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COMMUNICATION FROM THE EUROPEAN ECONOMIC COMMUNITY

The following communication, dated 13 November 1987, has been received from the delegation of the European Economic Community with the request that it be circulated to members of the Group.

The Balance of Payments Articles

The European Community has expressed its support for the proposal to review the GATT Articles relating to the application of trade restrictions for balance of payments purposes. As a contribution to the work of the Group, this communication sets out the Community's views on the operation of the relevant GATT provisions (Articles XII, XIV, XV, XVIII), as well as a first identification of the issues which should be addressed in negotiations.

A. The relationship between GATT rules and the International Monetary System

The principal justification for the BOP exception in Article XII of GATT was the adjustable peg rate system of Bretton Woods which could require temporary trade measures to facilitate adjustment while domestic policy measures or a change in par values of currencies took effect. The rules of the international monetary system have evolved in recognition of the principle that balance of payments equilibrium should be achieved through a combination of exchange rate adjustment and appropriate internal measures. By acknowledging that restrictive trade measures are an inefficient means to correct balance of payments disequilibria, the 1979 Declaration represented a step in the same direction. In practice, developed countries have been able to withstand external shocks, which have imposed heavy adjustment costs in their economies, whilst avoiding the imposition of trade restrictions for balance of payments purposes or, at least, limiting them to a strict minimum.

The specific nature of the balance of payments problems experienced by developing countries is acknowledged in Art. XVIII:B and is not in question. Indeed, the evolution in the assistance policies of the IMF and WB is based on the concept that a longer time-frame for adjustment is required for economies engaged in a process of development. Thus, it is not intended to propose a renegotiation as such of Article XVIII:B. However, problems have arisen over interpretation of Article XVIII:B, to the point where its implementation should be reviewed. The distinction between Article XII and XVIII:B should not obscure the fact that both impose similar disciplines; equally, the principles of multilateral surveillance agreed in the 1979 Declaration apply to both developed and developing countries. The essential concept that trade restrictions are temporary and should not substitute for adjustment measures must be firmly upheld. This implies that any improvement in the BOP situation of a country having previously invoked Art. XVIII:B, should be reflected in a diminution of trade restraints actually maintained. In any event the requirements that restrictions shall not exceed what is necessary to maintain external balance and that preference be given to those measures having the least disruptive effect on trade are also essential elements of both Article XVIII:B and the 1974 Declaration.

A particular area of concern is the confusion between restrictions applied for protective reasons and for balance of payments purposes. Given the widespread recognition that trade restrictive regimes can act as an obstacle to adjustment and the development process itself, the GATT should play a positive role in encouraging the progressive liberalisation of LDC's trade policies. In fulfilling this task, due account should be taken of the different levels of development of countries consulting under Article XVIII:B.

Article XIV and XV give to the IMF a prominent role in BOP consultations. For historical reasons, there are no similar provisions in the IMF Agreement. As a result, contracting parties lack sufficient information on the considerations on the basis of which decisions with a direct repercussion on rights and obligations under the General Agreement are taken. This basic imbalance has been highlighted by the increased activities of the IMF in the trade policy field, as shown both by article IV consultations and the commitments assumed under Fund-assisted programs.

B. Consultations in the BOP Committee

Effective multilateral surveillance depends on political will clear principles and effective procedures. BOP consultations have been found deficient on all three counts, with the result that the BOP Committee has had a very limited influence on the trade policy of countries experiencing balance of payments difficulties. The weaknesses of current consultation arrangements relate to the three basic concepts of transparency, guidance and co-operation.

1. Transparency : there are loopholes in the surveillance mechanism : countries maintaining restrictions without notifying measures or maintaining them after the formal desinvocation of article XII or article XVIII:B are not subject to surveillance. There is also an absence of follow-up procedures to support the efforts made by countries to adapt their policies in light of the conclusions of the BOP Committee. This situation has become more serious because of the increased time-lags between full consultations. Simplified consultations have become a formality and do not provide the information necessary to evaluate the BOP situation and the evolution of the trade regime of consulting countries.

2. Guidance : the plan of discussions for consultations already contains all the elements relevant for the BOP Committee to reach clear conclusions. The 1979 Declaration should have contributed to improved surveillance by formulating clear principles on which this would be based. In practice, however, there has been little discussion of those elements on which guidance from the BOP Committee would have been most useful : alternative measures to restore equilibrium and protective effects. As regards the first element, there has been a tendency to rely exclusively on the IMF, although article XII and XVIII:B clearly recognize GATT competence in the matter. The neglect of the second element is particularly serious since it tends to undermine the very rationale of the GATT balance of payments exception.
3. Cooperation : given the serious nature of the balance of payments difficulties experienced by many developing countries, consultations should be approached in a spirit of cooperation from all parties concerned. Consulting countries have on occasions proved unwilling to enter into a frank discussion of their adjustment strategies and trade regimes. As a result consultations have rarely favoured a climate in which the possible contribution from other contracting parties to alleviate balance of payments difficulties could be examined. Clearly progressive liberalisation also requires improved cooperation between GATT, the IMF and the WB, since each institution has its specific role to play in helping adjustment to more open trade regimes.

C. Issues for negotiations

The European Community believes there is a clear case for improving the disciplines related to the operation of the Balance of Payments exception in GATT. Negotiations should aim at achieving higher commitments from all contracting parties and take into account the fact that the flexibility of economies to adjust to external shocks increases progressively with their level of development. Balance requires that reinforcements in multilateral surveillance apply across the board to all GATT obligations including the B.O.P. consultations.

Negotiations should concentrate on the following issues :

1. Under most circumstances, Article XII has lost its *raison d'être* for countries which have reached a high level of development. There is therefore an argument to go beyond the qualified commitment assumed in the 1979 Declaration. The precise form in which this could be achieved and the institutional arrangements under which exceptional situations could be dealt with should be addressed in negotiations.
2. Procedures for consultations should be revised. While maintaining the specific role of the BOP Committee, the deficiencies of the present system might be best addressed by establishing a link with more general surveillance mechanisms that could be established in the Uruguay Round. Surveillance would provide the opportunity both for an in-depth examination of the policies maintained by individual countries and for a more general examination of the operation of the GATT system that is possible under present fragmented notification and review procedures. This solution appears to be simpler and more

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symmetrical than the extension of the competences of the BOP Committee, to cover existing gaps. Simplified consultations should cease to be generally available. Only countries at very low levels of development for which regular consultations would represent an excessive administrative burden should continue to consult under simplified procedures. Furthermore attention needs to be given to possible improvements of simplified consultations in order to increase transparency of trade policy actions.

3. Existing principles of multilateral surveillance should be examined with a view to making them more operational. A better linkage should be assured between the application of these principles and the plan for consultations. Particular attention should be given to the identification of protective effects and the relationships between article XVIII:B and article XVIII:C.
4. Symmetry should be achieved both in BOP consultations and within the GATT system. For legal and economic reasons the primary focus of consultations should continue to be the measures taken by the consulting country. External factors should become a regular feature of consultations rather than depend on invocation by the consulting country. Contributions from other contracting parties should therefore be taken into account. Better symmetry within the GATT system should be achieved through parallel progress in the reinforcement of multilateral surveillance, both on a general basis and in the application of other GATT exceptions.
5. Improved cooperation should be achieved between GATT and the IMF and WB. Given the expertise and specific contribution of each institution, it is essential that they should play a mutually reinforcing role in the progressive liberalisation of developing country trade policies.