1. In accordance with the decision of the Council of 30 October 1964, the Working Party met on 7 December to consult with the Government of the United Kingdom with respect to the temporary import charges imposed by the United Kingdom on 27 October in order to safeguard its external financial position and to correct its balance of payments. The Committee had before it the United Kingdom notification (L/2285), the terms of reference established by the Council (C/M/23), documentation supplied by the United Kingdom (W(64)2-4) and documentation supplied by the International Monetary Fund as mentioned in paragraph 2 below.

Consultation with the International Monetary Fund

2. Pursuant to the decision of the Council, and in accordance with Article XV of the General Agreement, the CONTRACTING PARTIES had invited the International Monetary Fund to consult with them in connexion with this consultation. The representative of the Fund was invited to make a statement supplementing the Fund's documentation concerning the position of the United Kingdom. The statement made was as follows:

"The Fund invites the attention of the CONTRACTING PARTIES to the background papers dated June 22, 1964 and November 23, 1964 which it has transmitted for their information and use. It will be noted from the second of these papers that, at the end of October 1964, it was expected that the United Kingdom would experience in 1964 a deficit on current and long-term capital account of £700 million to £800 million. In the absence of corrective action, a reduced but still substantial deficit was also anticipated for 1965. While resources were available to the United Kingdom to finance this deficit, including a $1 billion stand-by arrangement with the International Monetary Fund, action was required to safeguard the balance of payments. As part of this action, the United Kingdom has imposed certain import charges. These import charges do not go beyond the extent necessary at the present time to stop a serious decline in the United Kingdom's monetary reserves."
"The United Kingdom has stated that the import charges are to be temporary. To assist in controlling domestic demand and in restoring the external position, certain taxes were increased. In addition, Bank rate has been raised from 5 per cent to 7 per cent primarily to strengthen the international position of sterling. The Government is pressing ahead with other steps including the establishment of an effective incomes policy and a review of public expenditure. The resolute implementation of these measures supplemented, if need be, by other domestic financial action should benefit the balance of payments position and so ensure that the need for the import charges is, in fact, temporary."

Opening statement by the United Kingdom representative

3. In his opening statement, which was mainly based on the Note annexed to this report, the representative of the United Kingdom reviewed the circumstances that led to the serious deficit in the United Kingdom balance of payments. He explained that owing to a sharp increase in imports which had been accompanied by a much slower rise in exports the deficit on trade had increased to £215 million in the first half of 1964 as compared with a surplus of £36 million in the same months of the previous year. Invisible receipts were also lower and there was a heavy outflow of private long-term capital accompanied by an exceptionally large decrease in net private long-term investment in the United Kingdom and increased public lending under aid programmes. Altogether, the identified deficit in the first half of the year amounted to £341 million. In the second half of the year about which information is as yet only incomplete, imports appear to have levelled off but exports seem to have declined somewhat, so that the visible deficit increased in the third quarter of the year to a monthly average of £51 million as compared with £44 million in the second quarter (seasonally adjusted). These developments had created a severe strain on reserves which had led to the sterling crisis and the exceptional measures to maintain the value of sterling in recent weeks. While various temporary factors which aggravated the situation in 1964 warranted the expectation that the balance-of-payments situation in 1965 would be considerably improved, it was felt that both the deficit on current account and the total deficit would have been unacceptably large, especially following on the very large deficit in 1964, in the absence of immediately effective measures to reduce the deficit.
4. Accordingly, as an immediate step temporary import charges amounting to 15 per cent ad valorem were imposed on imports other than foods, feeding stuffs, fuel, unmanufactured raw materials for industry and those which have undergone elementary processing and unmanufactured tobacco.

5. In addition to longer term measures described below attention had been given to the question of proper control of home demand. Unemployment has continued to fall during 1964, but gross domestic product and industrial production have increased only slightly. There is still unused capacity in some industries and some areas, though in others not. It is the United Kingdom view that the economy is not overloaded in any general sense, and for this reason that resort to deflationary measures on the scale needed to effect equilibrium in the balance of payments would have done serious damage both at home and in the countries which sell to the United Kingdom. However, the Government had introduced a new tax on petroleum products which was expected to exercise a substantial deflationary force and with the new import charges yield net new revenue at the rate of some £220 million annually, or about 1 per cent of national income. These new charges would have an immediate dampening effect and would at the same time serve to finance certain improvements in social services which are to take effect mainly in the next financial year. Furthermore, on 23 November the United Kingdom bank rate was increased from 5 to 7 per cent. (In the course of the consultation the representative of the United Kingdom also called attention to action taken by the Governor of the Bank of England to ensure that commercial banks would also follow a more selective policy with respect to new lending, so as to discourage especially new loans for property development, personal and professional purposes and instalment buying.)
6. Because of widespread discussion of the question whether enough action has been taken to restrain domestic demand in the United Kingdom the representative of the United Kingdom emphasized at this point that the Government had carefully considered this problem and had concluded that they had gone far enough. The Government face the problem of evening out growth in the demand for goods and demand for labour. Resort to deflationary measures would be likely to create unemployment which would in turn discourage the investment needed for technological advance. For this reason short-term and long-term measures must be carefully linked, so as to safeguard the confidence and cooperation between Government employers and labour on which a successful policy on incomes and productivity depends. It is success in the latter to which the Government looks for long-run improvement in the balance of payments.

7. As to longer-term remedial measures, the list of measures under way includes first a review of all Government expenditure with the object of reducing both overseas spending and unnecessary pre-emption of domestic resources. Next, obstacles to exports are being studied with a view to devising ways of encouraging and helping exporters; also as announced on 26 October, a plan for rebate of certain indirect taxes is being worked out, and this is to be a permanent reform measure. To develop an effective incomes policy, agreement between management and labour is being sought this month so that implementation may begin early in the new year. Machinery and procedures for review are being studied, and, finally, an effort will be made to agree on a rate of wage and salary increases consistent with sound economic growth and to establish ways of exercising some influence to prevent price increases not in the public interest.
A comprehensive national plan providing a framework for production and investment planning is in preparation. Attention is also being given to special regional plans, designed to relieve pressure in more prosperous regions and to utilize excess capacity in under-developed areas. On manpower, it is hoped that measures can be devised which will make labour more mobile, as by the offer of expanded facilities for restraining and provision of new severance payments. Monopolies and restrictive practices legislation is to be strengthened. Finally, great efforts are being made to stimulate innovation and the introduction of modern techniques.

**Nature of the difficulties and alternative corrective measures**

8. As a practical matter the Working Party then turned to a discussion of individual points raised by the United Kingdom action after first hearing a series of general opening statements. In order to present the debate in a somewhat more ordered point-by-point development, the proceedings are here reported in an order sometimes different from that in which they actually took place.

9. The Working Party agreed that there was no need to debate whether a very serious balance-of-payments difficulty existed, although some members felt that the part played by capital movements had perhaps been more substantial than seemed to be implicit in the measures taken. This in turn led to the question whether measures operating directly on capital flows might not appropriately be considered. However, in their view, the central question appeared to be whether the economy were not suffering from "overheating" which would call perhaps for measures of a different kind than those which were being taken, or a different combination of measures. In this connexion, a drop in employment to a figure of 1.5 per cent or less and the rise in the number of unfilled vacancies to a level equal to or even slightly higher than the level of unemployment was cited.
This seemed to suggest that measures to control demand should figure more prominently in the remedies undertaken. It was also mentioned that Italy and France had recently been coping with inflationary tendencies by internal measures. To these representatives, the United Kingdom ideas on control of internal demand appeared to be good, but too much depended on the future, and specific details were lacking. There also appeared to be some internal conflict in the measures proposed in that it might be difficult to effect an incomes policy without bringing pressure to bear on restrictive labour and price policies. Further, if overheating were not the cause of the difficulty, these delegates enquired what was the difficulty in the view of the United Kingdom.

10. In reply the United Kingdom representative explained that it was believed the role of capital movements might have been rather considerable in aggravating the 1964 deficit but that this had been true for reasons partly of a non-recurring character. The Government of the United Kingdom naturally felt that, in devising a programme to overcome its difficulties, it was prudent to look to the basic causes; however further controls on capital movements would necessitate introduction of exchange controls with incalculable repercussions. On the question of inflationary pressure, they felt that the case was quite different from those which had been mentioned in that an integral part of the United Kingdom difficulty is the sluggish growth of production and of exports; this difference suggests that perhaps because the United Kingdom was the first country to reach a high stage of industrialization, its equipment and production methods were not the most modern, and rigidities of various kinds might have contributed to making British industry less competitive than is that of some other countries.
11. Once the immediate situation had been dealt with, it would therefore be essential to pursue policies which would bring about a modernization of British production and marketing which would enable production and exports to expand. Deflation alone had been tried in 1961 and had only brought on a recession. The structural character of the difficulty combined with the need for immediate steps to meet the balance-of-payments difficulty had now led the United Kingdom to envisage remedies in two stages, as outlined in the opening statement. In the short run, the temporary import charges would give some immediate relief to the balance of payments, the new tax and rise in the bank rate, along with tighter commercial credit which would follow, would tend to dampen demand; a breathing space would thus be provided within which to make headway on implementation of the various measures of a longer-term character which would improve utilization of resources and increase productivity. In this connexion the United Kingdom representative also pointed out that the new Government had only been in office a little over a month and that it seemed understandable that long-term measures could only be worked out over a somewhat longer time. Also, the recent budget message would not be the only one. It contained only two new revenue measures and forecast the general outlines of the main budget which would be forthcoming in the spring and which might contain additional revenue measures. Further, among the longer-term measures already in view, one might distinguish some from which medium-term results could be expected, such as the review of the very large Government expenditures and an incomes policy, while others would frankly require a somewhat longer term in which to make themselves felt.

12. The question was then raised how the import charges, which the United Kingdom had repeatedly described as very temporary, could be regarded as effective in overcoming this rather long-term internal problem. It was also noted that the import charges would actually be counterproductive and tend to delay the very structural changes which the United Kingdom regards as essential if they were maintained for any length of time, since they would inevitably make it less urgent for a given industry to take steps to improve its competitive position. So long as the import charges remained, moreover, foreign suppliers were bearing a burden created by the need for internal readjustments not yet made.
13. The representative of the United Kingdom concurred generally in the view that benefit to the United Kingdom could only be obtained of the surcharges were removed quickly, and also agreed that the basic problem appeared to be of a longer-term nature. As to the first point, he said this was why so much stress had been laid on their temporary character and an industrialist would be taking a great risk in relying on continuation of the charges. On the second, he was confident that adequate longer-range measures would be devised. Meantime, one should not exaggerate the amount of reduction in imports in view; the hope is to save £25 million per month, or about 5 per cent on imports in a recent month.

14. With regard to alternative measures, the question was asked whether the IMF had had any other alternative measures to suggest; the reply was that at this time it did not.

15. There was a discussion of export promotion measures, including the export rebate. Question was raised as to whether all of the taxes which were to be rebated were of a kind which the General Agreement would permit the United Kingdom to rebate consistently with the commitments of Article XVI. The way in which calculations of the amount to be rebated would apply to individual products was another point on which reserve was expressed. However, as details of the scheme were not yet available, the Working Party agreed that it would not be possible to pursue this matter, even if it were within the competence of the Working Party. There was no question but what export promotion measures as such were appropriate and useful and the Working Party welcomed the assurances that additional measures to promote exports were under study.

Nature of the measures taken and possible effects on economies of other contracting parties

16. With regard to the import charges, it was noted that they are non-discriminatory in character, and the hope was expressed that this would continue to be the case for as long as the charges are maintained and that steps to reduce and eliminate the charges would also be taken in such a way as to retain their non-discriminatory character.
17. With respect to the effects of the surcharges, the point was strongly urged by various representatives that the imposition of the charges, and especially any continued maintenance of the charges, created a serious question about the value and usefulness of the Kennedy Round of tariff negotiations. It was also suggested that it might be appropriate to arrange separate consultations on the impact of the charges on these negotiations. The consensus was that it would be much regretted if the charges were to place the success of this entire enterprise in jeopardy. In reply the United Kingdom representative drew attention to the fact that the negotiations alone were likely to last into 1966 and that if results were necessarily placed in effect gradually after that time the temporary import charges should be gone long before a time when they might be relevant. He felt that the short United Kingdom exceptions list was an earnest of the good intentions of the United Kingdom in this matter. Others felt that the mention of several years was disturbing in this connexion, but the United Kingdom representative indicated that his Government in fact had in mind a much shorter duration, more appropriately described as a matter of months.

18. The additions to the list of items exempted from the charges which had been announced since the charges were first imposed were welcomed, and interest was expressed in the criteria which had been used in effecting these changes. Other delegates asked about the effect of changes in the level of inventories and wondered how the United Kingdom proposed to avoid a running down of stocks during the period of effectiveness of the charges, followed by a rapid build-up once they were removed.

19. To these questions the United Kingdom representative replied that the charges had initially been applied on the basis of rather rough-and-ready interpretations as to which particular goods fell within the overall exempted headings and that the modifications were really rectifications which had been made where it was possible to relieve a hardship by extending the coverage of an exempted class
without creating new anomalies more serious than those which already existed. So far as stocks were concerned, the United Kingdom representative agreed that some build-up of stocks might have contributed to the increase in imports in the months before imposition of the import charges, and he agreed that the charges could not be counted upon to continue to effect as much reduction in imports as they would at first do, since stocks would be drawn down before new supplies were ordered. A rise in imports upon their removal would have to be reckoned with.

20. The question was also asked why the United Kingdom could not do as Canada had done and make provision to exempt goods in transit when the new charges became effective. The representative of the United Kingdom replied that immediate effect was wanted, and that as nearly a month's imports were estimated to be in transit, it seemed preferable to impose the measure in the way that would give the most immediate help. However, steps were being taken to see that the law would not debar foreign suppliers from obtaining relief when sales had been made on a duty-paid basis.

21. As matters stood when the charges were imposed, the law permitted a foreign supplier to recover duties imposed subsequent to the date of sale of merchandise in the absence of an agreement to the contrary. However, a price fixed on a duty-paid basis is considered to be "an agreement to the contrary" under the law as it now stands. Consequently legislation has been introduced to alter this situation. Members commented that this did not really do much to shift the real burden of the tax since further sales would still be made subject to increased costs while competing domestic goods remained unaffected. (To be supplemented in light of any further discussion in Working Party.)

22. Questions were also asked concerning the possibility of exemption of additional goods from the effects of the import charges. These related to three categories of goods:
(1) goods of which less-developed countries are the principal or very substantial suppliers;

(2) other goods having special significance for less-developed countries, such as hand-made products, where the harm to trade of less-developed countries would usually be greater than the corresponding benefit to the United Kingdom balance of payments;

(3) goods which were being shipped to the United Kingdom under quotas or other special arrangements to restrict the quantity of shipments.

23. The less-developed countries made the point that even though much of their trade happens to consist in raw materials which the United Kingdom has exempted from import charge for domestic reasons, there still remains an amount of trade subject to charges which, though small in total United Kingdom imports, is often very important to the exporting country either because it represents a recent venture into manufacturing or because it is the main livelihood of a large segment of the population. Even if, as was pointed out, the result of these additional exemptions were to increase the burden borne by the developed countries for so long as the charges remain in force, the amounts in question could hardly prolong the duration of the charges. Moreover, it would appear entirely consistent with recent efforts to help less-developed countries for the developed countries to assume a greater share of this new burden. Both the Action Programme and the new Chapter on Trade and Development had in fact looked to greater burden-bearing by those best able to pay, to the extent that this could be done within the limits of non-discrimination. What was asked here was not intended to be discriminatory beyond the choice of items to be exempted.

24. The case for goods already subject to quota, in which one developed country joined, presented the special feature that there was a double penalty on exporters, who had already agreed to limit their shipments and were now asked to pay added duty also. The quotas already gave positive assurance against any increase in
imports, so that these imports had had no part in the recent increases in United Kingdom imports and posed no threat to increase in the future. Had the United Kingdom used the normal recourse provided for countries experiencing balance-of-payments difficulties it was an open question whether they would have considered it necessary to intensify quotas on such items, and the exporters of these products felt that they had simply been caught by the sweep of a larger action the cost of which they were not well able to pay.

25. The general viewpoint of the United Kingdom representative on these questions was that further modifications in the nature of rectifications of the present exemption list were not excluded but that it would raise many problems to alter the criteria. The United Kingdom felt that it was a happy result of the method adopted that so large a portion of less-developed countries' trade was exempt—the proportion of less-developed countries' trade exempt amounted to no less than 90.9 per cent of total imports from such countries into the United Kingdom on the basis of 1963 trade. Moreover, there was no absolute bar to a continuation of the remaining trade, amounting to £145 million, which should rather be described as the total trade at risk. To alter the criteria would, however, raise serious difficulties. Exemptions would frequently create anomalies between treatment of related products. If consideration were given to exempting products supplied only in part by less-developed countries the total amount of trade involved would inevitably be greater, with benefit to developed countries. Any exemption of quota goods and not of similar non-quota imports would create a price advantage to the former. In any event, the United Kingdom thought that the views of other contracting parties would have to be taken into account on any proposals of this kind.

26. The view was expressed by the representative of one developed country that his country would be gratified if further modifications which would benefit less-developed countries could be found within existing criteria. He did wish to note,
however, that neither the Action Programme nor the Chapter should be interpreted as committing any country to take discriminatory action, though he agreed that selection of particular items for across-the-board exemption would not raise this difficulty. At the risk of being misunderstood, he felt obliged to say, however, that selection on such grounds might go beyond the bounds of discretion accorded to countries in balance-of-payments difficulties in another sense. That is, essentiality was a recognized reason for according priority to some goods over others, and selection on this ground may help speed recovery. Exceptions on other grounds might have an opposite effect and in this case would certainly intensify the burden on developed countries if they did not also prolong the need for maintenance of the restrictions.

27. It was also brought out in the discussion that at the time when Canada had been in process of removing import surcharges some special consideration had been given to early reduction and removal of charges on goods of less-developed countries. In this connexion, it was noted that when the balance-of-payments situation begins to improve, this is generally translated into action by making modifications which aim to permit given additional amounts of foreign exchange to be spent on imports; there would therefore be a possibility of selecting items in a way that would ease special hardship cases without material interference in the rate of recovery of the country imposing the charges.

28. A further suggestion was also made with regard to the items which have been under quota. It was argued, namely, that if there were insuperable obstacles to relieving these items from double penalty by exemption, such as the price advantage involved in exempting quota suppliers, it would seem fair to eliminate the quotas for so long as the temporary import charges remain in effect.