Committee on Balance-of-Payments Restrictions

DRAFT REPORT OF THE COMMITTEE ON BALANCE-OF-PAYMENTS RESTRICTIONS
ON THE CONSULTATION UNDER ARTICLE XVIII:12(a) WITH PERU

1. As requested by the Council at its meeting of 27 March 1968 and in accordance with its terms of reference, the Committee has conducted a consultation with Peru under Article XVIII:12(a). The Committee had before it BOP/81, the text of the Decree of 29 February 1968 containing provisions concerning the suspension of imports referred to in document L/2996, together with material supplied by the International Monetary Fund.

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 20 May 1968. The present 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 this consultation with Peru. 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 Peru. The statement made was as follows:

"In 1967 the balance of payments deficit on current account was $165.8 million against $137.3 million in 1966. Taking account of capital transfers and errors and omissions, the over-all deficit, reflected in a fall in the foreign reserves of the official banking system, was $90.7 million compared to $60.6 million in 1966. In the first quarter of 1968 the balance of payments situation deteriorated further and at the end of March the net reserves of the official banking system were a negative $26.2 million."

"On August 18, 1967 the Fund approved a stand-by arrangement with Peru effective from that date authorizing Peru to draw up to the equivalent of $42.5 million over a period of 12 months. The arrangement is in support of a financial program which is designed to restore confidence, to bring about an improvement in the balance of payments, and to achieve reasonable price stability. However, difficulties have been encountered in the implementation

1 This calculation of the net reserve position of the official banking system includes liabilities for short-term borrowings and swap transactions not reflected in the monetary accounts."
of the program and the balance of payments has continued to be under pressure. Although steps have been taken to raise budgetary revenue, including adjustments in tariff rates, a difficult fiscal situation persists. In September 1967 the monetary authorities withdrew from the exchange market and the exchange rate depreciated sharply. Early in October the Government reinstituted on a temporary basis the system of exchange certificates in operation prior to May 16, 1960. The certificates which originate with export receipts are freely negotiable for all import payments and certain other transactions. To date the exchange rate in the certificate market has been maintained at S/.38.70 per U.S. dollar while the draft rate has fluctuated and as of April 11 was at S/.41.32 per U.S. dollar.

"At the present time, the general level of restrictions of Peru which are under reference does not go beyond the extent necessary to stop a serious decline in its reserves."

Opening statement by the representative of Peru

4. In his opening statement, the full text of which appears in an Annex, the representative of Peru explained the background leading up to the economic situation in which Peru now found itself and described the measures which had been taken. For a number of years, the value of Peru's exports had increased steadily at a rate of about 9.9 per cent per annum, and up to about 1962 the increase had corresponded to an increase in volume as well as in price, but more recently the increases had represented mainly from higher prices rather than from sustained increases in the quantity of exports. Several factors had contributed to this relative stagnation of exports, which was no doubt connected with Peru's efforts to build up its infrastructure. Chief among other causes one might cite an inadequate rate of new investment in exports and the inelasticity of demand for Peruvian products. Meantime, on the import side there had been a spectacular increase, amounting to some 13.5 per cent per annum, or double the rate of increase in Peru's gross national product. Needs for capital equipment to carry out development programmes went some way to explain the increase, but the failure of domestic agricultural production to keep pace with the needs of the population for foodstuffs had also played its part, and imports of foodstuffs had risen sharply in 1965 and 1966, reaching 17 per cent in the latter year, and recently there had also been increased imports of non-essential consumer goods. Now it seemed that Peru's economy had begun a process of deceleration. To a considerable extent, this reflected deliberate Government policy which, for financial reasons, now sought to strengthen the forces of stability by increasing revenues and by reducing expenditures so as to reduce the fiscal deficits which were recognized as a source of the inflationary pressure.
5. With respect to the balance-of-payments position, he recalled that Peru's net deficit in 1966 had been equivalent to $61 million and in 1967 to $91 million. In the first three months of 1968 the net deficit already amounted to $19 million. The unsatisfactory position of exports and high rate of imports were partly responsible, but losses in the trade sector had been aggravated by an outflow of short-term capital. An exchange rate adjustment amounting to a depreciation of some 30 per cent was made in September 1967 when the central bank withdrew support of the rate which had been maintained up to then.

6. The Government of Peru was now taking both long and short-term measures to attain stability without sacrificing the reasonably high rate of growth which Peru had enjoyed. The development of Peru's infrastructure had undoubtedly put an extra strain on the balance of payments but it comprised an essential objective which could not be sacrificed. On the other hand, it was recognized that the budget would have to be balanced if stability were to be assured. To that end also, there had been introduced requirements that banks hold higher reserves, restrictions on credit and, finally the restrictions on imports which were of special concern to the Committee.

7. The representative of Peru noted that his country fitted precisely the contingency foreseen in Article XVIII, paragraph 8 of the General Agreement. Peru had therefore invoked the provisions of Section B of that Article as justification for the import restrictions which it had been obliged to impose and was now consulting with the CONTRACTING PARTIES in accordance with the provisions of paragraph 12(a). The temporary import prohibitions which had been imposed on 29 February 1968 for a ninety-day period covered non-essential goods which had accounted for some 20 per cent of Peru's imports in 1967. Some were products which could be grown or manufactured within the country, and the others, if not available from domestic sources, could be dispensed with for a while at least. He recalled that Peru had made more concessions in GATT than almost any other developing country, and he felt that in the circumstances there could be no question concerning Peru's right to take the action required to safeguard its balance of payments. A certain number of other measures auxiliary to this main effort to curb imports had been taken and Peru was also doing what it could to increase exports. He could not of course guarantee what the balance-of-payments results would be for 1968 but he noted that one recent estimate looked for a favourable current account balance of some $70 million. On certain assumptions concerning capital movements this same forecast predicted a net favourable balance of over $22 million.
Balance-of-payments position and prospects and alternative methods of restoring equilibrium

8. Members of the Committee praised the representative of Peru for the very illuminating presentation he had made of Peru's present position. It was not questioned that Peru had acted correctly in invoking Article XVIII:B when it had been found necessary to impose temporary import restrictions. It was noted in this connexion that Peru's long record of maintaining a liberal commercial policy only underlined the seriousness of the concern regarding Peru's present situation. The hope was generally expressed that the months ahead would permit relaxation and removal of the restrictions, as might be possible if increasing reliance could be placed on various domestic anti-inflationary measures. Representatives of several countries expressed their sympathy for the difficulties now being experienced by Peru, which seemed to be caused by a number of factors including a fall in prices of some exports.

9. Members of the Committee noted that Peru had notified the CONTRACTING PARTIES earlier that tariffs were being increased on a list of products, and they referred to the establishment of a working party to consider the relationship between these tariff increases and Peru's GATT obligations. The working party had not yet met as it was understood that data were not yet available concerning the products and rates of duty involved. The representative of Peru replied that Peru had indeed asked the CONTRACTING PARTIES for guidance and advice as to how to deal with its difficult international situation whilst avoiding the use of quantitative restrictions. The working party had not yet met, but Peru was available for consultation in that working party whenever others were ready to meet; the representative of Peru stated that the required information had been submitted some time ago.

10. In the discussion which followed, members of the Committee noted that Peru presented one of the more successful examples of development in Latin America and had achieved very considerable progress without too much difficulty up to about 1965. They agreed that to some extent special factors beyond Peru's control went a long way to explain the less favourable development of exports and imports since that time. On the other hand, it did appear that a rise in long-term public investment outlays at about that time unaccompanied by a corresponding increase in receipts from taxation had resulted in resort by the public authorities to increased inflationary borrowing from the banking system and also in the accumulation of a heavy load of short-term foreign debt. It seemed clear that the resulting inflationary pressures had been a major factor lying behind the large rise in imports since 1965 and that the service of foreign loans also had been placing an additional strain on the balance of payments in that period. These difficulties had been further intensified by the outflow of short-term capital which had taken place last year. Many of the very serious problems which now confronted Peru seemed to be explained by this process.

1 See C/M/41.
There was a danger that increased costs would make it more difficult than before for Peru to compete effectively in world copper and fishmeal markets while the added burden of debt would continue to add difficulties to the restoration of balance-of-payments equilibrium. On the other hand a continuation of import control would risk adding to the inflationary pressures; it would deprive the Government of a certain amount of revenues and it might even lead to establishment of unwanted industries. Obviously, it would be difficult to abandon the controls unless budget deficits could be eliminated, and this very likely would require new sources of revenue as well as strict economy. The price-wage spiral would also have to be arrested and it was noted that commendable progress had already been made in that direction and without much resort to price controls. The question was raised whether stabilization might not in any case be essential to any permanent stemming of the flight of short-term capital. Likewise, it was suggested that Peru might have interest in undertaking negotiations to rephase debt servicing. Effective action on the domestic front, combined with some easing of the effects of past strains on the balance of payments, it was suggested, might make possible an early relaxation of control on imports.

11. The representative of Peru felt that there were many encouraging elements in what had been done already on domestic policy. There had been new strict controls on government spending for more than a year past. A linear cut of 7 per cent in all governmental expenditures had been instituted last year and other new measures had recently been introduced, including a ban on new official borrowing abroad for the next two years. Price control had indeed been used sparingly, in fact only with respect to the essential foodstuffs which account for as much as 60 per cent of the expenditures of much of the population. New sources of foreign exchange income were in sight not only in a hoped-for increase in exports and an expected $40 million saving on imports, but also in savings which it was hoped to make on the services account. New private investments in paper and copper were expected to bring in some $40 million of private investment. Apart from selected new investments essential to development, there was to be a reduction in spending. As for rephasing the foreign debt, the representative of Peru believed his Government was favourable to that course but that a decision had not yet been taken.

12. Turning to the balance of payments, members expressed interest in the estimate that had been given concerning 1968 prospects for a favourable balance and asked to what extent it was estimated that increased export income would contribute to this. Bearing in mind that the drought of 1966 had been the worst in forty years, also the general situation of stagnation in the volume of exports that had been described they asked to what extent increased volume was expected and to what extent increased prices. They enquired also what was planned concerning reduced reliance on foreign loans. They noted that as concerned the heavy expenditure on food imports, this appeared to be more than a temporary phenomenon induced by drought and suggested that perhaps more should be spent on improving agricultural output even if that meant spending less in the immediate future on industrial investment.
13. The representative of Peru replied that according to the estimate he had cited it had been calculated that exports would improve by over 4 per cent in 1968 as compared with 1967, yielding an increased return of some $131 million, thanks partly to higher silver prices, partly to an increased volume of coffee and cotton exports, and partly to the more competitive prices which devaluation would enable Peru to offer. With respect to agriculture, the representative of Peru assured the Committee that improvement of agriculture enjoyed high priority. Over $50 million was being invested in irrigation schemes and there were also programmes to teach better farming methods to farmers. A programme of land reform had encountered delays but was on the way. Education concerning nutritional standards was believed to offer prospects for enabling the population to obtain more of their protein requirements from relatively inexpensive foods available from fish and other marine products. Efforts were also being made to rationalize food distribution. He agreed fully that reliance on loans would have to be reduced and stated that already efforts were being made to keep a closer watch on the borrowings of the semi-public sector.

14. In reply to a question as to what special measures had been taken to attract needed capital for productive investment and to stop the outflow of short-term capital, the representative of Peru stated that measures to attract investment had a long history in his country. Certain fiscal burdens had long been removed for importers of machinery and equipment for new industries, and recently extra favourable tax treatment had been made available for investment in certain areas such as Tacua, Arequipa, and Lima-Callao. No special measures had ever been taken to restrict repatriation of foreign capital. However, recently new measures had been taken to slow down the outflow of Peruvian capital and, incidentally, to tighten up on the payment of taxes on income from capital held abroad. For example, it was no longer permitted to sell in Peru shares in mutual funds, as it was considered that the funds of the medium-income saver could better be directed to other investments. Similarly a register was being drawn up of all Peruvian capital held abroad.

15. A question was asked concerning Peru's efforts to promote exports, especially in the non-traditional sector. It appeared that the Banco Industrial had recently been reorganized to make a contribution in that area. It would be interesting to learn more of such efforts and also of what use was being made of a study carried out by the International Trade Centre regarding Peru's trade prospects. The representative of Peru replied that the two questions were linked. The creation of an Export Board within the Banco Industrial had in fact been a consequence of the GATT study. The Decree of 1 March 1968 mentioned in his opening statement had in fact established a new Board to which a new section of the Banco Industrial would serve as technical secretariat. Obviously there was not much more he could say of so recent a move, but the GATT study had clearly given a start to something which might prove very useful.
System and methods of the restrictions and effects of the restrictions

16. Members of the Committee expressed interest in knowing about how the list of import prohibitions promulgated on 29 February had been drawn up and in knowing whether they were in part selected because of their local availability. They also expressed great interest in learning about plans concerning the removal of restrictions when the ninety-day period for which they had been imposed expired.

17. The representative of Peru referred to the text of the decree imposing the prohibitions (as contained in BOP/81) where it was stated that economic development and stability in prices were the two guiding criteria of his Government. Where a commodity was not essential for development needs, it had been considered that in the interests of safeguarding the balance of payments the product should be regarded as dispensable. Clearly in some cases the fact that a product was available locally had operated as a factor making its importation less essential. The fact that many of the banned items were available from local sources would moreover reduce the extent to which a backlog of demand would build up to swell the imports when restrictions were removed, for many products on the prohibition list were available either from local assembly or local manufacture and it was only the finished products which were banned. As for the position his Government might take at the end of the ninety days, he could only say that it was quite understandable that no prediction could be made on such a matter as it would only lead to trade speculation, but for the moment no change had been announced in the original plan to maintain the restrictions for ninety days only.

18. Members of the Committee expressed strong interest in seeing the prohibitions terminated, though they understood well the difficulty about making any prediction at this time. Some stressed the serious prejudice that had been caused to certain areas of their trade and their concern that, if the restrictions remained in force for long, permanent impairment of trade relations might occur. Others pointed out that so long as the restrictions continued the Government was certainly losing revenue which it could well use. Moreover, the availability of fewer goods on the domestic market was sure to increase inflationary pressure. The representative of Peru replied that new restrictions on credit were designed to reduce the money supply and that in particular very strict regulations on instalment sales were now in force.

19. In answer to questions whether the import prohibition applied to imports from all sources without any discrimination, the representative of Peru replied that there was no exception for imports from any source. The representative of Chile, speaking as an observer, stated that his Government was of the view that any waiving of the restriction which Peru, as a member of LAFTA, might accord to imports from other LAFTA countries would be compatible with the free-trade area concept.
20. The question was also asked whether the aforo system mentioned in the background documentations was a system of minimum prices on which duties were calculated or whether it implied a levy on imports valued at less than the established minimum values. The representative of Peru replied that he did not believe the aforo system was relevant to this consultation.

Conclusion

21. Members of the Committee thanked the representative of Peru for his frank answers to their questions. They reiterated their sympathy with Peru's efforts to maintain stability whilst increasing the pace of development and especially commended the steps taken to increase the efficacy of domestic controls over expenditure, to eliminate fiscal imbalance and to search for new sources of revenue. They urged Peru to take energetic steps to solve its economic difficulties primarily through domestic measures. They wished Peru success in these efforts and also in the various steps taken to improve the balance of payments through increased exports and better control of short-term capital outflow. They expressed the view that these various alternatives would certainly be preferable to any continued use of import prohibitions, which they hoped might be dismantled in the very near future. The representative of Peru thanked the Committee for the sympathetic understanding which had been accorded to his explanation of the difficulties confronting his country and promised to convey the Committee's views to his Government.