1. In accordance with the decision of the Council of 18 December 1964, the Working Party met on 4, 5 and 11 March to resume the consultation with the United Kingdom concerning the temporary import charges imposed in October 1964.

2. A comprehensive statement by the representative of the United Kingdom, which is contained in Annex I to this report, was presented to the Working Party, together with an analysis of trade developments in the months since the temporary import charges were first imposed. Attention was called to the announcement by the United Kingdom, contained in L/2364, that the import charge would be reduced from 15 to 10 per cent on all goods subject to it entered with the United Kingdom Customs on or after 27 April 1965. The representative of the United Kingdom reiterated his Government's unreserved intention that the import charge shall be strictly temporary and shall be removed as quickly as possible.

3. On the invitation of the Chairman, the representative of the International Monetary Fund made a statement to the Working Party concerning the balance-of-payments position of the United Kingdom; this statement is reproduced in Annex II to this report.

4. After hearing these opening statements, the Working Party welcomed the United Kingdom's decision to reduce the import charge by 5 per cent, and expressed the hope that the remaining 10 per cent could be eliminated shortly. One member of the Group interpreted this decision as giving an indication of the seriousness of the United Kingdom's intention to remove the charges completely as soon as possible. One member of the Working Party expressed the view that since 27 April 1965, the date on which the reduction would become effective, would be six months from the date of the imposition of the charges, it might, therefore, be questioned whether the charges would be removed completely in time to justify their being described as strictly temporary.
5. The Working Party then divided its review into three parts on the basis of the various elements in its terms of reference: first, the nature of the balance-of-payments difficulties; secondly, the alternative corrective measures which might be available; and thirdly, the measures taken and their effects on the economies of other contracting parties, including prospects for the removal of the charges.

The balance-of-payments situation, developments in recent months, and prospects for the immediate future

6. The representative of the United Kingdom in his statement had called attention to developments in the principal items of the United Kingdom balance of payments: an improvement in the trade balance due to a 2 per cent decline in imports in the last quarter of 1964 and some recovery in exports, continued net invisible earnings at about the same level in the fourth quarter as in the third, and some net reduction in the capital outflow. Although much remained to be done to restore equilibrium in the balance of payments, he noted that, thanks to the energetic measures taken last autumn, together with the IMF drawing and the $3 billion credit, the crisis in confidence had been successfully overcome. Figures for February 1965 showed the first increase in United Kingdom reserves since last May, notwithstanding the fact that some repayments had been made with respect to the emergency credits. Production in the United Kingdom had increased, unemployment had now fallen to a very low level, and the Government was hopeful that imports might be held down during 1965 and that exports might continue to increase.

7. The United Kingdom representative was asked whether any target for levels of imports and exports was envisaged by the United Kingdom Government as a condition for the removal of the charges. The United Kingdom representative said that no such specific targets were in mind. The United Kingdom must of course aim for the future at something much nearer balance in visible trade. Invisible income was no longer able to support as large a trade gap as had been the case pre-1914 and to a lesser extent in the inter-war period. So far the charges had not yet made a significant contribution to the improvement in the balance-of-payments situation. The Government had, nevertheless, decided that it should make the 5 per cent reduction as evidence of good faith.
8. It was also noted the United Kingdom production had increased considerably and that unemployment had now reached a very low level. The question arose as to whether, since all resources were now fully employed, increasing production could help exports, since the new production was mainly going to satisfying domestic demand. The United Kingdom representative agreed that demand in the United Kingdom was at a high level and that there was clearly a very active economy. These factors were in the process of being assessed in relation to the forthcoming budget. He said that he was sure that the Working Party would understand his delegation's inability to indicate at this stage what the Government might eventually decide to do in this area; the question of the level of internal demand was very much in the mind of Ministers.

9. Questions were also asked concerning the basis on which the United Kingdom opening statement predicted a continued rise in exports accompanied by a marked reduction in imports. In this connexion it was noted that apart from an expected growth in exports to North America, notably because of increased sales of aircraft to the United States, there appeared to be no factors in prospect more favourable than those existing in 1964. On the import side likewise, the various details given did not seem to indicate any great likelihood that there would be a reduction in imports, apart from an expectation that prices might be lower. Some representatives felt that higher industrial activity in the United Kingdom might tend to increase imports of capital equipment as well as of food and raw materials. In reply, the United Kingdom representative stated that it had not been the intention to indicate any dramatic change; however, certain features had been particularly unfavourable in 1964 and it was hoped that these would disappear. For example, exports to countries experiencing a period of disinflation had been exceptionally low; similarly on the imports side stock-building should be less, the import charge should have some effect and food prices should be lower. As regards invisibles, about which delegates had also enquired, it was explained that a smaller increase in Government expenditure abroad was expected, together with less net expenditure on shipping, although such savings would be small.
10. On the basis of the foregoing discussion, some members of the Working Party suggested that developments so far appeared to reflect little beyond the working of measures which had been announced at the meeting of the Working Party in December rather than improvement induced by new internal measures. It was recognized that the United Kingdom budget was in the process of formulation and that the United Kingdom could not be expected to indicate at the present time what measures might be taken in the budget. However, the importance of a budget containing measures which restrained domestic demand and freed resources for exports was stressed. It was considered that such a budget was essential not only for the surcharges to be eliminated at the earliest possible date, so that the burden of the United Kingdom's balance-of-payments difficulty was not placed primarily on international trade, but also to assure the health of the United Kingdom economy.

Alternative measures

11. Some doubts were expressed as to how it was possible to reconcile the strict review of Government expenditure and the increase in public expenditure amounting to approximately 4 1/4 per cent a year over the next five years which were referred to in the United Kingdom statement; doubt was also expressed as to whether it would be easy to restrain domestic demand if at the same time Government expenditure continued to expand. In reply, the United Kingdom delegate stated that to expect a drastic change in the rate at which Government expenditure had been expanding would be unrealistic as some growth in public expenditure in the social and production sectors would have to continue. The review of the situation now in progress in the United Kingdom was intended to ensure that expenditures would be as restrained as possible, especially in the short term, and should reflect the right priorities. The decision to curtail defence expenditure illustrated the Government's intentions in this area. The growth of Government expenditure envisaged would, he said, be slightly above the rate of the last five years taken together but somewhat below the current rate. The Government were well aware that this would involve holding back expansion of the private sector if the restraint needed to improve the balance-of-payments situation was to be assured.
12. In reply to a question whether, if the diversion of defence production into other activities involved additional imports of defence material, the balance of payments would be improved, the United Kingdom representative said that this was a matter for judgment but the resources liberated when the cost of imported material was substantially lower should provide more than counterbalancing import savings or exports.

13. In response to a question about the extent to which the budget might contain anti-inflationary measures, the representative of the United Kingdom assured the Working Party that such measures would in fact be a theme of the coming budget, as would the need to promote exports. The emphasis would also be on economy in public finance and the level of public expenditure now envisaged might even be reduced further. Some major expenditures were in prospect but the Government had definitely accepted the implication of such expenditures for the private sector. The desire to maintain public spending and to keep up capital investment needed for structural change would certainly make restraint on private spending essential.

14. In answer to questions on incomes policy, the representative of the United Kingdom emphasized the serious nature of the statement of intent in December and the meaningful character of the machinery established early in February to implement that declaration. Thus, very great progress had already been made, and the third stage, now under study, was intended to provide guidance concerning the amounts of increase in prices and incomes which would be consistent with national policy. For the present, the objective was to seek a voluntary commitment by all parties to the process of stabilization. Other ways would obviously have to be considered if this voluntary approach was ineffective, but the Government was very hopeful of attaining fundamental improvements following the present lines of action.

Effects of the measures

15. In his statement, the representative of the United Kingdom had indicated that his Government had, after careful consideration of the views expressed in the Council in December, found that it would not be possible to meet requests for special modification in favour of the less-developed countries without substantially narrowing the coverage of the charge or running into other difficulties. The announced 5 per cent reduction had therefore been adopted for application to all imports subject to the charge.
16. Several members of the Working Party expressed their disappointment that special consideration had not been shown for the trading interests of the less-developed countries. The 15 per cent surcharge on their exports of manufactures would be a hard blow to their newly-established industries. The burden would be disproportionately heavy in the case of industrial products already subject to quantitative restrictions in the United Kingdom. The argument that it was not possible to accord special treatment to exports of less-developed countries "without substantially narrowing the coverage of the charge" was not convincing. The Working Party was informed at its December meeting that the surcharge would affect only about 9 per cent of United Kingdom imports from less-developed countries. If that were so, the grant of special treatment for imports from less-developed countries would not materially affect the United Kingdom's balance of payments nor prejudice the possibility of a general reduction in the rate of surcharge. A cut deeper than 5 per cent in the surcharge in the case of imports from less-developed countries would have been fully in accord with the hope expressed by the Council when adopting the Working Party's report on 18 December and with the spirit of the new Part IV of the General Agreement. The least the United Kingdom should have done was to abolish the surcharge on products of which the less-developed countries were the principal suppliers to the United Kingdom market.

17. The United Kingdom representative indicated that any possible exceptions would either have had to be discriminatory in the sense of applying to some countries' trade and not others or, alternatively, would have had to include a large amount of trade coming from developed countries and so narrow considerably the scope for a general reduction of the charge. A check of imports of all the goods on the Action Committee lists revealed that, of total imports amounting to some £150 million, only about £59 million came from less-developed countries. A similar check on an additional list of items selected for priority study indicated that of total imports valued at £120 million only about £20 million came from less-developed countries. As there were very few products subject to the charge of which as much as 80 per cent of total imports come from less-developed countries it would have been difficult to find an area to which special treatment could have been accorded without seriously reducing the impact of the surcharge.
18. The Working Party then discussed the considerations underlying the earlier report adopted by the Council. The United Kingdom representative pointed out, as some other members of the Working Party agreed, that the Council on 18 December had not given any clear guidance on the consensus of views of the CONTRACTING PARTIES. Attention was called to the many pressures to which the United Kingdom would have been subject if special treatment had been accorded to any class of trade. At the same time some delegates reiterated their reluctance to see any new import barrier treated as being beyond the scope of the obligation to give priority to the needs of less-developed countries, and these delegates felt that it might be desirable to examine on an item-by-item basis the products subject to the charge, to determine whether there were not some on which special treatment could be accorded.

(Debate on this point was suspended)

19. To an enquiry whether it was as yet known how individual countries had fared under the surcharge, the United Kingdom representative replied that such information was not yet available although it was true that total imports from the sterling area had declined more than those of any other area in the fourth quarter in 1964.

20. Several delegations expressed views concerning the working of the surcharges tending to show that in many instances the surcharge had not had much effect other than to increase prices to United Kingdom purchasers. A good many instances had been reported in which exporters were absorbing the charge by accepting lower profit margins (especially where large supplier firms were involved) in the interest of retaining markets which had been built up over a long period of time and at considerable expense. In other cases, the importer was helping to absorb the charge. In both situations it was noted, there was inevitably some discrimination against the position of the small trader, who may be unable to meet this competition. In this respect, it was pointed out that it would be unfortunate if temporary measures should have unfavourable effects of a continuing nature. Certainly, where the charge was being completely absorbed without resultant price increase, very little benefit was accruing to the United Kingdom balance of payments. In fact, it would appear to some that whenever
imports continued to enter, even though sold at increased prices, the major part of the potential benefit of the charge to the United Kingdom balance of payments was lost. Hence, while it appeared that the charge was less of an obstacle to trade than third countries had feared at the outset, it appeared by the same token to be less important that it be retained. The feeling was expressed that the charge had served its main purpose in providing an immediate response to the exchange crisis and that it could now be removed, before it began to have long-term effects of a protective character. In reply, the representative of the United Kingdom indicated that a test check of the operation of the charge had been made. It had been found that in the main it increased the final price to consumers, though as might be expected there were cases where the exporter had reduced his prices to the importer or the importer had not passed it on. The United Kingdom representative said he felt that three months' trade returns were an inadequate basis on which to make a judgement concerning the effectiveness of the charge; in Canada, he understood, a longer time had been required. He did, however, agree as to the undesirable effects of such a measure in the long run.

21. Some attention was also directed to the question of criteria for removal of the charge and to the problems which might be faced in that connexion. In response to questions, the representative of the United Kingdom indicated that it was not possible to specify the conditions in which the charge could be removed but in the judgement of United Kingdom authorities considerable further improvement in visible trade would be required; it was their policy to keep internal demand under control and any further necessary measures would be taken to that end. The United Kingdom representative repeated his assurance that the charges would be removed as quickly as possible.
22. Mention was also made of the question of United Kingdom export rebates on which details had not been available in December. Although more information was now available such information was still inadequate on too many points for an appreciation of all the aspects of such rebates to be possible; it was agreed that further information would be given on request. It was moreover indicated that a request might be made at some time in the future for the establishment of a working party which might examine the relevant provisions and interpretations of the General Agreement and existing tax rebate systems, including the United Kingdom system, in relation to those provisions and interpretations.

23. It was clear to the Working Party that the United Kingdom balance-of-payments difficulties still persisted and were likely to continue for some time; the effects of the surcharge on the balance of payments appeared uncertain but some improvement in the situation seemed to have occurred. Much of the Working Party's discussion had inevitably been inconclusive in character mainly because of the fact that it was not known what measures the United Kingdom Government might decide to take in the forthcoming budget; and it was still too soon to ascertain the full effects of the surcharges. In these circumstances the Working Party recommends to the CONTRACTING PARTIES that it might appropriately resume its consultation with the United Kingdom sometime after the budget is presented and that, in the meanwhile, the Working Party's present report should be considered an interim report.