GENERAL AGREEMENT ON

TARIFFS AND TRADE

RESTRICTED

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Limited Distribution

Committee on Balance-of-Payments Restrictions

1989 CONSULTATION WITH PERU (SIMPLIFIED PROCEDURES)

Background Paper by the Secretariat

1. This paper has been prepared in accordance with paragraph 7 of the Declaration on Trade Measures Taken for Balance-of-Payments Purposes (BISD, 26S/205) to assist the Committee in taking the decision referred to in paragraph 8 of the Declaration.

I. Peru's previous consultations with the Committee

2. Full consultations with Peru have been held in 1968, 1970, 1975 and 1987; simplified consultations in 1974, 1977, 1979, 1982, 1983 and 1986. At the last full consultation, held in December 1987 (BOP/R/173), the Committee recognized the critical economic situation faced by Peru and the serious character of its balance-of-payments problems. It underlined the importance of both external factors and domestic economic policies in the evolution of the balance-of-payments situation and emphasized the need to give appropriate weight to all relevant factors. It recognized that Peru was particularly vulnerable to external developments because of its export structure.

3. While recognizing that the situation would remain difficult in the short term, and expressing understanding of the economic and social problems faced by the Peruvian authorities, the Committee expressed its preoccupations concerning the balance between the use of import restrictions by Peru and the development of appropriate financial, budgetary, monetary and exchange rate policies. It was noted that trade restrictions, while they might be justified under the present circumstances, were an inefficient means of restoring balance-of-payments equilibrium and should be temporary. The Committee also noted the concerns expressed by some members on the lack of transparency, predictability and stability in Peru's import régime and the multiplicity of restrictions applied to similar products and drew attention to the relevant provisions of the 1979 Declaration. It recalled that import restrictions taken for balance-of-payments purposes should not be used to protect particular industries or sectors.

4. The importance of restoring conditions for healthy capital inflows and the development of investment in Peru was emphasized. In this context, the Committee expressed its satisfaction at the statement by the Peruvian representative concerning the renewal of contacts with foreign creditors and international financial organizations, and took note of Peru's declarations concerning the repayment of its external debt. It also took note of the announcement made by Peru at the meeting concerning changes in the exchange rate régime and tax developments.

5. In relation to the requests made by Peru under paragraph 12 of the 1979 Declaration, the Committee took note of all the points made.

II. Evolution of trade policies since the last consultation

(a) Import licensing

6. The structure of Peru's import licensing system is being gradually modified. The first steps have been taken by the liberalization of prior import licensing requirements for 373 items in the agricultural and agroindustrial sectors (Supreme Decrees Nos. 039-89-AG, 040-89-AG, 041-89-AG of June 1989, notified in L/6557). All other imports are subject to prior import licensing, as specified in Supreme Decree No. 097-87-PCM of 16 September 1987 (notified in L/6245). Licences are non-transferable, and have a validity of six months. The decision to grant an import licence is made within ten working days of the receipt of a request for a licence. No financial credits may be extended for imports unless an import licence has been approved. Under Supreme Decree 169-89-EF, import licence requirements will be waived until 31 December 1989 for imports of a value lower than US$ 5,000, up to a value of US$ 20,000 per importer (L/6575).

(b) Exchange policy

7. In February 1987, a foreign exchange licensing system was introduced under which quarterly allocations of foreign exchange, based on the Central Reserve Bank's foreign exchange budget, were made by a commission chaired by the President of the Institute of Foreign Trade. Importers were required to obtain a foreign exchange licence for every transaction. Such licences were generally granted on the basis of the degree of priority considered appropriate to the goods in question and the past performance of the importer. Priority was generally given to capital goods and inputs for agriculture and related industry, fisheries and exporting industries; second priority to essential consumption goods and to inputs and capital goods for import-substituting industries; low priority to other items.

8. In January 1988 an "own users' funds" system was introduced for import of inputs, spares, and intermediate and capital goods. These still require import licences, but since March 1988 payment for such imports through the banking system, prior to shipment, has been allowed. The system has grown steadily in importance as a channel for private sector imports, and was linked to the free market exchange system described below.

9. Over the period under review Peru has operated a system of multiple exchange rates. Four separate exchange rates may be identified as being in operation since September 1988: the controlled official exchange rate (MUC), in which the exchange rate of the inti is pegged to the United States dollar and determined periodically by the Central Reserve Bank; the rate at which foreign exchange retained by exporters is transacted for import purposes (established by auction between exporters and importers through free availability certificates (CLD - certificados de libre disponibilidad); the free market exchange rate for bank certificates of deposit denominated in foreign currency (CBME); and the free market rate (also used by importers to obtain "own users' funds" for imports.

According to the IMF, the taxes on the FOB value of traditional exports (6 per cent) and fish products (3 per cent) created an additional exchange rate. (In this connection it is worth noting that the tax on fish products was eliminated in February 1989 (Supreme Decree No. 024-89-EF, notified in L/6570).)

10. Following the introduction of the "own users' funds" system mentioned above, the parallel market was legalized in April 1988, when banks and other financial institutions were authorized to trade in foreign cash and travellers' cheques at a freely established rate for "own users' funds" imports as well as for travel expenditure abroad and repurchases of foreign exchange y non-residents up to defined limits. At the same time, industrial companies were permitted to pay up to one third of the c.i.f. value of imports with foreign currency certificates of deposit held under regulations prohibiting profit remittances and private debt service payments. In May, sales of foreign exchange to pay for imports with external financing, and for related interest and commission charges, was authorized.

11. In June 1988, the free market rate was made applicable to purchases of tickets for travel abroad, fees for passports, fuel for international flights, port fees and maintenance charges for international transport ships, freight costs related to exports, payment of any other transportation costs denominated in foreign currency and remittances of profits by multinationals. At the same time, exporters of traditional mining and fish products were entitled to receive foreign exchange certificates equivalent to 10 per cent of the f.o.b. value of exports (as quoted in the free market) for use in payment for capital equipment, inputs and spares or for sale to other exporters. In July 1988, the free market exchange rate was made applicable to travel abroad for study or health reasons, insurance and technical services to other persons than petroleum companies, expenses for students in universities abroad and insurance related services.

12. Further modifications were made in August 1988 and in September all controlled exchange rates were unified at a rate of 1,250 intis per US dollar. This rate applied to all transactions by oil companies, as well as to domestic financing of non-traditional exports through FENT (the Fund for Non-Traditional Exports) and sale of foreign exchange for students' expenses abroad. Service payments related to audio-visual services were to be made at the free market rate for foreign banknotes, most capital goods imports, sales and purchases of silver, and taxes on tickets for travel abroad. Advance sale of foreign exchange for payment for imports with foreign financing was once again banned; imports of books and motor vehicles were to be made at the free market rate, as would payments for most transportation expenses and users' fees. Foreign exchange deposit accounts were legalized and banks were authorized to sell such foreign exchange (at the free market rate) for tourism abroad and "own users' funds" imports. The effects of these changes in the exchange system on Peru's real effective exchange rate are shown in the section on "Economic and Trade Developments".

(c) Tariffs

13. Peru has, since the last consultation, notified to GATT three decrees concerning tariffs (L/6537). Of these the most significant is Supreme Decree 222-88-EF of 24 November 1988 which established a maximum tariff of 84 per cent ad valorem, replacing tariffs previously up to 120 per cent. Tariffs on 224 headings were thus reduced. At the same time, a minimum duty of 10 per cent was established applying to goods which were previously subject to tariffs of less than 16 per cent including duty-free items. This minimum does not apply to rates agreed under international treaties or conventions (including those in Peru's GATT schedule), basic drugs and the like, and medicaments for the treatment of cancer.

14. In June 1989, tariffs were reduced to rates of 10 and 5 per cent for imports of machinery, equipment, inputs and spare parts for the agricultural and agro-industrial sectors (L/6557). In July 1989 the maximum tariff for imports of capital goods and inputs was reduced from 84 per cent to 60 per cent.

III. Economic and trade developments

Aggregate supply and demand

15. The rate of growth of GDP was close to 8 per cent during 1987, after having grown nearly 10 per cent in 1986. These growth rates were primarily the result of policies undertaken by the government after mid-1985 to stimulate the economy by boosting aggregate demand. The rapid rise in real income that resulted from a policy of price controls, increased subsidies, and lower interest rates and taxes, made private sector consumption and investment grow briskly at 10.2 and 33.8 per cent respectively during 1987. While public consumption increased at 4.5 per cent (after a growth of almost 6 per cent in 1986), public investment fell by nearly 28 per cent reflecting increasing strains on government finances. Strong growth of 8.8 per cent was also recorded in real imports of goods and non-factor services, while exports declined by 4.5 per cent largely due to strong domestic demand and a real appreciation of the inti.

16. As prices and bottlenecks increased, the expenditure- and credit-led expansion of 1986-87 turned into a recession in 1988. For 1988 as a whole, the Peruvian economy is estimated to have experienced a decline in GDP of almost 9 per cent. Private consumption and investment fell by almost 6 and 13 percent, respectively. Public investment continued to decrease, this time by about 18 per cent, while public consumption declined for the first time since 1984 (by almost 10 per cent). Despite improvements in international prices for major Peruvian exports, real exports fell more than 9 per cent as a result of supply constraints, including the effects of strikes in the mining sector. Real exports have rebounded sharply in the first half of 1989, mainly due to high international prices for mineral exports, a recovery in fishmeal production and a shift of production of other goods from the domestic to external sectors. The prospects for 1989 are for a large fall in domestic expenditure, both as a result of a major decline in real wages and of the constraints imposed by a continued fiscal deficit.

Public finance

17. The public sector deficit deteriorated in 1987 to 7.5 per cent of GDP from 5.8 per cent in the previous year. This resulted from a reduction in total government revenue equal to 3 per cent of GDP, which was only partially offset by a decline of total expenditures equal to 1 per cent of GDP. In 1988, the public sector deficit further rose to 8.9 per cent of GDP, mainly because of the rapid deterioration of the finances of public enterprises, largely the result of a policy of holding down prices on domestic sales. In 1988, total expenditures of the public sector declined to 18.2 per cent of GDP. Public sector net capital expenditure fell from 4 per cent of GDP in 1987 to 3.4 per cent in 1988. Despite the continuation of measures to reverse the consequences of the tax reductions and exemptions of 1985 and 1986, total revenues also fell rapidly to a level of 9.3 per cent of GDP.

18. All the activities of the central bank of Peru related to the operation of the multiple exchange rate system, and the financial operations with the rest of the banking system and with the public sector, resulted in central bank losses (quasi-fiscal deficits) of about 4.3 per cent of GDP in each of the last two years, against 0.3 per cent in 1986. If this deficit is added to the public sector deficit, the overall public deficit (PSBR) was 11.8 per cent of GDP in 1987 and 12.4 per cent of GDP in 1988.

19. Difficulties in obtaining foreign credits coupled with the growing public sector deficit, increased the size of the PSBR that had to be financed domestically - to 9.5 per cent of GDP in 1987 as against 1 per cent the previous year. During 1988, that share dropped to 8.3 per cent of GDP reflecting the depreciation of the domestic currency (that is, after the depreciation, a given net inflow of foreign financing represented a larger amount of intis). While gross new disbursements from abroad declined to about 1 per cent of GDP in 1988, the accumulation of interest arrears in 1988 amounted to 3.5 per cent of GDP, up from 1.5 per cent in 1987.

Money and credit

20. During the years 1987 and 1988, Peru experienced a significant decline in its net international reserves and a rapid rise in the net domestic assets of the banking system. However, the acceleration of inflation, coupled with the policy of ceilings on interest rates, produced high negative real interest rates which led to a sharp decline in deposits, which in turn reduced the domestic resource base of the banking system.

21. Net domestic assets of the banking system grew almost 121 per cent in 1987, mainly because of a significant rise of net credit to the public sector (about 44 per cent) and the foreign exchange and financial losses of the central bank (almost 32 per cent). Central bank net credit to the public sector rose to 4 per cent of GDP in 1987 and the central bank's losses amounted to almost another 3 per cent of GDP. During 1988, net domestic assets expanded almost 330 per cent, mostly due to credit to the private sector and to central bank losses (2.9 per cent of GDP). In the

first half of 1989, the domestic resource base of the banking system contracted further as broad money fell to 5.8 per cent of GDP.

Balance of payments

22. Changes in economic policy since mid-1985 have resulted in a widening of the deficits on the current account, the capital account and the overall balance of payments (Table 1). IMF data show that the latter steadily worsened from almost 6 per cent of GDP in 1985 to 14 per cent of GDP last year. This deficit was financed through a reduction in international reserves (excluding gold) from $1.8 billion to $0.5 billion between 1985 and 1988, and through the accumulation of external payments arrears estimated by the IMF at $10 billion at the end of 1988. These trends were partially reversed in the first half of 1989 as the current account reached near equilibrium, on the basis of an improvement in the trade balance. Net international reserves rose by about US$500 million.

Table 1 - Balance of Payments, 1985-88 and 1st. half 1989
(US$ million)

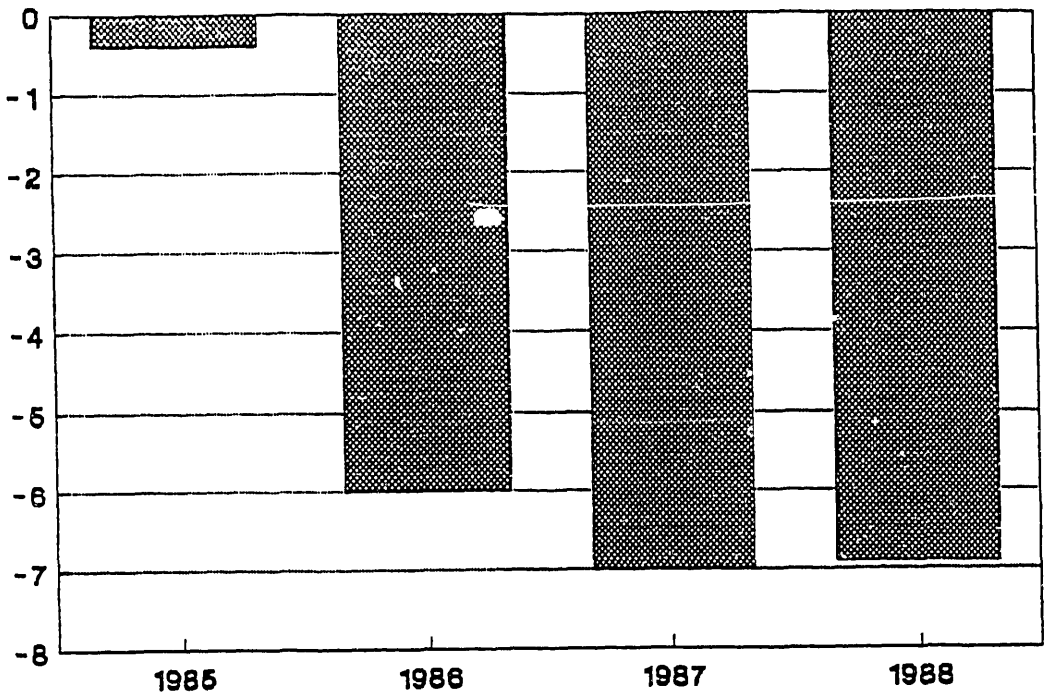
	1985	1986	1987	1988	1st. half 1989
Trade balance	1,172	-65	-521	-56	747
- Exports (f.o.b.)	2,978	2,531	2,661	2,694	1,745
- Imports (f.o.b.)	-1,806	-2,596	-3,182	-2,750	-998
Investment income	-1,203	-1,072	-1,125	-1,397	-720
- Public sector	-899	-856	-949	-1,215	-639
of which: imputed on arrears	-155	-249	-407	-611	-397
- Private sector	-304	-216	-176	-182	-81
Other services	-170	-343	-422	-453	-137
Transfers	134	150	180	157	77
Invisibles balance	-1,239	-1,265	-1,367	-1,693	-780
Current account balance	-67	-1,330	-1,888	-1,749	-33
Capital account[1]	-887	-986	-1,419	-1,201	-621
Long-term capital	-558	-1,006	-1,030	-1,117	-475
- Public sector	-435	-958	-1,006	-1,142	-475
- Private sector	-123	-48	-24	25	-
Short-term capital and errors and omissions	-329	20	-389	-84	-146
OVERALL BALANCE	-954	-2,316	-3,307	-2,950	-654

[1]Net of rescheduling.

i. The current account

23. Peru's current account deficit deteriorated from 6 per cent of GDP in 1986 to about 7 per cent of GDP in the last two years (Graph 1). This resulted from an excess of national expenditure over output, as well as a real appreciation of the inti and a deterioration of Peru's terms of trade (until 1987).

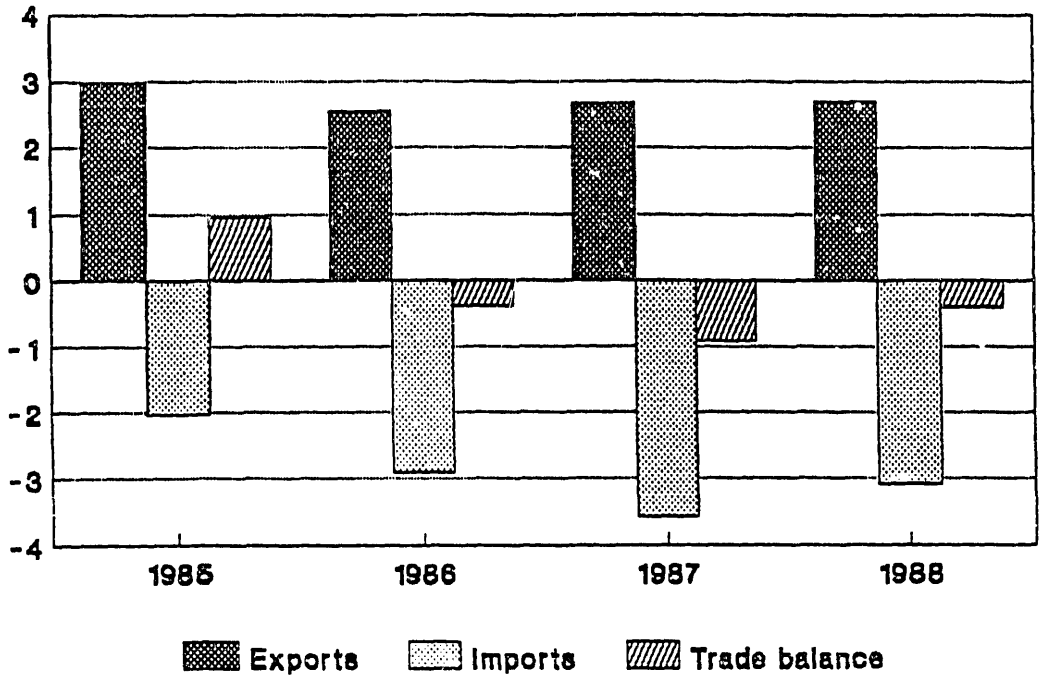
Graph 1 - Current account balance
(percentage of GDP)



24. Peru's merchandise trade balance moved from a surplus equivalent to 7 per cent of GDP in 1985 to a deficit of 1.7 per cent of GDP in 1987, and then back almost to balance in 1988. According to preliminary estimates, the trade balance recorded a surplus of $0.7 billion in the first half of 1989.

25. Merchandise export earnings rose 3 per cent in 1987 and 2 per cent last year, partly as a result of improvements in world prices of fishmeal and minerals which more than offset volume declines of 7 per cent in 1987 and 21 per cent in 1988 (Graph 2 and Table 2). Oil exports declined steadily from $645 million in 1985 to $274 million and $151 million in 1987 and 1988 respectively.

Graph 2 - Value of merchandise trade*
(Billion US dollars)



*On a customs basis

Table 2 - Value of merchandise exports
($US million)

	1985	1986	1987	1988	% change 1988 over 1985
Fishmeal	118	206	229	368	211.9
Mineral products	1,205	1,047	1,153	1,194	-0.9
Agricultural products	225	333	179	170	-24.4
Petroleum and derivatives	645	232	274	151	-76.6
Other	785	716	771	780	-0.6
TOTAL	2,978	2,534	2,606	2,663	-10.6

26. Merchandise imports (c.i.f.) grew 22.4 per cent in 1987. The strength of import demand is largely explained by the impact on domestic expenditure of the fiscal and monetary expansion, as well as expectations of a devaluation of the exchange rate and/or more restrictive trade policies. In late 1987 the authorities started depreciating the inti, which resulted in a depreciation of 9 per cent (on a period average basis) in the real effective exchange rate comparing 1988 with 1987. This, combined with changes in the exchange system mentioned above, and with the depressive effects of the 1988 recession, resulted in a decline in imports of more than 13 percent last year.

27. The public sector's demand for foreign goods in 1987 was even stronger than that of the private sector. The import categories that grew most rapidly were military equipment and capital goods (Table 3). The decline in imports during 1988 also involved public purchases, including military equipment. The shares of military equipment and capital goods in 1988 imports were 4 per cent and 26 per cent against 13 and 31 per cent in 1985 respectively.

Table 3 - Value of merchandise imports
($US million)

	1985	1986	1987	1988	% change 1988 over 1985
Consumer goods	112	378	405	271	142.0
Raw materials and intermediate goods	841	1,242	1,450	1,565	86.1
Capital goods	558	761	923	693	24.2
Military equipment	227	159	234	117	-48.5
Other	68	56	56	54	-20.6
TOTAL	1,806	2,596	3,068	2,700	49.5

28. The deficit on invisibles widened to $1.5 billion in 1987 and to $1.6 billion in 1988 from $1.2 billion in 1986. Interest obligations of the public sector, on an accrual basis, grew to $1.2 billion in 1988 from 0.9 billion in 1985.

ii. The capital account

29. The capital account has weakened from a deficit of $887 million in 1985 to estimated deficits of $1.4 billion in 1987 and 1988. This was largely accounted for by developments on long-term capital account. Both the public sector and the private sector components of it have been affected by the policy of putting a ceiling on service payments on the foreign debt.

30. The government policy of restricting payments on the service of medium- and long-term foreign debt has resulted in an accumulation of payments arrears that reached almost $10 billion at the end of 1988, according to the IMF. As was indicated above, this constituted the major source of financing of the overall balance of payments deficit. The total external debt of Peru has grown from $13.9 billion (81.6 per cent of GDP) in 1985 to $17.9 billion (71.3 per cent of GDP) in 1988. As a result of the country's policy on servicing debt, actual debt servicing represented only 21 per cent of the scheduled interest and amortizations in 1985, falling to 8 per cent last year. The ratio of total debt service to exports of goods and services, including payments of arrears, fell from 23 per cent in 1985 to 9 per cent in 1988.