

GENERAL AGREEMENT ON TARIFFS AND TRADE

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Committee on Balance-of-Payments Restrictions

REPORT ON THE 1981 CONSULTATION WITH PORTUGAL

1. The Committee has consulted with Portugal in accordance with its terms of reference and the Declaration of the CONTRACTING PARTIES on Trade Measures Taken for Balance-of-Payments Purposes (L/4904). The consultation was held on 13 May 1981 under the chairmanship of Mr. Robert Martin (Canada). The International Monetary Fund was invited to participate in the consultation pursuant to Article XV of the General Agreement.
2. The Committee had the following documents before it:
 - Report on the last consultation with Portugal held on 5 May 1981 (BOP/R/111)
 - Basic document supplied by the Portuguese authorities (BOP/216/ and Add.1 and Add.1/Corr.1)
 - Background paper by the secretariat (BOP/W/50)
 - Recent Economic Developments supplied by the IMF dated 18 June 1980 and Supplementary Background material dated 1 April 1981

Opening Statement by the representative of Portugal

3. In his opening statement, the representative of Portugal described recent developments in the Portuguese economy and the prospects for 1981. In 1980, the rate of inflation had decreased to less than 17 per cent from more than 24 per cent in 1979. GDP had increased by about 5.5 per cent and the deficit in the balance of current transactions was estimated at 1.1 billion dollars. The unemployment rate had gone down from 8.2 per cent in 1979 to 7.7 per cent in 1980 and real wages had increased by about five per cent. In 1980, the favourable weather conditions, the slowdown in the monthly rate of depreciation of the escudo, and the rise in subsidies to essential goods contributed to dampen the rise in the consumer price index.
4. The representative of Portugal emphasized that in 1980 Portuguese external accounts had aggravated, showing a deficit of over one billion dollars due to a substantial deterioration of the trade balance and also to a reversal in the services balance, mainly due to the "Capital Income" debit. The growth rate of emigrant remittances had slowed down.

5. The representative of Portugal said that in 1980 exports were estimated at about 4.6 billion dollars as a result of a growth of about seven per cent in volume and 23 per cent in price (escudos). Imports (CIF) were estimated at about 9.4 billion dollars resulting from a growth of nine per cent in volume and about 30 per cent in price (escudos) so that the negative trade balance would probably be about 3.8 billion dollars, i.e. 1.3 billion dollars more than in 1979. In 1980 the oil import payments were estimated at about two billion dollars.

6. At the end of 1980 the Portuguese external debt stood at around 7.7 billion dollars, a rise of 22 per cent as compared with the end of 1979. There was a higher share of short term debt in this total.

7. Even though less restrictive than in previous years, in 1980 the balance-of-payments strategy had continued to be based on a realistic exchange rate policy, credit management, implementation of a system for tax and financial incentives to investment, etc. In this regard, the representative of Portugal noted that the crawling peg system continued to be applied at a monthly rate of depreciation of the escudo which since June 1980 was 0.5 per cent.

8. With regard to import restrictions, the representative of Portugal made the following points:

- as a result of general exemptions granted to imports for social and economic development reasons and applied on a non-discriminatory basis, the 10 per cent surcharge had affected about 10 per cent of Portuguese imports in 1980;
- the 60 per cent surcharge had only covered 0.7 per cent of total imports in 1980 and two products had been removed from the respective list;
- the quota system on consumer goods which had again been extended was estimated to have covered 0.9 per cent of total imports in 1980;
- quotas for CKD motor vehicles had increased by 36 per cent in 1980.

9. In referring to the 1981 Plan which had been approved by Parliament, the representative of Portugal said that their aim was to achieve a 4.8 per cent growth rate for overall economic activity. Productive investment was expected to rise by 10 per cent, private consumption by 3.5 per cent and a seven per cent growth rate was envisaged for imports and exports. The deficit in the balance of current transactions would be around 1.3 billion dollars and the inflation rate was expected to be slightly lower than in 1980. However, these aims were under revision. In particular the projected growth of exports was considered to be too optimistic given the international economic recession, and the composition and geographical breakdown of the Portuguese exports. Because of the need to increase the imports of some agricultural products and electrical power due to the dry winter season, the rise in the oil bill and the need to maintain a level of imports compatible with a high investment rate, it was estimated that imports would continue to grow significantly in

1981 and that the deficit in the balance of current transactions might eventually exceed the initial forecast of 1.3 billion dollars. In this context, the Portuguese Government could not but maintain the restrictive measures taken for balance-of-payments reasons. All such measures would be implemented on a non-discriminatory basis.

Statement by the representative of the International Monetary Fund

10. 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.

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

11. Members of the Committee welcomed the direction of Portuguese economic policy over the last few years. Sound policies with respect to exchange rate, credit expansion and other instruments of economic management had contributed in a major way towards restoration of a more manageable balance-of-payments situation. Since the stabilization programme was implemented in 1978 the economy had shown strong and sustained growth. They noted as positive developments the decrease in the rate of inflation, the increase in the level of employment, investment and real wages in 1980. However, some members indicated concern with the deterioration in Portugal's external position, citing the increase in the current account deficit which reached over one billion dollars in 1980 as compared with a nearly balanced position in 1979. One member said that the proper response to this situation should be appropriate monetary, fiscal and exchange rate policies which should permit a reduction in reliance upon trade restrictions. The questions of concern to the Committee in this connexion centered on how the Portuguese authorities were planning to manage the current movement towards an increased current account deficit in the face of continued expansion in the domestic economy. Members also asked for assurances that import restrictions would not be increased if the external situation continued to worsen.

12. Noting that imports of oil had contributed to the widening of Portugal's current account deficit, some members asked what measures were taken or envisaged in the energy sector to deal with that problem. The representative of Portugal stated that this was a particularly critical problem for his country in that about 80 per cent of domestic energy requirements were imported, mostly in the form of oil. It was not easy to reduce the ratio of energy used to GDP, which might on the contrary be expected to increase in the light of Portugal's development needs. However, studies were being carried out which envisaged the replacement of oil by coal in certain energy-using industries such as cement and fertilizers over the medium-term period.

13. In reply to a question on the impact of higher levels of food imports necessitated by the recent drought and whether or not this was a continuing prospect, the Portuguese representative replied that the agricultural problem in Portugal was a structural one, but that efforts were being made to restructure the agricultural sector over

the medium term and to reduce dependence on a few agricultural goods. However, the response would be slow and 1981 may still see the need for increased food imports as a result of the drought.

14. Referring to other factors which had contributed to the current account deficit in 1980, the Portuguese representative stressed the difficulties surrounding textile exports which had accounted for 30 per cent of total export receipts in 1979, but about 25 per cent in 1980 and whose share was expected to decline further this year. Difficulties were due not only to voluntary export restraint agreements but also to problems of marketing of traditional textile products. Efforts were being made to diversify exports but this was a slow process.

15. Questions were addressed to various aspects of Portugal's monetary and fiscal policies. Some members noted that although the rate of inflation had declined from 24 per cent in 1979 to 17 per cent in 1980, there were several potential factors which might cause prices to rise again. They wished to know therefore how the Portuguese authorities intended to contain the present rate of price increase. In reply, the Portuguese representative stated that the official target for inflation in 1981 was set at 16 per cent. To this end the government had recommended that nominal wages rise by 16 per cent and that any real wage increase should only reflect productivity gains. Price controls would also be maintained for a few goods. In this context, the Portuguese representative informed the Committee that the forecast for the public sector deficit for 1981 was lower than that of 1980. The government's intention was to achieve this by reducing subsidies to public enterprises and to consumer goods. A programme of fiscal and monetary incentives for investment had been implemented last year whose procedures were now under review. Grants were to be given for investment according to various criteria including those of job creation, the industrial sector concerned, the region chosen to execute the project, etc.

16. One member, stressing the need for more effective monetary restraint, noted that lending ceilings in the past had not been very effective and wondered if new measures had been taken to overcome this problem. The Portuguese representative stated that the efficiency with which the increase in domestic liquidity could be controlled was affected by the substitutability between external and domestic credits. The authorities were now moving to try and control more closely short-term capital movements from abroad, and to try to exert monetary control through primary liquidity which they considered would prove to be a more efficient approach than that of using credit limits which had been followed up to present. Although broad money had expanded substantially in 1980, monetary policy for 1981 was planned to be more restrictive. However, Portugal being a small open country, account must necessarily be taken of developments in interest rate movements abroad.

17. Several members asked questions about the future role of the crawling peg in maintaining external competitiveness, noting that in 1980 the depreciation of the escudo had slowed to two per cent against

the U.S. dollar. The Portuguese representative replied that there had been a shift of emphasis in exchange rate policy since 1979, and that the crawling peg was increasingly directed towards helping to attain domestic price stabilization rather than to promote the competitiveness of Portuguese export industries. It was the intention of his authorities to maintain the present rate of monthly depreciation of the escudo under the crawling peg system throughout 1981. He drew attention to the IMF statement which reiterated this intention.

18. In response to questions on the adequacy of reserve holdings and foreign capital inflows, the representative of Portugal stated that there had been a slight decline in the reserve position. While net foreign assets of the Central Bank (with gold valued at the former official price) had amounted to six months' import coverage at end 1980 they represented at the end of March 1981 less than five months' coverage. There were however no generally accepted criteria for what constitutes an adequate level of international reserves for any country. Capital inflows into Portugal increased in 1980 but there had been a shift in emphasis away from medium and long-term capital towards short-term holdings (namely commercial credits). The latter more than doubled from 1979 to 1980, to reach 1.2 billion dollars.

19. Some members noted that as a consequence of this shift towards increased short-term capital holdings, the maturity profile of Portugal's external debt had deteriorated. The Portuguese representative stated that this was a matter of concern to his authorities and that they would try to keep debt levels within acceptable international standards, particularly since the repayment period on many of these loans was soon falling due. As for further borrowing, the Portuguese authorities would stress flexibility both in sources and in types of credit. A syndicated loan of 500 million dollars was likely to be signed this month, and Portugal had approached bilateral and multilateral lending bodies and the private international financial market to obtain additional external financing.

System, method and effect of the restrictive import measures

20. Several members noted that very little change had occurred in the nature or method of import restrictions since the last consultation. The import surcharge schemes of 10 and 60 per cent were still in place as well as the quota systems for some consumer goods and for unassembled vehicles.

21. In reply to a number of questions, the representative of Portugal recalled that the main import surcharge had been reduced from 20 per cent in October 1978 to 10 per cent in May 1979. It had also been modified as to product coverage since its entry into force in 1975. About 20 per cent of imports were now covered by this surcharge scheme which was enforced on a non-discriminatory basis. The percentage of imports covered by the surcharge had been reduced because of the numerous exemptions which were allowed for certain products from imposition of both tariff duties and surcharges. These exemptions

were decided in conformity with various domestic laws and decrees for certain categories of products such as raw materials, investment goods, etc. About 50 per cent of imports otherwise subject to the surcharge benefitted from these exemptions.

22. As for the 60 per cent surcharge scheme, the Portuguese representative emphasized that it applied to non-essential, luxury goods which were a small proportion of imports. This surcharge would be replaced by an appropriate level of value-added tax at the latest at the time of Portugal's accession to the EEC.

23. Several members urged Portugal to phase out these restrictions. One member said that this was particularly relevant in light of the fact that the balance-of-payments situation had allowed the Portuguese authorities to pursue a course of domestic economic expansion. The desirability of setting a concrete timetable for such removal was stressed by several members in the discussion. The Portuguese representative said that it was his government's intention to remove the import restrictions in force, including quotas, as soon as possible, and to progressively relax these measures as soon as Portugal's external situation improved.

24. It was noted that although some modification as to product coverage had taken place under the 10 per cent scheme, in the cases of products no longer covered by the surcharge, tariffs on these items had been increased, so that on the whole little or no basic liberalization had occurred. It was also pointed out that the large number of exemptions from the 10 per cent surcharge scheme seemed to indicate that its removal would not have serious consequences on Portugal's external position. Another member said that while the large number of exemptions was welcome, the system contained elements of uncertainty as to market access which were harmful to both exporters and importers. These were additional reasons to eliminate the surcharges. The Portuguese representative stated that conditions for exemptions were set out in their domestic legislation and were applied without regard to country of origin.

25. One member noted that Portugal's trade policy as set out in the basic document was based on the principle of non-discrimination in the application of import restrictions and attached considerable importance to maintenance of this principle.

26. In reply to a question on the reorganization of the automobile sector mentioned in the basic document presented by Portugal, the Portuguese representative stated that a new regime to restructure the motor car sector was set up on 1 January 1980, with the purpose of inter alia eliminating uneconomical assembly plants. Within the programme the quota system for unassembled cars of less than 2,000 kgs had been maintained.

27. A clarification of the residual restrictions mentioned in the secretariat background paper was requested. The Portuguese representative stated that this list was the same as that notified to the GATT at the time of accession, but that the import restrictions

for balance-of-payments were applied independently of any residual restrictions.

28. In response to a question regarding the cause for delays in the delivery of BRI "bulletins" which had affected exports of some contracting parties to Portugal, the representative of Portugal stated that the bulletins, which served inter alia to check against over- or underinvoicing, were delivered automatically. If any particular problem arose, the Portuguese authorities were prepared to examine the matter with the exporting country concerned.

Conclusions

29. The Committee noted that the current account of the balance of payments had gone into deficit in 1980 and that this deficit was expected to increase in 1981. It also noted that the Portuguese authorities had not relaxed substantially the restrictive import measures in place nor announced a timetable for such relaxation as had been recommended by the Committee last year. At the same time it noted the statement of intent made by the Portuguese authorities to phase out these measures as soon as circumstances permit.

30. The Committee recognized that some of the factors adversely affecting Portugal's balance of payments were outside the control of the Portuguese authorities but that the current account deficit appeared to be manageable, especially if appropriate internal policies were followed.

31. The Committee considered that further efforts towards relaxation of the restrictions should be made with a view to their early removal. The Committee expressed the hope that no intensification of restrictive import measures would take place. Finally, the Committee recommended that a timetable for the removal of such measures should be announced by Portugal in the near future.

ANNEX

Statement by the Representative of the International Monetary Fund

Portugal experienced a strong recovery in economic activity in 1979, achieving 4.8 per cent growth in real GDP, spurred mainly by a sharp increase in exports of goods and services (28 per cent in real terms). The export performance, along with a surge in workers' remittances, helped to bring the current account of the balance of payments to near equilibrium. A substantial net capital inflow resulted in an overall payments surplus of about US\$1.4 billion.

In 1980 the GDP growth rate was sustained at over 5 per cent by the strength of domestic demand. While the financing of a public sector deficit of the order of 10 per cent of GDP contributed to the liquidity expansion, credit to the private sector also accelerated strongly, accommodating a marked recovery of investment. With broad money rising by more than 35 per cent during the year, there was a considerable buildup of liquidity in the economy. The rate of inflation was cut back to 17 per cent, from 24 per cent in the preceding year, partly through the postponement of certain administered price increases and through a 6 per cent effective revaluation of the escudo in February 1980. As nominal interest rates were kept unchanged while the inflation rate declined, real interest rates became positive, contributing to the maintenance of a high household savings ratio.

The current balance deteriorated markedly in 1980 to an estimated deficit equivalent to US\$1 billion or over 4 per cent of GDP. This deterioration, which occurred notwithstanding continued strong performance in tourism and workers' remittances, is a reflection of the recovery of domestic demand, a near stagnation of external demand and the sharp rise in the price of crude oil. Another contributing factor has probably been the marked decline in the average effective depreciation rate of the escudo (2 per cent, as against 15 per cent during 1979). The trade imbalance was financed by large medium-term and short-term borrowing, particularly by public enterprises, resulting in a US\$0.8 billion overall surplus.

In the past several years Portugal's restrictive system has been liberalized. In 1979, the improvement in Portugal's payments position enabled the authorities to take further steps to liberalize imports: the global quotas on certain imports were increased, several items were exempted from the import surcharge, and the 20 per cent import surcharge was reduced to 10 per cent. However, given the deterioration in Portugal's payments position, the authorities felt unable to make significant progress in the relaxation of import restrictions in 1980.

In 1981, the Portuguese economy is officially projected to grow by about 5 per cent, and the Government has announced a 16 per cent target for price and wage increases. The inflation target is to be achieved, however, at a minimum cost in terms of allocative distortions. Notably, since the end of last year a number of administered prices of public services and basic commodities has been adjusted to reflect cost increases (transportation services, gasoline products, foodstuffs, etc.). Instead, greater reliance is likely to be placed on monetary restraint. Also, there may be some moderation in fiscal stimulus with a projected reduction in the government deficit equivalent to almost 1 per cent of GDP, an increased proportion of it being financed by the nonbank public.

The largest contribution to growth will come from domestic demand, particularly fixed investment undertaken by the public sector at the onset of the 1981-84 Medium-Term Investment Program and by the private sector, also in response to the recently promulgated investment incentive schemes. In contrast, the foreign trade balance is expected to worsen in part because of the continued weakness of external demand. The official forecast of the current account deficit of US\$1.3 billion, or about 5 per cent of GDP, may be exceeded given the probable shortfall in export production and rise in agricultural and energy imports caused by last winter's drought.

The authorities intend to maintain the crawling peg of the escudo, at a preannounced monthly depreciation rate of 0.5 per cent in effective terms, which appears broadly adequate to maintain the international competitiveness of Portugal's exports as long as the wage and price targets are adhered to. At the end of February 1981, Portugal's international reserves, excluding gold, stood at US\$0.6 billion, and gold reserves, valued at US\$254.92 an ounce, amounted to US\$5.6 billion. The Fund notes that, given the outlook for a weak trade performance, which is in part beyond the authorities' control, no further substantial liberalization in Portugal's trade and payments system is planned for the immediate future. The Fund hopes, however, that progress towards liberalization of the restrictive system will be resumed once the current pressures on Portugal's payments position have eased.