SM/85/282

October 22, 1985

To: Members of the Executive Board

From: The Secretary

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

There is attached for the information of the Executive Directors a report by the Fund representative on meetings of the GATT Committee on Balance of Payments Restrictions, held in Geneva from October 8 to 11, 1985.

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 21, 1985

1. Introduction

The GATT Committee on Balance of Payments Restrictions met in Geneva during October 8-11, 1985, under the chairmanship of Ambassador P.-L. Girard (Switzerland). It conducted full consultations with Portugal, and consultations under simplified procedures with Sri Lanka and Turkey. The Fund representative was Mr. S.J.Anjaria.

2. Portugal 1/

In his introductory statement, the representative of Portugal recalled that the consultation was taking place against the background of the impending accession of Portugal to the European Community on January 1, 1986, which would have a significant impact on Portugal's trade regime. He emphasized that Portugal's balance of payments situation had improved considerably in 1983 and 1984, mainly as a result of comprehensive adjustment efforts, which included a realistic exchange rate policy. On present trends, the external current account deficit was expected to decline further to about $200 million in 1985, compared to $520 million in 1984. As regards Portugal's import regime, the coverage of the quota system for some consumer goods had been reduced successively in 1984-85; these quotas would be eliminated entirely by the end of 1985. Similarly, the coverage of the 10 percent import surcharge had been reduced recently, and both it and the 60 percent surcharge would be eliminated at the end of the year. In addition, the system of the "bulletins" required for certain imports would be liberalized upon Portugal's accession to the EC. The representative of Portugal stressed that the aims of the financial program introduced by Portugal with the support of the Fund had been broadly met.

1/ For the consultation with Portugal, the Committee had before it the following documents: the latest Recent Economic Developments report by the Fund Staff (SM/85/242, 8/26/85); a GATT Secretariat background paper (GATT documents BOP/W/88, 9/25/85, and Corr. 1, 10/8/85); a basic document supplied by Portugal (GATT document BOP/254, 9/27/85, and Corr. 1); and related GATT documents (L/5145/Add.4, 9/30/85; L/5543/Add.2; 9/30/85, and L/5558/Add.2, 10/8/85).

The representative of the Fund made a statement, which is reproduced in the Attachment. 1/

Members of the Committee on Balance of Payments Restrictions discussed Portugal's balance of payments situation and prospects and the nature of its restrictive measures under Article XII of the GATT.

The representatives of the United States, the European Community, Japan, Sweden, and the Philippines welcomed the recent improvement in Portugal's external sector and its import liberalization. The representative of the United States sought clarification on several points, including the likely impact of Portugal's accession to the European Community on its balance of payments, the prospects for industrial restructuring in Portugal following accession, and Portugal's price performance. The representative of the European Community inquired about the likely impact of recent movements in the U.S. dollar exchange rate on Portugal's external sector. The representative of the Philippines asked about Portugal's plans to reduce dependence on petroleum imports.

The representative of Portugal provided further information relating to the points raised. He noted that only a preliminary assessment could be made at this stage of the impact of accession on the external sector. The effect on the trade balance in manufactured products could be positive, especially after the dismantling of restrictions on Portuguese exports. The impact on the agricultural trade balance was likely to be negative as Portugal switched to higher cost imports from Community partners. However, the transitional period for agriculture would provide an opportunity for Portugal to improve its agricultural sector, for which technical and financial support would be made available from the Community. The inflow of workers' remittances was expected to improve. In addition, Portugal would be better placed to finance its current account deficit, both through the improvement in its credit standing that was expected as a result of accession, and because of the financial facilities available from Community institutions. The representative of Portugal concluded that, on the whole, there was no reason for pessimism regarding Portugal's balance of payments prospects following accession.

On industrial restructuring, the representative of Portugal noted that the treaty of accession provided for a transitional period for phasing in the European Community's common external tariff. The authorities were committed to modernization, and Community funds for such areas as manpower training were already contributing to industrial restructuring.

2/ The statement of the Fund's findings on Portugal had been prepared for the CONTRACTING PARTIES and approved by the Executive Board (EBD/85/252, 9/24/85).

As regards the movements in the exchange rate of the U.S. dollar, the representative of Portugal was hopeful that a lower dollar would ease protectionist pressures and alleviate the burden of debt service payments. He also noted the recent improvement on the inflation front, attributable both to the low level of domestic demand and the absence of a discrete devaluation since mid-1983.

In discussing the nature of Portugal's restrictive measures, Committee members inquired about their present scope and prospects for their liberalization. The representative of Portugal explained that all restrictions for balance of payments purposes would be eliminated on January 1, 1986. The restrictions that would remain, in particular those on imports from Japan, were specifically authorized under the protocol of Portugal's accession to the GATT. The scope of the restricted list applying to Japan had been substantially reduced since Portugal's accession to the GATT, and now covered only 31 "sensitive" products; the list was also taken up in Portugal's treaty of accession to the Community. Apart from the measures specifically provided for in Portugal's protocol of accession to the GATT, all restrictions would be applied on a nondiscriminatory basis. In the case of agriculture, the Community regime would be fully applied at the end of the transitional period. Committee members noted that the GATT CONTRACTING PARTIES would have a chance to examine non-balance of payments related measures in the context of the forthcoming enlargement of the Community, the documents relating to which were to be made available shortly to the GATT.

Following the discussion, the Committee adopted the following conclusions:

> The Committee took note with satisfaction of the favorable development of Portugal's external balance in 1984 and the outlook for 1985 resulting in particular from the program of economic stabilization undertaken by the authorities, strong external demand and good production performance in agriculture in 1984. It was recognized that the two latter elements might not play such an important role in the future as in the past. The domestic costs of adjustment in terms of demand and employment were also recognized. In relation to price inflation, the situation was relatively satisfactory, although some progress remained to be made. The Committee also took note of the generally beneficial effects on Portugal's external financial situation expected to result from Portugal's entry to the European Communities.
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> The Committee welcomed the substantial liberalization and simplification which had taken place in the measures maintained by Portugal for balance of payments purposes, as well as the announcement by Portugal that no such measures would be maintained for balance of payments purposes after 31 December 1985. The Committee noted that other restrictions expected to remain in force after that date were those now maintained under the terms of Portugal's Protocol of Accession to the General Agreement. In the

light of these considerations, the Committee looked forward to the disinvocation of the balance of payments provisions of the General Agreement by Portugal.

3. Sri Lanka 1/ and Turkey 2/

The representative of Sri Lanka made a brief statement outlining the balance of payments situation of Sri Lanka and the import liberalization undertaken in recent years, including the tariff reform of 1984.

The representative of Turkey highlighted the major recent changes in Turkey's import regime and related domestic and external sector developments. The representative of the United States requested clarification on the measures maintained by Turkey for balance of payments and other reasons. In response, the representative of Turkey acknowledged that, while the import deposit and the import authorization were the main restrictions applied for balance of payments reasons, other measures, such as the stamp duty, also had an impact on the balance of payments.

The representative of Hungary expressed his authorities' concern about the possible discriminatory impact of the exclusive right granted to specified public and private companies to import goods from countries whose foreign trade had been nationalized. The representative of Turkey emphasized that no discrimination was involved, and indeed, Turkey's imports from the countries to which this regime applied had expanded very rapidly in recent years.

Following these statements, the Committee concluded that full consultations were not necessary with Sri Lanka and Turkey, and that these countries should be deemed to have fulfilled their obligations under Article XVIII:12(b) of the GATT for 1985.

4. Other matters

The Committee agreed in principle to the following schedule of balance of payments consultations for 1985 and 1986 proposed by the chairman:

1/ For the consultation with Sri Lanka, the Committee had before it the following documents: the latest Recent Economic Developments report by the Fund staff (SM/85/112, 4/25/85); a GATT Secretariat background paper (BOP/W/87, 9/24/85); and a statement submitted by Sri Lanka (BOP/251, 9/20/85).

2/ For the consultation with Turkey, the Committee had before it the following documents: the Fund's Recent Economics Development report (SM/84/215, 9/13/84) and supplementary background material prepared by the Fund staff (SM/85/227, 8/12/85); a GATT Secretariat background paper (BOP/W/89, 9/24/85); and a statement submitted by Turkey (BOP/252, 9/20/85).

December 1985:	Full consultations:	Israel Colombia
	Simplified consultations:	Brazil Egypt Ghana Tunisia
Spring 1986:	Simplified consultations:	Peru Nigeria
Fall 1986:	Full consultations:	Philippines
	Simplified consultations:	Korea India Yugoslavia

In addition, it was agreed that informal consultations would take place shortly to ascertain the feasibility of holding full consultations with Argentina in 1985.

GATT--Committee on Balance of Payments Restrictions

Consultation with Portugal

Statement by the Representative
of the International Monetary Fund

October 1985

The Government of Portugal implemented a stabilization program in 1983 supported by a stand-by arrangement from the Fund, following a serious deterioration in its external accounts which raised the current account deficit of the balance of payments to the equivalent of 13.2 percent of GDP in 1982. The main objective of the program was the reduction of the current account deficit 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 to promote foreign exchange earnings. The thrust of the stabilization effort centered around fiscal restraint, a scaling down in the rate of growth of monetary and credit aggregates, improved competitiveness through a devaluation of the escudo and a continuation of the 1 percent effective average depreciation per month, and wage moderation.

The adjustment effort undertaken by the Portuguese authorities was remarkably successful as regards the external accounts. The current account deficit of the balance of payments declined to around 7 percent of GDP in 1983, and to under 2.5 percent of GDP in 1984. Total nonmonetary external debt increased by US$475 million less than programmed in 1983 and by US$718 million less than programmed in 1984. The improvement in the external accounts reflected a marked shift in Portugal's relative cyclical position, as well as a strengthening of competitiveness. Domestic demand, which had grown by nearly 14 percentage points faster than in Portugal's main trade partners between 1979 and 1982, declined by a cumulative 14 percentage points in the period 1983-84, as against a growth of over 4 percent in partner countries. There was, in terms of relative unit labor costs, a marked improvement in competitiveness in 1983 and 1984. Both the decline in domestic demand and, to a lesser extent, the improvement in competitiveness exceeded program forecasts.

While the strength of the foreign balance moderated the impact of the decline in domestic demand on output, GDP is estimated to have declined by 1.7 percent in 1984, following virtual stagnation in 1983. The impact of the recession on employment remained modest, in reflection partly of existing rigidities in labor market legislation and, more importantly, of the flexibility of real wages which declined markedly during the stabilization period. After accelerating sharply in the latter part of 1983, in reflection of substantial increases in administered prices, especially petroleum products and essential foodstuffs which have a large weight in the index, the rate of price increases decelerated markedly in the course of 1984, ending significantly below the program target of 23 percent by year-end.

The overall stance of financial policies was kept relatively tight throughout the period, with the rate of growth of total (domestic and external) financing decelerating from nearly 29 percent in 1982 to under 20 percent in both 1983 and 1984, which implies a substantial decline in real terms. The rate of growth of total domestic credit remained significantly below the target in 1983 and through most of 1984. The fiscal-monetary policy mix, however, diverged in 1984 from that envisaged in the program, as the public sector borrowing requirements substantially exceeded the target in the second half of the year, and the monetary authorities endeavoured to offset the impact of this development on total domestic credit by reducing the ceilings on bank credit to the productive sector.

Preliminary indications on economic developments so far in 1985 indicate continued progress in the external accounts reflecting the maintenance of a relatively low level of domestic demand and, to this point, an adequate level of competitiveness. The current account deficit in the first quarter was almost 50 percent less than that recorded in the same period of 1984. However, this was aided, in part, by a sharp fall in agricultural imports resulting from a good harvest. While recovery in domestic demand is likely to lead to some acceleration in import demand in the latter part of the year, the current account deficit for the year as a whole is likely to remain under the equivalent of 2.5 percent of GDP, and the overall balance of payments will likely record a surplus allowing some further rebuilding of foreign exchange reserves. Inflation has been on a clearly decelerating trend, aided by the weakening of the U.S. dollar and the moderation of foreign prices, but also by a slowing of the growth of administered prices. The 12-month rate of inflation in consumer prices declined to 17 percent by July 1985. On the other hand, it appears that the decline in real wages has been arrested. This is expected to support a moderate recovery in domestic demand which, in turn, would be consistent with some rise in the current account deficit in the medium term.

The significant turnaround in the external accounts reflects the adoption by the Portuguese authorities of a more consistent framework of macroeconomic policy and their support for a basically open trade and payments system. In this regard, Portugal rolled back its import surcharge from the 30 percent level to 10 percent in March 1984. In addition, the 60 percent surcharge on "nonessential" goods and the 10 percent general import surcharge will be abolished and the former replaced by indirect taxes in the context of overall tax reform and the introduction of a value-added tax upon the accession of Portugal to the European Community in 1986. In the context of the accession agreement, Portugal has undertaken to administer its import licensing system liberally. In light of the progress made so far and the strength of Portugal's external accounts, the Fund hopes that Portugal will soon abolish the remaining trade restrictions for balance of payments purposes and supports the authorities' efforts in this area.