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GENERAL AGREEMENT ON TARIFFS AND TRADE

REPORT OF THE WORKING PARTY ON THE ITALIAN IMPORT DEPOSIT

1. The Working Party on the Italian Import Deposit, established by the Council of Representatives at their meeting of 3 May 1974, was asked:

> "To examine the Import Deposit Scheme introduced by the Government of Italy and its implications, to report to the Council and to continue to be available for consultation as necessary."

2. The Working Party noted that a temporary Italian Import Deposit had been introduced with effect from 7 May 1974, which subjected imports to a prior non-interest bearing deposit of 50 per cent of the c.i.f. value of the goods for a period of 180 days. The product coverage of the deposit scheme, affecting some 40 per cent of Italy's imports, was detailed in document L/4029.[1]

3. The Working Party held two meetings, on 7 June and 12-13 September 1974. At the first meeting the Working Party heard a statement by the representative of Italy, giving a detailed account of the deterioration of the country's balance of payments and in particular of its trade balance, (the full text of this statement is reproduced in Annex I). The Working Party also heard a statement by the representative of the European Communities (see Annex II) to the effect that the prior deposit had become a trade measure of the Community, the conditions and modalities of which had been defined in conformity with Article 108, paragraph 3 of the Rome Treaty. It was the Communities' view that the measure was not more restrictive than the quantitative restrictions specifically provided for in Article XII of the GATT. The deposit was applied without distinction to the origin of products, although that did not mean that the Community regarded itself as bound to accept that as a rule of the General Agreement.

[1]Later modifications to the deposit's product coverage and rates were notified in documents L/4059, L/4065 and Adds.1, 2 and 3.

4. At its second meeting, the Working Party carried out a consultation with the International Monetary Fund which supplied a comprehensive background document. The statement presented by the representative of the Fund (the full text of which is reproduced in Annex III), concluded as follows:

"In the current period of exceptional and widespread balance-of-payments difficulties, strong pressures may exist in a number of individual countries for the adoption of trade and other current account restrictions. The Committee of the Board of Governors on Reform of the International Monetary System and Related Issues in its communiqué issued after its Rome meeting last January stressed that in managing their international payments, countries should not adopt policies that would aggravate the problems of other countries and that, in this connexion, they should avoid the escalation of restrictions on trade and payments.

"In the case of Italy, however, the imposition of the import deposit requirement was warranted on a temporary basis given the exceptionally serious balance-of-payments problems, including a large deficit on non-oil transactions, and the policy options at that time. The Government has now taken measures that should permit the termination of the import deposit requirement and the Fund notes the intention of the Italian Government to terminate in early 1975. In the context of the financial policies discussed earlier, the approach of the Italian authorities to the temporary employment of current account restrictions is in conformity with the general policy mentioned above."

5. Members of the Working Party thanked the representative of the IMF for the Fund's statement on Italy's balance of payments and measures taken to restore equilibrium in the country's economy and external position.

6. At the second meeting the representative of Italy made a statement (the full text of which is reproduced in Annex IV) in which he traced the developments of the balance of payments from May to August 1974. The deficit on current account had worsened in May and June; July had shown a small surplus, but preliminary figures for August and September were negative and cause for further concern of his authorities. The deficit on trade account resulted from a continuing trend of greater rate of increase of imports over export receipts, even if the former showed some slowing down in recent months. He recalled the improvements and relaxation that had been introduced in the import deposit, and which had resulted in the scheme now covering some 27 per cent of total imports into Italy, compared to 40.7 per cent when the measure was first introduced. The first conclusion that could be drawn after a few months of operation was that the scheme did not appear to have reduced the value of global imports into Italy. He also gave a

brief account of the other measures that had been taken to adjust the balance of payments, principally fiscal measures. As the import deposit, these had been introduced in the context of the overall situation of Italy, which remained most serious and uncertain. Nevertheless, he confirmed his authorities' intention to abolish the import deposit, which was an exceptional and temporaty measure, as soon as possible.

7. The representative of the Communities said that in July, after re-examining Italy's balance-of-payments situation, the Community authorities had confirmed the maintenance of the prior deposit subject to certain adjustments. The decision provided in particular for elimination of the deposit requirement in respect of certain agricultural products subject to common organization of markets. The common characteristic of those products was that they were subject to compensatory amounts, tied to variations in exchange rates; according to the case, those amounts took the form of import charges in the event of revaluation or of import subsidies in the event of devaluation. The purpose of the compensatory amounts was to avoid situations where the support prices, converted according to fixed exchange rates in the member States concerned, could be brought into question by imports settled at the effective exchange rate. The compensatory amount, which in Italy took the form of an import subsidy to take account of the depreciation of the lira, had been eliminated on the agricultural products concerned to the extent of the rate of devaluation of the lira, and at the same time the import deposit had been removed in respect of those same products. In that way two measures operating in contrary directions had been abolished. Some members expressed concern over the criteria for selecting the aforementioned products for exemption and stressed the need for non-discriminatory selection of products for removal.

8. At both meetings, members of the Working Party expressed understanding for the seriousness of the situation. It was regretted that Italy had taken a unilateral measure which, by affecting other countries' trade, could lead to a chain reaction of protective trade measures. At a time when the impact of the price increase for oil would cause many countries' balance-of-payments situation to deteriorate, it was all the more important to avoid unilateral trade restrictions. Modifications and improvements introduced to the scheme were welcomed, and it was hoped that further improvements would be made before termination of the measure. The Working Party noted with satisfaction the statement by the representative of the IMF that the Italian Government had informed the Fund of its intention to terminate the import deposit requirement in early 1975. While the Working Party took note that in the judgement of the Fund the present situation justified the temporary continuation of the scheme, it hoped that the Italian Government would be in a position to terminate the measure at an early date. Certain members expressed concern that the representative of Italy could not be more specific concerning the termination date. Pending termination, Italy was urged to consider a gradual phase-out of the rates of

deposit and coverage of the requirement. The representative of the EEC said that the Community authorities were following the situation very closely, in close consultation with the Italian authorities, and a further general review would take place in October. At the present juncture, one could not foresee what conclusions would be the outcome of that or any future review regarding the maintenance or elimination of the deposit. The deposit would be eliminated as soon as circumstances permitted.

9. Members of the Working Party considered that the deposit had been introduced for a dual purpose, the principal one being the reduction of domestic liquidity, and the secondary one the limitation of imports in order to relieve the pressure on the balance of payments. They also noted that domestic fiscal and credit measures had been taken; it was felt that it would be appropriate to strengthen these internal measures so that the deposit would be removed at an early date, and thus lessen its impact on other countries' trade, particularly at a time when other countries were having balance-of-payments difficulties of the same nature. Meantime, a flexible administration of the deposit was called for. With respect to goods in transit or shipped from distant countries prior to the entry into force of the measure, it was suggested that such goods be exempted from the scheme. The representative of Italy emphasized that his Government's main objective was to contain internal demand: domestic fiscal and credit measures were more important tools for achieving this end than was the deposit; but the reduction or change of composition of certain imports would also be relevant, no doubt, in order to reduce excessive demand. In this context it was pointed out that the deficit on current account was only partly attributable to higher oil prices.

10. Members of the Working Party expressed concern with the impact of the deposit on their respective trade with Italy particularly concerning agricultural goods. Some members stressed the impact of the measure on manufactured goods, an important element in their exports to Italy. It was considered a matter of urgency that adverse effects to Italy's partners' trade be minimized as soon as possible.

11. Several members of the Working Party, in particular developing countries, stated that their trade with Italy was seriously damaged; in many instances, they spelled out the extent of damage incurred or expected. They were very concerned with the immediate effects on their own trade and payments flows, and with the repercussions these could have in the future. Many members therefore urged Italy, in view of Part IV of the GATT, to exempt from the deposit scheme products from developing countries, in particular those subject to the Generalized System of Preferences and, if the deposit requirement could not for any reason be completely withdrawn, to reduce substantially the amount of deposit required and to liberalize the conditions relating to its refund. They further

requested that in the process of dismantling the scheme, priority be given to the removal of the deposit requirement for imports from developing countries and for products for which the developing countries are substantial suppliers. Some members, whose trade had been particularly affected by the measures, stated that, failing complete exemptions from the import deposit, compensation for trade damage should be considered. Some members of the Working Party pointed out that the modifications introduced to the deposit requirement had not brought any relief to their trade. The representative of Italy reiterated his earlier statement that it was imperative for Italy to reduce internal liquidity, inter alia, through the deposit. Any effects that it might have on certain countries' trade was regretted; however, any trade damage that might be caused to developing countries did not seem to be such that it would justify application of the import deposit on a discriminatory basis. He pointed out that products imported into Italy under the GSP were duty free; therefore the incidence of the import deposit on these products was equivalent to the cost of the interest on the deposit, some 2 to 3.5 per cent for six months, which was not excessive.

12. Some members of the Working Party stressed, at both meetings, the importance they attached to the non-discriminatory application of the import deposit. They welcomed the statement by the representative of Italy that non-discrimination would continue to be observed, and hoped that this would also be the case should a phase-out of the scheme be introduced before its termination. Some members were pleased to note that the proposals for including a preferential margin for EC exporters were not adopted.

Conclusions

13. The Working Party examined the import deposit scheme introduced by Italy with effect from 7 May 1974 in the light of the finding of the International Monetary Fund that "... the imposition of the import deposit requirement was warranted on a temporary basis, given the exceptionally serious balance-of-payments problems, including a large deficit on non-oil transactions, and the policy options at that time". Taking into account this finding, there was a wide measure of support for the conclusion that the Italian import deposit scheme was not more restrictive than measures that an application of the provisions of Article XII of the GATT permits.

14. The Working Party agreed that this Conclusion was without prejudice to the rights of contracting parties under the General Agreement.

15. The Working Party took note of the statements by Italy and the European Communities to the effect that the measure was temporary and would be abolished as soon as circumstances allowed.

16. The Working Party will keep the matter under review.

ANNEX I

Statement by the Representative of Italy at the Meeting of the Working Party on 7 June 1974

Delegations attending this meeting are undoubtedly acquainted with the basic elements of the situation that has brought about the measures adopted by the Italian Government on 2 May. Some cardinal points of information were given at the meeting of the Council of Representatives which set up this Working Party. We consider, none the less, that a thorough study of the Italian measures has to be based on a detailed analysis of the manner in which the situation of Italy's external accounts has developed recently.

I. Evolution of the balance of payments

In accordance with the provisions of Article XII of the General Agreement, the essential parameter remains - where this matter is concerned - the balance of payments, which has to be analysed by reference to its basic component items as well as to its direct impact on the level of reserves. As is well known, even in 1973, the balance on current account showed a heavy deficit for Italy. Compared with a credit balance of Lit 1,168,000 million in 1972, last year ended with a deficit of Lit 1,405,000 million. The worsening of the situation was markedly accelerated in the second half of 1973. This persisted in the ensuing months, and the first quarter of 1974 closed with an aggregate balance-of-payments deficit of Lit 2,800,000 million - excluding any offsetting loans - or a figure already higher than the deficit for the whole of 1973. Should this trend be maintained, the estimates which forecast the current deficit for 1974 at about Lit 4,100,000 million would be exceeded, since a projection of the first quarter of the year on an annual basis produces an adverse balance almost twice as large.

It is clear that, in the face of this situation, which the international monetary authorities consider an extremely difficult one, the Italian Government was forced, even before the close of 1973, to take action on a vast scale in order to obtain the capital sums necessary for financing the deficit on the aggregate balance. Recourse to external loans was intensified during the second half of 1973 and the first months of 1974; this enabled the Italian authorities to obtain credits amounting in 1973 to Lit 2,570,000 million, and, for the first quarter of 1974, further credits to an amount of Lit 1,131,000 million. In total, the loans secured during the last two years amount to Lit 6,720,000 million at the current dollar exchange rate.

Unfortunately, progressive recourse to international credit has not been rapid enough, seeing that it has failed to halt a very substantial drop in the Italian reserves: between the close of 1973 and the end of February 1974 they fell from Lit 3,344,000 million to Lit 2,765,000 million.

It should further be emphasized that if one takes account solely of foreign exchange reserves (excluding gold and special Drawing Rights), the sum available at the end of February 1974 amounted to no more than Lit 746,000 million, a figure lower than the debit balance on a single month of foreign trade.

The reasons for this rapid deterioration in our balance of payments are clearly reflected in the evolution of the main component items. An examination of the variations occurring between 1972 and 1973 in items in the balance of payments that are traditionally favourable shows a reduction, moderate, it is true, yet significant, in the surplus on tourism and remittances from Italian workers in foreign countries, while the favourable balance on services is reduced from Lit 881,000 million to Lit 722,000 million.

II. <u>Evolution of the trade balance</u>

But, beyond question, the most disquieting element - and one that has a direct bearing on this adverse development - is the balance on the movement of goods (f.o.b.-c.i.f. data, based on settlements): the deficit of Lit 1,826,000 million in 1972 rose by the end of 1973 to Lit 3,366,000 million - easily a record figure for the Italian trade balance. Here again, there is no improvement in the first months of 1974: quite the contrary - the debit balance having already reached Lit 1,964,000 million by the end of the first quarter; furthermore it is thought, on the basis of preliminary estimates, that it may have exceeded by the end of April the level of Lit 2,700,000 million - if, that is, it is confirmed that the trade deficit recorded in that month was Lit 830,000 million.

It becomes easier, in the light of the disturbing data that I have cited, to understand why the Italian authorities found it necessary, at the end of April, to adopt measures affecting the external accounts, and why the choice fell on imports, to serve as basis for a new measure designed to restore financial well-being.

It is indeed the abnormal increase in import payments that must be deemed the main cause of the deterioration of Italy's external accounts.

After reaching 44 per cent at the end of 1973, the increase proceeded apace to 95 per cent for the first quarter of 1974: the growing tempo is illustrated by the fact that purchases in March 1974 exceeded those for March 1972 by 154 per cent, i.e. they were 2 1/2 times higher.

Although petroleum plays an important part, the "non-oil" component is an even weightier element in the development of the situation. For reasons that are linked both with financial speculation and with psychology, we have witnessed in recent months a veritable invasion of the Italian market - an invasion nourished by an internal demand swollen by a very high inflation rate, and which seeks to convert available liquid assets into foreign goods.

The import flow is spread fairly widely over most sectors, since - apart from fuel, with a 254 per cent rise in value in the first quarter of 1974 - the following increases have been recorded: agricultural products and foodstuffs, 67 per cent; machinery and related products, 60 per cent; metallurgical products, 107 per cent; textiles, 72 per cent; chemical products, 64 per cent; other products, 86 per cent.

Given that the expansion of imports is not adequately counter-balanced by increased exports (despite a rise of 66 per cent by comparison with the first quarter of 1973), the aggregate balance shows a progressively graver deterioration, in particular because of a fairly extensive weakening of exchange rates. In the circumstances it is not possible to hope that an export drive may effectively offset the imbalance caused by the abrupt rise in imports.

III. General framework for measures towards recovery

The statistical information that I have offered throws light on the reasons that impelled the Italian Government to take action in regard to imports. At the same time, it should be stressed that even at the beginning of 1973 the Italian authorities had applied a series of measures aimed at controlling the monetary situation and the balance of payments.

Thus, in February 1973, the decision to allow the lira to float and the introduction of the two-tier exchange market were designed to isolate speculative pressures; the same purpose underlay the reduction of the terms prescribed for advance payments for imports which, in a situation of extremely fluid exchange rates, facilitated the flight of capital to foreign countries.

In June 1973 extensive machinery for freezing prices was set up, coupled with the entry into force of an initial measure for controlling the liquidity of banks, through the obligation to invest at least 6 per cent of their deposits in public or private securities.

As the situation deteriorated still further during last winter, the Italian Government was led to intervene again in March 1974, with measures that were especially restrictive in respect of the size of bank credits, the rate of expansion being limited to 8 per cent for the period March-September 1974. Concurrently, the bank rate was raised from 6.5 to 9 per cent, while very severe restrictions were imposed on the export of foreign currency, even by tourists (maximum $770 per annum), together with a 30 per cent tax deduction on stock and share dividends.

The series of measures just cited is by no means complete, for the gravity of the situation calls for further steps aimed at reducing internal liquidity. Thus, after raising rail transport rates by some 30 per cent, the Government is at present considering analogous increases for other public services (in particular, electricity, water and gas), while far-reaching fiscal measures are expected to follow the introduction of advance collection of certain income taxes. It is aimed, more particularly, to raise tax rates generally, including the value-added tax and the property sales tax.

The stated end-purpose - in the monetary sense - of all these measures is to withdraw from the market a sum of Lit 3,000,000 million, so as to effect a corresponding relaxation of pressure on the general liquidity of the market.

IV. Import deposit

It is within the framework of the measures just described that we must view the decision announced on 30 April 1974 and implemented on 7 May, to impose a prior deposit on a portion of imports, in accordance with a Ministerial Decree of 2 May 1974, published on 4 May in the Official Gazette; the full text was reproduced in GATT document L/4029 of 17 May.

There is a manifest link between the latter measure and those cited earlier, since the aim is identical in every case: rapidly to reduce the liquidity inherent in the Italian monetary system.

The stated purpose enables us to reject any interpretation that might tend to place the measure in a context of trade protectionism, or, worse still, of autarky.

The high degree of Italy's dependence on foreign supplies and foreign outlets suffices in itself to belie the possibility that we are pursuing such objectives, which, within a short interval, would, in any event, bring destruction to Italy's economic system.

We must emphasize that the import deposit is only one among numerous measures that have been adopted with the object of mopping up part of the internal liquidity by bringing pressure to bear upon a sharply rising commercial trend that is not devoid of speculative elements.

The details concerning the working of the prior deposit system emerge from the text of the cited Decree. Fifty per cent of the c.i.f. value of the goods imported has to be paid to the Bank of Italy, as a non-interest-bearing deposit for a period of six months. The measure applies solely to definitive imports, temporary imports and those of a non-commercial nature being exempted. On the other hand, reasons of urgency precluded the exemption of goods in course of transport or already bonded on the date when the system came into force. It should, however, be stressed that the interval of eight days between announcement and application of the measure made it possible to settle most of such cases, as the abnormal number of customs clearances on the eve of applying the deposit system bears witness.

On the administrative plane, no difficulty has arisen in applying the system, since the deposit involves no more than a receipt from the Bank, for presentation to customs with the banking documents ordinarily required for importation.

A special problem concerns the possibility of the deposit's being financed by the exporter of the goods. Although in previous cases where a similar system has been applied by other contracting parties, this possibility has been barred, the Italian authorities did not consider it expedient formally to exclude such a solution. It is none the less clear that the objective - to mop up internal liquidity - is jeopardized if the deposit is financed in that manner, even when the effect on the balance of payments is, in the very short term, favourable.

A difficult problem has been to select the goods to be subjected to the new system. Announcement of the measure was accompanied by a statement that it was aimed at agricultural products, foodstuffs and consumer goods, to the exclusion of raw materials and capital goods. This definition remains basically accurate, even though it proved necessary to extend the measure to certain categories of capital goods, so as to achieve the desired monetary end, namely, to withdraw from internal liquidity a sum of about Lit 3,000,000 million. It may be noted that this fact in itself constitutes a deferred guarantee of the provisional character of the measure, since protracted maintenance in its present form would be detrimental to Italy's system of production.

According to calculations based on 1973 imports, the deposit affects 40.7 per cent of the total of Italian purchases, or Lit 6,439,000 million on a total value of Lit 16,224,000 million of imports. Agricultural products and foodstuffs are the items mainly affected by the deposit, which is applied to 65.2 per cent of their aggregate value, whereas it touches only 32.6 per cent of the value of industrial products.

It has not so far proved possible to calculate the incidence by geographical and economic zones, seeing that most of the relevant tariff headings are broken down into numerous sub-divisions.

We are especially concerned over the possible impact of the measure on the exports of the least developed countries, and we are accordingly relieved to note that only a very slight percentage - well below the average - of their sales appears to be affected; this is due to the fact that the export of raw materials (exempt from the deposit) plays an important rôle in their economies.

Obviously it is not possible, on the basis of only thirty days' application, to attempt even tentative conclusions regarding the measure and its effects. Following the first days of uncertainty, commercial transactions appear to reflect a neutral reaction - in the sense that the tempo at which the deposit is being paid does not suggest any appreciable decrease of imports.

It should be possible in coming weeks to establish whether a slowing-down of imports is discernible as a consequence of the deposit - and, if so, to what extent. In any case, the deposit is of very limited scope: even at today's high bank rates, its financing for six months does not exceed 3.5 per cent of the value of the merchandise - a proportion that is far from constituting a real barrier to imports.

In any event, the deposit is without doubt an emergency conjunctural instrument essentially of a provisional character; it is certainly less likely to disrupt trade flows throughout the world than other alternative measures, such as devaluation of the lira at the high level that the present state of our payments would warrant.

It goes without saying that the Italian authorities are the first to hope that the decision they have taken, which is, in our view, justified by the existing situation, will likewise prove adequate, in the context of the measures already adopted or to be adopted on the internal plane. Our objective is to redress the situation rapidly, so that the normal system of importation may be fully restored, vis-à-vis the other contracting parties, at the earliest possible moment.

ANNEX II

Statement by the Representative of the European Communities at the meeting of the Working Party on 7 June 1974

At the meeting of the GATT Council in May 1974 which took up the question of the import deposit, the Communities reminded the Council that the Treaty of Rome contains provisions regarding balance-of-payments difficulties similar to those which Italy is encountering, and they pointed out that the various procedures and provisions prescribed in the Treaty would come into play in the case of the prior deposit imposed by Italy. The bodies of the Communities have in fact considered this question and taken decisions, in particular under Article 108 of the Treaty of Rome, which is applicable where a Member State encounters difficulties as regards its balance of payments that result from an overall disequilibrium of its balance and that are likely to prejudice the functioning of the Communities. Having regard to the figures which the Italian delegation has just cited, the authorities of the Communities felt that a marked deterioration had occurred in Italy's balance of payments, and that such a development could not be tolerated. They considered the deposit to be an appropriate measure in the framework of the totality of arrangements that Italy had made, and accordingly they defined the conditions and modalities applicable to the deposit in conformity with Article 108, paragraph 3, of the Treaty. More recently the Council of the Communities expressed its sympathetic understanding of the difficulties confronting Italy and took note of the willingness of Member States to provide, on a Community basis, effective co-operation, with the object of overcoming the problems facing the Member State in question.

It follows from what we have just said that the trade measure applied by Italy to safeguard its balance of payments is henceforth a trade measure of the Communities, and it is on that ground that the Communities are intervening. The Communities believe that the prior deposit is being applied consistently with the spirit of Article XII. The particulars that have been submitted regarding the various items in the balance of payments, including the important item concerning the trade balance, lead the Communities to recognize that there exists a balance-of-payments difficulty within the meaning of Article XII and to conclude that application of quantitative restrictions would be justified. The Communities are of the opinion that the device of a prior deposit, though not expressly prescribed in existing provisions of the General Agreement, is not more restrictive than the device of quantitative restrictions, which Italy would be justified in applying in this particular case. Furthermore, the measures specifically applied are less restrictive than those that could have been applied under Article XII, taking account of the grave balance-of-payments difficulties. As the Italian representative has pointed out, the prior deposit is a measure that is applied without distinction as regards the origin of products, although that does not mean that the Communities regard themselves as bound to accept that principle, in view of the provisions of Article XXIV.

In accordance with the provisions of Article XII, in particular paragraph 2(b), the prior deposit will be relaxed as the balance-of-payments position improves and will be abolished as soon as the balance of the account no longer justifies its maintenance.

ANNEX III

Statement by IMF Representative at the Meeting of the Working Party on 12 September 1974

Recent economic developments in Italy have been marked by a strong and widely-based expansionary trend in the domestic economy, which developed in 1972 and gained momentum in 1973, setting in motion inflationary pressures which doubled the annual rate of increase in consumer prices in 1973. At the same time there was a rapid and substantial deterioration in the external position. For some years before 1972 the balance of payments had been in surplus, both on current account and overall. However, from a surplus of SDR 2.1 billion in 1972, the current account swung to a deficit of SDR 2.0 billion in 1973. The overall deficit, excluding compensatory borrowing (borrowing abroad by state-controlled institutions at the behest of the authorities), increased from SDR 2.1 billion in 1972 to SDR 4.0 billion in 1973.

In spite of the effective depreciation of the lira by an average of about 10.5 per cent during 1973, non-oil exports rose only by 4.5 per cent in volume terms. The reasons for the small rise in exports included industrial strikes during the spring, shortages of capacity, and strong domestic demand. Non-oil imports, on the other hand, rose by 15 per cent in volume terms and 40.3 per cent in value during 1973, largely reflecting the strong overall demand and, in particular, the upswing in fixed investment with a relatively high import content, as well as speculative stock-piling in response to the depreciating lira and the rising trend of world market prices. The surplus on services and transfers also declined in 1973, partly because of higher official transfers, increased freight charges on imports, and larger interest payments on foreign loans.

From mid-1973 the weakening of the current account was accompanied by very substantial outflows of capital. Much of this outflow took place through unofficial sales of Italian banknotes, resulting in underrecording of tourist receipts (net) and transfers by emigrant workers. The trend was reinforced among other things by expectations of further depreciation of the exchange rate. In the second half of 1972, the authorities undertook large-scale compensatory borrowing abroad, in order to support the exchange rate and prevent a sharp decline in reserves. As exchange market pressures mounted in early 1973, the Government separated financial from commercial transactions and allowed the financial rate to fluctuate. (The financial market was abolished on March 22, 1974.) Subsequently, in February 1973, the authorities floated the commercial lira. Compensatory borrowing continued throughout 1973 (to a total of SDR 4.8 billion between mid-1972 and end-1973), but despite continuing intervention in the market, the effective exchange rate depreciation compared with January 1, 1972 was 12-13 per cent by December 1973.

As early as mid-1973 the authorities concerned by the weakening of the external position, had tightened monetary policy. Selective credit restrictions had been introduced in an effort to slow down the growth of short-term credit while not affecting the growth of long-term credit for investment, and bank lending rates were allowed to rise substantially. In early 1974, as the rate of domestic inflation accelerated, a comprehensive credit programme was introduced in a further effort to arrest the growing deterioration of the external accounts. The main features of the programme were tighter restrictions on the growth of credit and further requirements that the banks hold part of investment portfolios in the form of long-term bonds.

Balance of payments developments in the first half of 1974 were heavily influenced by the impact of increased oil prices; in Italy 80 per cent of primary energy consumed is derived from oil and virtually all of it is imported. However, non-oil imports were also increasing at a much faster pace than anticipated earlier, reflecting the continued buoyancy of domestic demand. The rate of increase in non-oil imports in the first half of 1974 was around 15 per cent above the second half of 1973 on an annual basis in real terms, and 60-70 per cent in value terms. Although exports increased faster than expected, the overall trade deficit amounted to SDR 4.7 billion in the first half of 1974, compared with SDR 3.3 billion for 1973 as a whole. The overall deficit in January-June 1974 was SDR 6.1 billion, compared with SDR 4.0 billion for the whole of 1973.

In addition to the deterioration on the trade account, net services and transfers were seasonally low in the first half of 1974, partly because of continuing capital outflows in the form of unrecorded receipts (net) from tourism and emigrant transfers, and partly because of increased interest payments resulting from compensatory borrowing since June 1972. Such borrowing continued and amounted to nearly SDR 2.1 billion in the first half of 1974; in addition a short-term credit from the EEC, equivalent to about 1.6 billion EEC units of account, was fully utilized. Nevertheless, gross official reserves declined from SDR 5.3 billion at the end of 1973 to SDR 4.4 billion at the end of June 1974. Market intervention continued at a substantial rate through mid-June, but the lira continued to depreciate. Following a sharp fall of 3-4 percentage points in the wake of the floating of the French franc in January, the trade-weighted depreciation of the lira continued to drift gradually downward and by end-July 1974 it had reached 20 per cent compared with January 1,1972.

The current account deficit was in fact much larger than had been expected in February when Italian officials held discussions with the Fund staff as a prelude to a request for a stand-by arrangement with the Fund (authorizing Italy to purchase up to the equivalent of SDR 1 billion), which was approved by the Executive Board on April 10. The Government in May introduced certain trade and payments restrictions. These included (a) a regulation under which residents are granted a basic allowance of Lit 500,000 (equivalent to $775 at a rate of Lit 645 = US$1) a year for tourist travel abroad and (b) an import deposit requirement which went into effect on May 7, 1974. Under the provision of the scheme, imports of certain commodities (accounting for about 43 per cent of 1973 imports) were to be permitted only after cash payment by the importers as a non-interest-bearing deposit with the Bank of Italy of an amount equivalent to 50 per cent of the c.i.f. value of the imports. The deposits were to be released after 180 days. The requirement was introduced on a temporary basis and the Italian authorities explained that its monetary impact would offset part of the liquidity creation caused by the large Treasury deficit, and thereby contribute to the adjustment of the balance of payments. The effect of the deposit requirement was estimated as equivalent to a 3 to 4 per cent rise in the cost of imports covered by the scheme. Modifications were made on July 22 which reduced the deposit on beef imports (5 per cent of total imports in 1973) to 25 per cent and eliminated it on other agricultural products and live cattle. The 50 per cent deposit now covers 24 per cent of 1973 imports.

In early July after a period of domestic uncertainty and in further response to continued balance of payments difficulties, a number of fiscal measures were taken. The measures included increases in charges for public services and health insurance, increases in the value-added tax on meat, luxury goods and property sales and an extension in coverage to professional services, increases in taxes on gasoline, a once for all capital levy on automobiles, and on dwellings, and an increase in corporation tax. A partial offset was provided by increasing the standard deduction in the personal income tax for those in the lower income brackets. The net yield of these measures is expected to be about Lit 2,750 billion, equivalent to 2 to 3 per cent of estimated 1974 GNP. The tax measures were ratified by the Italian Parliament on August 14, 1974.

In connection with the consultations under the existing stand-by arrangement, the Italian Government has informed the Fund of its intention to terminate the import deposit requirement in early 1975. In the event of any major change in circumstances, they stated that they would be prepared to consult further with the Fund.

In the current period of exceptional and widespread balance of payments difficulties, strong pressures may exist in a number of individual countries for the adoption of trade and other current account restrictions. The Committee of the Board of Governors on Reform of the International Monetary System and Related Issues in its communiqué issued after its Rome meeting last January stressed that in managing their international payments, countries should not adopt policies that would aggravate the problems of other countries and that, in this connection, they should avoid the escalation of restrictions on trade and payments. In the case of Italy, however, the imposition of the import deposit requirement was warranted on a temporary basis given the exceptionally serious balance of payments problems, including a large deficit on non-oil transactions, and the policy options at that time. The Government has now taken measures that should permit the termination of the import deposit requirement and the Fund notes the intention of the Italian Government to terminate in early 1975. In the context of the financial policies discussed earlier, the approach of the Italian authorities to the temporary employment of current account restrictions is in conformity with the general policy mentioned above.

ANNEX IV

Statement by the Representative of Italy at the Meeting of the Working Party on 12 September 1974

At the first meeting of this Working Party the Italian delegation furnished information concerning the period up to April last; I think, therefore, that we can now concentrate our attention on developments in recent months, more particularly since May when the new import régime was brought into operation.

As regards the balance of payments, we must state unfortunately that the negative tendency was broadly confirmed in May and June to the extent that the negative balance on current account increased from Lit 2,800 thousand million at the end of April to Lit 4,201 thousand million at the end of June - four times the negative balance for the corresponding period in 1973.

For July, a surplus of Lit 254 thousand million was recorded. The result for August appears to be a deficit of approximately Lit 200 thousand million. The data so far available for September confirm a trend that is giving much concern to the Italian monetary authorities.

In order to meet this situation, steps to seek foreign credit have been intensified in order to ensure coverage of the growing deficit, but this solution has encountered substantial difficulties since compensatory loans have only increased to a modest degree, from Lit 1,131 thousand million at the end of the first four months to Lit 1,389 thousand million at the end of June. More recently, new financing resources have been assured, although on a short-term basis and on exceptional terms.

As I indicated at our last meeting, this negative situation in Italy's foreign payments is basically attributable to the trade deficit, which is today still more burdensome because of the decline in receipts from tourism and remittances by Italian workers abroad, by 12 per cent and 16 per cent respectively.

All the facts I have just mentioned are broadly confirmed by the report of the International Monetary Fund that was put before this Working Party a short while ago and presents a series of valuable elements for evaluating the present situation.

As in the past, the trade deficit is still very substantial even if a trend that might seem less negative is beginning to emerge. Indeed, in May and June last, the trade deficit was Lit 573 thousand million and Lit 596 thousand million respectively; while this gave great cause for concern since it was equivalent to double the monthly deficit in 1973, it nevertheless indicates a certain slowing down of the upward trend recorded in the first quarter of the year, and more particularly in April last when the deficit reached Lit 815 thousand million. Notwithstanding this the overall deficit for the first six months of the current year has reached Lit 3,941 thousand million, that is to say more than two and a half times that for the first six months of 1973 (Lit 1,539 thousand million).

This situation is attributable to the fact that in recent months imports have continued to increase at a more rapid rate than exports so that the deficit has grown still further.

It should be noted, nevertheless, that from May on the growth rate slowed down somewhat in comparison with the early months of the year, on both the export and import sides; indeed in May and June imports were 45 per cent and 42 per cent respectively over the corresponding level for 1973, while in the first four months of the year the growth rate had reached 99 per cent.

The fact that this change in trend coincided with the introduction of the import deposit scheme might lead one to view the measure as being the principal cause of this new development. One should bear in mind, nevertheless, that at the beginning of May only about 40 per cent of Italy's import trade was subject to the prior deposit requirement. The data concerning imports of products subject to the deposit scheme show that there was no reduction in the overall amount in May and June; on the contrary, there was even a certain increase which, though modest, invalidated the fears that had been expressed at the outset regarding a possible decline in imports of products affected by the new scheme.

This situation is confirmed by the information available for the months of July and August, despite the customary seasonal decline during these holiday months.

I think that we can underline as being positive this first conclusion that we can draw from the early months of application of the deposit scheme; from the overall aspect the scheme does not seem to have caused any reduction of Italy's imports, not even in respect of the products affected by the measure. This should reassure exporting countries which at the beginning had feared a sudden drop in their sales to Italy.

Another reassuring factor can be found in certain very substantial changes introduced in June and August last, on the basis of decisions at Community level in the agricultural sector; the representative of the EEC will be able to give more detailed information concerning these. As a result of these measures a whole series of agricultural products has been withdrawn from the deposit scheme, representing a trade value exceeding Lit 1,100 thousand million, in other words one sixth of the total amount. These measures have had the effect of reducing from 40.7 per cent to about 27 per cent the total of Italy's imports subject to the deposit requirement, for the benefit of the agricultural exports of many contracting parties, including several developing countries. This is a very substantial modification in the scope of the scheme which in practical terms reduces its impact to only one quarter of Italy's imports.

Among the products that have now been exempted one may mention in particular bovine animals and swine, bovine meat and pig meat, cheese, tunny fish, certain vegetables, milk and butter.

In the context of these relaxations of the import deposit scheme some administrative adjustments have been made; in particular, the minimum import value exempt from the deposit requirement has been reduced from Lit 1 million to Lit 500,000 in order to avoid any speculation by means of fragmented customs operations.

After this outline of experience gained during the first months of operation of the scheme, I should also like to mention some other decisions that the Italian Government and Parliament have made with a view to restoring our balance of payments to a sound situation. These include a broad set of fiscal measures which should in the coming months contribute to solving problems of internal liquidity. An additional fiscal levy has been decided upon, and is expected to yield a total of Lit 3,000 thousand million by means of increased direct and indirect taxes which will impose a heavy sacrifice on Italy's taxpayers, in particular corporations which will be taxed at a rate increased from 25 to 35 per cent.

All these measures should be viewed in a global context designed primarily to improve Italy's economic structure and which also, as we had stated from the outset, comprises the prior deposit scheme.

Now clearly, as one proceeds with other means toward attaining the same objectives - although with less immediate efficacy - one is no doubt striving to establish the basic premises that could make it possible (at a moment which we are the first to hope will be soon) to take into consideration the possibility of eliminating the import deposit scheme.

It is, of course, still too early to make any forecasts in this respect, given the uncertainty that still exists regarding prospects for this autumn which looks very difficult in many respects. It has to be acknowledged that our external accounts are still in a very serious situation and that there has been no substantial improvement in the conditions that obliged the Italian authorities to introduce the prior deposit requirement. Nevertheless I am glad to confirm the intention of my authorities to conclude as soon as possible this measure, which is of a provisional and exceptional nature, as we had occasion to state unequivocally in GATT from the very day on which it was brought into effect.