

GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

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Committee on Balance-of-Payments
Restrictions

REPORT ON THE CONSULTATION WITH PORTUGAL
AND EXAMINATION OF PORTUGUESE IMPORT
SURCHARGES

1. In accordance with its terms of reference the Committee has conducted the 1979 consultation with Portugal, and has examined Portugal's temporary import surcharges introduced on 31 May 1975 and additional surcharges introduced on 6 June 1977. The last consultation with Portugal had taken place in January 1978 (see BOP/R/96).
2. The Committee had before it a basic document supplied by the Portuguese authorities (BOP/195 and Add.1). An additional document describing the Portuguese economic situation (BOP/195/Add.2) and notifications of changes in the import régime (L/4647, L/4568 and Adds. 3, 4 and 5 and L/4709). The International Monetary Fund supplied a background paper dated 22 December 1978. The Committee generally followed the plan for such consultations recommended by the CONTRACTING PARTIES (see BISD, 18th Supplement, pages 52-53). The consultation was held on 30 April 1979. This report summarizes the main points of the discussion.

Consultation with the International Monetary Fund

3. Pursuant to the provisions of Article XV of the General Agreement, the CONTRACTING PARTIES had invited the International Monetary Fund to consult with them in connexion with the consultation with Portugal. Upon the invitation of the Committee, the representative of the Fund made a statement as follows:

"The Portuguese authorities had considerable success in 1978 in reducing the degree of both internal and external disequilibrium. The rate of domestic credit expansion was brought under better control while the demand for escudo money balances stabilized and the rate of inflation declined. The current account deficit of the balance of payments was reduced markedly and part of the proceeds of the external cash borrowing by the Government was used to increase the country's external reserves. At the same time steps were taken to reduce some trade and payments restrictions.

"Real output grew on average by about 3 per cent in 1978, but this compares with about 6 per cent in each of the two previous years and most of this growth occurred early in the year. Available indicators show a weakening of the economic activity during the year which undoubtedly added to unemployment, already at almost 8 per cent in the first half of the year. In part due to administered price increases, the rate of inflation accelerated slightly in the latter part of the year, but on average prices rose by 22 per cent in 1978 compared with an inflation rate of 27 per cent in 1977. The ceiling of 20 per cent on wage increases was observed and real wages declined again after a sharp reduction in 1977. The expansion of domestic credit was brought under firm control. Interest rates were increased by 3.5-4 percentage points in May 1978, and in combination with the moderating rate of inflation, holdings of escudo money balances rose on average by 26 per cent in 1978, compared with 22 per cent in 1977. The deterioration in the external position of the banking system which had characterized earlier years, was arrested. The major policy disappointment in 1978 was the budget outturn. The government deficit rose from almost 8.0 per cent of GDP in 1977 to more than 10 per cent of GDP in 1978.

"For the first time since 1975, the foreign sector was responsible for most of the growth that occurred. As a result of the slowdown in domestic growth and the further depreciation of the escudo, the volume of imports remained roughly unchanged while exports grew by almost 15 per cent in volume terms in 1978. There was no change in the terms of trade. In addition, receipts from tourism and workers' remittances were up sharply and the external current account deficit declined to below US\$1,000 million (5 per cent of GDP) compared with US\$1,500 million in 1977 (9 per cent of GDP). nonmonetary capital movements, including short-term errors and omissions, also turned sharply positive. As a result, the authorities borrowed abroad a net amount of about US\$300 million for balance of payments reasons in 1978, compared with almost US\$1,500 million in 1977.

The improvement in the balance of payments in 1978 resulted from a number of special factors which are not likely to be repeated to the same extent in 1979. On the export side, market shares abroad that were lost in the postrevolutionary period have largely been regained, while capacity constraints are being reached in some export-oriented industries, including tourism. Imports were affected in 1978 by an amelioration of the speculative climate that had led to stockpiling of imported goods in earlier years. The reduction of stocks has, however, once-over effect, and most of the impact on the trade balance has by now occurred. Similarly, the services account, private remittances from

abroad, and net capital inflows, benefited substantially in 1978 from the once-over effects of a reduction in speculation. In the absence of these special factors, and in spite of the very modest growth in economic activity anticipated for 1979, the current account deficit is unlikely to show much improvement as compared with 1978. Given likely autonomous capital inflows and the need for debt service, the balance of payments financing requirement in 1979 will amount to approximately the same magnitude as in 1978, that is about \$300 million.

The improvement in the external situation was achieved during a period when restrictions on trade and payments were being liberalized. In May 1978, in connection with a stand-by arrangement with the Fund, the authorities announced a timetable for the phasing out of the 30 per cent import surcharge which applied mainly to consumer and some intermediate goods. (The 60 per cent surcharge, applicable to non-essentials, was not affected.) Under this schedule, the surcharge was reduced to 20 per cent in October 1978 and to 10 per cent at the beginning of April 1979. In the latter part of 1977, the process of authorizing imports had been subject to often considerable delays; however, in May 1978, it was announced that all applications for imports of raw materials and intermediate goods would be authorized automatically and in September this automatic procedure was extended to all imports not subject to quantitative restrictions. The value quotas on certain consumer items which had been introduced in February 1977 representing 4 per cent of 1976 imports were raised in escudo terms in May 1978 to keep their foreign currency value unchanged. The value quota on automobile parts (3 per cent of 1976 imports) was also raised in December 1978.

The Fund welcomes the steps that have been taken during the past year to reduce the restrictiveness of the trade and payments system. The authorities have not, however, found it possible to make progress toward the objectives of reducing the restrictiveness of the import value quota system and the 60 per cent surcharge on nonessential imports. Some preliminary studies have been undertaken on these two matters but so far no concrete steps have been announced. Present indications are that Portugal will continue to incur substantial external current account deficits for the immediate future. The Fund believes, however, that the surcharge and other restrictions should be used only on a temporary basis while additional domestic and external policy measures are implemented to strengthen the underlying balance of payments situation. As the payments situation improves, the Fund hopes that Portugal will take steps to phase out the remaining restrictions.

Opening statement by the representative of Portugal

4. The representative of Portugal made an opening statement, the full text of which is annexed, in which he described the developments of the Portuguese economy and its balance of payments in 1978. He recalled that the stabilization programme adopted aimed primarily at reducing the substantial deficit on current account which, in 1977 had amounted to \$1.5 billion, and which by the end of 1978 had been reduced to \$776 million. The decline in the growth of the economy was the result of limited public expenditure and reductions in real wages, together with an increase in interest rates and credit restrictions. This had led to a rate of unemployment of 8 per cent in 1978 compared to 7 per cent in 1977. Inflation had been reduced from 27 per cent in 1977 to 22 per cent in 1978. The representative of Portugal went on to describe the various items in the balance of payments. He pointed out that Portugal's foreign debt had continued to increase from 19.5 per cent of GDP in 1976 to 28.3 per cent in 1977 and finally 31.8 per cent in 1978. In view of the balance-of-payments situation, despite its improvement, and the level of the foreign debt, the Portuguese Government decided to maintain the import surcharges and the quantitative restrictions for certain consumer items. He stated that it was the Portuguese authorities intention to have recourse to import restrictions only to the extent necessary to correct the balance-of-payments position and that as circumstances permitted, they would proceed with the reduction and finally the elimination of the measures in question. The representative of Portugal then briefly described the Government's economic and social objectives for 1979, as contained in the first budget and plan proposal submitted to Parliament.

Parts I and IIBalance-of-payments position and prospects - alternative measures to restore equilibrium

5. The members of the Committee thanked the Portuguese representatives for the comprehensive and detailed documentation submitted for the consultation. They congratulated the Portuguese authorities on the remarkable improvement in the balance of payments and economic performance since the last consultation in 1978. The deficit on current account, which had been expected to be just below \$1 billion for 1978 had actually been reduced to \$776 million. It was noted that the factors contributing to the substantial improvement included a good performance of the external sector, a courageous real wages policy and the improvement in Portugal's external sector, and had coincided with a reduction of import restrictions. One member of the Committee pointed out that this performance was ample evidence that the correct internal fiscal and monetary policies, along with a realistic exchange rate policy could correct a serious balance-of-payments situation without resort to unnecessary restraints on trade. The members of the

Committee expressed the hope that continued improvement in Portugal's balance of payments, level of reserves, and economic performance would soon enable it to terminate all import restraints imposed for balance-of-payments purposes. It was recognized that the positive developments in 1978 had been achieved at considerable cost in terms of social conditions, real wages and unemployment; and it was hoped that the economic stabilization programme would achieve all its objectives.

6. In reply to a question concerning the present status of Portugal's negotiations with the International Monetary Fund for a new stand-by arrangement, the representative of Portugal said that negotiations had started early in 1979 but had been interrupted because the Portuguese Parliament has not approved the Government's budget and plan. By mid-May a new budget and plan would be presented to the Parliament. Negotiations with the International Monetary Fund would be resumed after their approval. It was asked whether the limits set on the level of domestic credit in 1978 would be pursued in 1979. The representative of Portugal explained that these limits had been set, until the end of March 1979 in agreement with the International Monetary Fund. These limits were still being imposed under the responsibility of the Government.

7. Questions were asked concerning the structure of the external debt. The representative of Portugal explained that the total external debt, public and private, had moved from \$4.426 billion in 1977 to \$5.420 billion in 1978. There had also been a difference in the composition of this debt; the private sector making up 44 per cent of it in 1977 and only 37 per cent of it in 1978. The decline of the share of the private sector in the foreign debt was due to the Government's policy to reduce the level of the short-term debt, and to restructure the foreign debt to a longer-term maturity profile.

8. Questions were asked concerning Portugal's exchange rate policy which was described in the basic document as basing the value in effective terms of the escudo on the differential rates of inflation between Portugal and its principal trading partners. It was asked whether this policy would continue in 1979. The representative of Portugal explained that the daily value of the escudo was calculated according to an average monthly target which took into account inter alia the average inflation rates of its trading partners. This policy had led, from May 1978 to April 1979, to an average monthly depreciation of 1.25 per cent; this objective had recently been modified to a monthly depreciation rate of 1 per cent, in effective terms. The aim of the policy was to depreciate the escudo no more than was required to maintain a balance between domestic inflation and export competitiveness.

9. It was asked whether Portugal had a target for the level of its reserves in terms of number of months of imports. The representative of Portugal said that gross reserves held by the Bank of Portugal and the Treasury were

calculated at \$1.451 billion for 1977 and \$1.931 billion for 1978. Gold holdings were calculated at the ex official price. If calculated at market prices the figures for 1977 and 1978 would be respectively \$4.336 billion and \$5.806 billion.

10. It was remarked that whereas monetary and balance-of-payments objectives for 1978 had been met there had been some disappointment in the achievement of the fiscal targets for 1978. The Government budget deficit had amounted to some 10 per cent of GDP. It was asked whether measures were envisaged to bring this deficit under control and whether the large public investment projects accounted for a sizeable part of this deficit. The representative of Portugal confirmed that the level of current expenditure in 1978 had been higher than both the budgeted figures and the actual receipts. There had been delays in the promulgation of the budget and also in the collection of taxes. Tax collection in 1978 had generally been poor and had not achieved projected estimates. Public investment projects had not accounted for the main share of the deficit. The objective for 1979 was to achieve balance in the current budget.

11. Several questions were asked on the objectives of a stabilization programme for 1979 and particularly on measures envisaged to reduce the rate of inflation. The target for 1978 had been 20 per cent but the rate achieved had been 22 per cent. The representative of Portugal acknowledged that the objectives for the rate of inflation in 1978 has not been fully met. However, the objective for 1979 was to further reduce the rate of inflation to some 18 per cent. The measures envisaged to achieve this were to pursue the Government's policy to maintain the wage levels, to reduce public expenditure, and to lower the rate of depreciation of the escudo.

12. Members of the Committee asked what measures the Portuguese authorities were taking to encourage foreign investment. The representative of Portugal referred to the basic document BOP/195/Add.2 on page 15 where such measures were described. He added that early in 1978 a new institution had been created to centralize and give out information designed to facilitate foreign investment. The measures which had been adopted and described in the previous consultation (BOP/R/96) had resulted in an increase of the volume of private investment capital inflow from \$57 million in 1977 to \$62 million in 1978. He added that there had been a decline in the share of the United States in this figure from \$16 million in 1977 to only \$7 million in 1978.

13. Members of the Committee noted that the balance of payments in 1978 might have improved even more had it not been for unfavourable developments in the agricultural sector and asked whether agricultural production was likely to improve in 1979. More generally it was asked how the Portuguese authorities envisaged the prospects for the balance of payments in the future.

The representative of Portugal confirmed that agricultural production had been very poor indeed in 1977, registering minus 10 per cent due to poor weather conditions; in 1978 production had increased by 4 per cent although some harvests had remained poor; had it not been for the poor performance in certain agricultural sectors such as wine and olive oil, the production could have increased by more than 6 per cent. With respect to the likely developments of the balance of payments in 1979 the representative of Portugal replied that it was difficult to estimate this. Several factors which were not presently defined would have an impact on developments, such as adoption by Parliament of the revised government budget and plan. The initial plan had aimed at a current account deficit at the end of 1979 of less than \$1 billion. A further factor which would influence developments was the negotiations with the International Monetary Fund which would be resumed in May/June 1979. Commenting on the relatively good performance of exports in 1978 the representative of Portugal cautioned that 1979 would not necessarily see such an increase in exports because certain export items such as textiles were meeting import restraints. Generally, it was felt that the deficit on the current account would be below \$1 billion.

Parts III and IV

System, method and effect of the restrictions

14. Members of the Committee welcomed the fact that improvements in Portugal's balance of payments had been accompanied by a gradual relaxation of restraints on imports; the deposit scheme had been terminated on 31 December 1977 and it had been announced that the 30 per cent surcharge would be phased-out by reducing it to 20 per cent on 1 October 1978; it was then envisaged to reduce it to 10 per cent, and to terminate it on 1 October 1979. It was noted that once that surcharge had been phased-out there would remain only a few restrictions on imports: some residual quantitative restrictions, the 60 per cent surcharge on certain luxury goods covering less than 1 per cent of 1978 imports, quantitative restrictions on automobiles and on certain luxury items again accounting for only a small percentage of Portuguese imports. Some members felt that these restrictions probably served other purposes than balance of payments, such as the luxury tax and the development of domestic industries. One member of the Committee suggested that Portugal might wish to consider removing these remaining restrictions where possible or, when the item in question was bound, using the provisions of the General Agreement to renegotiate higher duties. In October 1979 when Portugal would have removed its 10 per cent surcharge it would appear that Portugal would no longer have import restrictions taken to protect its balance of payments and would therefore no longer need to consult under Article XII.

15. Referring to the statement by the International Monetary Fund, members of the Committee asked whether the "other restrictions" referred to as having to be used only on a temporary basis while additional domestic and external policy measures were implemented, included restrictions on Portugal's negative list (L/2981/Add.14, dated 25 July 1968). The representative of the International Monetary Fund said that the statement referred essentially to restrictions taken for balance-of-payments reasons and did not include restrictions taken for protective reasons.

16. In reply to a specific question the representative of Portugal confirmed that the 1968 list of residual restrictions (L/2981/Add.14) had not undergone any change and was therefore still valid. It was asked whether the Portuguese authorities envisaged any modifications of this list in the future such as removal of items from it. The representative of Portugal stated that there were no plans at present to modify this list. Some members of the Committee noted that according to the basic document BOP/195 there was a régime of exception from the negative list for certain goods when imported from the EEC, or the EFTA. Items on the negative list were subject to individual import licence when imported from non-EC-EFTA countries, but were either free of quota or subject to special quota arrangements when originating in the EC-EFTA region. These members hoped to see the negative list abolished. In the event that the negative list was maintained, these members recorded their view that it made little sense that such exemption should exist for imports from EC-EFTA region given the serious Portuguese balance-of-payments problems. Furthermore, it appeared to these members that since the import surcharge was applied for balance-of-payments reasons to all imports regardless of source, there did not seem to be a legal impediment to a non-discriminatory application of all other Portuguese measures including items on the negative list. Justification under Article XXIV of the General Agreement was referred to by other members of the Committee. It was generally felt that the Balance-of-Payments Committee was not the adequate forum in which to discuss the legal interpretation of GATT provisions.

17. Referring to the remaining 60 per cent surcharge which would continue to be applied after the remaining surcharge would have been removed in October 1979, one member suggested that this could be replaced by a luxury tax; it was also remarked that the product coverage of the import surcharge could usefully be expressed in terms of percentage of tariff lines rather than in terms of the previous year's imports.

18. It was specifically asked whether the delays presently reported in obtaining import licences would be reduced in the future. The representative of Portugal explained that delays incurred in certain cases were due to the reformulation of prior registration requirements; which was not intended or used as a restrictive measure; however, efforts would be made to reduce any delays that could occur.

Conclusions

19. The Committee welcomed the improvement registered in 1978 in Portugal's balance-of-payments position, and the gradual relaxation of import restrictions taken for balance-of-payments reasons. It fully shared the view of the International Monetary Fund that "the surcharge and other restrictions should be used only on a temporary basis while additional domestic and external policy measures are implemented to strengthen the underlying balance-of-payments situation". The Committee expressed the hope that the policies adopted by the Portuguese authorities would contribute to further reductions of its external current account deficits and that Portugal, in the foreseeable future, would no longer need to resort to import restrictions to safeguard its balance-of-payments position.

ANNEX

Introductory Statement by the Portuguese Representative

1. The Portuguese delegation is happy to be meeting once more with the members of the Committee on Balance-of-Payments Restrictions, to consult again with the contracting parties in the spirit of collaboration that has always guided it.
2. On the basis of the documentation prepared by the Portuguese authorities, I think I can simplify the Committee's task by outlining briefly, as I did last year, the main characteristics of Portugal's economic situation in 1978, and in addition indicating the prospects for the current year.
3. The information available allows us to estimate the growth rate of GDP in 1978 at 3.4 per cent in terms of volume, as against 6.5 per cent in 1977. This slowing down in the growth rate of GDP is the result of the economic policy line pursued, consistently with the agreement that Portugal negotiated with the IMF in April-May 1978.
4. The economic policy that has been adopted - a stabilization programme corresponds to the need for a substantial reduction in the deficit of our balance on current transactions. Whereas that deficit had reached nearly \$1,500 million in 1977, it is estimated to have been reduced in 1978 to \$776 million.
5. The slowing down in economic activity was achieved primarily by limiting public expenditure and real wages, in combination with an increase in interest rates and credit restrictions.
6. The growth of GDP by 3.4 per cent corresponds to an increase of approximately 4 per cent for the agricultural sector and 3.3 per cent for output of the industrial sector, reflecting a deceleration in the latter sector in comparison with the rate recorded last year (9.5 per cent). In the construction sector, the deceleration rate was less pronounced; the increase in value added in this sector is estimated at 5 per cent in 1978, as against 11 per cent in 1977.
7. Gross fixed capital formation is estimated to have risen by 4 per cent in terms of volume in 1978, as against 12 per cent in 1977. The variation in stocks is expected to have shown a positive trend, although to a less extent than in the preceding year - representing 5.4 per cent of GDP in 1977, and probably 2.2 per cent in 1978.

8. The unemployment rate is estimated to have reached 8 per cent in 1978 (as against 7 per cent in 1977), attributable mainly to persons seeking employment for the first time. The growth rate of GDP made it possible to maintain the employment volume at a stable level.

The inflation rate declined to 22 per cent in 1978, as against 27 per cent in 1977, partly as a result of the wage trend (real wages diminished in 1977 and 1978, although less rapidly in the latter year) and partly because of the slowing down in the depreciation rate of the national currency in 1978.

9. One should underline a pronounced reversal in the trend for the deficit balance of current transactions as recorded in recent years: indeed this deficit was in the amount of - \$776 million, appreciably below the level reached in 1977 (- \$1,499 million).

The trade deficit also declined, by approximately \$200 million, reaching - \$2,315 million in 1978.

Exports of goods and services increased in volume by approximately 16 per cent (of which nearly 13 per cent in respect of goods).

Imports of goods and services are believed to have remained virtually stationary, mainly because of the modest increase in GDP, together with utilization of existing stocks.

Net earnings from tourism and emigrants' remittances increased substantially contributing to a still greater extent than the trade balance improvement to reduce the overall deficit in the balance on current transactions, to which I have already referred.

10. Nevertheless, Portugal's foreign debt continued to increase, and was equivalent to 31.8 per cent of GDP in 1978, as against 28.3 per cent in 1977 and 19.5 per cent in 1976.

11. In 1978, the "crawling peg" policy which had been introduced in 1977 was further continued in respect of the effective rate of the escudo. Since May 1978 the devaluation rate has run at an average of 1.25 per cent per month, but since last week it has fallen to 1 per cent.

12. In view of the continuing aggravation of foreign indebtedness, despite some improvement in the negative balance on current account, the Portuguese Government has decided temporarily to maintain the application of import surcharges and likewise quota restrictions on certain less-essential consumer goods and CKD motor vehicles having a kerb weight not exceeding 2,000 kgs.

The Portuguese authorities have been careful to resort only in a limited way (and always on a temporary and non-discriminatory basis) to the import restrictions in effect since 1975.

As we have reiterated on a number of occasions since the initial consultations in this Committee, we have always been ready to examine, with contracting parties who so desired, any questions concerning the application of those measures.

Consistent with the intentions reaffirmed on the occasion of earlier consultations, and notwithstanding the fact that the balance-of-payments situation is still a matter for considerable concern, the Portuguese authorities have eliminated or eased some of the measures concerned, as and when circumstances permitted.

In this connexion, I would mention the following:

- the prior deposit on imports was abolished as from 31 December 1977;
- the 30 per cent surcharge was reduced to 20 per cent as from 1 October 1978 and will be further lowered to 10 per cent within the next few days.

13. Turning now to prospects for the current year, I should like first to say that the fourth Constitutional Government has drawn up the general budget and the economic and development Plan for 1979 and has resumed conversations with the IMF with a view to negotiation of a new agreement

We are endeavouring to secure a balanced situation in the current budget for the public administration sector, which last year showed a deficit of some Esc 28,000 million, whereas the deficit initially envisaged amounted to only Esc 5,000 million.

The Government has defined the following economic and social objectives in the context of the Plan:

- to hold down the deficit on current transactions to a level below \$1,000 million;
- to reduce the inflation rate (the increase in the consumer price index is expected not to exceed 18 per cent);
- to hold down, in real terms, public consumption of goods and services and to increase direct public investment;
- to adopt measures conducive to economic and social profitability of the State-enterprises sector;

- to raise the standard of living of the population, through a moderate increase in private consumption and real wages, taking into account an expected increase by 3 per cent in GDP (it is estimated that total wages should not be more than 18 per cent above the level as at 31 December 1978);
- to implement an investment policy designed to attain the medium- and long-term development objectives (in particular Portugal's integration in the European Economic Community, negotiations with a view to accession having already commenced);
- fully to satisfy public needs (to the extent that current economic and financial conditions allow), particularly in the public health and education sectors.

After having been discussed by the Assembly of the Republic in March last, neither the budget nor the Plan were approved. They are currently under revision, and it is hoped to re-submit them again to the Assembly of the Republic before the end of May.

It is expected that negotiations with the IMF can be completed immediately following approval of the budget and the Plan.

The development of Portugal's economy in 1978 showed some fairly positive aspects, though at the cost of quite substantial social sacrifices, in particular in terms of employment and real wages, as well as in terms of development.

We believe, nevertheless, that the pursuit of an overall programme of economic stabilization, going beyond any adjustments that may prove necessary for conjunctural reasons, will contribute in the medium term to ease the crisis and establish structural equilibria in the Portuguese economy at both domestic and external levels.

Lastly, I would like to underline the importance that Portugal attaches to full solidarity on the part of the economically strong countries, so that they may implement a more open trade policy allowing broader access to their markets for products from countries at a stage of economic development identical to that of Portugal, as a condition for success of our own economic policies.