DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

SM/85/343

December 31, 1985

To: Members of the Executive Board

From: The Acting 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 from December 3 through 10, 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

December 27, 1985

The GATT Committee on Balance of Payments Restrictions met in Geneva during December 3-10, 1985, under the chairmanship of Ambassador P.-L. Girard (Switzerland). 1/ It conducted full consultations with Israel and Colombia, and consultations under simplified procedures with Egypt, Brazil, Ghana, and Tunisia. *The Fund representative was Ms. Naheed Kirmani.*

1. Israel 2/

In his introductory statement, the representative of Israel outlined the factors contributing to Israel's serious problems of inflation and balance of payments, the major policy measures taken to rectify them, and the results achieved so far. Strong demand pressures had been created by the historically rapid development of the Israeli economy aimed at absorbing mass immigration, developing industry and infrastructure, and increasing the standard of living, together with the direct and indirect effects of high security expenditures. Rapid increases in prices of oil and other basic imports during the later 1970s had added to pressures, both on the trade balance and on domestic prices. Efforts to subdue inflation through the maintenance of a high exchange rate and subsidization of staple goods had proved unsuccessful. The systematic indexation of wages to the cost of living had made it more difficult to break the inflationary spiral. Israel's external deficit on goods and services had increased to some US$5 billion in 1983; total external debt had grown to US$5,500 per capita, almost the highest level in per capita terms in any country. Debt servicing had increased to some 35 percent of exports in 1984 and, despite an increase in short-term borrowing, reserves had declined by around one third since 1982. These developments had adversely affected confidence and led to capital outflows.

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

2/ For the consultation with Israel, the Committee had before it the following documents: the latest Recent Economic Developments report by the Fund staff (SM/85/129, 5/10/85); a GATT Secretariat background paper (GATT document BOP/W/92, 11/25/85); a basic document supplied by Israel (GATT document BOP/257, 11/18/85); and related GATT documents (L/5697, 10/12/84, and Add. 1, 10/25/84; L/5769, 1/9/85, and Corr. 1, 1/25/85; L/5784, 3/12/85; and L/5855, 8/6/85).

The representative of Israel stated that several policy packages had been undertaken since the last consultation, and a comprehensive policy program had been introduced in July 1985. A gradualist approach, encompassing a variety of measures in several areas with far-reaching but gradual effects, was preferable to drastic measures in a few areas which could undermine socio-political stability. The July 1985 measures comprised budgetary policies aimed at decreased expenditure, increased revenue, tighter monetary policy, and a temporary freeze on prices and wages. Given the small margin of maneuver for reductions in government spending, any cut in expenditure was bound to cause severe hardships in the provision of social services. The expected total increase in tax revenue was about 10 percent in real terms in January-September 1985 over the corresponding period in 1984. The combination of spending cuts and tax increases had succeeded in putting the budget back on the target planned for 1985. Monetary policy maintained interest rates substantially above inflation, and restricted the volume of credit and the overall growth of the money supply. Israel's traditional savings ratio of over 30 percent was re-established, compared to the 22 percent rate registered in 1983. Subsidies on many basic consumer goods, including milk, bread, eggs, and public transport and oil were reduced considerably or abolished, and the share of subsidy payments in the total budget fell from 9 percent in 1981 to 2 1/2 percent in 1985. The automatic linkage of wages to the cost of living was discontinued temporarily. In the course of the year, real wages declined by 26 percent; on an annual average basis, the decline was estimated at 17 percent.

The exchange rate of the shekel was devalued substantially in July 1985, and the current rate of IS 1,500 = US$1 was expected to be sustainable. In the view of the Israeli representative, trade policy measures during the period were less stringent than could have been justified by the size of the economic problems and of the debt burden. The overall import deposit was abolished in July 1985, and the prohibition on imports of luxury items was lifted in February 1985. A degressive special import deposit on luxuries was introduced in February 1985; for reasons of overall policy, the regular monthly reduction of this special deposit was, however, halted in December 1985 at the rate of 18 percent. The 2 percent import levy was maintained.

The representative of Israel said that the initial effects of the measures were reflected in a rapid decline in domestic demand in 1985, including both public and private consumption and investment. The increase in exports was not sufficient to compensate for these declines, leading to low real growth and a considerable rise in unemployment. The civilian deficit in goods and services had fallen by US$720 million in 1984 and was estimated to decline by a further US$1 billion in 1985. Reserves had been stabilized as from June 1985 and capital outflow had been arrested. Inflation was declining and a stabilization target of around 2 percent monthly had been set. Despite its serious and persistent balance of payments difficulties, Israel would continue to consider the removal of trade-restrictive measures in line with progress on economic recovery and improvement in the balance of payments.

The representative of the Fund made a statement, which is reproduced in Attachment I, 1/ after which the Committee discussed Israel's balance of payments situation and prospects, and the nature of its restrictive measures.

The representative of the United States, noting the efforts being made to reduce the budget deficit and that additional measures were to be taken in the future, inquired how far such measures would involve the reduction of subsidies affecting exports. He also asked about prospects for reducing reliance on price controls, and plans for increasing the effectiveness of monetary policy. Noting that the value of the shekel had remained unchanged in terms of the U.S. dollar since July 1985, he inquired how external competitiveness would be maintained, given that inflation rates in Israel, albeit declining, nevertheless remained above those of Israel's trading partners.

The representative of the European Communities (EC) recognized that substantial policy changes had been made to tackle Israel's economic problems. He inquired about the targets for 1986 for inflation, the budget deficit, and the balance of payments. He also wondered whether consideration was being given to delinking the shekel from the U.S. dollar. The representative of Sweden commented that Israel had implemented difficult measures, particularly bearing in mind its special situation, and he wished the Israeli authorities success in their endeavors to tackle economic difficulties.

In response, the representative of Israel stated that export subsidization was being eliminated in accordance with the terms of Israel's accession to the GATT Subsidies Code. Although certain price controls were in force, there was no official supervision of such prices. Administrative controls on prices were expected to be gradually dismantled in 1986. Regarding monetary policy, the Bank of Israel had raised banks' liquidity requirements, and also operated certain administrative controls. Moreover, a law had been adopted under which ceilings had been set on lending by the Bank of Israel to the government.

For 1986, the Israeli representative continued, containment of inflation to within the 2 percent monthly target appeared broadly achievable, and the aim was to reduce the budget deficit further. The trade deficit was also likely to decline, though less rapidly than in 1984-85; exports of goods and services were projected to increase by some 7 1/2 percent in 1986, but the decline in imports registered in 1985 was not expected to continue. Economic activity should be stimulated from 1986 onward, initially through increased investment in fixed assets; real GDP growth should rise gradually from about 2 percent in 1986 to 5 1/2 percent by 1989. Even so, unemployment would remain a cause for concern.

1/ The statement of the Fund's findings on Israel had been prepared for the CONTRACTING PARTIES and approved by the Executive Board (EBD/85/300, 11/27/85).

Regarding exchange rate policy, he noted that the depreciation of the U.S. dollar vis-à-vis other major currencies in recent months had helped Israel's export competitiveness in European markets. While the shekel's present exchange rate was considered appropriate, adaptations would be made if circumstances warranted. The representative of Israel also provided clarifications on the impact of the economic program on government procurement.

In the discussion on the import regime, the representative of the European Communities asked if the suspension of the monthly reductions in the special import deposit implied any change in the proposed February 1986 elimination date, and whether the 2 percent import levy would be continued after March 1986. The representative of Israel replied that the future of both measures was subject to review. In response to queries by the representative of the United States, the representative of Israel said that less than 6 percent of total imports (based on the 1984 import structure) were likely to have been covered by the special import deposit. He also confirmed that both import licensing and import levies had been notified to the Committee as balance of payments measures. The representative of the United States said he shared the hope of the Fund, as expressed in the last sentence of the statement made by the Fund representative, that the Israeli authorities, by further strengthening the adjustment effort, would permit a return to a more liberal exchange and trade system.

After the discussion, the Committee adopted the following conclusions:

> The Committee took note of the improvement in Israel's current account balance during 1984 and 1985 to date. It welcomed the renewed efforts made by the Israeli authorities to re-establish internal and external financial balance and to reduce inflation and recognized the importance of the comprehensive economic program adopted in mid-1985 for achieving these objectives.
>
> The Committee also noted the various import measures adopted by Israel since the previous consultation. It welcomed the elimination of the general 15 percent import deposit and the replacement of import prohibitions on luxury goods by a degressive special import deposit scheme, while observing with some concern that the process of reduction in the rate of this deposit had been interrupted. The Committee noted that the future of this measure, as well as that of the 2 percent import levy in force since 1982, would be subject to review in the light of developments in the balance of payments and the stabilization of the domestic economy. The Committee, noting that a number of import measures were still applied concurrently, encouraged Israel, in line with what had been achieved to date, to pursue its efforts to eliminate remaining import measures taken for balance of payments reasons.

2. Colombia 1/

In her opening statement, the representative of Colombia noted that this consultation was the first since her country had acceded to the GATT. As a developing country, Colombia faced balance of payments difficulties caused by structural problems in its domestic economy and by its heavy dependence on exports of a few primary products. She recalled that the Working Party to examine Colombia's request for accession had been of the view that Colombia's foreign trade regulation, the legal basis of which was Decree-Law 444 of March 1967, was in accordance with the GATT. Import licensing and other measures affecting imports maintained by Colombia were taken pursuant to Article XVIII of the General Agreement.

Since 1981, Colombia had been seriously affected by negative developments in the world economy. Between 1982 and 1984, net international reserves declined to one third of their 1981 level. The trade balance registered large deficits during 1981-83 and the balance on the capital account deteriorated. The rate of economic growth declined from an average of 5 1/2 percent during the 1970s to about 1 percent per annum in 1982-83, and unemployment rose significantly. The domestic recession and external disequilibrium were caused by both external and internal factors. External factors included the severe reduction in trade among Latin American countries in 1983, the sudden interruption of international capital flows in 1982, the worldwide increase in interest rates and hardening of credit terms, protectionist measures affecting products of special interest to Colombia, and the decline in Colombia's terms of trade. The liberal import policy that had been pursued in the second half of the past decade, and exchange rate overvaluation had aggravated Colombia's economic situation.

As from the second half of 1982, the pace of devaluation was accelerated, tariffs were increased, a monthly foreign exchange budget was introduced, and a more restrictive import licensing policy was adopted. These measures resulted in a decline of the trade deficit from 1982 to 1984. However, given the persistence of the trade deficit, the continuing decline of international reserves, and the increase in the fiscal deficit, the adjustment process clearly had to be accelerated. Consequently, in 1984 a new economic adjustment policy was adopted. Colombia's comprehensive adjustment program was monitored by the IMF and the IBRD. Measures adopted under this program included the restructuring

---

1/ For the consultation with Colombia, the Committee had before it the following documents: the latest Recent Economic Developments report by the Fund staff (SM/85/172, 6/19/85); a GATT Secretariat background paper (GATT document BOP/W/90, 11/20/85); a basic document supplied by Colombia (GATT document BOP/256, 11/20/85); and related GATT documents (L/5542, 10/28/83, and Add. 1, 4/17/84, Add. 2, 6/6/84, Add. 3, 6/20/84, Add. 4, 6/19/85, Add. 5, 9/11/85, Add. 6, 11/15/85, and Add. 7, 11/29/85; L/5806, 5/23/85, and Add. 1, 12/2/85).

of public investment, the reduction of the fiscal deficit through containment of expenditure and tax increases, tightening of monetary policy, the establishment of an appropriate exchange rate, investment measures directed toward expanding production and exports of petroleum and coal, promotion of foreign investment, simplification of export procedures, gradual liberalization of the import licensing regime, reduction of tariff differentials, and elimination of barter trade.

The improvement in the balance of payments situation in the first half of 1985 made it possible to reduce substantially the number of products subject to prohibition or prior licensing. The list of freely importable products as of December 1985 covered 1,159 tariff lines (23 percent of the total), as against 23 tariff lines in December 1984; prohibited items now covered 69 tariff lines (1.4 percent of the total) compared with 828 tariff lines in December 1984. Prospects for further import liberalization depended on the availability of foreign exchange which would determine the size of the import budget. In this respect, the representative of Colombia drew attention to the urgent need for improved access to markets of industrial countries for Colombian exports. In this connection, she recalled Colombia's statement at the November 1984 meeting of the GATT Council. 1/ She hoped developed countries would open their markets to developing countries in the new round of trade negotiations. Colombia would provide the Committee with a list of products for which it sought better access in the markets of industrial countries.

The representative of the Fund made a statement, which is reproduced in Attachment II. 2/

Commenting on the statement by the Fund representative, the representative of Colombia, while recognizing the deterioration of the economic situation in Colombia during 1980-83, said that policy measures taken by Colombia had prevented a potentially worse situation, and that, relative to many other Latin American countries, the Colombian situation had deteriorated less. In particular, Colombia had fully met its foreign debt repayment obligations. While external debt had increased in this period, management of the structure and volume of this debt had made the Colombian situation less critical than that of some other countries in the region. She also referred to the recent volcanic eruption, which could have some negative effect on Colombia's balance of payments.

The representative of Colombia provided clarifications on the background paper prepared by the GATT Secretariat with respect to the role of the Foreign Trade Council and the foreign exchange budget. The latter mechanism was not an additional import-restrictive measure, but

---

1/ GATT document C/M/183, p. 70.

2/ The statement of the Fund's findings on Colombia had been prepared for the CONTRACTING PARTIES and approved by the Executive Board (EBD/85/300, 11/27/85).

geared rather to an overall assessment of Colombia's foreign exchange resources in order to establish priorities for their efficient use. Any importer who obtained an import license would be provided the necessary foreign exchange. While import licenses were granted on a case-by-case basis, this was done in accordance with general priorities under criteria which were published and well known to importers. The advance import payment deposit, which had been abolished in November 1983, had been applied as a monetary measure and not as a trade policy instrument.

Following these statements, the Committee discussed Colombia's balance of payments situation and the nature of its trade system.

The representative of the United States expressed satisfaction with Colombia's adjustment policies, and asked for further details on fiscal, monetary, and exchange rate measures, and policies on foreign investment and internal prices for petroleum. The representative of the European Communities posed questions concerning the latest forecasts for Colombia's trade balance in 1985 and 1986, the considerations behind the management of the exchange rate, the internal effects of the current stabilization program, measures taken to diversify exports, external debt policies, and the impact of the current adjustment measures on government procurement.

In reply, the representative of Colombia provided detailed information on the aims of her authorities' fiscal and monetary policies, and the results achieved so far. Fiscal and monetary policies had been tightened, and the program targets for 1985 were being achieved. The public sector deficit had been reduced significantly in 1985, and a further--albeit smaller--reduction in the deficit was likely in 1986. Internal petroleum prices had been adjusted upward. A cautious wage policy was being pursued. No further decline of net international reserves had occurred in 1985, and reserves were expected to increase in 1986. Concerning exchange rate management, a crawling-peg system was followed under which the Colombian peso had been devalued by over 40 percent in 1985 to date, while inflation for the year was expected to be around 22-23 percent. In addition to the movement of the U.S. dollar, other important factors in determining exchange rates included the evolution of trade with other countries, and inflation at home and abroad. Exchange rate policy aimed at increasing the competitiveness of Colombian exports, and important progress toward this target had been made. Regarding external debt, Colombia maintained a careful and selective borrowing policy, under which foreign funds were channeled to priority projects. Export diversification was given high priority, but the fall in the terms of trade and protectionist measures taken by other countries were important constraints. Regarding foreign investment, the Colombian government was bound to observe Decision 24 of the Andean Group; it was recalled that this Decision was in the process of revision by the member states. Insofar as Colombia had been able to take individual measures to attract foreign investment, it had done so. The current adjustment policies had directly affected government procurement, for example, by the postponement of public investment projects.

Present forecasts for 1986 indicated a significant increase in income from exports of coffee, coal, and oil. The successful implementation of the adjustment program had helped boost confidence at home and abroad.

In reply to a question concerning the relationship between the adjustment of the exchange rate and the increases of tariffs, the representative of Colombia stated that initially across-the-board tariff increases had been applied to compensate for the import subsidy element inherent in the overvaluation of the exchange rate. As an appropriate exchange rate was now being achieved, tariffs were being reduced and the tariff structure was being rationalized to reduce dispersion.

In discussing the restrictive system, the representative of the European Community asked for information in a number of areas, including measures to be taken in 1986 to continue the process of trade liberalization, simplification of administrative procedures, export incentives, and barter trade.

The representative of the United States considered that Colombia maintained a rather complex system of trade restrictions and that there was room for simplification. He referred to the simultaneous application of import license requirements, exchange license deposits, and requirements regarding minimum import financing periods and to the fact that license applications were considered on a case-by-case basis. These elements entailed uncertainty for importers. He also asked about the proportion of imports which could now be imported freely.

In reply, the representative of Colombia said the measures taken by her government to diversify and promote exports had to be seen in conjunction with the evolution of the exchange rate. When the exchange rate had reached the desired level, there would be less need for export incentives. With regard to the simplification of administrative procedures, she said that the number of products subject to prior approval for export had been reduced significantly. A recent liberalization measure concerned the reduction of the minimum import financing periods. In value terms, 55 percent of Colombian imports would be admitted freely as of December 1985. This figure covered imports of articles on the free list and imports from countries with which regional trade liberalization agreements were in force. The barter system had been abolished in July 1985. Regarding further trade liberalization measures, the global import budget for 1986, which had recently been established, was substantially larger than the budget for 1985. Further, the process of revising tariffs would continue. She stressed that the economic program pursued by Colombia sought to increase trade, and to rely more on an appropriate exchange rate to regulate imports and exports than on import controls. However, if markets for Colombia's export products were restricted and if the terms of trade continued to fall as in the past year, Colombia's balance of payments problems would inevitably increase. She reiterated the hope that in the new round of trade negotiations, industrial countries would take steps to increase market access for developing countries, particularly for agricultural and tropical products. The Colombian foreign trade regulations did not entail uncertainty for importers. Firstly, importers knew the size of the foreign exchange budget and the criteria and priorities established by the Foreign Trade Council concerning the issuance of import licenses. Secondly, any importer who had obtained an import license would always obtain the necessary foreign exchange for it. For monetary policy reasons, importers were required to make a deposit; however, this did not affect their access to the necessary foreign exchange. She added that the processing of license applications had recently been computerized, with the result that applications could now be processed within two and a half months. The import surcharge introduced in December 1984 would be abolished no later than December 1986.

Following the discussion, the Chairman paid tribute to the Colombian delegation for its comprehensive and frank exposition. The Committee adopted the following conclusions:

> The Committee noted that Colombia's domestic economic situation, as well as its trade and current account balance, had deteriorated sharply in the period 1981-83. This deterioration was due to a number of internal and external factors, including, as regards the former, the budgetary deficit and the level of exchange rate, and as regards the latter, unfavorable world markets for Colombia's principal exports, stagnation of import demand in its regional trading partners and restrictive import measures affecting products of export interest to Colombia in a number of markets.
>
> The Committee, while noting the concurrent application of a number of import restrictions, which might be a source of uncertainty for traders, welcomed the clarifications given by Colombia in this regard, which alleviated some of its concerns regarding the complexity of the system.
>
> The Committee appreciated the efforts being made by Colombia to restore internal and external equilibrium through fiscal, monetary, and exchange rate policies as well as its efforts to stimulate the growth and diversification of exports. It recognized that the success of these policies would depend partly on the evolution of world commodity markets and of the economic and commercial situation in Colombia's trading partners. The Committee welcomed the announcement by Colombia that the process of import liberalization initiated in 1985 would be continued and strengthened.

3. Consultations under simplified procedures with Egypt, Brazil, Ghana, and Tunisia

The representative of the Arab Republic of Egypt 1/ made a brief statement describing recent balance of payments developments and the main features of the foreign exchange and trade regimes. A number of Committee members, noting that since the last full consultation with Egypt, held in 1970, considerable changes had occurred in the Egyptian economy and its exchange and trade regime, suggested that a full consultation with Egypt was desirable.

Following these statements, the Committee concluded that Egypt be deemed to have fulfilled its obligations under Article XVIII:12(b) for 1985. Bearing in mind all relevant considerations including, in particular, the length of time elapsed since the last full consultation, it was the Committee's understanding that the next regular consultation with Egypt would be a full consultation.

The representative of Brazil 2/ made a statement highlighting the turnaround in the balance on external current transactions from a record deficit in 1982 to a small surplus in 1984. This result, which had been achieved despite increasing protectionism abroad, was due to growing trade surpluses produced by compressing domestic demand, a broad program for substitution of imports, and sharp devaluations of the cruzeiro against the dollar; it was also aided by the onset of world economic recovery, especially in 1984. Unlike the past, when the current account deficit determined the need for foreign resources, in recent years the maximum volume of external resources that Brazil could be sure of obtaining in the international market determined the result to be achieved in current transactions. The representative of the European Communities stated that, while he was not requesting a full consultation with Brazil, he did not consider Brazil to be an open market, and hoped that in the new round of trade negotiations Brazil would consider implementing more market-opening measures.

1/ For the consultation with Egypt, the Committee had before it the following documents: the latest Recent Economic Developments report by the Fund staff (SM/85/198, 7/10/85); a GATT Secretariat background paper (GATT document BOP/W/91, 11/26/85); and a statement submitted by the Arab Republic of Egypt (GATT document BOP/255, 11/25/85).

2/ For the consultation with Brazil, the Committee had before it the following documents: the latest Recent Economic Developments report by the Fund staff (SM/85/229, 8/14/85); a GATT Secretariat background paper (GATT document BOP/W/95, 11/26/85); a statement submitted by Brazil (GATT document BOP/260, 11/26/85); and related GATT documents (L/5555, 11/2/83; L/5726, 11/13/84; L/5618 and L/5857).

The representative of Ghana 1/ made a statement highlighting the policies and progress achieved under its economic recovery program with assistance from the IMF and the IBRD. In particular, in recent years the exchange rate had been substantially depreciated, producer prices of cocoa had been sharply raised, internal petroleum prices had been increased, the scope of price controls had been reduced, action had been taken on interest rates, and external arrears were being reduced.

The representative of Tunisia 2/ made a brief statement, noting recent changes in the exchange and trade system. Following these statements, the Committee concluded that full consultations were not necessary with Brazil, Ghana, and Tunisia, and that these countries should be deemed to have fulfilled their obligations under Article XVIII:12(b) for 1985.

4. Other matters

Following conclusion of the formal consultations, the Chairman stated that in his view the consultation process should be strengthened and made more dynamic, especially in the case of consultations under simplified procedures. He invited Committee members to reflect on methods to achieve this, and he himself would make certain proposals in this regard in due course. He suggested that the Committee consider this matter during the next round of consultations in spring 1986. The representative of the United States welcomed the Chairman's statement and said that he looked forward to proposals on strengthening the Committee's deliberations.

The representative of Greece announced that, in view of the strong deterioration in its current account balance of payments position, Greece had imposed prior import deposit requirements in mid-October 1985 for balance of payments purposes. A written notification on the measures would be provided soon to the CONTRACTING PARTIES. The representative of the European Communities said the EC had authorized the Greek measures under the Treaty of Rome and was willing to consult with the Committee on these measures at an appropriate time.

1/ For the consultation with Ghana, the Committee had before it the following documents: the latest Recent Economic Developments report by the Fund staff (SM/85/252, 9/4/85); a GATT Secretariat background paper (GATT document BOP/W/94, 11/22/85); and a statement submitted by Ghana (GATT document BOP/259, 11/25/85).

2/ For the consultation with Tunisia, the Committee had before it the following documents: the latest Recent Economic Developments report by the Fund staff (SM/85/281, 10/24/85); a GATT Secretariat background paper (GATT document BOP/W/93, 11/25/85); a statement submitted by Tunisia (GATT document BOP/258, 11/25/85); and related GATT documents (L/5908, 11/14/85; and L/5566/Add. 1, 11/9/83).

For 1986, the Committee agreed in principle to the following schedule for balance of payments consultations:

Spring 1986:

Full consultations:	Argentina, Greece
Simplified consultations:	Bangladesh, Peru, Yugoslavia

Fall 1986:

Full consultations:	Philippines
Simplified consultations:	India, Korea, Nigeria

The Committee also agreed in principle to hold a full consultation with Israel in spring 1987. The Chairman informed the Committee that *Argentina had become a full member of the Committee, as notified in* GATT document L/3657/Rev. 12, 12/3/85.

The GATT Secretariat informed the Committee that in response to requests for clarifications from five countries on their trade measures maintained for balance of payments reasons, Mauritius had indicated that it had liberalized such restrictions, but clarifications or replies were pending from Cameroon, Guyana, Ivory Coast, and Zimbabwe. The Committee encouraged the Secretariat to pursue its inquiries in the latter four cases.

The representative of the United States suggested that notification methods would be improved and the work of the Committee would be simplified if notifications by contracting parties clearly identified the GATT provisions under which the trade measures were introduced or maintained; trade measures taken for balance of payments reasons should be notified directly to the Committee. Other Committee members, while expressing interest in these proposals, requested time for further reflection, and it was agreed to revert to this matter in the next meeting of the Committee.

GATT -- Committee on Balance of Payments Restrictions

Consultation with Israel

Statement by the Representative
of the International Monetary Fund

December 1985

Economic activity has remained depressed in Israel, with growth averaging slightly above 1 percent per year in 1982-84, compared with 3 percent in 1980-81. Available indicators suggest that this weakness has continued into 1985. Reflecting the weakness in economic activity, the unemployment rate rose to 6 1/2 percent (on a seasonally adjusted basis) in the second quarter of 1985, the highest level in recent years. A shift in policy toward the end of 1983, aimed at compressing domestic demand and improving external competitiveness, resulted in a strengthening of the current account position of the balance of payments in 1984, after steadily rising deficits in earlier years. However, inflation soared to an average monthly rate of 23 percent in September-October 1984, and substantial capital outflows led to a weakening of the overall balance of payments position and a considerable loss in foreign reserves.

In these circumstances, the Israeli authorities reached agreement with the employers' and employees' federations in early November 1984 on a three-month price freeze--or first package deal--which resulted in a marked cutback in the inflation rate around the turn of the year. However, fiscal policy was not tightened over this period, and indeed part of the slowdown in inflation was secured by raising subsidies on basic goods and services. Despite two subsequent package deals, the rate of inflation reaccelerated and reached a monthly average exceeding 12 percent over the five months from February to June 1985.

Fiscal policy in 1985/86 (beginning April 1) is aimed principally at improving the external position and reducing the rate of inflation by cutting the public sector's claims on the resources of the economy and reducing the cash injection from the budget. The financing requirement for the 1985/86 budget (after taking foreign grants into account) was targeted at 9 percent of GNP, compared with 20 percent in 1984/85. Various measures were taken to boost fiscal revenues, while expenditures were to be cut significantly, principally through sharply reduced price subsidies, cuts and rationalization in various welfare programs and other public services, and a significant reduction in the number of public sector employees. Monetary policy--which has continued to be constrained by the large fiscal deficits, the widespread indexation of financial assets, and the high level of domestic debt--has been focused on curbing the growth of credit to the private sector and discouraging the provision of credit outside the banking system. The authorities have continued to maintain a policy of high real interest rates.

The civilian trade deficit in 1984 almost halved to US$1.2 billion (5 1/2 percent of GNP), due to an increase of 12 percent in exports and a decline of 5 percent in imports. Exports benefited from the recovery of foreign demand, an improvement in competitiveness, and the coming on stream of new productive capacity geared to export markets, while imports were reduced by the slack in domestic demand and by intensified exchange and trade restrictions. The improvement in the civilian trade account and enlarged government transfers (principally U.S. aid) helped reduce the current account deficit to 7 percent of GNP, from 9 1/2 percent of GNP in 1983. Nonetheless, because of substantial capital outflows, an overall balance of payments deficit was registered, and gross official reserves fell by US$0.6 billion in 1984 to an end-year level of US$3.1 billion. Available indicators suggest that the decline in the civilian trade deficit continued in the first three quarters of 1985, although at a slower pace, with imports falling marginally further and exports continuing to expand. Official reserves, however, continued to fall, reaching US$2.5 billion by June 1985, before picking up in September to US$2.9 billion (equivalent to a little over two months of imports of goods and services) following disbursement of U.S. emergency aid.

Gross external debt minus the foreign assets of commercial banks is estimated to have increased by 2 1/2 percent in 1984 to US$23.4 billion (equivalent to 104 percent of GNP). The short-term component of debt increased marginally in 1984 to 15 percent of the total; 70 percent of total debt was long-term, mainly at concessional interest rates. Service on debt (net of foreign assets of commercial banks) increased from 22 percent of exports of goods and services in 1983 to 24 percent in 1984.

In July 1985, the Israeli authorities introduced a plan for economic stabilization aimed at securing a substantial cut in the inflation rate while strengthening the external position. The steps included an immediate devaluation of the shekel by 16 percent (in addition to the regular depreciations that had reflected inflation rate differentials relative to the main trading partners), a marked cut in price subsidies, and appreciable increases in controlled prices. Following these adjustments, a price freeze was imposed for three months and was subsequently extended in principle through March 1986. The plan also provides for a reduction in the number of public sector employees, introduction of a property tax, and implementation of a new tax law boosting revenue from companies and the self-employed. The various fiscal measures are designed to reverse the deterioration in the budget in the first quarter of 1985/86 and ensure reduction of the Government's financing requirement to the original target. Monetary policy has also been tightened, mainly by increasing banks' liquidity requirements on unlinked short-term assets. In a step to cut back on the indexation of liquid assets, new deposits in PATAM (i.e., foreign currency-denominated) accounts of less than 12 months' maturity must be lodged in foreign currency, and no longer in shekels. Further, as part of a step toward unifying effective exchange rates (and concurrent with a cut in the import deposit requirement), directed credit for exports would henceforth be denominated entirely in U.S. dollars and would no longer be permitted in shekels. Against a background of rising real wages over 1981-83 well in excess of productivity gains, the plan provided for an immediate marked real wage erosion, followed by partial compensation spread over a number of months. With the introduction of the plan, the rate of inflation--which rose sharply to 27 percent in July in response to these various measures--subsequently declined to 4 percent in August and 3 percent in September; also, there has recently been a significant decline in real wages.

Although in 1977 most restrictions on payments and transfers for current international transactions and multiple currency practices were eliminated, the authorities have recently attempted to check capital outflows and protect reserves by introducing various trade and exchange restrictions. Apart from renewal of the 2 percent import levy, the 1 percent levy on the purchase of foreign exchange by the public and the 15 percent non-interest-bearing import deposit requirement, a series of new measures were taken in 1984 and early in 1985. In July 1984, the provision of foreign exchange for prepayment of imports was suspended, and in October a six-month ban was imposed on the importation of some 50 commodities considered luxury items; this latter was replaced in February 1985 by a 60 percent import deposit requirement to be reduced by 3 percent a month until February 1986. Further measures have included a 15 percent tax on imported services, a temporary increase in the foreign travel tax, a reduced foreign travel allowance, a ban on the voluntary prepayment of foreign obligations, and suspension of the allowance for gifts and support payments abroad (except for students). However, in conjunction with the devaluation of July 1985, and as a step toward unifying effective exchange rates, the import deposit requirement was eliminated except for luxury goods, where it was significantly reduced; furthermore, export subsidies were cut. The exchange rate insurance scheme introduced in July 1981 continues in force; the losses resulting from operation of the scheme--which are fully met from the Government budget--were somewhat lower at US$250 million in 1984.

A free-trade agreement with the United States became effective in September 1985, providing for a gradual phasing out of duties over the next ten years on all trade between the two countries except on a limited category of sensitive goods. It also provides for the elimination by 1991 of financial incentives by Israel for industrial and agricultural exports.

The Fund believes that implementation of a comprehensive stabilization program is essential to deal with the underlying causes of Israel's economic imbalances. While the plan for economic stabilization introduced in July 1985 continues to focus appropriately on strengthening the public finances, the financing requirement of the Government targeted for 1985/86 remains high. The Fund hopes that the authorities, by further strengthening the adjustment effort, will permit a return to a more liberal exchange and trade system.

GATT--Committee on Balance of Payments Restrictions

Consultation with Colombia

Statement by the Representative of the International Monetary Fund

December 1985

After a period of solid economic growth and balance of payments surpluses in the second half of the 1970s, Colombia experienced a substantial deterioration in its overall economic and financial situation in the early 1980s. From 1980 to 1983, real GDP growth decelerated from 4 percent to 1 percent, unemployment rose from 9 percent to over 12 percent, and the overall balance of payments moved from a surplus of US$1.2 billion to a deficit of US$1.8 billion. The rate of inflation averaged 23 percent a year during 1980-83.

The current account of the balance of payments moved from a small surplus in 1980 to a deficit of almost US$3 billion (about 10 percent of GDP) in 1983. Exogenous factors, such as a relatively weak international coffee market and depressed demand in neighboring countries and other markets for Colombia's non-coffee exports, adversely affected export earnings, which declined by about US$1 billion from 1980 to 1983. The negative impact of these factors was compounded by expansionary domestic demand policies that attempted to reverse the recessionary trends in the economy.

As a result of expansionary fiscal policy, the overall public sector deficit increased from 2.6 percent of GDP in 1980 to 7.6 percent of GDP in 1983. Although a reform of the income tax and the state and local taxes was introduced in 1983, the continued growth of expenditure led to a further increase in the public sector deficit in 1983. Public sector outlays reached 27 percent of GDP in 1983, compared with 20 percent in 1980.

Monetary policy also became increasingly expansionary during the 1982-83 period. The Banco de la Republica released funds that had been sterilized in the form of special reserve requirements imposed during the coffee export boom of 1975-77, eased its rediscount facilities, and broadened the role of the special funds it administers with the aim of promoting economic activity. These actions, together with the increased financing needs of the public sector, led to a significant acceleration in the growth of the net domestic assets of the Banco de la Republica. For the financial system as a whole, the expansion of net domestic assets accelerated from 29 percent in 1981 to over 37 percent in 1983.

Economic activity improved in 1984, with real GDP growing by about 3 percent. However, the rate of unemployment increased further to more than 13 percent. Despite further improvement in revenue performance in 1984, the public sector deficit remained unchanged relative to GDP because of the continued growth of outlays. While there was some slowdown in the pace of credit expansion in 1984, policy in this area continued to be expansionary.

To contain the deterioration in the balance of payments, the Colombian authorities resorted to intensified exchange and trade restrictions beginning in 1982. They also accelerated the rate of depreciation of the peso in August 1982 and October 1983. These actions contributed to a decline in 1984 in the current account balance of payments deficit to US$1.9 billion (6.5 percent of GDP). In particular, due in part to a recovery in world trade, exports rose by 16 percent in 1984, after having dropped for three consecutive years, while imports continued the decline that had started in 1983. Nonetheless, a further weakening in private capital flows and a reduction in trade credit lines from foreign commercial banks led to an overall balance of payments deficit of US$1.4 billion in 1984. By end-1984, gross official international reserves had declined to US$1.8 billion, equivalent to four months of imports of goods and nonfactor services.

Colombia's total external debt has risen significantly in recent years, and the debt service ratio more than doubled over the 1980-84 period. As of end-1984 total outstanding debt, including short-term debt, amounted to US$11.5 billion, equivalent to 40 percent of GDP. Debt service payments in 1984 constituted 45 percent of exports of goods and services.

Colombia has maintained a complex exchange and trade system for a number of years, involving, inter alia, exchange restrictions and multiple currency practices, import prohibitions, and prior approval requirements for imports. During 1983 and 1984, the exchange and trade system became more restrictive. In the face of the deteriorating external situation, the authorities intensified exchange restrictions by, inter alia, reducing limits on the sale of foreign exchange for a variety of purposes, including for travel and study abroad. In November 1983, one multiple currency practice was terminated by eliminating an advance import deposit required before clearing customs. However, another multiple currency practice continues to result from a 95 percent exchange license deposit for import payments to be made prior to the issuance of the corresponding exchange license. In 1983-84, the authorities also instituted across-the-board increases in import tariffs, the requirement of a prior import license was extended to virtually all imports, and a large number of imported goods were placed in the prohibited category. Also, special import-export arrangements in the form of barter, clearing, and triangular trade operations were instituted for a small group of products. In addition to customs duties, imports are subject to an ad valorem tax of 5 percent, with certain exceptions; a temporary import surcharge of 8 percent was introduced in December 1984.

To deal with the internal and external imbalances, the Colombian authorities have formulated a comprehensive adjustment program for 1985, and they intend to continue this effort in 1986. In July 1985, the Fund's Executive Board endorsed the authorities' 1985 program and agreed to monitor this program as well as the program to be formulated for 1986. The main objective of the 1985 program is to limit the loss of net official international reserves to US$75 million. This target is based on a reduction in the current account deficit to US$1.4 billion (4.8 percent of GDP), based on a projected increase in exports to US$4 billion together with the projected maintenance of imports at that level. This objective is being achieved through the tightening of monetary policy and through the reduction of the deficit of the nonfinancial public sector to 4.9 percent of GDP in 1985. These policies of restraint are being accompanied by an exchange rate policy that aims to restore the level of external competitiveness that prevailed in the mid-1970s, as well as by steps to liberalize the exchange and trade system. These policies are expected to be consistent with modest growth in output in 1985 and a 12-month rate of inflation slightly above 20 percent by the end of 1985.

Available indicators for 1985 suggest that real GDP is growing by about 2 percent, while inflation has subsided to an annual rate of around 25 percent in recent months, after rising sharply in the first five months of the year due to weather-related damage to food production. The overall balance of payments has been close to equilibrium so far this year as a result of the tight fiscal and monetary policies pursued and the sizable real depreciation of the Colombian peso. According to preliminary customs data through May 1985, exports appear to be rising by 6 percent over their 1984 level (measured in terms of U.S. dollars), while imports appear to be falling by more than 14 percent.

In 1985 the authorities initiated a process of simplification and liberalization of the exchange and trade system. Imports are being transferred from the prohibited and prior approval lists to the free list, and it is expected that by the end of 1985 over 55 percent of the value of imports will be on the free list, compared with about 25 percent as of September 1984. In addition, a rationalization of the tariff structure has been initiated. In June 1985, the barter trade system was eliminated and the minimum financing requirements for imports were reduced from three years to two years for capital goods, and from 18 months to 11 months for intermediate goods. Moreover, administrative measures to reduce impediments to exports have been adopted.

The Fund welcomes the efforts being made by the Colombian authorities to address economic and financial imbalances, and hopes that these adjustment efforts will be continued to allow for a further liberalization of the exchange and trade system.