Committee on Balance-of-Payments Restrictions

DRAFT REPORT OF THE COMMITTEE ON BALANCE-OF-PAYMENTS RESTRICTIONS ON THE CONSULTATION WITH THE UNITED ARAB REPUBLIC

1. In accordance with its terms of reference, the Committee conducted a balance-of-payments consultation with the United Arab Republic. The Committee had before it a basic document for the consultation (BOP/80 and Corr.1), the Executive Board Decision taken at the conclusion of the International Monetary Fund's consultation with the United Arab Republic on 15 March 1968 (Annex I) and a background paper provided by the International Monetary Fund dated 31 May 1967.

2. In conducting the consultation, the Committee followed the plan for such consultations recommended by the CONTRACTING PARTIES (BISD, Seventh Supplement, pages 97-98). The consultation was completed on 1 May 1968. This report summarizes the main points of the discussion.

Consultation with the International Monetary Fund

3. Pursuant to the provisions of Article XV of the General Agreement, the CONTRACTING PARTIES had invited the International Monetary Fund to consult with them in connexion with the consultation with the United Arab Republic. 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 the United Arab Republic. The statement was as follows:

"The Fund invites the attention of the CONTRACTING PARTIES to the Executive Board decision of March 15, 1968 taken at the conclusion of its most recent Article XIV consultation with the United Arab Republic and particularly to paragraphs 2 and 5 which read as follows:

'Economic growth slowed down in the last two fiscal years ending June 1967 after the impressive increase during the previous five-year period. Inflationary pressures, while reduced somewhat, continued to be strong and were reflected to an increasing extent in price increases as the policy of suppressing inflation was relaxed. Budgetary operations have been the
principal source of inflationary pressure. Since December 1965, the authorities have taken a number of measures to raise revenues and curtail expenditures. As a result, net recourse to the banking system by the Treasury was reduced substantially in fiscal 1966/67. The use of credit by other sectors has continued to be moderate. In the external sector the economic difficulties were reflected in a further decline in net foreign assets, while the problem of arrears in repayments of external debt has remained serious.

While it is expected that the internal measures that have been adopted will have a substantial effect on the balance of payments, the U.A.R. authorities recognize the need for an adjustment in exchange policies that would provide a basis for a liberal import policy and adequate incentives for export of goods and services, but they find difficulties in taking immediate action. The Fund, taking note of these considerations, feels that appropriate policies to place the balance of payments on a sound footing over the longer run should not be delayed unduly. The Fund notes also that the United Arab Republic has terminated several bilateral payments agreements with Fund members in the past two years, and urges that this policy be pursued with increased vigor.

"The general level of restrictions of the United Arab Republic which are under reference does not go beyond the extent necessary at the present time to stop a serious decline in its monetary reserves."

Opening statement by the representative of the United Arab Republic

4. In his opening statement, the full text of which is reproduced in Annex II, the representative of the United Arab Republic reviewed his country's progress since the last consultation. After referring briefly to other documentation concerning the mechanics of the commercial policy programmes of the United Arab Republic, he reminded the Committee that his Government's statement in the 1965 consultations had given preliminary results obtained during the United Arab Republic's First Five-Year Plan which had aimed at and achieved a significant increase in national income both with respect to agricultural production and with respect to the performance of new manufacturing and mining. Even then stabilization efforts had been stressed, he recalled, but the persistent balance-of-payments deficit had already been noted.
In the two years that had elapsed since the last consultation, growth and stability had continued to be the main objectives of economic policy, but a number of difficulties had been encountered, notably a rise in wages exceeding the rate of increase in productivity and an expansion in consumption which nearly equalled the rate of increase in gross domestic product. There had been a persistent deficit in the balance of payments resulting from increased imports, and from exports which did not measure up to planned targets mainly because of the deterioration in the cotton crop, especially in 1966/67. Various fiscal, monetary and price control measures had been instituted in an effort to stabilize the economy and some selectivity had been exercised with respect to investment in order to concentrate expenditure in the most productive projects in the different sectors. For the fiscal year which began in June 1967, a draft budget had been prepared which aimed at balance between revenues and expenditure, but the outbreak of hostilities had necessitated revisions in the programme which involved additional revenue measures and also a curbing of expenditure both for current outlay and for development. As a result of the various stabilization measures, the rate of expansion in the money supply during the last two fiscal years did not exceed 10 per cent and for the first time since the beginning of the First Five-Year Plan net currency circulation had been reduced in 1966/67. Arrangements had been completed with foreign creditors concerning the United Arab Republic's arrears in respect of bank credit facilities and suppliers' credits and relations with the International Monetary Fund had resulted in the United Arab Republic meeting its repurchase obligations and effecting new drawings. With regard to the balance-of-payments situation, he explained that, whilst some deficit had naturally been anticipated because of the heavy imports required for development, the strains had been intensified in the past few years by rising consumption, the growth of the population, unexpectedly large imports of cereals owing to inadequate local production and the heavy burden of external debt servicing. Capital inflow had however been large in 1965/66 and 1966/67 so that, together with the improvement in current account in the latter year, an overall net surplus had been achieved in 1966/67. Several additional factors of an unfavourable character developed in 1967/68, mainly connected with the hostilities, but it was expected that these would be offset by other special favourable factors so that on current account at least no deterioration was expected for 1967/68. As for the longer term, the outlook contained many elements which should lead to gradual improvement. These included notably the expected completion of the High Dam and the prospect of much improved agricultural outputs, the expectation that industrialization would make an increasing contribution to income and the excellent prospects for the oil industry. If costs of production could be reduced and increases in consumption restrained, an export surplus should emerge which would enable the external debt to be paid off. He felt confident that the Committee would understand the difficulties and appreciate the efforts being made for economic development. In his view the maintenance of import restrictions on balance-of-payments grounds was fully justified in the circumstances.
Balance-of-payments position and prospects and alternative methods of restoring equilibrium

5. Members of the Committee thanked the representative of the United Arab Republic for his well-presented and informative opening statement and expressed sympathy for the long-term economic problems and development needs of his country. It appeared obvious that despite achievements already attained, the economy still had some problems to be solved. Much of the difficulty centred on the balance of payments and particularly on the very heavy debt servicing problem. A reduction of reliance on external borrowing was obviously a pressing need. The key to the solution of these problems lay in careful management of the internal economy. Members expressed the hope that the present stabilization programme will limit further bank credit and sharply reduce deficit financing by the Government. It did appear that, apart from certain distorting factors, inflationary pressures seemed to have lessened. It was clear, however, that the way ahead would still be beset by many difficult choices, especially in the fiscal and monetary area, where avoidance of continued deficit financing seemed likely to require reduction of governmental expenditures both on current account and for development purposes. Although there could be no doubt that some trade controls were inevitable to restrain imports for the present, members of the Committee expressed interest in hearing about prospects for early trade liberalization. They indicated their support for the International Monetary Fund recommendation for an adjustment in exchange policies that would provide a basis for a more liberal import policy. They believed measures to institute such policies should be adopted as soon as feasible and enquired in this connection whether the representative of the United Arab Republic could comment on this.

6. The representative of the United Arab Republic replied that his Government was well aware, as indicated in his opening statement, of the internal difficulties to be overcome in the process of achieving the stabilization on which external balance would depend. With respect to the exchange rate question, although he fully recognized its relevance to the balance-of-payments problem, he preferred to leave this question for the customary discussion in the International Monetary Fund.

7. Members of the Committee reiterated their appreciation of the difficulties facing the United Arab Republic whilst expressing the hope that the actions suggested by the Fund might be implemented as soon as possible. They noted the sharp reduction which had occurred in imports of industrial materials and capital goods in 1966/67 and enquired whether the representative of the United Arab Republic could elucidate somewhat the way in which decisions were reached concerning the allocation of foreign exchange for imports, particularly as the cut in imports seemed to have adversely affected production in the industrial sector.
8. In reply, reference was made to the explanation contained in the background material where it had been stated that a foreign exchange budget based on estimated earnings is drawn up each year and allocated among the various sectors of the economy in accordance with needs. Certain priorities existed, including first and foremost the need for food, raw materials, and equipment needed for development projects. It was hoped that the reduction in imports to which reference had been made would be only temporary, and as rapidly as exchange availabilities permitted, the authorities expected to ease up on the restrictions, first of all in the investment, goods, raw materials and spare parts sectors, where reductions had been most severe.

9. Members of the Committee also enquired about the outlook concerning foreign debt which was understood to total some 1.7 billion, exclusive of debt having an original maturity of less than one year. Concern was expressed as to how the United Arab Republic planned to manage the service of such a large debt burden and whether consideration was being given to ways of avoiding further debt increase. The question was also asked whether agreement had been reached concerning scheduling of payments on all medium- and long-term debt.

10. The representative of the United Arab Republic confirmed that the figure cited was approximately correct. The United Arab Republic itself counted a debt as incurred only when the goods contracted for had actually been received, whilst the IMF counted the disbursement as having been made at an earlier stage. But the figure might be accepted nevertheless as there were certain other debts not included in it. It was hoped that supplier credits might contribute substantially to easing the burden of managing this debt, and the United Arab Republic counted on, and had received, assistance from other Arab countries. Much would depend on the success of the country’s export promotion efforts. The anti-inflationary policies which had been described, and restraint in importing, should improve the country’s capacity to pay. As to the arrears, arrangements for repayment had been reached in all cases, and repayment was proceeding smoothly, though there had been occasional requests for adjustment to permit some postponement of scheduled payments.

11. Looking to the long term, members of the Committee enquired whether in the working of certain anti-inflationary measures, there was not a circular element, particularly in the price controls and subsidies through which these were operated. It appeared that these devices had been used to try to neutralize the effects of rising incomes and costs but such operations not only involved the Government in extra expenditures which swelled its own deficit and increased disposable income but also led directly to increased consumption either of goods which might otherwise have been exported or of goods imported with scarce foreign exchange, and appeared to have had adverse effects on profitability in some sectors. Although the pressures
which had led to use of the price controls were well understood, members wondered whether the Government was moving toward a definitive abandonment of that kind of control or, if not, how it was proposed to siphon off a part of the income which was freed by the maintenance of artificially low prices. It was obviously of importance to avoid price and income increases, especially as these had affected costs and export availabilities and would continue to do so unless the excess income could be neutralized and income rises reduced. It was also noted that the savings ratio had been falling and the question was asked whether there were plans to increase it.

12. The representative of the United Arab Republic agreed that the dangers and the difficulties outlined did exist and said that fiscal and monetary measures already taken were designed to combat these risks. He did not think that the principal dangers lay in risk of the increased home consumption of goods which might otherwise be exported such as raw cotton, yarn, textiles and rice, but agreed that higher consumption would be reflected in increased imports rather than in reduced exports. As to the future, the immediate aim was to achieve a balanced budget, even though this meant scaling down investments. As regards the question of prices and subsidies, he said that in addition to the increase in the prices of certain subsidized commodities, it was the Government's intention to reduce these subsidies gradually. As far as saving was concerned, it was indeed an objective of the Government to encourage saving by all possible means. More saving would be one way to achieve a higher rate of growth as it would make more income available for investment; it was hoped that by limiting consumption, savings would increase. This was the logic of recent reductions in cost-of-living subsidies, although that reduction had also had the welcome effect of reducing governmental expenditures on current account.

13. Interest was expressed by the Committee in learning what plans the United Arab Republic had for encouraging foreign investment in the country, as for example in tourist installations. Especially in view of the heavy foreign debt, was not new foreign investment seen as the key to solution of the long-term problem of where increased foreign-exchange resources were to be found? The representative of the United Arab Republic replied that foreign investment in certain branches, including tourism, was of course welcome, although individual cases needed to be examined on their merits.

System and methods of the restrictions and effects of the restrictions

14. Members of the Committee were encouraged to note that in the interval since the last consultation the United Arab Republic had terminated several bilateral payments agreements with IMF trading partners. They joined in urging that this trend away from bilateralism be continued and enquired about prospects in that direction. The representative of the United Arab Republic confirmed
the information contained in the basic document to the effect that payments agreements with nine countries had been terminated; in the case of nine other countries, payments agreements had been replaced by trade agreements stipulating payments in convertible currencies coupled with mutual banking credit facilities. He noted in addition that most agreements with countries having centrally-planned economies provided for settlement of balances in excess of specified swing margins in convertible currencies. Altogether the United Arab Republic still maintained bilateral payments agreements with some twenty-five countries, including about ten with countries members of the Fund. There might be certain difficulties associated with further progress on termination of agreements in present circumstances but the question was under constant review. In response to a later question, he added that the urgency of terminating bilateral agreements was not in his view so great as might be thought since all such agreements in any case provided for payment of internationally prevailing prices so that their commodity lists provided at most indicative lists for the conduct of trade and he emphasized that all decisions were taken on strictly commercial considerations.

15. A question was also asked concerning the various additional charges on imports mentioned in the background material; interest was expressed in knowing how the Government regarded these taxes in the light of the United Arab Republic's obligations under GATT. The representative of the United Arab Republic stated that in fact there were not very many of these charges, and none of these were protective. Certain items carried excise duties, but the rate was in all cases the same whether the product was imported or of local manufacture. There were also certain municipal storage fees. In addition there was a statistical fee amounting to 5 per cent on food imports and to 10 per cent on all other imports. With the exception of the statistical duty, all were believed to be fully in conformity with the provisions of GATT. The legislative steps are being taken to remove the statistical tax.

16. Interest was also expressed in learning more about the operation of the restricted or prohibited list of imports. Members were not very clear as to its purpose or as to how products were added to or subtracted from it and on what grounds. The representative of the United Arab Republic noted that the purpose of the list was explained in the basic document of the present consultation (BOP/80) and that presently the list had perhaps less importance than it had then. The tendency had been to give almost complete freedom to the Commodity Boards to establish their own priorities concerning use of the foreign exchange allocated to them.

17. Interest was expressed in learning how competition was effected among the import agencies. The representative of the United Arab Republic explained that while all imports were limited to public owned commercial companies which function very
much like free enterprise firms, nevertheless care was taken that in formulating the commodity specialization policy for the thirteen such companies - of which two are specifically for the export of agricultural products - more than one company has been allocated to import any specific group of commodities. For this purpose all commodities imported were classified into nine groups, each group under the supervision of a special commodity board which judged all offers on the basis of prices and other commercial terms. Depending on the total value of imports of each group of commodities, a number of these commercial companies - sometimes reaching six or seven companies - were assigned to the importation of each group. This way, both the benefits of specialization and the advantages of competition were achieved.

18. In reply to another question, he added that there were certain exceptional cases in which it was found easier to allow some highly technical sectors to handle their own imports directly. The principal cases involved were pharmaceuticals, petroleum, and complete industrial projects where the highly technical nature of the products imported was a factor. In all cases the sectors concerned report to the relevant Commodity Boards and work within quotas assigned to them within the foreign exchange budget. He added that the priorities as among sectors were not a matter for determination by the Commodity Boards but were decided in the drawing up of the foreign exchange budget. To the extent possible, account was taken in drawing up the budget of the views of interested parties and organizations, but the broad lines of the priorities were, as stated in the background material, foodstuffs, raw materials, spares and capital goods, in that order.

19. The representative of the United Arab Republic stated that the system of trading referred to in Section V of BOP/80 (Use of State trading) was in fact the system just described, which operated mainly through the Commodity Boards within the foreign-exchange budget.

Conclusion

20. The Committee thanked the representative of the United Arab Republic for the very expert replies which he and his delegation had provided to the Committee. Members welcomed the assurances that care and attention were being devoted to the problem of bringing stability into the economy of the United Arab Republic as they felt that this would provide a key to the restoration of external equilibrium and would provide the essential basis for a liberalization of foreign trade. The representative of the United Arab Republic thanked the Committee for the sympathetic attention given to his country's problems and promised to convey to his authorities the views which had been expressed.