

# GENERAL AGREEMENT ON TARIFFS AND TRADE

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## Committee on Balance-of-Payments Restrictions

### REPORT ON THE CONSULTATION WITH ITALY

#### (DEPOSIT REQUIREMENT FOR PURCHASES OF FOREIGN CURRENCY)

1. As instructed by the Council at its meeting of 15 July 1981 (C/M/149, page 14), the Committee has consulted with Italy on the deposit requirement for purchases of foreign currency introduced on 28 May 1981. The consultation was held on 13 October 1981 under the chairmanship of Mr. J.N. Feij (Netherlands). 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:

- Statement submitted by Italy (BOP/219)
- Notification of deposit requirement (L/5162 and Add.1)
- Secretariat Background Paper (BOP/W/51)
- IMF Recent Economic Developments, dated 4 June 1981
- IMF Supplementary Information, dated 29 June 1981

#### Opening statements by the representatives of Italy and the Commission of the European Communities

3. In his opening statement the representative of Italy recalled that, on 28 May 1981, his government had introduced an advance deposit scheme under which most payments abroad were made subject to the requirement of a 90-day non-interest-bearing deposit equivalent to 30 per cent of the amount of the transaction. The scheme had been examined in the competent EEC bodies and, in the light of a decision of the Commission of the European Communities, the deposit requirement was reduced to 25 per cent on 1 October 1981, will be further reduced to 20 per cent on 1 January 1982, and to 15 per cent on 1 February 1982 and abolished at the end of February 1982.

4. The representative of Italy further recalled that, in the first five months of 1981, there had been a current account deficit of about

Lit 7,600 billion, of which 1,800 billion had arisen in the month of May, and an overall balance-of-payments deficit of Lit 2,700 billion. The foreign exchange reserves had declined from US\$10.9 billion at the end of 1980 to US\$5.5 billion at the end of May 1981. In the second half of May, when the sudden resignation of the government caused speculative foreign exchange movements, the Bank of Italy lost through exchange market interventions up to US\$120 million per day. In these circumstances a measure had to be applied with an immediate impact on domestic liquidity and the balance-of-payments. The representative of Italy added that the deposit scheme helped absorb about Lit 1,800 billion per month; by 1 October 1981 total net liquidity absorption taking into account deposit repayments had reached Lit 5,200 billion. At the same time the balance of payments improved sharply. In the three months following the introduction of the scheme, that is in June, July and August 1981, the current account had registered a surplus of Lit 2,900 billion on a cash basis, which - together with capital inflows of Lit 2,600 billion - led to an overall payments surplus of about Lit 5,500 billion. It appeared that the main influence of the scheme had been to induce the postponement of import payments rather than a reduction in imports. Preliminary data indicated that the import volume had not been substantially affected but that the scheme had led to deferred payments of about Lit 3,000 billion.

5. The representative of Italy emphasized that the scheme could not be abolished at once but had to be phased out gradually so as to avoid a concentration of foreign currency payments, both current and deferred, in a period seasonably unfavourable for Italy's external financial position and to spread over a longer period the increase in liquidity resulting from the repayment of the deposits.

6. The representative of the Commission of the European Communities said that the Commission had examined the economic and financial circumstances that had led to the adoption of the deposit scheme in accordance with Article 108:1 of the Treaty of Rome and had, on 1 July 1981, addressed to the Italian government a recommendation on ways to deal with the structural causes of Italy's very difficult economic situation. The extension of the measure beyond 1 October 1981 had also been the subject of detailed discussions in Brussels, and the Commission, on the basis of Article 108:3 of the Treaty of Rome, had decided on 23 September 1981 to authorize Italy to maintain the deposit requirement on the condition that it be phased out in accordance with a fixed time-schedule.

#### Statement by the representative of the International Monetary Fund

7. 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.

#### Discussion in the Committee

8. The representative of Italy recalled that he had already pointed out in the Council that, in the opinion of his government, the GATT

rules on trade measures taken for balance-of-payments purposes did not apply to the deposit scheme because it was of a monetary nature and its main and primary effects were financial and monetary. He had nevertheless not opposed a further discussion in a GATT body because such discussions gave the opportunity to exchange information and clear up any misunderstandings about the causes and effects of the measure. Committee members expressed their appreciation for Italy's positive and cooperative attitude towards their proposal to hold a consultation on the deposit scheme in the Committee. Measures restricting payments could have a trade impact and they should therefore not be ignored by the GATT; if they were taken for balance-of-payments reasons the obvious forum to hold consultations on them was this Committee.

9. Members expressed their understanding for the pressures that led to the imposition of the deposit requirement, especially for the pressures that arose in May 1981 when Italy was awaiting the formation of a new government. However, they also expressed their disappointment and concern that Italy had not relied exclusively on monetary and fiscal measures, and that, once the new government had been in place, had decided to extend and phase out the scheme rather than to abolish it on 1 October 1981 as had originally been planned.

10. Members of the Committee said that Italy should have adopted policies that address the basic problem rather than the temporary deposit scheme, which only dealt with the symptoms. In this connexion it was pointed out that all of the effects of a deposit scheme of the kind imposed by Italy could be achieved with alternative policies that caused less distortions in the economy and less problems for the trading partners. The liquidity impact of a deposit requirement could be achieved through fiscal and monetary restraint, the effect on import prices through a devaluation, and the improvement of the overall balance-of-payments through official borrowing.

11. Some members said that the exports of their countries to Italy had been adversely affected by the deposit scheme. There was however agreement in the Committee that the overall trade effect of the scheme was not severe: there were no quantitative limits on import payments, the measure raised import costs by less than 2 per cent, was applied to imports from all countries and to most product categories, and was to be phased out in accordance with a publicly announced time-schedule. It was further recognized that the primary objective of the measure was not to restrict imports but to influence the timing of import payments and to reduce domestic liquidity as well as inflationary pressures. However the view was also expressed that the measure, though monetary in form, did have an effect on trade, and that it therefore ran counter to the spirit of the 1979 Declaration on Trade Measures Taken for Balance-of-Payments Purposes in which the CONTRACTING PARTIES recognize that "developed contracting parties should avoid the imposition of restrictive trade measures for balance-of-payments purposes to the maximum extent possible".

12. The representative of the European Communities stressed that the measure, given its broad application, could not be compared with the restrictive trade measures permitted under the provisions of the General Agreement dealing with balance-of-payments difficulties. He did not deny that the spirit of the undertaking of the developed contracting parties in the 1979 Declaration on balance-of-payments measures was relevant in this case.

13. In response to the various comments about alternative policies the representative of Italy said that all of the policies mentioned took time to adopt or to produce effects: a change in fiscal policy required parliamentary approval and could therefore not be brought about immediately; monetary and exchange rate policies usually produced results only after a lag. In May 1981, when Italy lost reserves at the rate of US\$ 120 million a day, the government had no option but to adopt the deposit requirement, the only policy instrument available that could produce an immediate balance-of-payments and liquidity impact. He doubted whether the alternative policies proposed would have had, in the particular circumstances of Italy in early 1981, a more favourable effect on the exports of Italy's trading partners. He stressed that the government had applied the measure on a non-discriminatory basis and had carefully avoided granting protection to particular industries; even raw material imports had been included in the scheme with the consequence that it made exports of Italian manufactured goods more expensive. A phased dismantling of the scheme was necessary to permit alternative policies to take effect and a shortening of the phasing-out period could in the present payments situation not be envisaged.

14. Some members of the Committee noted however that the present deposit scheme was the third import or exchange measure which Italy had introduced in a period of seven years to resolve balance-of-payments problems. These measures had not addressed themselves to Italy's fundamental economic problems and their repeated use created the expectation that they would again be resorted to in the future. This could intensify balance-of-payments problems if traders, in anticipation of a new measure, made advance payments. In response the representative of Italy said that there was no evidence that the introduction of the requirement had been anticipated; in fact, imports had decreased in the month before the introduction of the scheme.

15. Several members asked which actions the Italian government was now undertaking to resolve the basic economic problems that had led to the introduction of the scheme. The representative replied that monetary restraint measures had been reinforced to reduce inflation and that the Lira had recently been devalued within the European Monetary System so as to restore Italy's competitive position. Regional and local government agencies had been obliged to return unspent credits to the Treasury, which were thereby withdrawn from circulation. The Bank of Italy had decided to no longer act as a buyer of last resort of Treasury bills not sold on the market. The

central government's budgetary expenditures now had to follow a programme of expenditures for three years rather than one, which limited the possibilities of increases in expenditures. To achieve its objectives in the area of public finances, the government had recently approved a package of expenditure cuts concentrated in the areas of social welfare and health services, which would lead to annual savings of Lit 10,000 billion. Although politically difficult, serious efforts were also made to secure wage moderation.

### Conclusions

16. The Committee examined the advance deposit scheme introduced by Italy on 28 May 1981, initially for a four-month period, under which most purchases of foreign exchange were made subject to the requirement of a 90-day non-interest bearing deposit equivalent to 30 per cent of the amount of the transaction. It noted that the deposit requirement was applied on a non-discriminatory basis, that the deposit rate had been reduced to 25 per cent on 1 October 1981, that it was to be progressively reduced further in accordance with a fixed time-schedule, and that the scheme was now to terminate at the end of February 1982.

17. The Committee appreciated that the deposit requirement was introduced at a time of serious political and economic uncertainty which had led to a steep decline in foreign reserves and noted the statement of the representative of Italy that in this situation rapid action was required. However it shared the view of the International Monetary Fund that macro-economic policy action of a more general nature would have been preferable, in addition to the actions of that kind that had already been taken by the Italian government. The Committee noted that the deposit scheme, though monetary in form, had some effect on trade and that, in so far as these trade effects were concerned, the scheme could be considered in the spirit of the Declaration on Trade Measures Taken for Balance-of-Payments Purposes, in which the CONTRACTING PARTIES recognize that developed contracting parties should avoid restrictive trade measures for balance-of-payments purposes to the maximum extent possible. In this connexion the Committee noted that the establishment of a fixed phasing out programme for the deposit scheme was in keeping with paragraph 1(c) of this Declaration according to which contracting parties shall, whenever practical, publicly announce a time-schedule for the removal of measures taken for balance-of-payments purposes.

18. The Committee urged the Italian authorities to remove the measure as soon as possible and encouraged them to pursue their efforts to achieve a lasting improvement of the external financial position through monetary restraint and a strengthening of the public sector's finances.

19. The Committee agreed to keep the progressive elimination of the deposit requirement under review.

ANNEX

Statement of the representative  
of the International Monetary Fund

Over the past two years, there has been a substantial deterioration in Italy's current account balance mainly as a result of sharply increased international oil prices and the maintenance of a high level of domestic economic activity in relation to that of Italy's main trading partners. In 1980 the current account of the balance of payments registered a deficit of Lit 8,500 billion or the equivalent of about 2 1/2 per cent of GDP, compared with an average surplus equivalent to 1 1/2 per cent of GDP over the preceding three years. The marked shift in the current account balance since the middle of 1979 was concentrated primarily in the trade account which deteriorated appreciably due to a worsening in the terms of trade, an increase in import volumes, and a loss of momentum in exports.

During the first half of 1981, there was a significant reversal in the pattern of domestic demand in response to a tightening in monetary policy. This tightening was aimed at offsetting the expansionary impact of the Treasury deficit which during the first three quarters of 1981 has been running well in excess of the authorities' target. The enforcement of stricter credit ceilings by the Bank of Italy was complemented by greater reliance on interest rate policy in the control of credit demand. However, the favorable impact that these measures might have had on the trade balance was more than offset by a further sharp deterioration in the terms of trade. Preliminary estimates of the Bank of Italy suggest that the current account deficit in the first half of 1981 was between Lit 7,000 billion and Lit 8,000 billion, while the deficit for the whole of 1981 is forecast at Lit 11,000 billion.

Despite the large swing in the current account balance since mid-1979, the foreign exchange position of the Bank of Italy improved in 1980. This improvement reflected in large measure a sizable increase in the net foreign indebtedness of the commercial banks in response to the increasingly severe restrictions on bank credit denominated in lire, a significant slowdown in the repayment of compensatory loans, and a high level of foreign borrowing by public and private enterprises. In the early months of 1981, however, Italy's international reserves declined as a result of continued weakness in the current account and mounting pressures in the exchange market. Foreign reserves in convertible currencies decreased from US\$10.9 billion at the end of 1980 to US\$5.4 billion by May 1981.

Since March 13, 1979, Italy has participated in the European Monetary System with a 6 per cent margin. The effective exchange rate was broadly stable through the first half of 1980. A subsequent moderate effective depreciation was not sufficient to offset the sizable inflation rate differential between Italy and its main trading partners. Faced with a continued deterioration in the external position and with pressures in the exchange markets during the first quarter of 1981, the Italian authorities devalued the central rate of the lira within the EMS by 6 per cent on March 22, 1981. Following the realignment, the lira remained fairly stable with respect to the other EC currencies, while continuing to depreciate vis-à-vis the U.S. dollar. From December 1980 to mid-August 1981, the lira depreciated by around 7 per cent in effective terms and by 26 per cent with respect to the U.S. dollar.

In the face of continued pressures in the foreign exchange markets, and in order to complement the monetary restraint measures, on May 28, 1981 the Government of Italy introduced an advance deposit requirement on most payments abroad. Under the scheme, which was initially introduced for a four-month period, purchases of foreign exchange were made subject to the requirement of a 90-day noninterest-bearing deposit equivalent to 30 per cent of the amount of the transaction. Payments for imports of grain and oil, as well as for other specified transactions, were exempt from the deposit requirement, up to 50 per cent of which could be financed by banks outside the existing credit ceilings. The measure, which resulted in a restriction under Article VIII, Section 2 of the Fund's Articles of Agreement, was approved until September 30, 1981 by the Executive Board on July 8, 1981.

After June the balance of payments did record a substantial improvement. While a more favorable evolution in both relative cyclical and competitive positions contributed to this improvement, the deposit scheme itself and a further tightening of monetary policy were also important factors affecting short-term capital flows. As a result, foreign exchange reserves in convertible currencies rose to US\$9.0 billion at the end of August 1981. In the six weeks through the end of September, the lira regained approximately 6 per cent of its value with respect to the dollar, paralleling the gains recorded by the other currencies within the EMS. However, in effective terms the exchange rate was virtually unchanged. On October 4, within the context of a realignment in the EMS, the central rate of the lira, along with that of the French franc, was devalued by 8.5 per cent against the German mark and the Dutch guilder, and by 3 per cent against the Danish kroner, the Belgian franc, the Luxembourg franc and the Irish pound.

It would appear that the main influence of the deposit scheme has been through its effect on the timing of import payments rather than through its effect on import volumes. Preliminary estimates at the Bank of Italy suggest that the deposit scheme might have induced somewhere between Lit 2,000 billion and Lit 4,000 billion in short-term capital inflows related to these leads and lags. At the same time, deposits subject to this scheme had risen to Lit 5,500 billion by August, which exceeded the increase in the monetary base over this period and was approximately equal to the increase in total bank credit to the private sector. Important offsets to this contractionary impact on liquidity, however, have been the indirect contribution to liquidity provided by the short-term capital inflows associated with the deferment of import payments and the fact that half of the financing of the deposits has been permitted outside the credit ceilings.

On September 30, 1981, the Italian authorities informed the Fund of their decision to gradually phase out the deposit scheme over a five-month period. The Fund has extended approval of this restriction until February 28, 1982. Over this period, the deposit requirement expressed as a percentage of the amount of the foreign exchange purchase will be reduced: to 25 per cent on October 1, 1981, to 20 per cent on January 1, 1982, and to 15 per cent on February 1, 1982. In addition, since October 1, 1981 the coverage

of the scheme has been further narrowed--by the exemption of some payments for nonferrous metals, certain energy products (including coal, natural gas, and electric power), and agricultural products covered by provisions of the Common Agricultural Policy of the European Community (EC). These exempted items represent some 15 per cent of Italy's total imports thereby reducing the coverage of the scheme to around 60 per cent of imports. The authorities have indicated that their decision to phase out gradually the deposit requirement is motivated by the desire to avoid a concentration of foreign currency payments, both current and deferred, over a period seasonally unfavorable for Italy's external accounts, and to spread over time the increase in domestic liquidity which will result from the abolition of the scheme.

In the period during which the advance deposit scheme is to be phased out, the Italian authorities are committed to a sustained strengthening of more general policy actions with a view to preventing the continuation of high payments deficits and the acceleration of inflation in a new expansionary phase. They intend to reduce in 1982 the domestic financing requirement of the public sector by some 2 percentage points of GNP below the level that would have been reached in the absence of corrective actions. To achieve its objectives in the area of public finances, the Council of Ministers recently approved a package of expenditure cuts concentrated largely in the areas of social expenditures and health which would reduce public expenditures by Lit 10,000 billion on an annual basis. These measures in the fiscal area are to be accompanied by continued restraint in monetary management and by efforts to secure wage moderation. The recent devaluation of the lira in the context of a realignment within the EMS will also allow a needed improvement in the competitive position.

To sum up, the advance deposit requirement was introduced on May 28, 1981 on a temporary basis against the background of mounting pressure on Italy's foreign exchange position and at a time of serious political and economic uncertainties, although macroeconomic policy action of a more general nature would even then have been preferable. The progressive elimination of the deposit requirement--rather than its outright abolition--was motivated by the desire to prevent an abrupt reversal of leads and lags, and a sudden release of liquidity. The Fund welcomes the elimination of this restriction which will take place by February 28, 1982, but believes that determined implementation of the decision to strengthen the public sector's finances is essential to a lasting improvement of the external position. In view of the circumstances of Italy, including the seasonal pressures on the balance of payments, the Fund considers that the maintenance for a limited period of the exchange measure, while regrettable, will give time to permit the alternative policies to take hold.