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MEMORANDUM ON GATT RULES AND PROCEDURES GOVERNING
TRADE MEASURES FOR BALANCE-OF-PAYMENTS PURPOSES

Revision

The attached revised memorandum by the United States representative, the Honourable Clayton K. Yeutter, is being circulated to the Group in connexion with item 3 of the Annotated Provisional Agenda (CG.18/W/13) for the fourth meeting of the Group to be held on 25-26 October 1976.

MEMORANDUM

TO: Members, GATT Consultative Group of 18

FROM: Clayton K. Yeutter

SUBJECT: GATT Rules and Procedures Governing Trade Measures for Balance-of-Payments Purposes

At the last meeting (24-25 February) of the GATT Consultative Group of 18 (G-18), there was full discussion of the operation of existing GATT rules and procedures governing trade actions for balance-of-payments purposes. The discussion focused on suggested approaches for improvement of GATT review procedures set forth in a paper presented by the United States. Review of the issue by the G-18 indicated broad agreement that improvement was needed. However, concerns in addition to those dealt with in the United States paper were raised.

In particular, certain representatives argued strongly that trade measures are the least desirable measures that can be taken for balance-of-payments purposes and that the emphasis should be on limiting the use - at least by developed countries - of trade measures for such purposes. Other representatives noted the special balance-of-payments problems of the developing countries and the need to take fully into account their concerns. At the conclusion of the G-18 discussion, I indicated that the United States would revise its paper in light of concerns raised at the meeting and present specific recommendations for action by the GATT Council.

The suggested approaches outlined in the balance-of-payments paper presented by the United States concentrated on the need to strengthen existing GATT procedures to ensure more effective and constructive international review of trade measures taken for balance-of-payments purposes. This was principally because revision of the GATT review procedures involves questions of internal GATT management which are well suited for consideration by the G-18 and action by the Contracting Parties over the short term. Agreement on the use of trade measures for balance-of-payments purposes, on the other hand, will necessarily involve a more complex and somewhat longer term effort.

The United States still believes that the G-18 should submit recommendations to the Council for improving GATT balance-of-payments review procedures. Attached, for purposes of discussion, is a set of suggested recommendations together with a short paper explaining the rationale for each proposed recommendation.

The United States shares the view, however, that trade measures are not a desirable means of addressing balance-of-payments problems and that alternative policies for adjustment, including exchange rate adjustment, are preferable. The United States therefore proposes that an agreement be sought to develop provisions limiting the use of such measures.

We suggest that the first issue to be addressed be obligations which developed countries might undertake. As a working hypothesis, developed countries might consider adoption of a declaration not to invoke GATT Article XII and not to employ trade measures of any kind for balance-of-payments reasons. The United States recognizes that in certain exceptional circumstances, the imposition of trade measures might be unavoidable. Discussion would reveal the extent to which departures from the basic obligation would be required. The United States believes that where trade measures are necessary, they should be temporary, and subject to specified conditions.

The situation of developing countries should, of course, also be discussed. The ability of developing countries to accept restrictions on the use of trade measures for balance-of-payments purposes is, however, understandably more limited than for developed countries. Any guidelines developed should clearly reflect this.

SUGGESTED RECOMMENDATIONS TO THE GATT COUNCIL FOR
IMPROVEMENT OF GATT PROCEDURES GOVERNING TRADE
MEASURES FOR BALANCE-OF-PAYMENTS PURPOSES

Existing procedures for review by the CONTRACTING PARTIES for balance-of-payments purposes would be significantly improved by implementation of the following recommendations:

- (i) any contracting party which imposes any trade measure for balance-of-payments purposes should immediately notify such action to the CONTRACTING PARTIES. In the event such contracting party fails to notify the CONTRACTING PARTIES of such action within a reasonable time, any other contracting party may so notify the CONTRACTING PARTIES;
- (ii) the Balance-of-Payments Committee should review all trade measures taken for balance-of-payments purposes, fully appraise the trade actions taken in terms of their conformity with the GATT, including, in light of the appropriate GATT provisions, the effect of such actions on the trade of the developing countries, and examine whether alternative trade measures or adjustments to reduce distortions might not be possible. In so doing the Committee should pay due attention to limitations that might exist with respect to the flexibility of the country concerned in adjusting to disturbances in the international economy;
- (iii) the GATT secretariat should prepare objective trade-policy-oriented studies on the measures taken. Such studies should include the effects of the measures taken on the trade of developing countries;
- (iv) in evaluating actions taken by developing countries the Balance-of-Payments Committee should take account of the special needs of those countries;
- (v) as part of its in-depth analysis the Committee ought to examine the implications of trade restrictions imposed by other countries that may have precipitated the specific action in question;
- (vi) the Committee should report its conclusions and state fully the reasons behind its decisions so as to build up a body of commentary that could facilitate the development of guidelines governing future trade actions for balance-of-payments purposes;
- (vii) the surveillance rôle of the Committee should be enhanced to enable it to follow up and review actions that are taken in the light of the Committee's recommendation or conclusions; and
- (viii) the GATT and the IMF secretariats should be encouraged to develop procedures for improved co-ordination and exchange of information between the CONTRACTING PARTIES and the Fund.

RECOMMENDATIONS FOR IMPROVEMENT OF GATT PROCEDURES
GOVERNING TRADE MEASURES TAKEN FOR BALANCE-OF-PAYMENTS
PURPOSES - BACKGROUND PAPER

- (i) Any contracting party which imposes any trade measure for balance-of-payments purposes should immediately notify such action to the CONTRACTING PARTIES. In the event such contracting party fails to notify the CONTRACTING PARTIES of such action within a reasonable period of time, any other contracting party may so notify the CONTRACTING PARTIES

The obligation of a contracting party to notify the CONTRACTING PARTIES of the imposition or intensification of trade restrictions taken for balance-of-payments reason is already implicit in the consultation obligations contained in Articles XII:4(a) and XVIII:12(a). However it has occasionally been the case that contracting parties have failed to notify such measures. Without proper notification, international review procedures cannot operate effectively. Accordingly there should be provision for third party notification of balance-of-payments trade measures to the CONTRACTING PARTIES in cases where the party taking the measures fails to notify the GATT within a reasonable period of time.

- (ii) The Balance-of-Payments Committee should review all trade measures taken for balance-of-payments purposes, fully appraise the trade actions taken in terms of their conformity with the GATT, including, in light of the appropriate GATT provisions, the effect of such actions on trade of developing countries, and examine whether alternative trade measures or adjustments to reduce distortion might not be possible. In so doing, the Committee should pay due attention to the limitations that might exist with respect to the flexibility of the country concerned in adjusting to disturbances in the international economy

The balance-of-payments exception to the general GATT prohibition on the use of quantitative restrictions (QRs) reflected the widespread use of QRs for balance-of-payments purposes at the time the GATT was drafted. Trade measures other than QRs were not generally used and are not provided for under the balance-of-payments provisions of the GATT. However, since the mid-1950's contracting parties have turned increasingly to surcharges and import deposit requirements for balance-of-payments purposes.

Both surcharges and deposit measures have been brought before the GATT on an ad hoc basis, but regular review procedures within the GATT have not been developed. In some cases, surcharges and prior deposits are reviewed by the Balance-of-Payments Committee. In others, they have been reviewed by working groups. In a significant number of cases, the measures have not been notified to, or reviewed by, the CONTRACTING PARTIES at all.

Provision for review by the Balance-of-Payments Committee of all restrictive trade measures taken for balance-of-payments purposes would allow regular and thorough surveillance procedures. It would eliminate the current dual practice of review by working groups (generally favoured for developed countries' actions) and review by the Balance-of-Payments Committee and provide regular procedures for notification to, and review by, the CONTRACTING PARTIES of all restrictions imposed for balance-of-payments purposes.

Objections have been raised that adoption of regular review procedures for trade measures other than QRs taken for balance-of-payments reasons would encourage their use. Based on recent experience, it appears difficult to maintain that present practice effectively discourages their use (indeed, providing procedures for regular review should discourage, rather than encourage, their use). Furthermore, and more importantly, such regular review procedures would not in any way prejudice the legal rights of any contracting party to question the GATT consistency of a surcharge, a prior deposit requirement or any other trade measure. To the extent import surcharges have been reviewed by the CONTRACTING PARTIES, procedural assimilation has not changed the rights of the countries affected thereby. In some of its conclusions on surcharges, the Balance-of-Payments Committee has reaffirmed the rights of adversely affected contracting parties by stating that the review in no way precludes recourse under the appropriate provisions of the General Agreement. This practice should continue.

Increased use of restrictive trade measures for balance-of-payments purposes is, of course, cause for legitimate concern. In light of the trend towards greater flexibility in exchange rate adjustments, the need for such trade measures - at least on the part of most developed countries - has been reduced. The cure to the problem is not, however, to avoid the development of effective international review procedures. Rather, it is to develop improved rules restricting the use of trade measures for balance-of-payments purposes. An effort in this direction would complement efforts to improve GATT surveillance procedures.

In addition to establishment of regular review procedures for all trade restrictions imposed for balance-of-payments reasons, existing practice could be materially improved by better review of the trade effects of such restrictions. Currently, the Balance-of-Payments Committee discussion of the trade effects of balance-of-payments measures concentrate on the nature of quotas for specific goods or special tax or import regulations which are detrimental to a particular country's trade interests. There is little or no discussion of the operation of the trade measures as a whole and no general review of alternative trade measures or adjustments to the trade measures taken which could reduce the trade distorting effects.

Without appraisal of the overall trade effect of a balance-of-payments measure, it is difficult to determine accurately the consistency of the measure with the understanding that developed country contracting parties should take maximum efforts to avoid actions which adversely affect the export opportunities of the developing countries or the requirements of the GATT governing non-discrimination in the application of QR's, surcharges or prior deposit measures. Assuming that the necessary information is provided, the Balance-of-Payments Committee should review the trade impact of balance-of-payments measures and would be in a position to recommend either alternative trade measures or adjustments to the trade measures taken with a view towards reducing trade distortions.

Where justification for trade measures is found to exist, there should be a strong presumption in favour of measures that have a less distorting effect on trade. Review by the Balance-of-Payments Committee should fully reflect this policy objective and, where appropriate, adjustments or alternative measures should be recommended to the party taking the balance-of-payments action.

- (iii) The GATT secretariat should prepare objective, trade-policy-oriented studies on the measures taken. Such studies should include the effect of the measures taken on the trade of developing countries

Background information on balance-of-payments consultations is now provided by (i) the IMF and (ii) the country taking the trade action. The IMF supplies an assessment of the consulting country's external financial position and the most recent Fund reports on economic developments in the country (or where not available, a specially prepared economic background paper). The consulting country submits a "basic document" describing the operation of the trade restrictions, their effects, and the general policy behind their use.

At present, the GATT secretariat does not prepare independent studies on the trade measures taken. As a result, the background information does not generally provide a basis for effective appraisal by the CONTRACTING PARTIES of the trade impact of such measures. This, in turn, limits the ability of the CONTRACTING PARTIES to suggest adjustments to reduce distortions or the impact of such measures on developing country contracting parties. The information provided by the IMF is not intended to focus on the trade effects of balance-of-payments trade measures. While the "basic document" prepared by the consulting country generally includes an appraisal of the effects of the import restrictions on trade, the amount of information provided has varied considerably and the analysis has frequently been incomplete. For example, the trade effects of restrictions have rarely been quantified.

Trade-policy-oriented studies on the effect of trade actions taken for balance-of-payments purposes would provide a basis for better focused and more productive consultations in the Balance-of-Payments Committee on the trade effects of such actions. The GATT secretariat is well equipped to undertake such studies and should be encouraged to do so.

(iv) In evaluating actions by developing countries, the Balance-of-Payments Committee should take into account the special needs of such countries.

The recent world economic disruptions have had a particularly hard impact upon many developing countries and have aggravated what in many cases already were serious balance-of-payments difficulties. The worsened balance-of-payments problems of the developing countries do argue for a more sympathetic and constructive consultative process by the CONTRACTING PARTIES. In this connexion, review of measures imposed by developing countries might include examination of long-term import restrictions maintained by others which significantly limit the export opportunities of such countries and are a cause of their balance-of-payments difficulties. Where balance-of-payments restrictions are found to be justified, the emphasis of consultation would be on a mutually beneficial effort to make appropriate adjustments in order to reduce trade distortions and minimize the administrative burdens resulting from the trade actions taken.

Some of the recent changes in IMF policies (major liberalization of IMF Compensatory Financing Facility, etc.) may lessen the need of the developing countries to impose trade measures for balance-of-payments purposes. However, the developing countries do not, in practice, enjoy the same flexibility as most developed countries to adjust their exchange rates. In this regard, in any review of the existing GATT rules governing balance-of-payments actions, the CONTRACTING PARTIES might usefully examine the operation of Article XVIII:B to determine whether the use of surcharges might be permitted (provided the eligibility criteria for Article XVIII:B actions are met).

Recognition of the special balance-of-payments needs of the developing countries should not be taken as a basis for weakening international procedures for review of balance-of-payments trade actions of the developing countries. Special rules are appropriate, but only in the context of satisfactory review procedures by the CONTRACTING PARTIES. As noted above, the key is to ensure that the process of review should become more constructive.

- (v) The Balance-of-Payments Committee ought to examine, as part of its in-depth analysis, not only the specific action taken by an individual country with respect to its own balance-of-payments problems, but also the implications of trade restrictions imposed by other countries that may have precipitated the specific action in question.

In certain cases, balance-of-payments restrictions may be imposed, at least in part, in order to offset the loss of export opportunities resulting from restrictions imposed by other countries. In particular, where the export earnings of a country are heavily dependent upon exports of a given product (or products), trade restriction on such product can precipitate a serious balance-of-payments problem. While difficulties of this nature will arise most frequently in the case of developing countries, they may also affect certain developed countries.

Where there is a clear cause-and-effect relationship between balance-of-payments restrictions imposed by one country and trade restrictions on its exports maintained by other countries, review by the CONTRACTING PARTIES of the balance-of-payments measures should, if it is to be complete, also involve review of the relevant trade restrictions.

In this connexion, however, care will have to be taken to prevent a balance-of-payments consultation from becoming a general review of various trade restrictions maintained by several contracting parties. This would blur the focus of the Balance-of-Payments Committee function and weaken, rather than strengthen, the operation of the Committee.

- (vi) The Committee should report its conclusions and discuss them narratively so as to build up a body of commentary that could facilitate the development of guidelines governing future trade actions for balance-of-payments purposes

There has been a general hesitancy on the part of the Balance-of-Payments Committee to state the reasons for conclusions reached. This appears to reflect a concern for development of a consensus on the particular trade measures reviewed. While expedient for short-term purposes, this approach sacrifices the longer-term benefits of developing general criteria, by way of precedents, which could guide contracting parties in planning financially motivated trade controls. Full discussion of the reasons for Committee conclusions would also tend to promote a more sharply focused review of trade measures and, as a result improve the consultative process.

A clear statement of the reasons behind Balance-of-Payments Committee review would, on balance, appear to be desirable. However, care should be taken not to restrict the flexibility of the Committee to reach the appropriate conclusions in each particular case. For this reason, the conclusions reached, and the reasons therefor, should be viewed as general guidelines but not binding precedent for future cases.

(vii) The Committee's surveillance rôle should be enhanced to enable it to follow up and review actions that are taken in light of the Committee's recommendations or conclusions

The effectiveness of the Balance-of-Payments Committee is seriously compromised by its present inability to follow up and review actions taken in response to Committee recommendations or conclusions. Such follow up review need not involve a detailed analysis of the balance-of-payments measures taken and their trade effects. Indeed, in many cases, follow up might require no more than a written submission indicating the steps taken to meet the recommendations or conclusions of the Committee. Until there is effective provision for review of implementation of Committee recommendations, surveillance by the CONTRACTING PARTIES will not be complete.

(viii) The GATT and the IMF secretariats should be encouraged to develop procedures for improved co-ordination and exchange of information between the CONTRACTING PARTIES and the Fund

Review of the operation of the balance-of-payments rules and procedures of the GATT has indicated considerable scope for improved co-ordination and exchange of information between the CONTRACTING PARTIES and the Fund. There appears to be a range of possible measures to improve co-ordination. The GATT secretariat should review the problems involved with the staff of the Fund and based on such review, present recommendations for such action as may be appropriate to the CONTRACTING PARTIES. Improvement in internal GATT review of balance-of-payments measures should itself facilitate efforts to improve GATT-IMF co-ordination. The better GATT review of such matters, the more productive exchange of information will be for the Fund.