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October 26, 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 October 11 and 13, 1983.

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

Meetings of the GATT Committee
on Balance of Payments Restrictions

Report by the Fund Representative

October 25, 1983

The GATT Committee on Balance of Payments Restrictions met in Geneva on October 11 and 13, 1983, under the chairmanship of Mr. J.N. Feij (the Netherlands), to hold full consultations with Portugal, and consultations under simplified procedures with Egypt, Korea, and Sri Lanka. In preparation for the consultations, the Fund had transmitted its latest Recent Economic Development reports on the four consulting countries for use by the CONTRACTING PARTIES. 1/ In addition, pursuant to existing arrangements for Fund-GATT cooperation, a statement of the Fund's findings on Portugal had been prepared for the CONTRACTING PARTIES and approved by the Executive Board. 2/ The Fund representative was Mr. S.J. Anjaria.

1. Portugal

In addition to the Fund documentation, the Committee had before it documents prepared by the Portuguese authorities 3/ and by the GATT secretariat. 4/

In his opening statement, the representative of Portugal outlined the evolution of Portugal's economic situation. During 1982, the Portuguese economy confronted two main problems--a deterioration in the balance of payments, and a large overall public sector deficit. The Government which took office in June 1983 had embarked on an 18-month emergency stabilization progam that aimed at redressing the external and internal imbalances in the Portuguese economy through a series of corrective measures, including a 12 percent effective devaluation of the escudo on June 22, 1983, substantial reductions of state subsidies, and a significant cutback in the public investment program. A new set of monetary policy measures was announced in August, including increases in interest rates and a revision of the interest rate bonus system. As part of the stabilization effort, the authorities were committed to a restrained wage policy for state enterprises and the civil service, and to a more realistic pricing policy in state

1/ Portugal: SM/83/94 (5/25/83) and Cor. 1 (6/16/83); Egypt: SM/83/116 (6/7/83); Korea: SM/83/141 (6/27/83); and Sri Lanka: SM/83/186 (8/17/83).
2/ EBD/83/253 (10/6/83).
3/ BOP/236 (9/29/83); L/5543 (10/6/83); L/5145/Add.2 (4/28/83).
4/ BOP/W/68 (9/29/83).

enterprises. Measures involving both direct and indirect taxation had also been taken.

The Portuguese representative added that the program being pursued involved austerity and sacrifices by the population; in 1983, real GDP growth was expected to remain below 1 percent, and real wages were expected to drop by 4 percent. The representative of Portugal emphasized his authorities' intention to roll back, at the end of this year, the 30 percent import surcharge to its pre-February 1983 rate of 10 percent, thus underscoring the authorities' commitment to eschew reliance on trade restrictions for balance of payments purposes. The short-term emergency program was expected to be backed up by a 2-3 year financial and economic recovery program designed to introduce changes in the economic and financial system, and a 4-year modernization program which will coordinate actions aimed at bringing about a structural reorganization of the economy. Finally, the representative of Portugal called upon Portugal's trading partners to demonstrate solidarity and reciprocity in support of the economic policies being pursued by Portugal.

The Fund representative made a statement of the Fund's finding on Portugal. 1/ In accordance with the normal practice, the Chairman then invited the Committee to consider Portugal's balance of payments position and prospects, and the system and effects of the restrictions.

Commenting on the documentation and the statement of the representative of Portugal, the representative of the United States welcomed the adoption of policies by Portugal to bring about an improvement in its balance of payments situation. He noted that a major long-term structural problem in Portugal was the expanding public sector. He, along with the representative of Japan, requested the representative of Portugal to provide further information on the fiscal and other measures being taken by Portugal to enable the authorities to reduce reliance on trade restrictions. The representative of the European Communities requested information on the evolution of Portugal's balance of payments in the first half of 1983.

In response, the representative of Portugal explained that further measures of direct and indirect taxation, as well as the reduction of state subsidies and public investment, were expected to lead to a decline in the overall public sector deficit to 9 1/2 percent of GDP in 1983, from 12 1/2 percent in 1982. In order to assist in curbing the growth of monetary and credit aggregates, interest rates had been raised by a total of 6 1/2-7 1/2 percentage points in March and August 1983. In addition, from March 1983 the rate of monthly depreciation of the escudo had been stepped up from 0.75 percent to 1 percent. In the first half of 1983, there had been a decline in the overall current account deficit, to US$1.4 billion, from US$2.2 billion in the first half of 1982; imports had declined from US$4.8 billion to US$4.2 billion, while exports had increased from US$2.0 billion to US$2.3 billion.

1/ See attachment.

In response to a question from the representative of the European Communities, the Fund representative noted that, of the total use of Fund resources of SDR 703 million approved by the Fund on October 7, 1983, SDR 258 million, equivalent to 100 percent of quota, was made available under the compensatory financing facility. Purchases under the compensatory financing facility in excess of 50 percent of quota required that the Fund be satisfied that the member had been cooperating with the Fund in an effort to find appropriate solutions for its balance of payments problems.

Turning to the system and effects of the restrictive import measures, the representative of the United States raised questions concerning the method of selection used to determine the product coverage of the import surcharges, and the possible replacement of the separate surcharge on luxury goods with a value-added tax. The representative of Portugal explained that the 30 percent import surcharge applied to nonessential consumer goods, as well as intermediate and capital goods used for the production of nonessential goods. He added that imports of goods subject to the surcharge had increased more rapidly than other imports; as a result, the share of surchargeable goods in total imports had increased from 20.3 percent in 1980 to 21.1 percent in 1982. The representative of Portugal noted that in the negotiations on accession to the European Communities, a three-year transitional period had been agreed for introduction of the value-added tax; the Portuguese authorities however were considering introducing the VAT at the time of accession.

In response to a question from the representative of the United States on the possible timetable for elimination of the trade restrictions for balance of payments purposes, the representative of Portugal observed that quota system for consumer goods was applied only on an annual basis, and would lapse unless renewed. The quotas on unassembled motor vehicles were expected to be phased out at the end of 1984, when the legislation for restructuring the automobile industry was scheduled to expire. Finally, the Portuguese Government would take the decision to reduce the 30 percent surcharge to 10 percent in a single step before the end of the year; the increase in the surcharge rate in early 1983 had been decided in politically difficult circumstances, pending the implementation of more basic adjustment policies.

The representatives of the European Communities, the Philippines, Japan, and Australia raised several other questions concerning Portugal's import regime. Several of them noted, inter alia, that the import licensing system continued to be restrictive. The representative of the United States referred to reports that an informal quota had been applied which limited established importers to an import value no greater than the level of the previous year. In addition, he noted that the import bulletins for importation of new products were reportedly virtually impossible to obtain, while import bulletins under regular quotas were frequently denied or delayed. The representative of Portugal observed that the import licensing system was not intended to be restrictive, and was not aimed at maintaining the import value at the level of the previous year. The authorities were taking steps to make the system more transparent and to avoid delays by introducing a computerized system, expected to be in full operation at the end of 1983.

At the end of its discussion on Portugal, the Committee adopted the following conclusions:

> The Committee noted that Portugal, faced with a sharp deterioration in its balance of payments in 1982, had increased in February 1983 the 10 percent surcharge to 30 percent and had retained the 60 percent surcharge and the import quotas for certain consumer goods and unassembled vehicles.
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> The Committee regretted that, although the surcharges had been applied since 1976 and the import quotas for consumer goods since 1977, no time schedule for the removal of these measures had as yet been announced in conformity with paragraph 1(c) of the Declaration of Trade Measures for Balance of Payments Purposes and the Committee's recommendations in previous consultations. The Committee therefore again requested the Portuguese authorities to announce a timetable for the removal of the restrictive import measures as soon as possible.
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> The Committee was concerned about indications that the procedures for the issuing of import licences had been used for restrictive purposes. It therefore welcomed the statement of the Portuguese delegation that the import licensing system was not intended to be restrictive, as well as the intention of the Portuguese authorities to make the import licensing procedures more transparent and to avoid delays in the issuing of licenses.
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> The Committee noted with satisfaction that the Portuguese authorities had recently embarked on a comprehensive program to bring about lasting improvement in the external position and that they intended to roll back the 30 percent surcharge to 10 percent by 1 January 1984. The Committee asked Portugal to reduce its reliance on restrictive import measures for balance of payments purposes as soon as the stabilization efforts begin to produce results.

2. Consultations under simplified procedures

On the basis of documentation supplied by the Fund, the consulting countries, and the GATT secretariat, 1/ the Committee concluded that, in the case of Egypt and Sri Lanka, full consultations were not necessary. It decided to recommend to the GATT Council that Egypt and Sri Lanka be deemed to have fulfilled their obligations under Article XVIII:12(b) for 1983.

In the case of Korea, the Committee noted that four years had elapsed since the last full consultation during which a number of changes had been instituted in the Korean import system. The Committee also noted that Korea's balance of payments situation had improved in recent years. For these reasons, the Committee decided that full consultations should be held with Korea on dates to be fixed subsequently.

1/ The documentation prepared by the consulting countries and the GATT secretariat included the following: Egypt, BOP/232 (8/25/83), and BOP/W/71 (9/28/83); Korea, BOP/234 (9/22/83), and BOP/W/70 (9/22/83); and Sri Lanka, BOP/235 (9/22/83), and BOP/W/72 (9/22/83).

ATTACHMENT

GATT--Committee on Balance of Payments Restrictions

Consultation with Portugal

Statement by the Representative of
the International Monetary Fund

October 1983

Following some years of reasonably good performance, there has been a significant deterioration in Portugal's economic performance over the past three years. The restoration of external balance in 1979 encouraged the Portuguese authorities to relax the stance of financial policies in the following year, with the principal objectives of stimulating investment and of securing a recovery in real disposable income. The easier stance of financial policies that ensued, accommodated a rate of growth of real domestic demand in Portugal some 15 percentage points in excess of the OECD average over the period 1980-82. Moreover, the relative inflexibility of interest rate and exchange rate policies during that period reduced incentives for Portuguese residents to hold domestic financial assets, contributing to disguised capital outflows. The adverse impact of these policies on Portugal's external accounts was compounded by external factors. These included a 10 1/2 percent deterioration in the terms of trade between 1979 and 1982, the international recession, high interest rates abroad, and adverse weather conditions, which necessitated a sharp increase in energy and agricultural imports. As a result, the current account of the balance of payments shifted from near equilibrium in 1979 to deficits of US$1,250 million or 5 percent of GDP in 1980, US$2,850 million or 11.5 percent of GDP in 1981, and US$3,240 million or 13.2 percent of GDP in 1982. The growth of real GDP, which had averaged some 5 percent annually during 1976-80, fell to below 2 percent in 1981, but recovered to over 3 percent in 1982. The rate of annual price increase remained considerably above the OECD average, rising to 22 percent in 1982.

The current account deficits over the past three years were financed through substantial external borrowing, mainly by the public sector enterprises. By end-1982, Portugal's external debt had risen to US$13 1/2 billion, of which some US$4 billion was of short-term maturity. The debt service ratio (excluding the rollover of short-term debt) reached 27 1/2 percent in 1982. The deterioration in economic performance in 1982, together with political uncertainties, caused considerable uneasiness in international capital markets in the first half of 1983. Foreign exchange reserves of the Bank of Portugal (excluding gold) declined to less than two weeks' imports, forcing the Bank to request sizable BIS loans secured by gold collateral. During the first half of 1983, Portugal's net foreign assets declined by US$980 million to around US$8 1/2 billion at the end of June 1983, with gold valued at market prices.

Preliminary indications point to a significant improvement in the current account balance during the first half of 1983, with the deficit tentatively estimated at US$1,400 million as compared with US$2,200 million in the first half of 1982. The main factor underlying this improvement was a sharp drop in imports, particularly of oil and agricultural products, associated in part with the difficulties of the public sector enterprises in obtaining external financing. For the whole of 1983, the Fund staff is projecting that the current account deficit will be held at US$2,000 million or 9 percent of GDP, while for 1984 the deficit is projected to decline further to US$1,250 million or around 6 percent of GDP. These projections are based on both an expected recovery in foreign exchange earnings and the containment of import demand, as a consequence of the stabilization program on which the Portuguese authorities have embarked, and in support of which they requested a stand-by arrangement from the Fund in the upper credit tranches.

The improvement in the external position at which the Portuguese authorities are aiming is to be achieved through a comprehensive policy effort designed to reduce domestic demand and to promote foreign exchange earnings. Steps already taken in this direction include a 12 percent effective devaluation of the escudo on June 22, 1983, a substantial cutback in the public investment program, a wide range of sharp increases in administered prices, including those of essential foodstuffs and of oil products, and the raising of interest rates in August by 2-2 1/2 percentage points following increases of 4-5 percentage points last March. The main contribution to the stabilization effort is to come from fiscal restraint with the combined position of the General Government and of the Supply Fund, which subsidizes essential commodities, targeted to move from a deficit equivalent to 12 1/2 percent of GDP in 1982 to a deficit of 9 1/4 percent in 1983, and to 6 percent in 1984. The improvement in the finances of the General Government is to be complemented by a comprehensive effort to contain the borrowing requirement of the public enterprises. At the same time, monetary policy is to be geared toward securing a scaling down in the rate of growth of the monetary and credit aggregates consistent with the targeted improvement in the balance of payments, and a deceleration of inflation. The rate of inflation is targeted to decline from a peak of 29 percent expected by end-1983 as a consequence of the recent sizable administered price adjustments and of the devaluation, to 20 percent by end-1984.

Faced with a sharp deterioration in the balance of payments in the previous two years, Portugal at the beginning of 1983 raised the 10 percent import surcharge initially introduced in 1975 to 30 percent, pending the introduction of more fundamental adjustment policies. There are also indications of some tightening of the administration of import licences over the past year. The import quota system introduced in 1976 for balance of payments reasons, and the 60 percent import surcharge on less essential products, were retained. The Portuguese authorities have recently embarked on a comprehensive program to bring about a lasting improvement in the external position. The Fund welcomes the commitment of the Portuguese authorities to an open trade and payments system, and in particular their undertaking to roll back the import surcharge to 10 percent, effective January 1, 1984. The Fund hopes that Portugal will reduce further its reliance on trade restrictions for balance of payments purposes as the current stabilization efforts begin to produce results.

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Mr. Chairman, as the members of this committee are aware, the Fund on October 7, 1983, approved the use of its resources totalling SDR 703 million by the Government of Portugal. Of the total, SDR 445 million, equivalent to 172.5 percent of quota, will be available over the period through February 1985, under a stand-by arrangement to support the government's economic and financial program whose main elements I have just described. In addition, SDR 258 million, equivalent to 100 percent of quota, is available immediately under the compensatory financing facility.