BACKGROUND PAPER FOR DISCUSSION
OF GATT RULES AND PROCEDURES GOVERNING TRADE
MEASURES FOR BALANCE-OF-PAYMENTS PURPOSES

The attached background paper is being circulated to the Group at the request of the United States representative, Ambassador Clayton K. Yeutter, as a contribution to the discussion under Item 4 of the Provisional Annotated Agenda.
I. Introduction

A number of developments have focused increased attention on measures which countries use to deal with balance-of-payments difficulties. The disruptions caused by the dramatic increase in the price of oil and the resulting balance-of-payments problems have increased the short-term temptation to take off-setting trade measures. Increased economic interdependence has aggravated the international effect of any such actions. These factors argue persuasively for strengthening the existing GATT rules and procedures governing trade measures for balance-of-payments purposes.

In light of these considerations, the October 1974 request of the Balance-of-Payments Committee to the GATT secretariat for a historical report on the operation of the Committee during the period 1970-1974 was particularly appropriate. Although limited to a factual examination of the operation of the Balance-of-Payments Committee, the report (GATT document L/4200 of 18 July 1975) does illustrate the need for improvement in the GATT rules and procedures dealing with trade measures taken for balance-of-payments purposes. It does not, however, suggest corrective actions.

At the 24/25 November meeting of the Consultative Group, the report and the general question of GATT handling of balance-of-payments trade matters was discussed. Several delegates indicated the need for improvement in the applicable GATT rules and procedures. Discussion of the balance-of-payments question will be taken up again at the next meeting of the Consultative Group.

In this paper the United States suggests approaches for review by the Consultative Group of GATT rules and procedures governing trade measures for balance of payments. After such review, the Consultative Group might appropriately present its conclusions to the GATT Council.

II. Suggested approaches

Reform in the area of GATT practices relating to balance-of-payments actions involves (1) improvement of the multilateral GATT procedures for surveillance and examination of trade measures justified for balance-of-payments reasons; and (2) revision of the rules which now provide de jure recognition of only one type
of trade measure taken for balance-of-payments purposes - quantitative restrictions. However, efforts in each area, while clearly complementary, are distinguishable and, since they involve important differences with respect to the substantive nature of a change and the requirements for review by the Contracting Parties, can be viewed separately.

The United States believes that initially efforts should be concentrated on improving GATT procedures. Revision of Article XII and Article XVIII:B is desirable but would involve a change in GATT rights and obligations. Improvement in internal GATT procedures is, however, more of a "housekeeping" function and could be more easily accomplished over the short term. Implementation of improvements in this area would then help to clarify the options for revision of GATT Articles.

In the final analysis, the success of efforts to improve the operation of GATT rules and procedures governing balance-of-payments trade actions will depend upon the will of the Contracting Parties to make the consultative process operate effectively. To this end, the Contracting Parties must accept the need for constructive consultations on common problems and demonstrate a willingness to seek solutions through international procedures.

A. Revision of the terms of reference and procedures of Balance-of-Payments Committee

1. In order to improve procedures governing balance-of-payments actions by contracting parties, the terms of reference of the Balance-of-Payments Committee should be revised to include surcharges, prior deposit requirements and such other measures as may be used for balance-of-payments purposes. While such a modification to the Balance-of-Payments Committee terms of reference without a corresponding change in the GATT rules would represent something of an anomaly in GATT practice, it would reflect de facto acceptance by the GATT of the use of surcharges and prior deposit schemes.

2. GATT review of trade measures taken for balance-of-payments purposes should provide full appraisal of the trade impact of the actions taken and include examination of possible adjustments to reduce trade distortions. A preference for measures which minimize such distortions should be recognized.

3. In order to encourage the development of better technical review of balance-of-payments measures, there should be provision for request by the Balance-of-Payments Committee for secretariat studies on the potential trade impact of particular trade measures taken for balance-of-payments purposes.
4. The secretariat should be encouraged to develop with the staff of the IMF procedures for improved co-ordination and exchange of information between the GATT and the IMF.

5. Balance-of-Payments Committee reports should indicate clearly the basis for Committee conclusions. This will facilitate the development of guidelines governing trade actions for balance-of-payments purposes.

6. Provision should be made for Committee consultations with respect to implementation of recommendations. At present the Balance-of-Payments Committee does not have adequate authority to follow up on action taken in light of Committee conclusions.

B. Revision of GATT Articles

1. Article XII and Article XVIII:B of the GATT, designed to meet the needs of the Contracting Parties during the immediate post-war years, have been overtaken by developments and should be revised accordingly. This would involve formal recognition of de facto acceptance by the Contracting Parties of the use of trade measures other than quotas for balance-of-payments purposes. At present the use of surcharges or prior deposit measures - both of which tend to have less distorting effect on international trade than do quotas - remains inconsistent with the GATT Articles.

2. Formal recognition of additional measures that may be taken for balance-of-payments purposes should be accompanied by criteria governing the use of any permitted measures. The precise nature of such criteria would, of course, need careful review but could, for example, prohibit discrimination in the application of trade measures and establish a preference for those measures having the least distorting effect on trade. Such criteria would be reflected in the appropriate GATT Articles.

III. Background

In the post-war period when the General Agreement was drafted, most of the Contracting Parties relied on a rigid system of quotas and licensing to regulate their import trade. These restrictions were justified under the balance-of-payments exceptions of Article XII to the general prohibition on import quotas. As the economies of the Contracting Parties maintaining balance-of-payments restrictions began to strengthen, the justification for the restrictions ceased and the pressures for removal grew.
These developments were recognized by the Contracting Parties and, in the mid-1950's, tighter balance-of-payments consultation procedures were adopted. Countries were forced to justify their restrictive trade measures and were asked either to eliminate those quantitative restrictions for which no justification could be given, or to obtain "hard core" waivers for particular restrictions with the understanding that such restrictions would be lifted over a specified period of time.

The impact of these trends on GATT balance-of-payments consultations was significant. The first case under these new procedures set a precedent for subsequent balance-of-payments consultations. Thereafter, GATT efforts to achieve the elimination of import restrictions gained momentum. A series of "liberalization communiqués" announced the elimination of a wide variety of import restrictions. The GATT Balance-of-Payments Committee performed a major rôle during this period in exerting pressure on the Contracting Parties to remove their remaining restrictions.

However, the success of the GATT Balance-of-Payments Committee during the late 1950's and the early 1960's in eliminating quantitative restrictions maintained by industrialized countries obscured emerging trends which have brought into question the effectiveness of GATT rules and procedures in dealing with the balance-of-payments trade issues facing the Contracting Parties.

The relative decline over past years in the rôle of the Balance-of-Payments Committee has paralleled:-

(1) the elimination of most residual import quotas justified for balance-of-payments reasons which were relied upon by many contracting parties during the post-war period;

(2) the emergence of import surcharges and import deposit schemes as widely used trade measures for balance-of-payments purposes;

(3) the significant increase in participation in the GATT by developing countries;

(4) the relatively greater importance assumed by the severe balance-of-payments difficulties of many developing countries; and

(5) the introduction of more flexible exchange rates.
Because of these developments, effective review by the Contracting Parties of balance-of-payments measures has become more complex. There is a recognized anomaly between the provisions of the GATT and the practice of the contracting parties which lends an air of unreality to the Balance-of-Payments Committee deliberations and an unevenness in the degree to which the actions of the contracting parties are subject to review. In order to ensure effective review of all measures, there is a need to establish agreed procedures for consultations on the range of measures - quotas, discretionary licensing, surcharges, deposit measures - which are currently used for balance-of-payments purposes.

There is also an imbalance in the Balance-of-Payments Committee discussions of a country's balance-of-payments situation and the effect on other contracting parties of corrective trade measures taken. Constructive consultation must take into account the balance-of-payments difficulties of country taking action, the causes thereof, including the extent to which long-term import restrictions of others adversely affect the ability of such country to export, and must involve appraisal of the trade effects of any measures taken. Review must also take into account the particular balance-of-payments difficulties of the developing countries.

While the introduction of more flexible exchange rates might reduce the long-term need for trade restrictions for payments purposes, this by no means solves the problem. Especially as short-term measures, trade actions will continue to be taken to correct payment imbalances.

The GATT must meet the needs of the trading system by providing a forum for constructive international consultations on, and review of, any such trade measures. The challenge before the Contracting Parties is to develop revised procedures that will encourage effective deliberations within the GATT Balance-of-Payments Committee on payments measures with a view towards ensuring that, where trade actions are necessary, they are justified and have a minimum distorting effect on trade.

IV. Discussion

A. GATT rules governing the use of balance-of-payments trade measures

Articles XII and XVIII:B of the General Agreement provide the basic GATT rules governing the use of trade measures for balance-of-payments purposes. Both Articles (Article XII for all countries and Article XVIII:B for developing countries) authorize contracting parties to impose quotas for balance-of-payments purposes. The drafters of the GATT did not provide for the use of any measures other than quotas for balance-of-payments purposes. The use of surcharges and import deposit schemes accordingly not only raise problems of GATT consistency,
but because surcharges and deposit measures are not the subject of GATT balance-of-payments rules, there is no formal requirement for consultations or provisions for surveillance. Both surcharges and deposit measures have been brought before the GATT on an ad hoc basis but regular procedures within the GATT for their review have not been developed and a significant number of such measures have not been notified to the GATT at all.

B. Jurisdiction of the Balance-of-Payments Committee

The terms of reference of the Balance-of-Payments Committee reflect the legal obligations of the GATT governing balance-of-payments trade measures. The Committee is charged with the responsibility "to conduct the consultations under Article XII:4(b) and Article XVIII:12(b) as well as any such consultations as may be initiated under Article XII:4(a) or Article XVIII:12(a) "(i.e., initial and subsequent consultations required when a country invokes Article XII or Article XVIII:B). The Committee is not given responsibility for consultations on, or review of, surcharges, import deposit measures or any other balance-of-payments trade measures not notified under Article XII or Article XVIII:B. Further, the Committee is not authorized to follow up on any consultations after Article XII or Article XVIII:B has been disinvoked. As import surcharges and import deposit schemes have become widely used for balance-of-payments purposes, the limitations on the jurisdiction of the Committee have assumed particular importance. The practice of the Contracting Parties to refer certain import surcharges and import deposit measures to the Committee for review has mitigated somewhat the effect of the Committee's limited terms of reference, but this has not proved a satisfactory solution.

The incidence of the Balance-of-Payments Committee examination of trade measures taken for balance-of-payments purposes illustrates the dimensions of the problem. From 1970-1974, there were forty-five consultations and seven waiver requests undertaken by the Balance-of-Payments Committee. However, these were largely the result of continuous consultations pursuant to invocations made prior to 1970. Within the five-year period there were only two new invocations and one revocation of Article XII or Article XVIII:B measures. No complaints were brought under either Article XII or Article XVIII:B contesting balance-of-payments measures inconsistent with the GATT. Over the same time period, import surcharges appear to have been applied in twenty-four cases (in eight of which the surcharge was imposed or reimposed in 1970 or thereafter) and seventeen different import deposit measures were apparently applied (six of which were imposed or re introduces in 1970 or thereafter). The Balance-of-Payments Committee reviewed ten of the twenty-four import surcharge cases and seven of the seventeen import deposit measures. Five of the import surcharge cases and three of the import deposit
measures were dealt with in other GATT bodies.\textsuperscript{1} Nine of the import surcharges and seven of the import deposit measures were not brought to the attention of the Contracting Parties at all.

C. Rules, procedure and practice of the Balance-of-Payments Committee

1. Import Restrictions Imposed Pursuant to Article XII or Article XVIII:B - The Balance-of-Payments Committee has developed and followed standard procedures in reviewing quotas imposed for balance-of-payments purposes under Article XII or Article XVIII:B. Background information for the consultations is furnished by the IMF and the country applying the trade measures. The IMF generally provides a statement on the balance-of-payments situation of the country, including an assessment of the appropriateness of the general level of trade restrictions in light of the country's balance-of-payments situation, and a recent background report on economic developments in such country. The country supplies information on the operation of the restrictions and the general policy behind their use. The Balance-of-Payments Committee does not undertake independent studies on trade measures taken. Such a study could be particularly useful in providing an independent appraisal of the trade effects of balance-of-payments measures and in examining the merits of alternative trade actions. Present procedures do not ensure adequate review in these respects. As noted above, IMF passes on the general level of import restrictions in light of the balance-of-payments position of the country imposing such restrictions; it does not offer a comprehensive appraisal of the trade effects of the actions taken.

The consultations are held according to a plan comprising of four main headings - balance-of-payments position and prospects; alternative measures to restore equilibrium; system and methods of restrictions and effects of restrictions. At the conclusion of consultations, the secretariat prepares a draft report for consideration by the Committee. The Committee report is submitted to the GATT Council for forwarding to the next session of the Contracting Parties for final approval.

In practice, the consultations have tended to emphasize the balance-of-payments status of the country taking action, the practical operation of the measures taken and the manner in which the measures affect specific export interests of contracting parties. There is no overview of the broad trade effects

\textsuperscript{1} Import surcharges and import deposit measures notified to the GATT but not dealt with by the Balance-of-Payments Committee have generally been referred to Working Parties by the GATT Council.
of measures taken in light of possible alternative courses of action. This may, in part, be due to the absence of (1) any independent study of such trade effects (see above) and (2) any guidelines on the nature of trade measure for balance-of-payments purposes (i.e., there should be a recognized preference for those measures with the minimum distorting effect on international trade).

2. Import surcharges and import deposit measures - In dealing with import surcharge measures referred to it, the Committee has moved away from a formal procedure of recommending a waiver (technically necessary to resolve the inconsistency of a surcharge with the GATT rules). Current practice is to equate the surcharge with a quota and deal with it as if no waiver were needed. The procedures (and the shortcomings thereof) for reviewing surcharges are similar to those described for restrictions under Article XII and Article XVIII:B. The conclusions of the Committee are made in light of the financial and commercial criteria set forth in Article XII and Article XVIII:B.

In connexion with those import deposit measures referred to it, the Committee has avoided presenting clear conclusions. This may, in large part, be due to the failure of the Contracting Parties to decide whether an import deposit requirements in respect to bound items is a violation of GATT Article II. Again, however, the procedure for review by the Committee of import deposit measures appears to be similar to that (with its drawbacks) for review of Article XII and Article XVIII:B actions.

3. Statement of conclusions - In all cases, there has been a general reluctance on the part of the Committee to state the reasons for its conclusions. While this may have proved expedient in the past, it has prevented the development of criteria to guide contracting parties in taking balance-of-payments trade actions. Such criteria would be particularly useful as the GATT begins to focus more on the type of trade action taken, in light of alternative measures, and the possibility of adjustment to reduce the trade distorting effects.

D. GATT-IMF co-ordination

Article XV of the GATT requires the Contracting Parties to seek co-operation with the IMF in order to pursue a co-ordinated policy with regard to exchange questions within the jurisdiction of the Fund and questions of quantitative restrictions and other trade measures within the jurisdiction of the GATT. Article X of the IMF Articles of Agreement provides generally that the Fund shall
co-operate "with public international organizations having specialized responsibilities in related fields". These provisions afford the basis for close and effective co-ordination of GATT-IMF policies with respect to balance-of-payments measures affecting international trade.

Periodic consultations between the GATT and IMF at the staff level could prove very useful in both developing and carrying out efforts to promote better co-ordination between the two institutions.