

GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

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Limited Distribution

Committee on Balance-of-Payments Restrictions

REPORT ON THE 1985 CONSULTATION WITH PORTUGAL

1. The Committee consulted with Portugal on 8 October 1985, in accordance with its terms of reference and the Declaration of the CONTRACTING PARTIES on Trade Measures Taken for Balance-of-Payments Purposes (BISD 26S/205). The consultation was held under the Chairmanship of Ambassador P.-L. Girard (Switzerland). The International Monetary Fund was invited to participate in the consultation in accordance with Article XV of the General Agreement.

2. The Committee had the following documents before it:

Basic Document	(BOP/254 and Corr.1)
Secretariat Background Paper	(BOP/W/88 and Corr.1)
IMF report "Portugal - Recent Economic Developments", dated 21 August 1985	
Notifications by Portugal:	
- Import Surcharge Scheme	(L/5154/Add.4)
- System of Quotas for Some Consumer Goods	(L/5543/Add.2)
- System of Quotas for Motor Vehicles	(L/5558/Add.2)

Opening Statement by the representative of Portugal

3. The representative of Portugal noted that the consultation took place a few months after the signature of Portugal's treaty of accession to the European Communities on 12 June 1985, and shortly before the accession of Portugal to the Communities on 1 January 1986. Accession to the EC represented a challenge to Portuguese entrepreneurs and government, and was a milestone in Portugal's history. From 1986, Portugal's international economic relations would be changed by its participation in the Community's common trade policy.

4. The current account deficit in 1984 reached approximately the amount predicted during the previous consultation, i.e. US\$520 million. This had been achieved mainly by an increase in exports and a decrease in imports, as a consequence of a squeezing of domestic demand, maintenance of wage increases well below the inflation rate and a "crawling peg" exchange rate with a monthly average rate of depreciation of 1 per cent. This situation could not be sustainable in the long run, without its social costs becoming unbearable. For 1985, Portugal expected to have a current account deficit of only some US\$200 million, if present policies of austerity were continued.

5. The coverage of the quota system for some consumer goods had already been reduced in March 1984. It was reduced to four groups of products in March 1985 and since June 1985 included only three groups of products:

fruit, stoves and motorcycles. The quotas were now established pro rata until the end of 1985, when they would be eliminated. The quota system for motor vehicles would continue for two years after the accession to the Communities even for imports from the EC. The representative of Portugal recalled that motor vehicles were included in the negative list notified at the time of Portugal's accession to GATT. The régime to be applied for non-Community countries after 31 December 1987 was still to be defined. The system of prior registration through bulletins for imports exceeding 15,000 escudos would also be abolished on the date of accession to the EC. Bulletins would continue to be used for liberalized industrial products during a three-year period, for statistical purposes only and to be issued within five working days. As regards agricultural products three cases were possible: the use of Community certificates instead of bulletins, a national document, to be issued in four working days, and even no import document for a few products.

6. The coverage of the 10 per cent surcharge had been largely reduced in the middle of 1985, and exemptions were no longer allowed. The surcharge would be eliminated at the end of the year. The same was the case for the 60 per cent surcharge, whose abolition was linked to the introduction of value-added tax in Portugal. This surcharge had already been removed or reduced to 10 per cent for many tariff headings in June and July 1985.

7. The representative of Portugal stated that in general terms, the objectives of the financial programme negotiated by Portugal with the IMF had been fulfilled. This was largely due to the good performance of foreign trade, which might have been even better had not textiles exports been affected by restraints. Portugal's current account balance for the first half of 1985 showed a deficit of only US\$ 259 million, following a continuing increase in exports and decline in imports.

Statement by the representative of the International Monetary Fund

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

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

9. Members acknowledged Portugal's achievements in the reduction of its external deficit, while recognizing the domestic costs implied by the stabilization policies pursued. Satisfaction was expressed with the degree of liberalization of quotas and surcharges already achieved and with the prospect of their complete liberalization.

10. Questions were posed concerning the impact on Portugal's balance of payments expected from accession to the European Communities as well as the degree of industrial restructuring which Community membership might imply, and in relation to the liberalization of the labour market. A question was also asked concerning the energy policy to be pursued by Portugal in future in the light of its heavy dependence on imported fuel.

11. In reply the representative of Portugal stated that Portugal's trade balance in industrial products might be expected to improve, in particular following the removal of existing restrictions on exports of textiles to the Community. For agricultural products, although negative effects might be expected, the transitional period foreseen in Portugal's Treaty of Accession to the Communities would give a substantial period for adjustment. Portugal would, during this period, receive substantial aid from the Community for the improvement of agricultural infrastructure. The inflow of workers' remittances from abroad was also expected to increase. Financing of the current account was expected to benefit from Community balance-of-payments assistance over a six-year period, while Portugal's contribution to the Community budget was expected to be alleviated by substantial reimbursements over the period 1986-1991 in order to avoid Portugal being a net contributor to the EC budget. Moreover, short-term monetary support and medium-term financial assistance would be available from the Community during the transitional period. There was therefore no reason for a pessimistic view of balance-of-payments prospects after accession.

12. A period of seven years was provided for harmonization of Portuguese tariffs with the Community's external tariff. Funds received from Community sources for such areas as manpower training were already contributing to industrial restructuring. Domestic political developments might have an effect on the legal structure of the labour market. Current energy policy provided for greater use of coal and hydro-electric power and the possibility of the introduction of nuclear energy was under study.

13. In reply to a question concerning the effects of the evolution of the United States dollar exchange rate on Portugal's external balance, the Portuguese representative said that he would expect a decline in the dollar's value against the escudo to assist Portugal's trade and payments to the extent that protectionist pressures eased and that Portugal's debt servicing burden was alleviated. In general, following devaluations in 1982 and 1983, the maintenance of the "crawling peg" exchange rate system led to a steady, but less rapid, effective depreciation of the escudo in 1984. In reply to a question on measures taken to reduce inflation, the representative of Portugal noted that the principal reasons for a high rate of inflation in 1984 were a sharp reduction in public subsidies for administered prices, a more realistic pricing policy for public enterprises and the impact on domestic prices of exchange rate developments. Figures for 1985 showed inflation slowing considerably from the 29 per cent registered for 1984 to a rate of 16 per cent in August 1985 over August 1984. This was in part due to the decline in real wages, and partly to a reduction in rates of indirect taxation. The slower rate of depreciation of the escudo in 1985 had also contributed to a lessening of inflationary pressures.

14. In reply to a question on unemployment, particularly trends in female unemployment and labour force participation, the representative of Portugal said that the difficulties experienced particularly in the textile industry had especially affected the female employment situation.

Systems, methods and effects of restrictive import measures

15. One member, noting that import surcharges and consumer goods quotas would be abolished from 1 January 1986, asked whether any measures taken for balance-of-payments reasons would remain in force after that date, and whether other measures would continue in force and, if so, whether they would be applied on a most-favoured-nation basis. He asked whether Portugal intended to introduce any new quantitative restrictions, in particular on oilseeds and vegetable oils, before or following accession to the European Communities, and requested information on the modalities of application of the value-added tax system in replacing the 60 per cent import surcharge. He also asked for information on industries which would benefit from supplementary protection in the transitional period and the intentions of the Portuguese authorities in respect of bringing government procurement practices into conformity with the GATT Agreement on Government Procurement. Another member referred to discriminatory restrictions maintained against his country by Portugal and asked when these could be expected to be abolished.

16. In reply, the representative of Portugal stated that all restrictions and charges maintained by Portugal for balance-of-payments purposes would be eliminated as from 1 January 1986. All remaining import restrictions were foreseen in the Protocol of Accession of Portugal to the General Agreement. Apart from measures specifically provided for in that Protocol, all restrictions would be applied in a non-discriminatory manner. The evolution of the customs union with the EC would naturally imply different treatment for Community member States than for other contracting parties. The list of measures applying to one country had been substantially reduced in the years since Portugal's accession to GATT and now, following Portugal's accession to the Communities, covered only 31 highly sensitive products. This was also included in Portugal's Treaty of Accession to the Communities. It was pointed out that, in relation to oilseeds and vegetable oils, like other agricultural products, the régime of the Communities would be fully applied at the end of the relevant transitional period. The value-added tax, which would now enter into force on 1 January 1986, would be applied to all domestic and imported goods in a non-discriminatory manner. Such questions as well as others not strictly relating to balance-of-payments restrictions could be dealt with in the CONTRACTING PARTIES' examination of the Act of Accession of Portugal and Spain to the Communities. It was noted that the Act of Accession of Portugal and Spain to the Communities was shortly to be notified to GATT by the Communities, as stated in the July 1985 GATT Council meeting (C/M/191).

Conclusions

17. The Committee took note with satisfaction of the favourable development of Portugal's external balance in 1984 and the outlook for 1985 resulting in particular from the programme of economic stabilization undertaken by the authorities, strong external demand and good production performance in agriculture in 1984. It was recognized that the two latter elements might not play such an important rôle in the future as in the past. The domestic costs of adjustment in terms of demand and employment were also recognized. In relation to price inflation, the situation was relatively satisfactory

although some progress remained to be made. The Committee also took note of the generally beneficial effects on Portugal's external financial situation expected to result from Portugal's entry to the European Communities.

18. The Committee welcomed the substantial liberalization and simplification which had taken place in the measures maintained by Portugal for balance-of-payments purposes, as well as the announcement by Portugal that no such measures would be maintained for balance-of-payments purposes after 31 December 1985. The Committee noted that other restrictions expected to remain in force after that date were those now maintained under the terms of Portugal's Protocol of Accession to the General Agreement. In the light of these considerations, the Committee looked forward to the disinvocation of the balance-of-payments provisions of the General Agreement by Portugal.

ANNEXStatement by the Representative
of the International Monetary Fund

The Government of Portugal implemented a stabilization program in 1983 supported by a stand-by arrangement from the Fund, following a serious deterioration in its external accounts which raised the current account deficit of the balance of payments to the equivalent of 13.2 percent of GDP in 1982. The main objective of the program was the reduction of the current account deficit to the equivalent of 9 percent of GDP in 1983 and 6 percent of GDP in 1984. The improvement in the external position targeted by the Portuguese authorities was based on a comprehensive policy effort designed to reduce domestic demand and to promote foreign exchange earnings. The thrust of the stabilization effort centered around fiscal restraint, a scaling down in the rate of growth of monetary and credit aggregates, improved competitiveness through a devaluation of the escudo and a continuation of the 1 percent effective average depreciation per month, and wage moderation.

The adjustment effort undertaken by the Portuguese authorities was remarkably successful as regards the external accounts. The current account deficit of the balance of payments declined to around 7 percent of GDP in 1983, and to under 2.5 percent of GDP in 1984. Total nonmonetary external debt increased by US\$475 million less than programmed in 1983 and by US\$718 million less than programmed in 1984. The improvement in the external accounts reflected a marked shift in

Portugal's relative cyclical position, as well as a strengthening of competitiveness. Domestic demand, which had grown by nearly 14 percentage points faster than in Portugal's main trade partners between 1979 and 1982, declined by a cumulative 14 percentage points during the period 1983-84, as against a growth of over 4 percent in partner countries. There was, in terms of relative unit labor costs, a marked improvement in competitiveness in 1983 and 1984. Both the decline in domestic demand and, to a lesser extent, the improvement in competitiveness exceeded the program forecasts.

While the strength of the foreign balance moderated the impact of the decline in domestic demand on output, GDP is estimated to have declined by 1.7 percent in 1984, following virtual stagnation in 1983. The impact of the recession on employment remained modest, in reflection partly of existing rigidities in labor market legislation and, more importantly, of the flexibility of real wages which declined markedly during the stabilization period. After accelerating sharply in the latter part of 1983, in reflection of substantial increases in administered prices, especially petroleum products and essential foodstuffs which have a large weight in the index, the rate of price increases decelerated markedly in the course of 1984, ending significantly below the program target of 23 percent by year-end.

The overall stance of financial policies was kept relatively tight throughout the period, with the rate of growth of total (domestic and external) financing decelerating from nearly 29 percent in 1982 to under 20 percent in both 1983 and 1984, which implies a substantial decline in real terms. The rate of growth of total domestic credit remained

significantly below the target in 1983 and through most of 1984. The fiscal-monetary policy mix, however, diverged in 1984 from that envisaged in the program, as the public sector borrowing requirements substantially exceeded the target in the second half of the year, and the monetary authorities endeavoured to offset the impact of this development on total domestic credit by reducing the ceilings on bank credit to the productive sector.

Preliminary indications on economic developments so far in 1985 indicate continued progress in the external accounts reflecting the maintenance of a relatively low level of domestic demand and, to this point, an adequate level of competitiveness. The current account deficit in the first quarter was almost 50 percent less than that recorded in the same period of 1984. However, this was aided, in part, by a sharp fall in agricultural imports resulting from a good harvest. While recovery in domestic demand is likely to lead to some acceleration in import demand in the latter part of the year, the current account deficit for the year as a whole is likely to remain under the equivalent of 2.5 percent of GDP, and the overall balance of payments will likely record a surplus allowing some further rebuilding of foreign exchange reserves. Inflation has been on a clearly decelerating trend, aided by the weakening of the U.S. dollar and the moderation of foreign prices, but also by a slowing of the growth of administered prices. The 12-month rate of inflation in consumer prices declined to 17 percent by July 1985. On the other hand, it appears that the decline in real wages has been arrested. This is expected to support a moderate recovery in domestic demand which, in turn, would be consistent with some rise in the current account deficit in the medium term.

The significant turnaround in the external accounts reflects the adoption, by the Portuguese authorities, of a more consistent framework of macroeconomic policy and their support for a basically open trade and payments system. In this regard, Portugal rolled back its import surcharge from the 30 percent level to 10 percent in March 1984. In addition, the 60 percent surcharge on "nonessential" goods and the 10 percent general import surcharge will be abolished and the former replaced by indirect taxes in the context of overall tax reform and the introduction of a value-added tax upon the accession of Portugal to the European Community in 1986. In the context of the accession agreement, Portugal has undertaken to administer its import licensing system liberally. In light of the progress made so far and the strength of Portugal's external accounts, the Fund hopes that Portugal will soon abolish the remaining trade restrictions for balance of payments purposes and supports the authorities' efforts in this area.