance of payments beyond the program's target. Results of the first quarter indicate that the current account balance recorded a deficit that was 60 percent lower than the corresponding period of 1983, and preliminary figures on merchandise trade through June substantiate the view that the 1984 target for the current account deficit (6 percent of GDP) will in all likelihood be undershot. Moreover, a moderate decline in the deficit of the enlarged public sector is expected in 1984. However, the rate of inflation shows little sign of abating, and is likely to exceed the year-end target of 24 percent.

Faced with the sharp deterioration in the balance of payments in 1981-82, Portugal at the beginning of 1983 raised the 10 percent import surcharge initially introduced in 1978 to 30 percent, pending the introduction of more fundamental adjustment policies. There was also some indication of a tightening of the administration of import licenses during this period of deterioration in the balance of payments. Following the substantial improvement in its external position in both 1983 and 1984, Portugal rolled back the import surcharge from the 30 percent level to 10 percent in March 1984. The authorities have indicated their intention to liberalize the administration of the import licensing system by making the granting of licenses virtually automatic except for selected products. The Fund hopes that the authorities will proceed speedily in the implementation of this intention, and will reduce further reliance on trade restrictions for balance of payments purposes as the country introduces fundamental structural changes to complement its recent adjustment policies.