SM/83/6

January 5, 1983

To : Members of the Executive Board

From : The Secretary

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

Attached for the information of the Executive Directors is a report by the Fund Representative on the meetings of the GATT Committee on Balance of Payments Restrictions, held in Geneva on November 30 and December 3, 1982.

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

Meetings of the GATT Committee
on Balance of Payments Restrictions

Report by the Fund Representative

January 4, 1982

The GATT Committee on Balance of Payments Restrictions met in Geneva on November 30 and December 3, 1982, under the chairmanship of Mr. J.N. Feij (the Netherlands). 1/ The Committee held consultations with Bangladesh, Ghana, Israel, and the Philippines. Full consultations were held with Israel, and the consultations with the remaining countries were held under the procedures for consultations under Article XVIII:12(b) of the General Agreement. In preparation for the consultations, the Fund had transmitted for use by the CONTRACTING PARTIES its latest Recent Economic Developments reports on the four consulting countries, as well as a Supplementary Background Material paper on Israel. 2/ In addition, pursuant to existing arrangements for Fund-GATT cooperation, a statement of the Fund's findings on Israel had been prepared for the CONTRACTING PARTIES and approved by the Executive Board. 3/ The Fund was represented by Mr. S.J. Anjaria.

1. Israel

In addition to the Fund documentation, the Committee had before it documents prepared by the Israeli authorities 4/ and by the GATT secretariat. 5/

In his opening statement, the representative of Israel outlined the main developments in the economy and the balance of payments of Israel since the last GATT consultation with Israel in May 1980. In the period since then, the hoped for improvement in the balance of payments had not been realized. On the goods and services account, although the average growth rate of exports in recent years had been higher than that of imports, the current account deficit in terms of U.S. dollars was expected to widen to US$4.5 billion in 1982 (compared

1/ Members of the Committee are: Australia, Brazil, Canada, Chile, the European Communities and member states, Finland, Ghana, Hungary, India, Japan, Malaysia, the Philippines, Romania, Sweden, the United States, and Zaire.

2/ Bangladesh: SM/82/50 (3/12/82); Ghana: SM/82/57 (4/2/82); Israel: SM//81/97 (5/1/81) and Cor. 1 (5/5/82); and SM/82/207, Rev. 1 (11/15/82); and the Philippines: SM/82/66 (4/9/82).

3/ EBD/82/258, Sup. 2 (11/23/82)

4/ BOP/230 (11/19/82)

5/ BOP/W/65 (11/19/82)

to US$3.9 billion in 1980 and US$4.4 billion in 1981). In the first ten months of 1982, there had been a sharp decline in merchandise exports, and for the full year they were expected to be lower in current U.S. dollars than in 1981. A wide range of sectors, including polished diamonds, textiles and apparel, chemicals, plastics, rubber products, and citrus fruits had been affected by the slowdown. The Israeli representative attributed the recent export performance to factors such as the slackening of demand for Israeli exports in the United States and Europe; a decline in export prices owing to tougher competition from other suppliers; changes in Israel's competitive position vis-a-vis Europe owing to the depreciation of key European currencies against the U.S. dollar; and high rates of interest abroad that particularly affected exports of polished diamonds for investment purposes.

The representative of Israel stated that the wider current account deficits had been financed by recourse to foreign borrowing. Since the last GATT consultation with Israel, Israel's external debt had increased by one fourth, and debt servicing now absorbed about one third of budgetary expenditure and one half of export receipts. Despite the unfavorable balance of payments developments, the Israeli authorities remained comitted to the trade liberalization process. An import deposit requirement had been abolished in November 1980. The 3 per cent ad valorem levy imposed on all commercial imports in June 1982 until April 1, 1983, was expected to have a negligible disturbing effect on trade. The two major problems of the Israeli economy in recent years had been inflation and slow growth. In 1982, the authorities had introduced a series of policy measures to curb inflation and improve the balance of payments, including a reduction in government expenditure and in subsidies to consumer goods, a tightening of bank credit, and an increase in the value added tax. For the medium term, the policy aims of the authorities included increasing the rate of economic growth, achievement of faster increases in productivity, encouragement of capital inflows, and increasing the export and investment components in total production.

The Fund representative made a statement of the Fund's finding on Israel. 1/ In accordance with the usual practice, the Chairman invited the Committee to consider the Israeli measures under two broad headings: (1) Israel's balance of payments position and prospects, and alternative measures to restore equilibrium; and (2) the system and effects of the restriction.

Under the first heading, several representatives sought further explanations regarding the balance of payments situation and prospects. The representative of the United States noted that the Israel shekel had appreciated in real effective terms during 1981 and 1982, and requested a clarification of the Israeli authorities' policy with regard to maintaining the competitiveness of manufactured exports. In response, the

1/ See Attachment.

representative of Israel stated that the long-term policy of Israel, as declared and applied, was to keep the depreciation of the shekel in line with the difference in the inflation rate in Israel and the average inflation rate in its major trading partners. In 1981, the shekel had appreciated by about 0.5 per cent in real effective terms, while, from January to September 1982, it had appreciated by some 4 per cent. However, there were indications that this appreciation would be temporary and would be evened out as the reinforced fiscal and monetary policies had their impact. In response to another question from the representative of the United States, the representative of Israel stated that the war in Lebanon had had only a marginal impact on export performance.

Under the second heading, the representative of the European Communities asked if the introduction of the 3 per cent import levy had been worthwhile, given its likely minimal impact on the balance of payments. The representative of Israel replied that the measure was one element in a package of policies, and was needed to respond to the public expectation that the authorities were addressing economic problems both by measures of internal restraint and by direct action on the balance of payments.

The representative of the European Communities expressed concern about reports that state enterprises in Israel were instructed to conclude compensation agreements under which at least 25 per cent of their foreign exchange expenditure was to be covered by export earnings. The Israeli representatives replied that the compensation agreements were designed to stimulate the transfer of technology rather than to promote exports.

After a brief further discussion, the Committee on Balance of Payments Restrictions adopted the following conclusions:

-- The Committee welcomed the fact that Israel had terminated in November 1980 the import deposit scheme introduced in November 1979.

-- The Committee noted that, during the course of 1981 and thus far in 1982, the Israeli currency had appreciated in real effective terms while the competitiveness of Israel's exports had declined and the current account deficit widened. The Committee further noted that the Israeli government, to reduce this deficit, had added 28 import categories to the list of quantitative restrictions and introduced a 3 per cent surcharge on all imports.

-- The Committee recognized that the effect of the additional restrictive measures on imports was relatively small. However, it believed that the increase in the restrictiveness of the import regime could have been avoided through a strengthening of the other, more fundamental, adjustment policies which the Israeli authorities are pursuing. For this reason the Committee welcomed the temporary nature of the surcharge and expressed the hope that it would not be extended beyond 1 April 1983, when the present legislation expires, and that the authorities, as a result of further adjustment efforts, would place themselves in a better position to shorten the list of quantitative restrictions.

2. Consultations under simplified procedures

The Committee, on the basis of documents submitted by the consulting countries, the GATT secretariat, 1/ and the Fund, concluded that full consultations with Bangladesh and the Philippines were not desirable, and that these countries should be deemed to have fulfilled their obligations under Article XVIII:12(b) for 1982.

In the case of Ghana, 2/ the Committee noted that a number of changes had been introduced in the import regime in the decade that had elapsed since the last full consultation, and a more detailed review was warranted. Accordingly, the Committee decided that a full consultation should be held with Ghana in 1983.

1/ Bangladesh: BOP/229 and Add. 1, and BOP/W/64; the Philippines: BOP/227 and BOP/W/62.
2/ BOP/228 and BOP/W/63.

GATT--Committee on Balance of Payments Restrictions

Consultation with Israel

Statement by the Representative of
the International Monetary Fund

November 1982

Following a strong expansion in economic activity in 1981, the pace of growth of the Israel economy appears to have eased in recent months. For 1982 as a whole, real growth is likely to be less than the 4 1/2 per cent estinated for the previous year.

A major problem facing the Israel economy continues to be a very high rate of inflation. After some easing in 1981, the rate of increase in prices has recently reaccelerated, reaching an annual rate of about 135 per cent during the first eight months of 1982. Expansionary fiscal policy contributed importantly to the deterioration in price performance; a reduction in government subsidies in 1982 was also a factor. Furthermore, expectations and the indexation mechanisms have helped make the inflationary process a persistent one. Real wages, after increasing considerably in 1981, declined modestly in the first half of 1982 as a result of restraint on public sector wages.

The budgetary situation has been under considerable strain. The attempt over much of 1981 to hold prices down by cuts in indirect taxes and increases in subsidies was abandoned when the related liquidity injections became large. In the face of rising expenditures, new revenue measures were introduced in mid-1982, with a view to containing the fiscal deficit. Monetary policy has been geared principally toward tight control over credit to the private sector. However, the financial injection stemming from the budget has been a dominant influence, with total financial assets rising considerably faster than the rate of inflation over the 12 months to June 1982.

The deficit in the current account of the balance of payments rose to 16 per cent of GDP in 1981, and the situation does not appear to have improved in 1982. Net private and official transfers have leveled off in the past two years, and the widening current account deficit has been covered by substantially higher net short-term capital inflows. At end-August 1982, official reserves amounted to $3.6 billion; while this represents a relatively high proportion of imports, Israel's level of reserves must be seen against the background of some special factors of uncertainty, considerable dependence on short-term capital inflows, and a relatively large amount of external debt.

The Israel authorities have allowed the value of the shekel to be determined on the basis of demand and supply conditions in the market, intervening when necessary to maintain orderly conditions. During the course of 1981 and thus far in 1982, there has been an appreciation of the shekel in real effective terms. The Israel authorities have recently taken measures to relax the regulations with respect to capital inflows from abroad.

The comprehensive reform of the exchange and trade system undertaken in 1977 eliminated most restrictions on payments and transfers for current international transactions and multiple currency practices. A further liberalizing step was taken in November 1980 with the abolition of the import deposit requirement. However, the restrictiveness of the exchange and trade system has been intensified since June 1982.

In particular, an import levy of 3 per cent was introduced in June 1982, with an understanding that it would be terminated by April 1, 1983. During the period mid-June through September 1982, residents of Israel traveling abroad were required to pay a travel surcharge. Also from June, residents of Israel selling domestic and foreign traded securities, as well as foreign residents selling domestic traded securities, have to pay a 2 per cent surcharge on the sale proceeds; this measure is expected to be terminated in March 1983. The Fund hopes that the authorities, by strengthening the adjustment effort, will be better placed to further liberalize the exchange and trade system.