

# GENERAL AGREEMENT ON

RESTRICTED

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## TARIFFS AND TRADE

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Committee on Balance-of-Payments Restrictions

REPORT ON THE 1987 CONSULTATION WITH PERU

1. The Committee consulted with Peru on 15 December 1987, in accordance with its terms of reference, pursuant to Article XVIII:12(a) of the General Agreement and the Declaration of the CONTRACTING PARTIES on Trade Measures Taken for Balance-of-Payments Purposes (BISD 26S/205). The consultation was held under the Chairmanship of Ambassador P.-L. Girard (Switzerland). The International Monetary Fund was invited to participate in the consultation in accordance with Article XV of the General Agreement.

2. The Committee had the following documents before it:

Basic document by Peru	BOP/277, Add.1 and Corr.1
Secretariat background paper	BOP/W/115
Reply to GATT questionnaire on import licensing	L/5640/Add.34 and Corr.1
Notifications by Peru concerning products subject to import licensing and prohibitions	L/5889 and Add.1-2, L/6208, L/6209, L/6245
Notifications by Peru concerning tariffs	L/5798 and Add.1
Notification by Peru concerning foreign exchange regulations	L/6178
International Monetary Fund, "Recent Economic Developments" dated 29 July 1987	

Opening statement by the representative of Peru

3. In his opening statement, the representative of Peru summarized the economic, financial, monetary and trading difficulties faced by Peru in most years since the last full consultation. A serious decline in the terms of trade had already seriously affected Peru's balance of payments and debt burden in the mid-1970s: the scale of liquidity problems obliged Peru to undertake a contractionary adjustment programme in 1976, combined with an emergency compensatory financing programme with Latin American central banks. While domestic demand fell by over 9 per cent in 1977 and 4 per cent in 1978, efforts to promote and diversify non-traditional

exports, coupled with higher oil sales and more favourable world price trends, led to a surplus in trade in goods and services and an improvement in the current account position in 1978. This made it possible to begin a broad import liberalization programme in 1979, under which import duties were markedly reduced and only a few products remained subject to import licensing (107 tariff headings) or prohibitions (7 tariff headings). In 1980, however, the resurgence of domestic and international inflation and a renewed decline in prices for Peru's main exports affected the economy adversely, and the combination of Peru's own import liberalization with contraction in export markets led to a current account deficit in 1981 equivalent to 8.6 per cent of GDP and a steady fall in Peru's net international reserves.

4. In order to protect the reserves and ensure necessary credit flows, the Peruvian authorities concluded a three-year extended facility agreement with the IMF in 1982 which contained strict adjustment and demand management conditions. However, in 1983, natural disasters affected both the northern coastal area and the southern altiplano. GDP declined by some 12 per cent; inflation increased to three-digit levels, imports and exports both declined sharply and the balance-of-payments situation was so seriously affected that it became impossible to carry out the adjustment programme. Inflation continued high in 1984, delays in servicing external debt continued and the scale of economic difficulties worsened, exacerbated by the problems of access to external finance which had existed since 1982. The level of debt servicing rose to 87 per cent of exports of goods and services in 1984, despite debt rescheduling.

5. The economic programme pursued by the new government since mid-1985 has the primary objective of gradually restoring the purchasing power of the population, with particular emphasis on the lowest income groups. A short-term emergency programme introduced in August 1985 included measures to stabilize prices and costs through price controls on staple food products, reductions in interest rates, particularly for loans to priority sectors such as agriculture, improved prices for farm products and increases in wage levels for urban and rural workers. In addition, in order to reallocate further resources for the needs of the domestic economy, servicing of medium and long-term public debt was limited to the equivalent of 10 per cent of the value of exports of goods and services. In July 1985, medium and long-term debt servicing for the next twelve months, including payments arrears, amounted to over US\$4,000 million, more than the total of Peru's export receipts. In order to reduce currency speculation the system of daily mini-devaluations was abandoned and, following an initial devaluation, the exchange rate in the Single Foreign Exchange Market (MUC) was partially fixed until December 1986, with an increasing proportion of both imports and exports taking place at higher exchange rates. The temporary suspension of conversion into foreign exchange of foreign currency certificates and deposits improved the Central Bank's foreign exchange position and restored national control of monetary policy.

6. The representative of Peru said that the new economic strategy had yielded positive results, with an increase of 8.5 per cent in GDP in 1986 and some 7 per cent forecast for 1987. Inflation, which stood at over 250 per cent on an annual basis in July 1985, had been reduced to 63 per cent by end-1986. Employment in industry, services and trade had grown and the "dedollarization" of the economy had been substantial. In spite of these achievements, Peru was still far from the levels of production, employment and income of two decades before, and the balance-of-payments trends were still worrying. In this regard, a number of factors were beyond Peru's control; including the dramatic decline in the terms of trade by 58 per cent in 1980-86, scarcity of external finance, high real interest rates and protectionist practices in international markets.

7. The balance of trade and the reserves position again deteriorated sharply in the first six months of 1987. Tighter conditions for financing from some international financial institutions were also having a harmful effect on Peru's economy. A new economic programme introduced in mid-1987 for the period up to 1990 seeks to maintain steady economic growth and increase investment, particularly to develop exports, while moderating the growth of private consumption. Peru, because of its sensitive and vulnerable economic situation and the need to increase export revenues to be able to pay its external debt, asked for the cooperation of its main trading partners to facilitate access to their markets. In this connection, the representative of Peru called attention to the list of Peruvian export products submitted in accordance with paragraph 12 of the Declaration on Trade Measures Taken for Balance-of-Payments Purposes.

Statement by the representative of the International Monetary Fund

8. At the invitation of the Committee, the representative of the International Monetary Fund made a statement, the full text of which is reproduced in the Annex.

9. Commenting on the statement by the IMF representative, the Peruvian representative stated that the stabilization programmes maintained since 1976 had had a high social cost; in particular, in 1983 the level of economic activity fell by 12 per cent, a fall which could only partly be explained by natural disasters. By contrast, the economic policy pursued since July 1985 had resulted in GDP growth of 8.5 per cent in 1986 and an estimated 7 per cent for 1987.

10. Price controls had been increasingly flexible since 1986. At present there was a large group of products whose sales price is freely determined by economic forces. The nationalization of private banks, which was only partial in scope, was aimed at achieving financial decentralization, avoiding concentration of credit and deepening the process of financial intermediation by means of a more aggressive policy of increasing and mobilizing financial resources. The nationalization did not affect foreign banks located in the country. Even for domestic banks, only 30 per cent of

the capital of regional banks would be affected; only in the case of banks established in Lima would the State have a majority share.

11. The debt repayment limit of 10 per cent of exports of goods and services referred only to medium and long-term public debt contracted prior to 28 July 1985, and excluded payments in kind. Furthermore, the private debt suspension was only a temporary measure until July 1988, and also referred only to medium and long-term debt disbursed prior to 28 July 1985. He pointed out that Peru had been promptly servicing credits stemming from its foreign trade as well as interest on loans for working capital. Since November 1987, the suspension of remittances of profits, payment of loans and depreciation of foreign companies under special contract with the Government and engaged in petroleum and mining activities has been eliminated. Relations with foreign creditors had been maintained and some agreements had been concluded; for example, Peru recently consulted under Article IV of the IMF Articles of Agreement, and in December received a mission from the World Bank. In addition, the Inter-American Bank had been granting new credits and disbursing resources on a large scale. Meetings with official creditors had been held bilaterally and in Paris; arrangements had been concluded for payment in kind with some private banks and a meeting with banks had been convened for January 1988.

12. The "fixing" of the exchange rate only referred to the rate on the Single Foreign-Exchange Market, at which a decreasing number of foreign transactions were made. The exchange rate for exports and imports had been gradually raised. Following an average devaluation of 25 per cent at the end of October, the average real exchange rate in November was 27 per cent below the level in force when the present Government came into power, at which date Peru had the highest real exchange rate in recent decades. The exchange authorization for the payment of imports of non-financial services was a mechanism by which the Central Bank could verify that the reasons for which foreign currency is used were in conformity with existing legal requirements and not a channel for capital flight.

13. Finally, he pointed out that, regarding the main subject of the consultations, the application of prior import licensing, together with the foreign exchange budget system in force until December 1988, had not led to reductions or obstacles in Peruvian imports. On the contrary imports had grown considerably between 1985 and 1986, by 40 per cent, and would probably have risen by a further 20 per cent in 1987, leading to a considerable rise in sales from almost all Peru's trading partners without discrimination against any of them. The licensing system was primarily aimed at establishing priorities for the use of available foreign exchange and not at reducing import flows.

Balance-of-Payments position and prospects: alternative measures to restore equilibrium

14. All members of the Committee recognized the grave economic difficulties confronting Peru and the seriousness of the

balance-of-payments situation. It was also recognized that the present current account situation was not sustainable, and that the prospects for relief in the short term were not favourable, given Peru's high degree of dependence on a limited number of basic commodities, many of whose prices had declined and for which the outlook was at best uncertain.

15. Some members stated that many of the present difficulties stemmed mainly from the pursuit by Peru of inappropriate fiscal, monetary and exchange rate policies, which should be adjusted. Noting that the 1979 Declaration recognized that trade restrictions are an inefficient means to maintain or restore balance-of-payments equilibrium, they recalled that Article XVIII:B permitted the temporary imposition of import restrictions but also required contracting parties to pay due regard to restoring the balance of payments on a sound footing. It was noted that new restrictions had been added and existing ones intensified in recent months. It was also noted that the performance of Peru's external sector had deteriorated markedly in recent years; in this context, members asked how Peru intended to make its exports more competitive and to attract a greater volume of foreign exchange inflows. They also noted the multiplicity and complexity of exchange rates applied by Peru and asked for more information on the measures taken by Peru to simplify the system, some of which had been mentioned in the IMF statement.

16. Other members welcomed Peru's efforts to restore economic growth, which were showing encouraging results. They supported the social objectives pursued by the Peruvian authorities and recognized the importance of consolidating economic developments within a democratic system. However, they expressed concern about the growing rate of inflation and the high level of public sector debt, and asked for clarification on Peru's view of the prospects for these elements. They welcomed the renewed contacts which had been made with Peru's external creditors, but stressed the need for more positive measures to be taken to attract foreign investment which could assist in diversifying Peru's trade and economic structure; in this context, they questioned whether the current restrictions on repatriation of capital would promote these ends. It was noted that Peru's import licensing system was used both for balance-of-payments and industrial protection purposes, and that the industrial protection element should be covered by other GATT provisions than Article XVIII:B. It was, however, recognized that it would be difficult for reductions in import restrictions to be made without an improvement in the balance-of-payments situation. They also asked for clarification of the policy guidelines applied by Peru concerning the repayment of debt among different creditors, in the context of restrictions maintained on debt repayment. The hope was expressed that the problem of Peru's indebtedness could be solved in consultation with relevant international organizations and that the trade restrictions could be reduced progressively.

17. Other members stated that the very complete documentation supplied by Peru illustrated well the problems facing many developing countries. The

decline in the terms of trade by 58 per cent between 1980 and 1986 had led to a marked fall in export earnings, with major effects on the growth of external savings, capitalization, economic growth and the redressment of the balance-of-payments situation. They also called attention to the incidence of external factors, including protectionist pressures, on the state of the Peruvian economy, and the fact that no reference was made to these in the IMF statement. Noting that all preceding statements had recognized the real problems faced by Peru, they emphasized that both external and internal factors should be fully taken into account, including the serious problems of inappropriate international monetary and financial policies, in particular in reserve-currency countries. They noted that the evolution of interest rates had had a major adverse effect on the possibilities for investments and on the servicing of external debt. Many complex factors affected the balance-of-payments situation of countries like Peru and these should be analyzed more completely by the Committee. It was emphasized that the crisis of the Peruvian economy was not temporary in nature and therefore Peru's import measures could be seen as fully justified.

18. In reply, the representative of Peru stated that Peru would, in order to regain economic equilibrium, require the cooperation of the international community and international organizations, and it was aware that adjustments to its domestic economic policy were needed. The government was continually reviewing its economic policies; in this connection, particular attention was being paid to correcting distortions in the exchange system. A major devaluation of the MUC rate for the inti from 20 to 33 intis per US dollar had been made on 14 December; and in addition to the October 1987 measures, the number of exchange rates applied to exports had been reduced from three to two, implying a reduction from 20 to 5 per cent in the dispersion of such exchange rates. The average exchange rate applied to traditional exports had moved to 40 intis per dollar, equivalent to a devaluation of 49.3 per cent in local currency terms; the rate applied to non-traditional exports had moved to 42 intis per dollar, or a devaluation of 31.3 per cent. The spread of the exchange rates applied to imports had also been reduced and the average rate applied to imports had moved from 25 to 39 intis per dollar, or a devaluation of 56 per cent. There was thus a significant reduction in the differential between the rates applied to exports and imports of goods, as also for imports of services. This would bring the real exchange rate back to its level of July 1985. The aim of the government in the forthcoming year was to maintain the current real exchange rate and to continue to reduce the dispersion between import and export rates and the multiplicity of exchange rates. Monthly adjustments of the exchange rate, equivalent to the change in the previous month's wholesale price index, would be made during 1988. In case this index was not available, monthly adjustments equivalent to 85 per cent of the previous month's change in the consumer price index would be made. He presented to the Committee a communiqué published in the Peruvian Official Journal by the Central Reserve Bank on 14 December, announcing the 65 per cent devaluation mentioned above and the exchange rate policy for 1988 (L/6291).

19. The representative of Peru also stated that major increases had been made in consumer taxation, including on alcoholic beverages, cars and cigarettes. A temporary tax had also been introduced on incomes of over 20,000 intis per month, as well as a tax of 25 per cent on foreign exchange used for foreign tourism, and the system of payment of other taxes had been adjusted to account for inflation. The budget for 1988 provided for a number of further new taxation measures, including major increases in real estate tax, decreases in tax exemptions, and a new tax of 3 per cent on companies. Taxation on gasoline had also been increased, as had public service tariffs. A period of 120 days had been accorded to the Executive to make changes in the tax system. Under this the direct tax system would be subject to thorough review, and in addition, a minimum tariff not to exceed 5 percentage points would be applied to certain imports that had previously not been subject to duties.

20. In relation to foreign investment, he stated that priority would be given to investment directed to the export sector. Restrictions on remittances from mineral and petroleum companies with government contracts had been eliminated. He noted that on 14 December, the Peruvian Congress had approved a modification to the law on hydrocarbons, providing for more favourable conditions for amortization of investment and assured access to foreign currency for oil companies. Concerning the foreign debt he noted that Peru would honour all its obligations. The suspensions which had been made were partial and temporary, resulting from rigidities in international capital markets, as well as Peru's reduced capacity to pay, and had been made in the light of the need to restore economic growth and development. He also stated that Peru was evaluating ways of converting part of its external debt into equity. Peru was attempting to avoid having net negative transfers of resources, and was giving priority to arrangements with creditors which would allow exports to grow. Several such agreements had already been concluded by which creditors agreed to receive as debt payment the equivalent of one unit of foreign currency in non-traditional exports and in return to buy similar exports to the equivalent of two additional units of foreign currency. He noted that Peru's private-sector debt represented less than 10 per cent of its external indebtedness.

#### System, methods and effects of the restrictions

21. A number of members noted that the measures taken by Peru to restrict imports were numerous, varied and complex in character. They commented on the lack of predictability and transparency in the Peruvian import system, the frequent changes which were made and the large number of exceptions to general rules. It was also remarked that a number of measures including licenses, prohibitions, tariffs, surcharges and foreign exchange controls were applied simultaneously, and that the large number of exchange rates in force could lead to discriminatory treatment. Attention was called to the provisions of Article XVIII:B and the 1979 Declaration in relation to the multiplicity of measures, the need to give preference to the measure which has the least disruptive effect on trade and the need to ensure that imports could be made in minimum commercial quantities. It was also

recalled that restrictions for balance-of-payments purposes should not be used for protection of individual industries. In this connection, it was recalled that 57 per cent of the tariff universe was covered by import licensing and a further 10 per cent by prohibitions, while tariffs and surcharges had raised the average level of import duties from 32 to 63 per cent; a further 4 per cent had been added to this in October to cover preshipment inspection. It was asked what impact the preshipment inspection charge was expected to have on the balance of payments and in what way it was expected to stem capital flight. Questions were also asked concerning the use of countertrade by Peru and the possible distortions which might result. Clarification was also sought on Peru's intentions to simplify its import measures. One member said that his authorities would encourage Peru to develop a timetable for the removal of prior import licensing requirements, or, if this were not practicable at the present time, to progressively eliminate the restrictions or to convert them to tariff-based measures which would allow market access and eliminate many of the distortions which the quantitative controls introduced.

22. In reply, the Peruvian representative stated that the prior licensing requirements and import prohibitions were temporary and had been adopted in the light of the balance-of-payments situation. Their scope was continually under review. Countertrade was regarded as a measure which could help to alleviate trading problems; its scope was currently not over 3 per cent of total exports. Preshipment inspection requirements did not affect trade adversely; they benefited Peru's trade balance through beneficial effects on trade invoicing and reduced the level of imported inflation; thus they assisted Peru in making more rational use of scarce foreign currency resources.

#### Factors relevant to paragraph 12 of the 1979 Declaration

23. The representative of Peru drew attention to the request lists circulated in document BOP/277/Add.1. Peru sought improvement in market access for these products and would look for specific offers by its trading partners.

24. A number of members stressed the importance of this part of the consultation. One member recalled that Peru's terms of trade had deteriorated notably over the past years, due both to declines in the world prices of Peru's major exports and protectionist measures in major markets. Declining prices had been particularly evident for goods such as sugar, where exports of subsidized products on international markets had a highly adverse effect. Other measures such as voluntary export restraints, discrimination in the application of GSP schemes and other tax measures had hindered the development of exports. He asked how the countries to which requests were made would deal with them. In relation to restrictions maintained by his country, he noted that many of the products mentioned in the Secretariat paper were included in the liberalization process under LAIA agreements.

25. A number of members expressed the opinion that the Uruguay Round provided the best opportunity for improving the trading environment. One member noted that his country was the largest single market for Peruvian exports and had run a trade deficit with Peru in recent years. He did not think that this Committee was the correct place to discuss questions relating to the GSP scheme but noted that Peru's interests had not been harmed by the 1986/87 review of his country's scheme. The products on which requests were made by Peru were mostly import-sensitive. He recalled that the GSP scheme was unilateral and autonomous in nature; however, consultations could be held on a bilateral basis. He also recalled that countervailing duty investigations were not initiated by government but resulted from petitions by the private sector, and reiterated his authorities' view that, as responses to unfair trading practices, these were consistent with GATT obligations and should not be included in this part of the consultation. Regarding trade in textiles, he noted that in the year ending September 1987, Peru's exports of apparel to his country had grown by 62 per cent and that quota utilization for the current year was still relatively low. Referring to sugar, he recognized the important problem of international subsidization of agricultural products and said that his authorities expected that substantial progress could be made towards a solution in the Uruguay Round.

26. Another member noted that many of the products mentioned in Peru's requests were covered by the tropical products negotiations, in which his delegation had recently made a specific negotiating offer. On textiles, he also noted that no basket exits had been implemented in relation to Peru. He remarked that the requests were addressed to a very limited number of countries and suggested that Peru might consider diversification into other markets. Another member noted that one of the products mentioned by Peru already received duty-free treatment in his country's market. His country was prepared to discuss other products listed in the context of the Uruguay Round. Yet another member stated that his authorities were in the process of reviewing Peru's proposals and supported the statement made that it was inappropriate to include anti-dumping and countervailing measures under this section of the consultation.

27. A number of members expressed disappointment at the responses made to Peru's requests, which had led only to statements of justification for maintaining measures against a consulting country. They recalled that under paragraph 12 the Committee was required to give particular attention to the possibilities for alleviating the balance-of-payments problem through measures to facilitate the expansion of export earnings of the consulting country. Moreover, paragraph 12 of the 1979 Declaration should not be related to political undertakings made in the context of any particular round of negotiations. More specific and positive responses would have been appropriate. Other members expressed the view that nothing in paragraph 12 prevented concessions offered within a specific round of negotiations from being taken into account in the present framework.

28. Before summing up, the Chairman welcomed the wider participation and fuller discussion which had taken place in this as well as in other recent consultations, which was a positive sign in the Committee's work.

### Conclusions

29. The Committee recognized the critical economic situation faced by Peru and the serious character of its balance-of-payments problems. It underlined the importance of both external factors and domestic economic policies in the evolution of the balance-of-payments situation and emphasized the need to give appropriate weight to all relevant factors. It recognized that Peru was particularly vulnerable to external developments because of its export structure.

30. While recognizing that the situation would remain difficult in the short term, and expressing understanding of the economic and social problems faced by the Peruvian authorities, the Committee expressed its preoccupations concerning the balance between the use of import restrictions by Peru and the development of appropriate financial, budgetary, monetary and exchange rate policies. It was noted that trade restrictions, while they might be justified under the present circumstances, were an inefficient means of restoring balance-of-payments equilibrium and should be temporary. The Committee also noted the concerns expressed by some members on the lack of transparency, predictability and stability in Peru's import régime and the multiplicity of restrictions applied to similar products and drew attention to the relevant provisions of the 1979 Declaration. It recalled that import restrictions taken for balance-of-payments purposes should not be used to protect particular industries or sectors.

31. The importance of restoring conditions for healthy capital inflows and the development of investment in Peru was emphasized. In this context, the Committee expressed its satisfaction at the statement by the Peruvian representative concerning the renewal of contacts with foreign creditors and international financial organizations, and took note of Peru's declarations concerning the repayment of its external debt. It also took note of the announcement made by Peru at the meeting concerning changes in the exchange rate régime and tax developments.

32. In relation to the requests made by Peru under paragraph 12 of the 1979 Declaration, the Committee took note of all the points made.

ANNEX

Statement by the representative of the IMF

PERU

Since the mid-1970s, Peru's economic performance has been characterized by stagnating exports, low economic growth, high inflation and declining per capita GDP. During much of this period Peru undertook heavy foreign borrowing to finance its fiscal and external imbalances. In combination with the weak performance of exports and real GDP, this has led to large external debt and debt service burdens. Recently, urban and rural terrorism has been a major problem.

Several attempts have been made since the early 1970s to establish the basis for sustained growth, in some instances through adjustment programs supported by the use of Fund resources. However, these efforts have not been carried to a successful conclusion.

In 1982, the Peruvian authorities began to implement a multi-year adjustment program supported by Fund resources under an extended arrangement, but this program went off track during its second year in the wake of natural disasters and slippages in policy implementation. In 1984, Peru undertook a renewed stabilization effort, supported by a Fund stand-by arrangement. At the beginning of this program a devaluation reversed part of the earlier real appreciation of the currency, and actions were taken to reduce the fiscal deficit. Real GDP recovered and inflation slowed somewhat, while the external current account deficit declined from 5 1/2 percent of GDP in 1983 to under 2 percent of GDP in 1984. However, by mid-year this program also became

inoperative due to deviations in fiscal performance, and external payments arrears began to emerge on a large scale. An effort was made to revive the program in early 1985, but the effort was not completed before the change of government.

Since mid-1985 the Peruvian authorities have been following policies that aimed at reactivating the economy. The authorities' program included a boost in real wages and a lowering of taxes and interest rates, together with tighter price controls, a fixed exchange rate (after a small initial depreciation), and an increase in the level and complexity of exchange and trade restrictions. To bolster the foreign exchange position, a unilateral limit of 10 percent of export earnings was imposed for debt service payments, which has resulted in a substantial further accumulation of external arrears. A number of different exchange rates were established for various categories of imports, exports, and other international transactions, and quantitative import restrictions in the form of licensing requirements or prohibitions were extended to 40 percent of all product categories, compared with 6 percent at end-1984.

Since 1985 there has been a significant deterioration in the public finances. Government revenues have declined markedly in relation to GDP and the public sector deficit is projected to reach over 9 percent of GDP in 1987, compared with 4 1/2 percent in 1985. In addition, the Central Bank is incurring losses of 2-3 percent of GDP a year from the operation of the multiple exchange rate system and from subsidized credit operations.

Initially the government's policies led to a reduction in the rate of increase in consumer prices and to a buildup of international reserves as imports declined and debt service payments were curtailed. After a modest recession, real GDP recovered, rising by 8 1/2 percent in 1986 and by over 16 percent (on an annual basis) in the second half of the year, before leveling off in the first half of 1987. However, with the strong economic upturn, led by consumption, the balance of payments position deteriorated as imports rose and exports fell (reflecting both the real appreciation of the currency and unfavorable price developments), while new external loan disbursements declined. The current account, including accrued interest payments, moved from a deficit of less than 1 percent of GDP in 1985 to a deficit of 7 percent of GDP (or US\$1.4 billion) in 1986, and a deficit of 6 1/2 percent of GDP (or US\$1.6 billion) is projected for 1987.

During 1986 and early 1987 exchange restrictions were intensified through the prohibition of most private debt service payments, the establishment of a foreign exchange licensing system for imports, the requirement of prior Central Bank authorization for most service transactions, and other measures. Peru's international reserves have been falling since early 1986 and external payments arrears have continued to accumulate at a rapid pace. As of end-September 1987, gross international reserves amounted to US\$1.2 billion or 5 months of imports, while external payments arrears had reached about

US\$6.9 billion or 200 percent of receipts from exports of goods and nonfinancial services. Meanwhile, inflation has accelerated and by October 1987 the 12-month change in the consumer price index was close to 100 percent.

In recent months the authorities have stated that they are considering various measures to address the deteriorating economic situation. They have indicated that they will seek to reduce the fiscal deficit through improved tax administration, a broadening of the tax base, and improved efficiency in the operations of the government and public enterprises. They have announced their intention to privatize some public enterprises, although they have nationalized the private financial system. Sizable devaluations were implemented at end-July and end-October, along with some reduction in the number of different exchange rates applicable to merchandise transactions. Despite these measures, at end-October 1987 the real effective value of Peru's currency was still about 40 percent higher than in mid-1985, and the exchange system remains highly complex and restrictive.

A comprehensive program will be needed to reverse the recent adverse economic trends. Such a program will need to aim at reducing inflation, improving resource allocation, and strengthening the balance of payments in order to help create the conditions for sustained growth. For these purposes it is necessary to restore external competitiveness on the basis of a satisfactory exchange rate system, reduce the public sector deficit, and move to restrained credit and wage policies. More generally, the country will benefit from an increased use of market mechanisms, including the scaling down of trade and

exchange restrictions and the lessening of other controls over the economy. In addition, Peru's medium-term growth prospects would be improved if relations were re-established with the country's external creditors.

In conclusion, Peru needs to act on a number of fronts if it is to deal with its serious domestic and external imbalances. The authorities have indicated that they are contemplating remedial actions, but they will need to frame a comprehensive program and to implement it without delay. As the present stance of policies does not provide assurances that Peru's restrictive exchange practices will be eliminated at an early date, at the conclusion of the 1987 Article IV consultation in November the Fund was not in a position to approve those practices under Article VIII.