Committee on Balance-of-Payments Restrictions

PRELIMINARY DRAFT REPORT OF THE COMMITTEE ON BALANCE-OF-PAYMENTS RESTRICTIONS ON THE CONSULTATION WITH URUGUAY

1. In accordance with its terms of reference the Committee conducted the consultation with Uruguay under paragraph 4(b) of Article XIII. The Committee had before it: (a) the "basic document" prepared by the secretariat; and (b) documents provided by the International Monetary Fund. In conducting the consultation the Committee followed the "plan" recommended by the CONTRACTING PARTIES. The discussion with the Committee was completed on 30 May 1960. The present report summarizes the main points discussed during the consultation.

Consultation with the International Monetary Fund

2. Pursuant to the provisions of Article XVI of the General Agreement the CONTRACTING PARTIES had invited the International Monetary Fund to consult with them in connexion with this consultation with Uruguay. As a part of the consultation between the CONTRACTING PARTIES and the Fund, the latter transmitted the Executive Board decision taken at the conclusion of the 1959 consultation with Uruguay under Article XIV of the Fund Agreement, and the background material prepared in connexion with that consultation as well as a supplementary paper giving information on recent developments. In accordance with the agreed procedure the representative of the Fund was invited to make a statement supplementing the Fund's documentation concerning the position of Uruguay. The statement made was as follows:

"The International Monetary Fund has transmitted to the CONTRACTING PARTIES the Executive Board decision taken at the conclusion of the 1959 consultation with Uruguay under Article XIV of the Fund Agreement, and the background material prepared in connection with that consultation. The consultation was concluded on September 18, 1959. The Fund has also provided a supplementary paper, dated April 21, 1960, to supply background information on recent developments.

"With respect to Parts I to III of the Plan for Consultations, Uruguay continues to require measures to stop a serious decline in its monetary reserves. Reserves declined during 1959 despite the existence of severe restrictions. The Fund hopes that Uruguay will examine measures to deal with this situation, including its fiscal and monetary policies."
Balance-of-Payments Position and Prospects

3. In his opening statement, the full text of which is attached as an Annex to the report, the representative of Uruguay expressed his Government's intention to continue its efforts in liberalizing imports. He described the measures which had been taken by his Government to achieve this objective and the general fiscal and monetary reforms which had been instituted with a view to ensuring high levels of employment and rapid economic development consistent with internal price stability. Despite the adverse circumstances in which these reforms had been undertaken some measure of success was already visible. The fiscal budget which had been in deficit for about a decade had shown a surplus in 1959 and the budget of the central administration had been in balance. It was hoped that budgetary deficits could also be avoided in future years. In another important move, all provisions for fixing the rate of foreign exchange had been rescinded by the Exchange Law adopted on 17 December 1959. The purchase or sale of foreign exchange were now regulated by the free play of supply and demand. As a further result of the measures with the entry into force of the Law, more imports had been liberalized and all discrimination had been abolished. Furthermore, the Government, in accordance with the objectives of the Exchange Law, was moving towards the gradual elimination of all bilateral agreements providing for bilateral payments. These changes were a clear indication of the Government's desire to free trade to the largest possible extent of import restrictions. The recent liberalization was even more remarkable if one considered that the country had been relying on artificial exchange regulations and trade restrictions for a long time, and that in 1959 Uruguay had suffered extensive damage from unfavourable weather conditions and floods. Those adverse conditions, through their effect on agricultural production and exports and consequently on import needs, had resulted in a considerable trade deficit and had contributed to the continued deterioration of the foreign exchange position during 1959. With export earnings of less than $100 million in 1959, which was equivalent to about 40 per cent of average annual imports during the period 1950-54, and in view of the continued unsatisfactory foreign reserve position, the Government had not found it possible to liberalize all imports. On 30 April 1960 total foreign exchange liabilities amounted to US$131.9 million, with obligations in arbitration currencies amounting to US$80.5 million and in agreement currencies to
US$51.4 million. Although it had been estimated that export earnings during the current year would reach about US$180 million, and thus show a considerable improvement over last year, but falling short of export earnings in the years before 1957, the reserve position continued to be precarious and the full effects of the measures intended to stimulate exports of agricultural products were not likely to exert their influence in the near future. Nevertheless, the Government was hoping fully to liberalize imports during the current year.

At the present time liberalization had reached a level of about 78 per cent of the total value of average actual imports during 1957-1959 and was even higher (88 per cent) for essentials.

4. As a result of the reform of the foreign exchange markets, agricultural exports were expected to recover and increase. Under the system of regulated exchange rates the often unfavourable exchange treatment given to certain agricultural exports had acted as a disincentive to exporters. In addition to the generally greater attractiveness of exports following from the institution of the free exchange market, the Government had adopted a plan for the improvement of agricultural and livestock production, involving an annual expenditure of 80 million pesos. Another plan for the improvement of agricultural and livestock production, financed with funds from the International Bank for Reconstruction and Development, to the amount of US$7.5 million was already in operation. Other measures to increase export earnings included the encouragement of tourism, for which there appeared to be favourable prospects, through the development of the road network particularly to seaside resorts and the building of hotels. During 1959, 200,000 foreign tourists had visited Uruguay and foreign exchange earnings from tourism had amounted to US$30 million.

5. The representative of Uruguay stated that the Government was a staunch believer in economic freedom, having regard to the fact that past experience with a planned economy and considerable State intervention had led to unsatisfactory results. Uruguay was steadily progressing along the road to trade and exchange liberalization and had made some considerable progress. The Government would continue to proceed towards the gradual elimination of restrictions.
6. The Committee thanked the representative of Uruguay for the comprehensive and informative statement. They welcomed the readiness which the Government of Uruguay had shown in introducing reform measures for dealing with a fundamental balance-of-payments disequilibrium and with which the Government had approached other far-reaching reforms in order to encourage the rapid development of a structurally sound economy. The Committee particularly welcomed the elimination of discrimination in the import control system in connexion with the changes introduced under the Exchange Law in December 1959. They also welcomed the statement of intention to remove the remaining import restrictions at the earliest time and possibly not later than by the end of the current year. They noted, however, that the system of deposit requirements, surcharges and the application of various levels of exchange withholding taxes which were used for the control of imports continued to make the control arrangements very complex. It was felt that insofar as these measures had been adopted to protect domestic industries, this purpose could, where such protection was necessary, better be served by the use of tariff measures.

7. The representative of Uruguay agreed that tariff measures were in principle preferable for the protection of industries to non-tariff measures for the protection of industries. For that reason the Government of Uruguay had taken steps to review and re-organize the tariff. This review had, however, not yet been completed and other measures had to be provided in the Law to deal with situations as they arose. The Government continued to pursue its objective of freeing imports from restrictions to the greatest possible extent. The maintenance of a number of trade controls had, however, been necessary in view of the low level of reserves and because of the necessity to proceed with the dismantling of import restrictions gradually so as not to cause undue hardship to industries which had long been operated in a restricted market. Although the Government had had to provide for the safeguarding of the balance of payments and for measures to cushion the impact of the recent reforms on industries, many of the protective measures provided for under the Law were of a permissive nature only, and the Government was determined to follow as liberal a trade policy as possible.
8. In discussion of the reasons for the decline in imports during 1958 and 1959, the representative of Uruguay explained that this decline had mainly to be attributed to the tightening of import restrictions in 1957 following a record trade deficit in that year and a crisis in the exchange market in October of 1957. The reduced imports were the direct result of the very large decline in export earnings. The latent import demand in 1958 and 1959 and, despite the moves towards liberalization which had since that time been made, also at present, though to a lesser extent, had certainly exceeded actual imports. In 1957 and 1958 recessionary forces in the world economy had significantly contributed to the decline in export earnings, particularly from wool, the largest single export commodity of Uruguay. Despite measures by the Government to counteract the decrease in exports, exports in 1959 had further declined as a result of a decrease in agricultural production due to adverse weather conditions and natural disasters. The wheat crop had, for example, been almost completely lost and Uruguay, normally an exporter of wheat, had become a net importer of this commodity in 1959. Also, the relatively unfavourable exchange treatment for wool and meat exports had led to the withholding of wool by exporters in the expectation of more depreciated exchange rates and had resulted in a marked reduction in the amount of meat available for export. He further explained that the substantial decline in export earnings from raw wool in 1959, by about 40 per cent as compared with 1958, was primarily attributable to a decrease in the volume of exports. Exports of raw wool in 1959 had amounted to 34.9 million kgs. to the value of US$34.1 million as compared with exports of 50.1 million kgs. and US$55.2 million in 1958. In reply to a question concerning the application of countervailing duties by one country on wool tops imported from Uruguay, the representative of Uruguay explained that this countervailing duty had been abolished in December 1958 but that exports to that market continued to be relatively small as compared to total exports of wool tops.

9. One member of the Committee noted that in 1959 about 10 per cent of exchange purchases from exporters and exchange sales to importers had been effected in the free market. He enquired whether these exchange transactions had been the result of the coming into force of the Exchange Law in the second half of December. The representative of Uruguay explained that these transactions
in the free exchange market reflected primarily the liberalization measures
which the Government had introduced during the year. For example, on
24 April 1959 a number of import commodities had been transferred for payments
purposes to the free financial market and on 30 June 1959 the Government had
simplified the exchange rate treatment for exports by moving all non-specified
exports to the free financial market. In the discussion of the effects of
the freeing of exchange rates on the development of exchange reserves it was
pointed out that the marked increase in net exchange losses of the Bank of
the Republic in recent years had largely been due to the policy of providing
the Government and public enterprises with exchange bought at the depreciated
free market rate at the relatively appreciated official market rate. On the
other hand it was pointed out that following the freeing of the exchange market,
budget expenditures would show a significant increase due to the less
favourable exchange rate applicable to Government expenditures abroad and
foreign debt repayments.
Alternative Measures to Restore Equilibrium

10. In describing the measures introduced by Uruguay to counteract the process of inflation and monetary expansion which had been particularly marked during the last two years and which had continued into 1960, the representative of Uruguay stated that emphasis had been placed on the limitation of credit expansion. Bank rediscount operations had been considerably restricted and commercial credit, largely through the introduction of more restrictive selective credit controls, had also been tightened. On the other hand, the Government confirmed its policy of giving favourable consideration to the increase in credit facilities for agricultural and livestock production. In the fiscal field the Government was attempting to eliminate budget deficits. Estimated increases in expenditure in the proposed four-year budget, as a result of the relatively larger Governmental expenditures abroad, debt repayment, and wage increases, following the reform of the exchange markets, were to be financed entirely by increases in taxation. To a large extent these increases were, however, nominal and did not reflect an increase in the real burden of these expenditures insofar as these payments had previously been covered by exchange losses. Nevertheless, the surplus in the fiscal budget for 1959 had primarily been achieved by a reduction in expenditures and more adequate tax collections without an increase in taxes then authorized.

11. Members of the Committee noted that the Government of Uruguay had instituted subsidies and fixed a maximum price for wheat, dairy products, and fuel which appeared to be below cost, in order to cushion the impact of the exchange reform on the prices of these commodities. They enquired about the possibilities for the Government to eliminate this subsidy, which was financed by the allocation of 20 per cent of the withholding taxes on export proceeds. Members of the Committee also noted that the finance provided by the present allocation of proceeds from the withholding tax on export earnings appeared to be inadequate and they enquired about the sources of revenue from which these subsidies were to be financed. The representative of Uruguay explained that the maintenance of supported prices for wheat, dairy products and fuel was of considerable importance for the welfare of the country and that it did not seem possible to eliminate this consumer subsidy in the immediate future. He agreed with members of the Committee that present allocations from withholding taxes on export proceeds were not adequate. However, a bill proposing an increase in funds for the operation of the subsidy scheme had been submitted to Parliament.
12. Members of the Committee enquired about the reasons for the regular two-monthly review of withholding taxes on export proceeds. They observed that the possibility of frequent adjustments in the rate of this tax might well act to lead to undesirable fluctuations in the volume of exports. Exporters speculating on improved peso returns following a reduction in the withholding tax might tend to accumulate stocks for later disposal, especially if adequate bank credit for the holding of such stocks were available as appeared to have been the case in Uruguay. Speculation appeared to have contributed to the sharp decline in wool exports after the brief increase in wool exports, following the implementation of the reform law. The representative of Uruguay explained that the withholding taxes which had been introduced in the currency and exchange reform had been conceived as a temporary and provisional measure to facilitate the shift from a system of rigid exchange controls to free exchange markets. The regular review of the operation of these provisional taxes had been decided upon as a means to counteract speculation, and thus to contribute to relative price stability of this commodity in the internal market in the interest of peasant producers. Furthermore, the Government was trying to curb any undue expansion of credits, particularly for such speculative stock-piling activities, and appropriate measures had already been introduced in connexion with the more general tightening of credit. At the same time, the Government was making considerable efforts to increase and improve agricultural production, and thus increase export availabilities.

13. In reply to other questions concerning the prospects for an increase in meat exports, the second most important single export item, the representative of Uruguay explained that the Government attached considerable importance to the revival of exports of meat and meat products after the drastic decrease in exports of these products in recent years. The decrease in exports had largely been caused by the unfavourable exchange treatment for meat and meat subsidies which had kept domestic prices low relative to world prices. The Government had now abandoned such subsidies in order to counteract a further increase in the already very high level of meat consumption in order to increase the proportion of domestic production available for export. Also, the withholding tax on export proceeds of meat and meat products had been set at the lowest rate provided for under the Law, i.e. 5 per cent - withholding taxes on export proceeds ranging from 5 to 50 per cent. In other measures the Government had assisted in the reopening of a number of packing plants
and thus contributed to the increase in exports of this product in 1959. The exports of meat and meat products continued to be much below the exports which had been registered during the first few years of the last decade and the Government was taking extensive measures to encourage the livestock industry to increase production and exports of these products.

**System and Methods of the Restrictions**

14. Members of the Committee noted with concern the manifestly protectionist element in the restrictions maintained for balance-of-payments reasons under the new Exchange Law. For example, under paragraph C of Article 2 of the Exchange Law the Government was authorized to prohibit imports in certain cases of goods which were not essential or were of a luxury nature and/or competitive with domestic products. The representative of Uruguay pointed out that the Government would impose such restrictions only in circumstances where this would appear to be justified and compatible with the objective of freeing trade to the greatest possible extent from such restrictions. Furthermore, the Law provided that such restrictions were to apply only for a limited and defined period of time. In the Decree of 17 February 1960 the Government had set out the conditions and circumstances in which such restrictions might be applied. For example, a product would only be considered to be competing with the domestic industry if a product, offering the same characteristics and technical features or conditions of use as the imported product, were to be regularly produced domestically with the further qualification that it be available in sufficient quantities. It was felt by members of the Committee that this feature of the Law might give rise to import restrictions not in conformity with the provisions of the General Agreement, particularly as the decision as to whether to impose such restrictions appeared to be made after consulting with representatives of business and industry, i.e. those most interested in protection. The representative of Uruguay explained that his Government had every intention of resorting to these provisions only in the case of absolute necessity. The conditions for deciding whether a product was a luxury item or a competing product to which such measures might be applied had been worked out by a Mixed Commission of high-ranking Government officials from various Ministries in consultation with representatives from the Chambers of Commerce and Industry. In its proceedings due account was given to consumer as well as producer interests. The representative of Uruguay stated that this review was soon to be completed. Notwithstanding the establishment of rules and
regulations for the implementation of the Exchange Law the Government was planning to proceed with the liberalization of imports and the elimination of most restrictions by the end of the current year.

15. Members of the Committee enquired whether the Government in proceeding with the liberalization of trade, had envisaged the elimination of prior deposit requirements and surcharges. The representative of Uruguay explained that although the Government was pursuing the objective of trade liberalization on a broad basis in view of the adverse effect which such a move might have on the balance-of-payments position, it was not yet considered possible to dispense with the possibility of regulating imports through prior deposit requirements and surcharges. Members of the Committee expressed the view that the use of such devices as withholding taxes on export proceeds, prior deposit requirements, etc. had a similar effect on trade as multiple exchange rates. As long as such measures were in operation trade could not be considered as being truly liberalized. It was pointed out therefore that the actual progress by Uruguay towards trade liberalization might not be as general or widespread as might at first occur. Members of the Committee expressed the hope that the Government of Uruguay would re-examine the effect of these measures on trade and would proceed with their elimination in accordance with the improvement in the foreign reserve position.

16. Members of the Committee noted that there had been a considerable shift in recent years in the direction of exports from Uruguay. Exports to Eastern Europe which had accounted for about 9 per cent of total exports in 1957 had increased to 23 per cent and 33 per cent respectively in 1958 and 1959. At the same time there had been a corresponding decrease in exports to Western Europe. The representative of Uruguay explained that the shift reflected largely a sharp increase in direct shipments of wool to Eastern Europe. The total amount of wool imported from Uruguay by Eastern European countries had, however, not significantly changed and the change in the pattern of shipments was almost wholly explained by direct purchases of this commodity by these countries in Uruguay as compared to the previous practice of importing wool via the Netherlands. He added that exports to Eastern Europe during the first few months of 1960 had, however, been on a small scale. Out of total exports of US$37.9 million during the first three months of 1960, only US$4.5 million had gone to Eastern Europe. In discussion of the proportion
of trade conducted under bilateral arrangements, the representative of Uruguay reaffirmed that his Government was striving towards a reduced reliance on bilateral trade and payments arrangements. The proportion of total trade which was at present conducted under bilateral agreements (including trade with neighbouring countries) was less than 20 per cent of total trade. Since the abolition of controlled exchange markets, the attractiveness of exports to bilateral account countries had been considerably diminished and it was expected therefore that the proportion of such trade would soon show some further decrease. Members of the Committee observed that the fairly large and sudden variations in the sources of supply for imports and sudden shifts in the direction of exports which had characterized Uruguay's trade in some recent years had, of course, had adverse effects on trade. The Committee welcomed therefore the progress which had been made in eliminating discriminatory restrictions and the reduction in the reliance on bilateral trade practices.

17. One member of the Committee noted that imports which had been shipped before authorization was obtained from the licensing authorities were subject to import fines to the amount of 10 to 15 per cent of the c.i.f. value of imports. Such fines could be considerable impediments to trade especially if the licensing authorities delayed decisions on import applications. Members of the Committee enquired in this context about the average time which elapsed between application for an import licence and a decision on the application by the licensing authorities. The representative of Uruguay explained that in recent months the average delay between the application for an import licence and the decision on the application had been less than forty-eight hours. This compared with a delay of eight to ten days before the simplification and liberalization of the import control system under the Exchange Law. Such import fines did therefore not significantly affect trade. Such fines had primarily been introduced to permit an orderly settlement of import applications which had been carried over from the time antidating the adoption of the Exchange Law. It was hoped that the remainder of those applications which were still pending approval could be decided upon during the current year.
18. One member of the Committee enquired about the import treatment applied at present to lard, tallow, lead pencils and rayon fibres. The representative of Uruguay undertook to supply this information.

[A concluding paragraph will be circulated separately.]
General

19. The Committee thanked the delegation of Uruguay for the spirit of co-operation with which they had engaged in the consultation and for the information which they had supplied in the course of the consultation. The Committee expressed appreciation of the readiness which the Government of Uruguay had shown in proceeding with the liberalization of trade and payments, particularly since the adoption of the Exchange Law. The Committee noted with satisfaction the progress which had been made in eliminating discriminatory import restrictions and the intention of the Government to reduce further the proportion of trade and payments conducted under bilateral arrangements. The Committee noted, however, that the maintenance of such restrictive devices as the prior deposit requirements, the withholding of taxes on export proceeds and the surcharges had the effect of reducing the benefit to trade that might be derived from the elimination of the multiple exchange rates. The Committee expressed the hope that, in accordance with its averted objective, the Government of Uruguay would soon be in a position to eliminate those non-tariff measures. They believed that the rapid elimination of these controls would be in the interest of balanced development of the economy.

20. The representative of Uruguay thanked the Committee for the understanding with which it had consulted with his country and assured the Committee that he would bring the comments and suggestions which had been made by members of the Committee during the consultation to the attention of his Government for careful consideration.