

GENERAL AGREEMENT ON  
TARIFFS AND TRADE

RESTRICTED

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Committee on Balance-of-Payments  
Restrictions

REPORT ON THE CONSULTATION WITH ISRAEL AND  
EXAMINATION OF THE ISRAELI TEMPORARY  
IMPORT SURCHARGE

1. In accordance with its terms of reference the Committee has conducted a consultation with Israel, and has examined Israel's Temporary Import Surcharge increased on 2 July 1974. The last regular consultation with Israel had taken place in March 1974, followed by a further meeting in October 1974 to examine specifically the re-introduction of an import deposit scheme and an increase in the rate of the surcharge. The Committee had before it a basic document supplied by the Israeli authorities (BOP/167), and a supplementary background paper supplied by the International Monetary Fund dated 29 September 1976.
2. The Committee generally followed the plan for such consultation recommended by the CONTRACTING PARTIES (see BISD, 18th Supplement, pages 52-53). The consultation was held on 1 November 1976. This report summarizes the main points of the discussion.

Consultation with the International Monetary Fund

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

"Developments in the Israel economy in the last two years have been characterized by efforts to adjust to the sharp imbalances caused by the depression in world markets and the substantial increases in the prices of imported goods and heavy government expenditures that followed the events of the last quarter of 1973. During these years, the trade deficit (including defense imports) increased from a level of a little over SDR 1 billion a year

in the years 1970-72 to around SDR 3 billion annually from 1974 onward. Net inflows of transfers and non-monetary capital in 1974-76 have increased but not sufficiently to prevent the emergence of persistent and large overall deficits, which are estimated to total almost SDR 1.8 billion for these three years. Over this period, the authorities have pursued restrictive domestic policies involving monetary and fiscal measures, designed especially to restrain private and public consumption, and have taken various external measures, including a very large cumulative depreciation of the Israel pound since November 1974, aimed at inducing a major shift of resources toward the export sector.

"As a consequence of these measures, real GNP rose only marginally in 1975 following increases of about 6 per cent per year in 1973-74, and is expected to grow by about 3 per cent in 1976, which is well below the long-term average. Associated with this slower growth in economic activity, there has been a substantial decline in real gross investment and a fall in real disposable income which has depressed the level of real private consumption. Consumer prices, after increasing by 56 per cent in 1974, rose by 24 per cent during 1975, but are expected to accelerate again in 1976 and increase by about 35 per cent due in part to certain policy measures undertaken in the framework of longer-term stabilization, such as the introduction of a value-added tax and the reduction of consumer subsidies.

"Given the time needed to produce a structural change in the economy conducive to a sustained and large increase in exports, the balance of payments has been slow to respond to the above-mentioned policies. The trade deficit reached SDR 3.1 billion in 1975, and, with a deficit of SDR 0.2 billion on the services account, the deficit on goods and services exceeded SDR 3.3 billion and was 18 per cent greater than in 1974. During 1975 export growth was hindered by the world recession and by the low profitability of Israel's industrial exports, so that total merchandise exports grew by 8 per cent in value (measured in terms of SDRs) and by only 3 per cent in volume; meanwhile the value of imports grew by 10 per cent, although when direct defense imports are excluded, civilian imports declined by 2 per cent in value and by 6 per cent in volume, reflecting the extent to which official policies reduced the growth of domestic demand. The net inflow in respect of transfers in 1975 remained at the same level as in the previous year, (about SDR 1.4 billion), while net inflow of non-monetary capital increased by more than SDR 0.8 billion to SDR 1.4 billion, mainly in connection with the increase in defense imports, but also on account of greater use of short-term financing facilities. Because of the larger net inflow of non-monetary capital, the net foreign assets of the banking system, which had fallen by over SDR 1 billion in 1974, declined by only SDR 420 million in 1975. Gross reserves of the Bank of Israel at the end of 1975 amounted to SDR 1.0 billion, equivalent to less than two months'

imports of goods and services at the 1975 level, and by the end of September 1976 they had risen slightly to SDR 1.1 billion. On the basis of available information, the deterioration in the trade account appears to have been halted in the first eight months of 1976, and a moderate improvement is forecast for the year as a whole. The overall balance of payments deficit in 1976 is expected to be somewhat smaller than the deficit of SDR 420 million registered in 1975.

"Exchange rate action has been one of the main elements in Israel's policy of export promotion. Since June 1975, Israel has followed a flexible exchange rate policy under which the Israel pound is depreciated by small amounts at frequent intervals, and since July 1976, the exchange rate has been determined daily on the basis of a basket of five currencies, representing primarily the structure of Israel's exports. As of September 29, 1976, the trade weighted depreciation of the Israel pound from the parities existing on May 1, 1970 amounted to 60 per cent. In addition, since March 1976 the authorities have periodically adjusted the rates at which indirect taxes are rebated to exporters pari passu with the depreciation of the exchange rate. Taking into account the increases in domestic costs that have taken place in the recent past, the combined effect of the policy to adjust the exchange rate and the rebate rates has been to maintain the overall profitability of industrial exports.

"The Government has continued with its policy of tariff reductions on a wide range of imports and further reductions are scheduled. The temporary prohibition of November 1974 on imports of automobiles was lifted in September 1975, and the advance import deposit requirement introduced in May 1974 was abolished in November 1975. The import surcharge which was also introduced as a temporary measure, and which now amounts to 15 per cent, is still in effect, and in February 1976, it was extended to cover payments for certain invisibles, the most important of which are for foreign travel. In March 1976, the tax on foreign travel was raised and the travel allowance for some categories of travelers was reduced. The Fund granted approval of the multiple currency practice involved in the application of the surcharge to certain invisibles and of the increase in the travel tax until December 31, 1976. On October 20, 1976, the approval was extended until June 30, 1977. The Fund will review this matter in the context of the mid-term review of the stand-by arrangement also approved by the Executive Board on October 20, 1976.

"In view of the continued serious balance of payments situation, the present restrictions in Israel, including the maintenance of the temporary import surcharge, may be viewed as warranted to prevent a deterioration in the balance of payments until more fundamental policy measures can be implemented."

Opening statement by the representative of Israel

4. The representative of Israel made an opening statement (the full text of which is reproduced in the Annex) in which he described Israel's balance-of-payments situation, its import régime and his authorities' appreciation of future developments. He pointed out the effects of the heavy defence expenditure, of immigration absorption and of development on the balance of trade and the level of the foreign debt. Despite the many difficulties facing Israel's economy, his Government had abided by its GATT obligations and had endeavoured to maintain as liberal a trade system as was possible.

I. Balance-of-payments position and prospects - alternative measures to restore equilibrium

5. Members of the Committee thanked the representatives of Israel and of the International Monetary Fund for their comprehensive statement. They noted that Israel had had an increasing balance-of-payments deficit from 1973-1975 due mainly to the trade and services accounts. It was noted with satisfaction that some improvement had taken place in 1976. Several questions were asked concerning the immediate and medium-term prospects for the balance of payments. The representative of Israel explained that it was hoped that existing policies would lead to further expansion of exports and to a reduction of demand for goods, including imported goods. Thus for 1976 as a whole, it was forecast that the deficit would decrease from I£ 4 billion to I£ 3.5 billion; the deficit for 1977 would be approximately the same as for 1976. However, he stressed that the exogenous factors, like prices of fuel, raw materials and of capital goods, as well as the trade policies of other countries might have negative effects. Furthermore future needs for foreign exchange to cover defence expenditure would depend primarily on developments beyond Israel's control.

6. Members of the Committee noted with interest that the Israeli authorities put great emphasis on the expansion of exports rather than the restriction of imports as a means of balance-of-payments adjustment. It was noted that exports had in fact grown by some 24 per cent in 1976 and several questions were asked concerning the measures which had been taken to encourage the growth of exports and to increase productivity in the export sector. The representative of Israel said that this was a deliberate policy on the part of his authorities. Efforts to expand exports were beginning to bear fruit. One of the prime factors contributing to this had been the exchange rate policy of frequent small devaluations in order to keep Israeli goods competitive on foreign markets. There had also been measures taken in the trade policy field. Whereas previously Israeli exports had met with some trade barriers abroad, today most of its trading partners had favourable terms of access for Israeli goods. As was known his Government had signed a Free Trade Agreement with the European Communities; while this had not yet translated itself into notable increases in trade, it was nevertheless a

step in the right direction which would lead to further progress. Israel had also obtained GSP treatment from most of its major developed trading partners. As a result some of the discrimination which Israeli goods had encountered in the past had been eliminated. Other types of measures had also helped increase exports. Great efforts to encourage diversification of production had been made. Israel's traditional exports such as agricultural products, food, clothing and textiles had been supplemented by production in metal chemicals and science based industries. These had been encouraged by increased government grants for research and development and by measures to encourage capital investment in these industries. Other measures in this field consisted of credit facilities for exports, and assistance for market research and for attending fairs abroad. In this context it was asked whether the recently signed Association Agreement with the European Communities was expected to have an effect on the balance of payments. The representative of Israel said that in the future this was bound to have a positive effect as freer trade to and from foreign markets would lead to a restructuring of the Israeli economy and to a tightening of conditions of competitiveness.

7. Members of the Committee noted that the level of inflation in Israel had remained high and it was asked what measures other than those already taken were being envisaged to reduce the rate of inflation. It was also asked whether this high level of inflation did not have a detrimental effect on the competitiveness of Israeli exports particularly as Israel's main trading partners had lower levels of inflation. The representative of Israel replied that his Government's basic objective was to restrain the growth of private and public consumption and to redirect resources to the export sector. Inflation was both a cause and a result of this policy. It was a case of cost-push rather than demand-pull inflation. Measures had been taken to curb domestic demand; reductions of food subsidies, increases in price of certain services such as education, water and electricity, monetary measures to reduce the liquidity in the economy (by some I£ 600 million or 12 per cent of total assets) and increases of bank interest rates by some 2 to 3 per cent. The exchange rate policy of frequent small adjustments had also contributed to reducing domestic purchasing power and therefore to curbing domestic demand. In this context several questions were asked concerning the value-added tax introduced by Israel in July 1976, in particular whether the VAT, which had been set at a level of 8 per cent, had not led to a parallel increase in consumer prices. It was also asked what impact it had had on inflation. The representative of Israel said that the introduction of an 8 per cent value-added tax had led to an increase in the level of prices, but of less than 8 per cent. One of the effects of the VAT had been to reduce the level of demand, which would necessarily reflect itself on the level of imports and therefore have a favourable effect on the balance-of-payments situation. Any decline of domestic demand had an immediate effect on the level of imports, and because Israel's import bill was so large (some 77 per cent of GNP in 1975), any change in the level of imports had a correspondingly large impact.

8. Turning to the question of the level of the foreign debt and the burden of debt servicing the Committee noted the statement by the representative of Israel that its foreign debt was one of the highest in the world and amounted to some \$3,000 per capita. Members of the Committee asked whether Israel expected to have difficulties in servicing and restructuring this foreign debt. The representative of Israel assured the Committee that the servicing and repayment of the foreign debt stood in very high priority of his Government's concerns. He stressed that its size was staggering: at US\$ $\frac{1}{2}$  billion it represented more than the annual domestic product. It had to be understood that in a situation where current receipts were inferior to current expenditure the servicing of the foreign debt represented a heavy burden on the economy. The structure of the debt was a matter of concern to his authorities and improvements were constantly sought in the extension of the dates of maturity of repayments.

9. Many questions were asked concerning the measures taken by the Government to encourage the inflow of private capital, in particular to promotion of foreign investment in new industrial sectors such as phosphates, potash and others. The representative of Israel said that the law enacted to encourage the inflow of foreign capital contained special facilities such as grants, loans at favourable terms, transferability of profits abroad, tax holidays and tax exemptions, duty exemptions on certain capital goods and, in preparation, provisions to ensure that the level of inflation would not impair the value of these concessions.

10. Members of the Committee turned to the question of the budgetary deficit. It was remarked that the deficit in the budget was surely one of the prime causes, besides devaluation and internal factors, for the level of inflation prevalent in Israel. It was noted that to cover the budgetary deficit the Government had recourse mainly to central bank loans and it was asked whether it was not possible to use resources of the private banking sector to meet the deficit. The representative of Israel recalled that in his opening statement he had stressed the heavy charges which lay on the Israeli economy and especially on the Government budget. Special items such as defence expenditure, the absorption of immigrants, and social services to lower income groups contributed to the heavy government expenditure. The deficit that was incurred was considered to be the minimum tolerable and there was little scope to make any further cuts in expenditure. He added that Government borrowing both from the public and from the banking sectors was already an important source of funds; however these sectors were called upon mainly to finance development expenditure rather than to cover the budget deficit. Israeli authorities had made very serious efforts to increase revenue through additional taxation. He pointed out that Israel was one of the countries with the highest level of taxation; efforts were made not only regarding the level of taxation but also to ensure tax collection. It was felt that from a fiscal point of view the limit had been reached and that no further financing could be obtained through increases in taxation. Therefore the only alternative left was to have recourse to deficit financing.

## II. System and method of the restrictions, and effects of the restrictions

11. Members of the Committee took note with satisfaction of the elimination of the import deposit scheme, which had been terminated in November 1975. With regard to the temporary import surcharge it was welcomed that the rate had been reduced from 35 per cent to 15 per cent; however, it was noted that in February 1976 it had been extended to cover payments for certain invisibles, the most important of which were for foreign travel. Members of the Committee noted that the measure was temporary and enquired whether the Israeli authorities had plans to phase out the surcharge and eventually eliminate it altogether. In this context several members of the Committee drew attention to the finding of the International Monetary Fund to the effect that the import surcharge could be viewed as warranted to prevent a deterioration in the balance of payments until more fundamental policy measures could be implemented. The hope was expressed that the fundamental policy measures required could be implemented within the near future so as to put the Israeli authorities in a position to eliminate the surcharge. In the same context members of the Committee noted with interest that Israel's list of quantitative restrictions had been somewhat reduced and that the level of import duties was being adjusted so that by 1978 the highest duty would be 20 per cent ad valorem. The representative of Israel stressed once again that in the present circumstances of his country, when imports in 1976 would amount to SDR 5.25 billion while exports would reach only SDR 2.25 billion it could not be expected that greater efforts could be made towards trade liberalization. His authorities had done the utmost to maintain a liberal trade policy under difficult circumstances; the number of restricted imports had been reduced, the austerity measures such as the import deposit scheme had been abolished, customs duties were being lowered, and finally the rate of the surcharge had been reduced. The austerity measures taken in 1974 had for the most part been eliminated; nevertheless, it was still imperative to contain the level of the imports. For this purpose the surcharge was essential and though it remained a temporary measure the Israeli authorities could not under the present circumstances envisage its reduction or elimination. He added that he hoped that these circumstances would meet with understanding and that it would be recognized that despite these measures the thrust of Israel's trade policy remained liberal. In reply to questions concerning subsidies the representative of Israel explained that there were no export subsidies granted in Israel. The subsidies referred to earlier concerned food subsidies to local consumers and these had been reduced because they could not be sustained from a budgetary point of view.

Conclusions

12. The Committee was understanding of the seriousness of Israel's balance-of-payments difficulties, especially on the trade and services accounts. The particular constraints of Israel's economy indicated that equilibrium of the balance-of-payments would not be achieved in the short term. The Committee noted with satisfaction the statement by the representative of Israel that despite these constraints, it was his Government's policy to maintain and pursue as liberal a trade policy as possible.

13. The Committee noted with satisfaction that the import deposit scheme had been eliminated, that the rate of the import surcharge had been reduced to 15 per cent and that some import liberalization had taken place. It recalled that the import surcharge was a temporary measure and as such should be phased out or eliminated. It was regretted that Israel, because of the current economic situation, was not in a position to give any positive indication as to an eventual removal of the surcharge. The Committee drew attention to the finding of the Fund that "the present level of restrictions, including the maintenance of the temporary import surcharge, may be viewed as warranted to prevent a deterioration in the balance-of-payments until more fundamental policy measures can be implemented", and invited the Israeli authorities to pursue these more fundamental policy measures, which should enable them to further liberalize trade.

ANNEX

Opening Statement by the Representative of Israel

You are all aware that Israel is not a newcomer to this Committee - we consult regularly with our trading partners united in the contracting parties to GATT on our import restrictions, including import surcharges.

You have before you document BOP/167 in which we have tried to give you as concise a picture as possible of our balance-of-payments situation, of our import régime and of our appreciation of future developments in these fields. While we have made every effort to present a full description of the situation we are aware of the shortcomings of this paper, as it is not easy to touch within the framework of such a survey on all the manifold aspects which our special situation presents.

I would, therefore, stress that we shall try to provide any additional information on any matter not covered, or not sufficiently covered by our document.

I have on purpose used the adjective "special" in describing our situation. When one draws up the basic document one is of needs restrained to follow a descriptive framework which is prescribed both by the decisions and the traditions of this Committee. It is, therefore, necessary to draw your attention to special problems which are not really covered by this document yet without doubt have a definite relevance to our balance-of-payments position; I refer to our defence effort, to our absorption effort and to our development effort. As far as our defence effort is concerned I think it is obvious that the need to maintain a creditable defence posture involves quite extraordinary expenditure, both domestic and external, which directly reflect on our balance of trade, our balance of payments, our reserves and our foreign debt.

One point is of direct relevance to GATT: certain measures of boycott taken against us have a direct trade effect and are in reality to be classified among non-tariff barriers. As far as our absorption effort is concerned I believe that most of you are aware that Israel continues to absorb thousands of new immigrants every year and tries to provide them with basic shelter, work and all the necessary infrastructure, such as schools, hospitals, community centres, etc. In mentioning our development effort I think I am already on ground more familiar to this Committee: Israel is of course only one of the many developing countries who regularly consult with the contracting parties on their

balance-of-payments problems. I do not think therefore that this aspect requires further elaboration.

To come back to our basic document: I would wish to draw your attention to paragraph 7 in which we have tried to elaborate in detail the effects of trade restrictions and general policy in applying restrictions for balance-of-payments consideration.

I would wish to stress both the relative and absolute size of our current deficit and our external debt. An expected deficit of \$3.7 billion in 1976 is per se extraordinarily serious, even for a large and developed country. For Israel, with its size and development needs, this means a per capita annual deficit of more than \$1,000. I believe that this is one of the highest if not the highest in the world.

As far as our foreign debt is concerned we are already approaching the staggering figure of \$3,000 per capita; again, this is among the highest if not the highest in the world. This too, must reflect on our possibilities concerning both trade liberalization and the servicing of debt. Yet despite these objective difficulties, we have made every effort to conduct ourselves as a liberal and outward-looking member of GATT. We have imposed no new import restrictions; on the contrary, we have continued with our import liberalization programme both with respect to tariffs and non-tariff measures. We have reduced the import surcharge significantly and instead have resorted to the orthodox measures of exchange rate adjustments by introducing a system of creeping devaluation. We have continued to adopt policies which will lead to a reduction in the trade deficit, not through import restrictions but through the encouragement of exports. Serious efforts have been made through monetary and budgetary means to restrict inflationary inferences.

In this context I think it is appropriate to quote from our document:

"The Government believes that it will be possible to obtain the objectives of its economic policy while maintaining its liberal trade policies. However, as long as exports are insufficient to eliminate the deficit, foreign intermediate capital aid is essential. Israel may face serious difficulties in maintaining its trade policy if it should prove impossible to mobilize the capital resources needed to cover the trade deficit and if restrictions on the free flow of international trade then other negative international developments would become more pronounced."

A number of conclusions flow from this declaration.

1. It is our firm hope that the special efforts, to which I have already made reference will receive both the moral and material support of the international community. I think it would also be appropriate here to register our deeply felt gratitude for the support which has been extended to us with unfailing generosity by friendly countries.
2. Any restriction on the free flow of trade and payments which might be imposed by third countries which might influence our exports, and private capital flows to Israel, would clearly have a negative effect on our own efforts.
3. Any deterioration in our terms of trade, particularly as far as imports of fuel are concerned, would immediately be reflected in an increased trade deficit and might call for measures to prevent that.

To sum up: we believe that despite all difficulties and our heavy debts, we have lived up to our obligations under the GATT by maintaining a liberal trade system. We shall continue to be able to do so if there is no further deterioration in the trade and assistance and capital climate and we hope that the multilateral trade negotiations now under way will contribute to an improvement of this climate. Israel for its part will try to do its part to assure the success of these negotiations.