DRAFT REPORT OF THE WORKING PARTY ON THE UNITED KINGDOM
TEMPORARY IMPORT CHARGES

Revision

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 £41 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 the fact that various temporary factors had 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 (broadly those which have undergone only 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 none 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 increased rates of tax on hydrocarbon oils which were 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 compensate for the fall in supplies of imported goods which would result from the import charge. 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 encourage exports and productive industry and 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 advances. 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 proposed to institute measures which will make labour more mobile, for example by the offer of expanded facilities for retraining 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. 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. Some members however 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 these members to question whether measures operating directly on capital flows might not appropriately be used. It was considered that the volume of these flows of capital would be handled within the limitations of the balance of payments in the framework of existing regulations and institutions. However, in the view of these members, the central question appeared to be whether the economy were not suffering from "overheating" which would call for measures of a different kind than those which were being taken, or for a different combination of measures. In this connexion, a drop in unemployment 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. It was indicated that 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, it was asked what was the difficulty in the view of the United Kingdom.

10. In reply the United Kingdom representative agreed that capital movements had played a considerable part in the 1964 deficit but these had been 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; moreover, further controls on capital movements would necessitate introduction of exchange controls on transfers within the sterling area which would be a very serious step. He called attention to the undertakings given by the British Chancellor of the Exchequer that action would be taken in the forthcoming April Budget, or if necessary before, to prevent any overheating of the economy.

11. It was therefore the United Kingdom Government's intention to pursue policies which would bring about a modernization of British production and marketing which would enable production and exports to expand. The deflationary action taken in 1961 had resolved the external difficulties only at the cost of a prolonged period of stagnation in output. 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 of two kinds, 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 taxes 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 in 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 been in office less than two months and long-term measures could only be fully worked out over a somewhat longer time. 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 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 those very structural changes which the United Kingdom regards as essential if they were maintained for any appreciable 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 if the charges were unduly prolonged they could have damaging effects on the competitive spirit of British industry. This was why so much stress had been laid on their temporary character: an industrialist would be taking a great risk in relying on continuation of the charges. Meantime, one should not exaggerate the amount of reduction in imports in view; the estimated saving was at the rate of £25 million per month, which represented about 5 per cent of the level of imports in October 1964.
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. In reply to a further question the representative of the IMF said that the Fund statement on import charges did not imply any judgment as to the type of measure used to reduce imports; the Fund's determination was limited to balance-of-payments and monetary reserves considerations referred to in Article XV:2 of the GATT.

There was a discussion of export promotion measures, including the export rebate. The question was raised whether in all cases the rebate of the taxes was consistent with Article XVI of the General Agreement. The way in which calculations of the amount to be rebated would apply to individual products was another point on which reserve was expressed. It was noted that details of the scheme were not yet available. Some members felt that while it would not be possible to pursue the matter at this time, they would wish to revert to this question when fuller information became available.

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

The Working Party noted the statement by the representative of the United Kingdom that the charges are applied without discrimination, 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.

With respect to the effects of the surcharges, the point was made by various representatives that the charges, if maintained for an extended period, could give rise to serious difficulties for the Kennedy Round. In reply, the United Kingdom representative drew attention to the fact that the negotiations alone were likely to last into 1966 and that 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. It was also pointed out that the United Kingdom linear offers in the Kennedy Round, which were tabled since the imposition of the surcharge, were based on the rates in effect before that imposition.

18. The additions to the list of items exempted from the charges which had been announced since the charges were first imposed were noted, 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 the running down of stocks during the period of effectiveness of the charges being followed by a rapid build-up once they were removed.

19. The United Kingdom representative said that there was no generally recognized definition of unmanufactured raw materials. The main criteria for adding to the list of exempted products since the charges were imposed were: existence of anomalies on products that had only undergone elementary processing, provided that their inclusion in the exempted list would not create a further chain of "anomaly cases". He agreed that one of the likely effects of the charge would be to encourage the use of existing stocks. This would save imports. No doubt some importers would defer making some new purchases in the hope that the charges would be reduced or removed by the time they decided to buy.

20. The question was also asked why the United Kingdom could not make provision to exempt goods in transit, as Canada had done, and to exempt all goods under contract at the time when the new charges became effective. The representative of the United Kingdom replied that it was necessary to effect an immediate relief to the balance of payments. The effect of the surcharge in limiting import demand comes into play only at the time when users and consumers are required to pay the higher price. The exemption of goods in transit would have postponed this and so delayed the import-saving effect.
21. On the question of goods under contract, the United Kingdom representative explained that under the existing law any seller of goods was permitted to pass on to his customers as an addition to the contract price the amount of any new duty imposed subsequent to the date of the contract, in the absence of an agreement to the contrary. However, a price fixed on a duty-inclusive basis might be considered to be "an agreement to the contrary" under existing law; consequently legislation had been introduced to allow the addition of the charge to the contract price notwithstanding that there is a specific clause in the contract that the price includes all customs duties. The possibility of exempting goods under contract had been carefully considered by his Government, who took the view that the above legislative provision should deal substantially with the cases of hardship to exporters. A blanket exception to cover all goods already on order on 27 October 1964 would delay the import-saving impact of the surcharges, and they had therefore decided that such an exception could not be granted. Most members of the Working Party considered that the proposed legislation was not sufficient to relieve the hardship to overseas suppliers; some added that it did not alter the policy of the United Kingdom Government under which no exemption from the surcharge is accorded on contracts concluded before 27 October. Even if exporters were to become legally entitled to recover the charges from importers, the commercial repercussions would remain unchanged. The representative of the United Kingdom stated that the views of these members of the Working Party would of course be transmitted to his Government.

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 be far 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 further explained that there is a sector of their trade subject to charges which, though small as a percentage of total United Kingdom imports, is often very important to the exporting country. Manufacturing is generally the most progressive sector in less-developed countries and a sector with which their development plans are especially concerned. Some of the new exports have not yet achieved an established place in the United Kingdom market, so that the charges may be very harmful; the fact that they are infant industries makes it especially difficult for them to withstand this new disadvantage in a major market. In other cases an industry may have exceptional social importance as the sole livelihood of a large segment of the population. It was felt that even if the result of additional exemptions for such cases 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. For less-developed countries with great shortages of foreign exchanges, even relatively small losses would be serious. 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 in the sense that the choice of items to be exempted would be
those of which the less-developed countries are principal or substantial suppliers,
but the exemption would not be limited to supplies from those sources only.

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 of increase in the future. Had the
United Kingdom used quantitative restrictions it was felt that existing restric­
tions on goods already under quota would not have been intensified. The exporters
of these products felt that they had simply been caught by the sweep of a larger
action and consequently they suffered a double penalty the cost of which they
were not able to bear, and they requested the immediate removal of the charges
on products under quota.

25. The United Kingdom representative said that further modifications of the
present exemption list were not excluded but it would raise many problems to
alter the criteria. The exemption of food, raw materials and fuel meant that a
large proportion of less-developed countries' trade was unaffected - about
91 per cent of total imports from such countries into the United Kingdom on the
basis of 1963 trade. There was no disposition to underestimate the seriousness
for less-developed countries of the remaining 9 per cent. But it would not be
possible to exempt goods imported specifically from less-developed countries and
the exemption of further categories of goods from all sources would obviously
narrow the range to which the charges applied and reduce their total import
saving effect. Moreover exemption based on source of supply considerations would
be likely to create anomalies in the treatment of related products. Any exemption
of quota goods and not of similar non-quota imports would create a price advantage
to those exempted. The United Kingdom did not agree that application of the charges to quota goods involved a double penalty. The possibility of fulfilling the quotas still existed and the new handicap of the charges applied to quota and non-quota goods alike. The United Kingdom would like to hear the views of other contracting parties on any proposals to give specially favourable treatment to imports from less-developed countries.

26. A further suggestion was also made by the representative of a developed country 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.

27. The view was expressed by the representative of another 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 sanctions discriminate or departures from the most-favoured-nation principle. He did not interpret the request of the less-developed countries to involve departure from the most-favoured-nation principle, but the selection of commodities by reason of source would require intensification of restrictions on other items or maintenance for a longer period to the disadvantage of all contracting parties and would distort trade.

28. It was also brought out in the discussion that at the time when Canada had been in process of removing import surcharges consideration had been given to, among other factors, equitable treatment of the trade interests of Canada's trading partners, including those 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 for less-developed countries without material interference in the rate of recovery of the country imposing the charges.